RAYMOND JAMES

Published for the friends and clients of
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October 2008 Newsletter

Crash Landing

The last few months have been absolutely ruthless for world markets, with expectations of recession and general pessimism evolving into world wide market panic.

Unfortunately while I expected an economic slowdown in North America and invested your portfolios in a (at the time) conservative manner, I did not predict multiple bank failures, the credit freeze, or total financial panic. As a result, while most of you have outperformed the market indexes by a very large margin, your results have been unacceptable to me (and no doubt) to you.

What we do now will be of critical importance to our retirement savings. I will try to provide balanced facts and options to take advantage of this major correction.

Raymond James

Fortunately for all of us, Raymond James has conservative and prudent risk management principles that have helped us avoid exposure to sub-prime loans in the United States and asset backed commercial paper in Canada. The tragedies we have seen for the major Wall Street firms were caused by extreme leverage and seemingly non-existent risk management controls. We can be thankful that Raymond James senior management has used leverage sparingly.

Not surprisingly, Raymond James is benefiting from the current crisis as financial advisors at some of our highly leveraged competitors come to us to seek refuge from the current chaos in our industry.

Market Returns from 2007 High

52 Week High to October 10 Close

TSX	- 40.2%
Dow Jones	- 40.5%
S&P 500	- 43.0%

Historical U.S. Bear Markets

Bear Market Began	% Decline	Duration (Months)	3 Month Return from End of Bear Market	6 Month Return from End of Bear Market	12 Month Return from End of Bear Market	2 Year Return from End of Bear Market
1-Jul-56	-19.0%	17	5.3%	13.1%	38.1%	49.8%
12-Dec-61	-24.6%	6	2.8%	15.3%	26.7%	5.9%
18-Jan-66	-22.1%	9	4.9%	17.8%	26.3%	34.1%
14-Nov-68	-36.1%	19	15.8%	26.7%	37.1%	47.3%
11-Jan-73	-48.2%	21	7.9%	31.2%	32.0%	65.6%
21-Sep-76	-19.4%	18	11.7%	18.7%	10.6%	31.0%
13-Feb-80	-17.1%	1	11.9%	22.9%	33.2%	40.7%
28-Nov-80	-27.1%	21	11.2%	35.7%	51.8%	50.2%
25-Aug-87	-33.5%	3	16.3%	13.8%	18.8%	37.7%
16-Jul-90	-19.9%	3	13.1%	23.5%	29.1%	58.5%
17-Jul-98	-19.3%	2	21.5%	29.3%	37.9%	36.7%
24-Mar-00	-49.1%	31	7.9%	4.0%	22.2%	17.7%
Average Decline	-28.0%	13	10.9%	21.0%	30.3%	39.6%
Median Decline	-23.4%	13	11.5%	20.8%	30.6%	39.2%
9-Oct-07	-26.1%	11				

Note: Bear Market defined as Peak-Trough corrections exceeding 15.0%. Data based on daily close prices

Source: RBC Asset Management

As the chart indicates, at this point this is the third worst market drop in the last 50 years. Note that the average market gain 2 years AFTER the end of a Bear Market is 39.6%. As history usually repeats itself we can expect a very strong rally once this market runs its course.

Interest Rates

Short term T-bill rates are amazingly low now, as panicked investors sell equities, corporate bonds, and money market funds with the understandable desire to safeguard their savings.

Cdn T-Bills	**Oct. 10, 2008**
30 Day	.18%
60 Day	.23%
90 Day	.28%
180 Day	1.09%

U.S. $ T-Bills	**Oct. 10, 2008**
30 Day	negative
60 Day	negative
90 Day	.01%
180 Day	.89%

To put this in perspective, $1 million invested at the current 90 day Canada T-bill rate, for one year would earn $2,800. A U.S. 90 day T-bill rate would provide a $1 million investment a return of $100 per year. Short term U.S. T-bills actually have NEGATIVE returns as panicked investors bid them above their maturity prices.

Risk Premiums

The "risk premiums" section below is from my January 2005 newsletter. At that time the yield differential between AAA Government bonds and corporate bonds was negligible. You didn't get adequately paid to take the extra risk to own corporate rather than Canada bonds. Note that I was longing for the "good old days" when a Royal Bank 10 year capital security paid 1% more than a 10 year Canada bond.

"Excerpt from January 2005 Newsletter"

Risk Premiums

Back in the "good old days" of 2000-2002, investors were extremely risk adverse towards corporate bonds, and many of you continue to own BC Gas capital securities, bank capital securities and other high quality income investments from those days. In 2000, a Royal Bank 10-year capital security paid over 1% more than a 10-year Canada bond. Unfortunately for today's investor, these spreads have diminished considerably.

Examples of this are:

		Rating	Yield to Maturity
Enbridge Pipeline Bond	Sept. 2008	A-	3.29%
Canada Bond	Sept. 2008	AAA	3.08%
George Weston Bond	March. 2014	A-	4.57%
Ontario Bond	March. 2014	AAA	4.36%

While there is a marginal yield advantage of buying an investment grade corporate bond, corporate bonds are less liquid (i.e. you get a worse price if you sell) than government bonds.

My conclusion is unless you buy a high yielding (higher risk) corporate bond to get a decent yield, you are currently better off buying Canada bonds than high quality corporates.

The Good Old Days are Back

The interest rate differentials between bank capital securities and Canada bonds are now unprecedented as follows:

	Yield to Maturity
Canada Bond – 6 years	2.94%
Bank of Montreal Capital Trust – 6 years	6.50%
Canada Bond – 10 years	3.79%
TD Capital Trust – 10 years	8.56%
Royal Bank Capital Trust – 10 years	8.21%

Bank capital trusts have the safety of bank preferred shares, except that they pay interest rather than dividends. They have less security than bank bonds, but will pay their interest unless the bank reduces its common share dividend to zero. The big 5 Canadian banks have never reduced their common share dividends, including the great depression, World War II, and all of the other crises we have experienced in the last 100+ years.

Each bank capital trust has unique terms, if these sound interesting to you please call so I can give you the details before you purchase them.

Other bonds and convertible debentures have had their prices fall sharply, providing very attractive yields. A review of your portfolio and your risk tolerance will determine if they fit in your portfolio.

What to Sell

Investors should have at least one year's cash flow either from pensions, cash, or safe dividends and income trust distributions. With this cash on hand no one will be forced to sell securities during a fire sale like last week. As the price of oil has fallen from $147 per barrel to $80.65 per barrel (45%) we can expect distribution reductions from oil-based income trusts.

While this type of market is always a wake-up call for our asset allocation and risk tolerance, selling after a 40% drop has historically not been that profitable.

Interesting Opportunities

Opportunities depend on your risk tolerance and view of the world. If you think that North America will end up with an economy like Zimbabwe's, 5% gold and 95% T-bills may be your answer.

A more balanced view is that North America is in recession. The natural response is for indebted households to reduce spending to repair their balance sheets. This will particularly hit discretionary spending such as new cars, new homes, travel, and other goodies that we like, but don't necessarily need. This will in turn reduce corporate profits and employment levels until household finances recover and consumer demand builds.

Even under these circumstances many investments now are discounting an extremely negative outlook in their prices. When the credit markets start to function again we can see a powerful market rebound.

Investment grade corporate bond yields are currently extremely high compared with government bonds or GIC's. The current credit freeze has given us a great opportunity to build the fixed income component of your portfolios with high yielding corporate bonds and capital trusts. There are many good choices at present to ensure diversification.

Westshore Terminals ($10.65)

This income trust is managed by the Jimmy Pattison group and operates the coal terminal next to the Tsawwassen ferry terminal. Coal from eastern BC is shipped through the port, mostly to China.

Westshore is debt free and at the current level pays a distribution of 19.5%. This distribution fluctuates with prices and volumes of coal through the terminal.

It is impossible to determine how the future Chinese demand for coal will be affected by the current market crisis, but an investment company owned by Jim Pattison purchased 2,046,300 shares of Westshore on October 8th. This would be an indication of management's faith in the long-term future for this business.

Buffett's Buying

During the last month the worlds' richest person, Warren Buffett has purchased $5 billion of Goldman Sachs Group preferred shares and $3 billion of General Electric preferred shares. While Mr. Buffett is not infallible and will not be living on the streets if these investments don't work out, he is a patient investor and didn't earn his wealth by being reckless.

There is an excellent article that was written by Warren Buffett for the New York Times on October 17 that provides a more in depth view of his thoughts on investing in the markets at this time.

Due to copyright issues we cannot reproduce the article in our newsletter, but I strongly recommend that you take the time to read the on-line version.

It can be viewed at:

http://www.nytimes.com/2008/10/17/opinion/17buffett.html

Betting with 4 Kings

Investing is one part risk tolerance, one part asset allocation, and one part "playing the odds". With the markets down so sharply, I would compare today's investing with betting on a poker hand with 4 Kings. While the odds seem strongly in our favour at this point, there may be 4 Aces lurking at the table. Invest accordingly.

Thank you

We have had very challenging markets lately that have created legitimate fears with all investors. Thank you all for your understanding and sunny dispositions during these challenging times.

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Note: For those of you who would like to receive future newsletters by email, please give Barbara a call and she will put you on our email list.