OCTOBER 2010 NEWSLETTER

Published for the friends and clients of Financial Advisor
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Insider Buying

Recently a number of large companies have been making strategic acquisitions in their industries. BHP has made a bid on Potash ($38 billion), Sanofi-Aventis SD has bid for Genzyme ($18.5 billion), Hewlett Packard has bid for Arcsight ($1.5 billion) and a number of smaller takeovers are in play. My interpretation of this is that deep pocketed insiders see value in building their asset bases at today's share prices.

Third Quarter Recovery – A Glimmer of Hope

Recently friends of ours brought a very nice bottle of red wine to our home. The wine called "A Glimmer of Hope" has an appropriate name for the state of the markets today.

The following is a quote from the Raymond James 3rd quarter report:

> *"In spite of the steep correction in the latter part of the June quarter, which was occasioned by the preceding extended, dramatic recovery following the March 2009 lows, our forecast of a slowly improving, volatile equity market remains intact. That recovery continues to be fueled by improving corporate earnings, even though consumer demand remains depressed by intransigent unemployment. In short, business spending and hiring remain constrained by an understandable fear of another down leg in the economy. Nonetheless, both hiring and spending will improve deliberately as cash coffers continue to grow, although economic growth may be sporadic."*

I agree with this outlook, and expect the market to be higher at this time next year.

	Sept 30/09	June 30/10	Sept 30/10	% Gain for Qtr	% Gain for Year
S&P 500	1,044	1,030	1,141	10.7%	9.3%
TSX 300	11,212	11,294	12,368	9.5%	10.3%

While the last 12 months were volatile, holding equities produced respectable gains.

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Canadian T-Bills and Bonds

	March 31/10	June 30/10	Sept 30/10
90 day	0.26%	0.46%	0.85%
180 day	0.47%	0.75%	0.97%
1 year	0.96%	1.03%	1.21%
2 year	1.73%	1.27%	1.33%
5 year	2.90%	2.32%	1.91%
10 year	3.56%	3.00%	2.75%
30 year	4.07%	3.64%	3.38%

While the Canadian government has raised short-term rates, long bond rates (5+ years) continue to fall as investors continue to demand safety.

U.S. T-Bills and Bonds

	March 31/10	June 30/10	Sept 30/10
90 Day	0.15%	0.17%	0.15%
180 Day	0.23%	0.22%	0.18%
1 year	0.37%	0.30%	0.24%
2 year	1.02%	0.61%	0.42%
5 year	2.56%	1.78%	1.27%
10 year	3.83%	2.94%	2.51%
30 year	4.71%	3.89%	3.68%

As the yields on Government bonds have fallen, the prices have risen, giving bondholders very attractive total returns. While some market strategists feel that a "double dip" recession will cause bond prices to rise further, I personally feel that buying a 10-year Canada Bond to get a 2.75% yield is too risky (these bonds will drop sharply if interest rates rise), particularly when compared with corporate debentures, preferred shares, and equities.

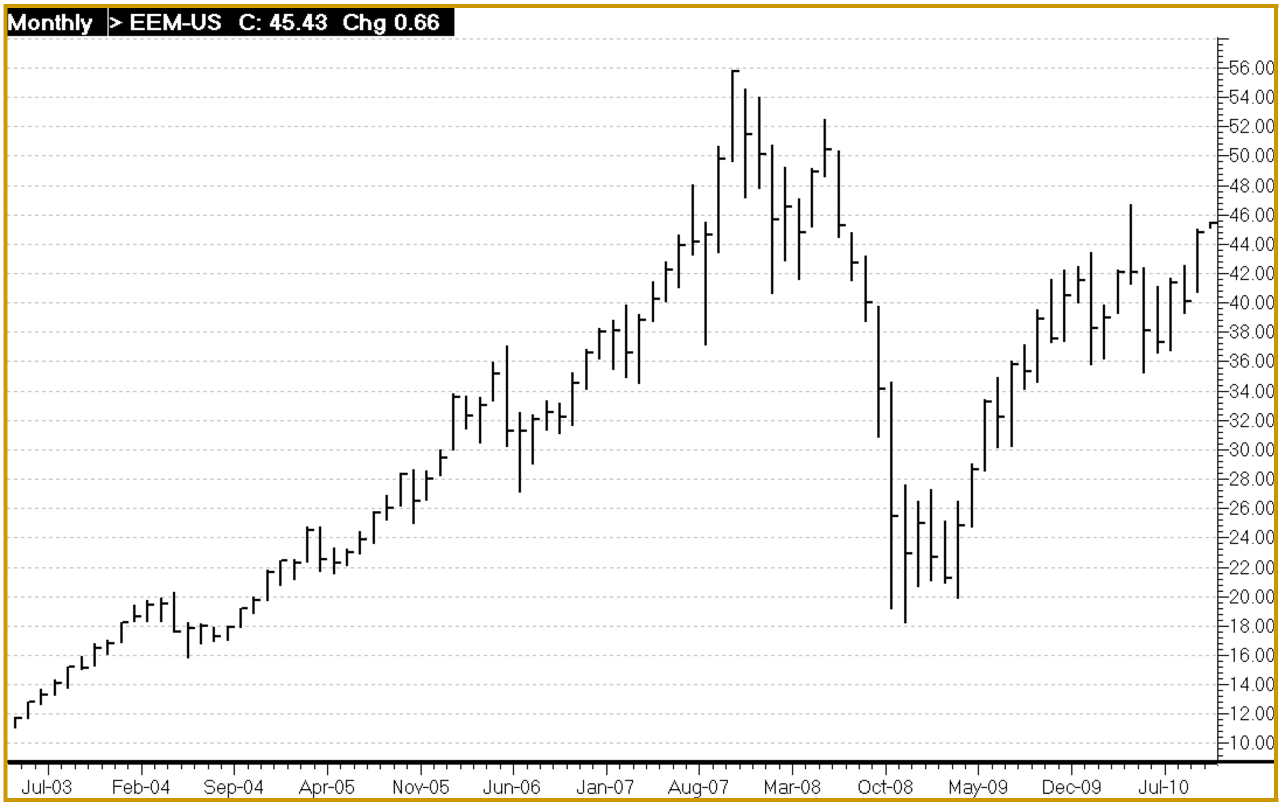
Attractive Yield Investments Today

Recently medium quality 5-year corporate convertible debentures have been issued at rates between 6 and 6.25%. Companies include Vicwest Income Fund, Aecon Group, and Canam Group, all in the construction business.

Innergex Renewable Energy and Fairfax Financial have recently issued 5-year rest preferred shares yielding 5% dividends. I believe that these provide an excellent risk/reward relationship for taxable investors.

Growth Investments

Emerging markets have the disadvantages of potentially corrupt governments and less transparent accounting standards, but have the advantage of young populations (they buy more stuff than older populations) more unmet consumer demands, and better growth rates. EEM is the Ishares of Emerging Markets, which will give you exposure to a variety of countries and all industries. I would think that a 5% weighting would be appropriate for investors' not needing income.



The Ishares of Emerging Markets have been "behaving well" since the financial crisis.

Are Stocks Expensive or Cheap?

If you are happy with a 1% money market account or locked in fully taxable GIC's paying between 2 and 3% there is no need to take risk. However, today equities seem to provide far better value than fixed income. Here are some examples of well known companies trading at very reasonable valuations.

Company	Profit per Share / Share Price	=	Earnings Yield
Wal-Mart	$ 3.90 / $53.52	=	7.29%
Microsoft	$ 2.10 / $24.49	=	8.57%
Johnson & Johnson	$ 4.84 / $61.96	=	7.81%
Intel	$ 1.67 / $19.20	=	8.69%
MacDonalds	$ 4.39 / $74.51	=	5.90%
Google	$ 23.03 / $525.79	=	4.38%

The six companies, which I picked on their size, international scope, and name recognition, have an average earnings yield of 7.10%. Assuming that profits NEVER increase from today's recession levels, you would expect to earn 7.10% into perpetuity. Compared with a 30-year U.S. treasury bond (perpetuity for most of us) earning 3.68%, stocks seem to be incredibly cheap.

How Do You Structure a Portfolio Today?

Due to today's pathetic interest rates on government bonds, new fixed income investments should either be in money market (1.1% yield) or medium quality corporate bonds and preferreds (5% to 7%).

As most stocks seem inexpensive we can purchase high quality stocks, keeping diversified to avoid getting too badly hurt on inevitable underperformers.

Himalayan Trek

While eating food cooked over yak dung fires, hiking in snow at 17,600 feet and using squat type outhouses is not everyone's idea of fun, I will be trekking in Nepal this fall.

I will be away from October 14th to November 15th. If you would like a review of your portfolio before I go please call.

While I am away Barb can handle administrative issues and Eric Kuehnel in Nanaimo or our managers Steve Werner and Dee-Ann Mayberry can help you if you have any investment questions.

All the best.

Ian Douglas	Barbara Holmes	Lindy Edgett
Financial Advisor	Administrative Assistant	Receptionist

Note: For those of you who would like to receive future newsletters electronically, please email Barbara at barbara.holmes@raymondjames.ca and she will put you on our email list.

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