OCTOBER 2011 NEWSLETTER

Published for the friends and clients of Financial Advisor
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Newsletter by Email

We will be sending this newsletter by email only to all our clients who have provided us with their electronic addresses.

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The 3rd quarter of 2011 has been very challenging for investors, with the TSX 300 down 12.6% and the S&P 500 down 14.3%. Most European and emerging markets have been worse.

	Oct. 1/10 Open	June 30 Close	Sept 30 Close	90 Day % Decline	1 Year % Decline
S&P 500	1,148	1,320	1,131	(14.3 %)	(1.4%)
TSX 300	12,204	13,300	11,623	(12.6%)	(4.7%)

Every investor remembers 2008 very clearly, and the debate is whether this is a normal correction, or whether we will experience the chaos that we experienced 3 years ago.

Canadian T-Bills and Bonds

	March 31/11	June 30/11	Sept 30/11
90 day	0.93%	0.91%	0.81%
180 day	1.10%	1.01%	0.85%
1 year	1.35%	1.18%	0.84%
2 year	1.83%	1.59%	0.87%
5 year	2.78%	2.33%	1.39%
10 year	3.37%	3.11%	2.14%
30 year	3.77%	3.54%	2.77%

U.S. T-Bills and Bonds

	March 31/11	June 30/11	Sept 30/11
90 Day	0.06%	0.015%	0.015%
180 Day	0.155%	0.10%	0.045%
1 year	0.23%	0.19%	0.10%
2 year	0.80%	0.48%	0.25%
5 year	2.25%	1.78%	0.95%
10 year	3.44%	3.18%	1.91%
30 year	4.48%	4.39%	2.90%

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Investors fearing an economic crisis and slowdown have purchased bonds of relatively safe countries driving the prices up.

As a wake-up call to my own predictive ability, I expected 30 year Canada bonds in March 2011 yielding 3.77% to be a very risky investment. With their yield falling to today's level of 2.77%, those long bond investors would have been in the top performing asset class during the last six months.

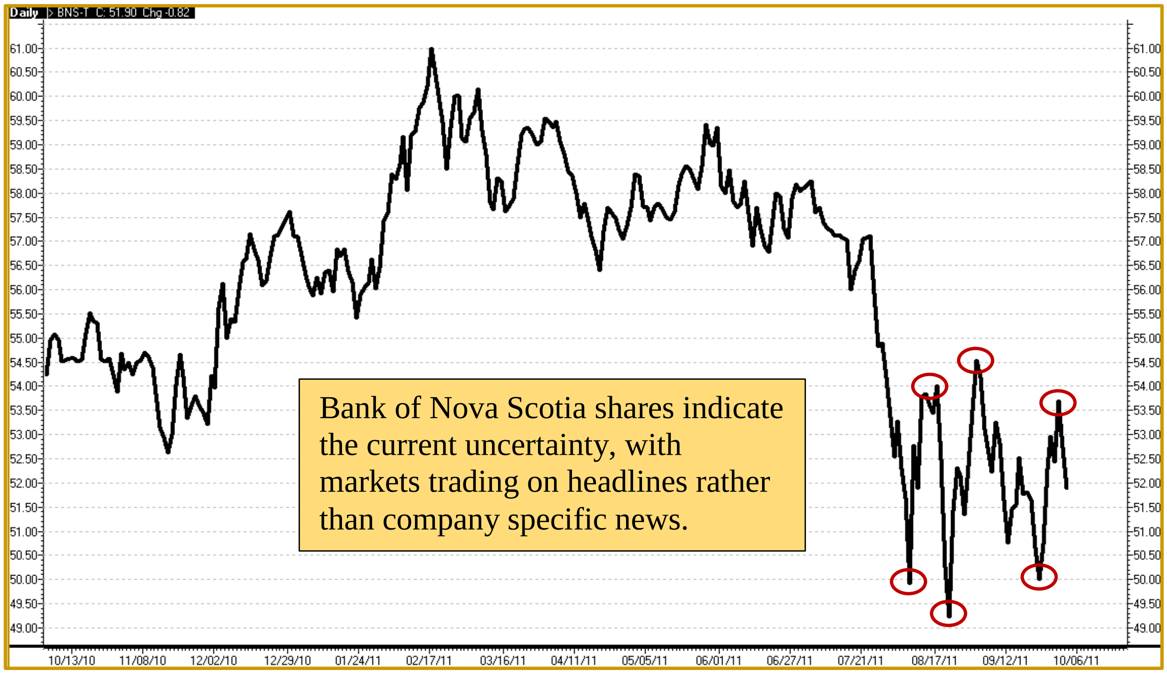
International 10 Year Bond Yields

	Aug 12, 2011	Sept 30, 2011
Japan	1.05%	1.03%
U.S.	2.26%	1.90%
Germany	2.33%	1.89%
Canada	2.45%	2.14%
U.K.	2.53%	2.43%
France	2.98%	2.56%
Spain	5.00%	5.13%
Italy	5.02%	5.53%
Ireland	9.83%	7.63%
Portugal	10.39%	10.93%
Greece	15.53%	22.68%

During the last few weeks we have seen "risk off" behavior as investors seek refuge in the bonds of safer countries, while selling bonds of suspect countries, particularly Greece. Based on the yield of Greek bonds I believe that the market has already priced in a default.

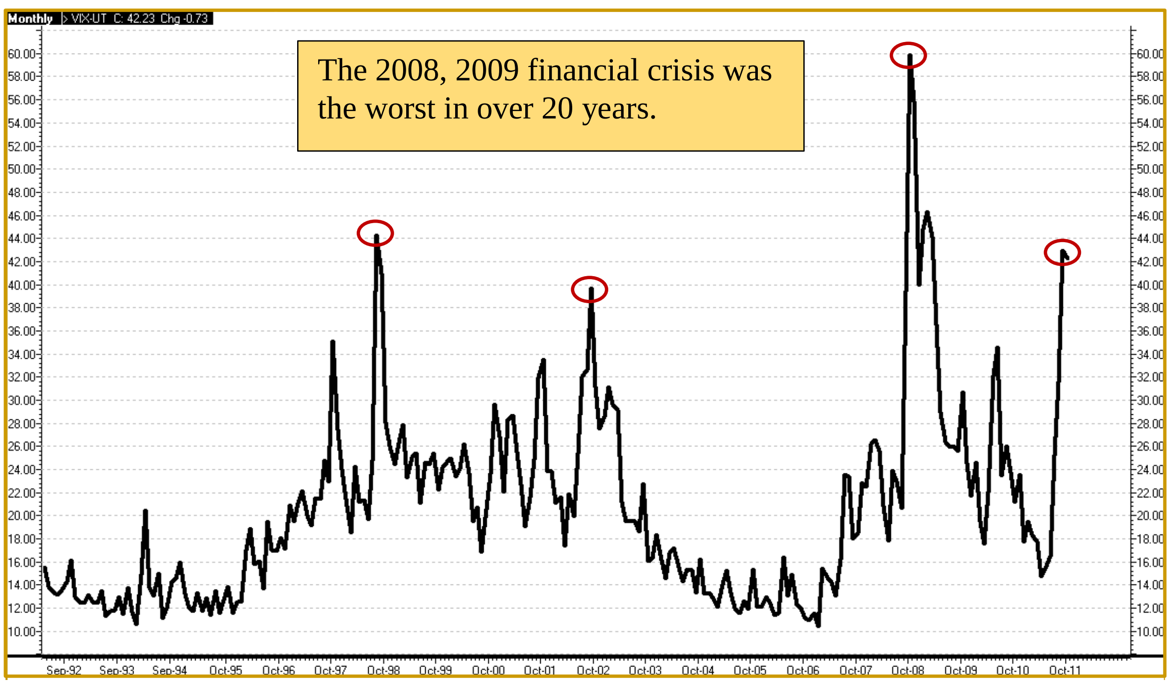
The uncertainty is whether this is an "orderly" default with agreed upon shared sacrifice between the Greek people, European taxpayers and Greek bondholders, or a "chaotic" default with Greece defaulting on transfer payments and European banks left with an uncertain residual value on their Greek bonds.

Confused?



BNS (Daily Chart) Source: Thomson ONE

So if you find the market confusing you are not alone.



VIX-UT (Monthly Chart) Source: Thomson ONE

VIX is a U.S. market volatility indicator. As a general rule you want to lighten equity positions when investors are complacent during times of low volatility, and consider adding equity positions during times of high volatility and investor fear. Currently we are at the third

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highest volatility level in 20 years. Historically you don't want to be selling with VIX readings above 40. We are currently at 42.81. During the 2008/2009 financial crisis the volatility was "off the meter" to 60. During that instance selling at the current level of volatility would have been wise, as long as you bought back in soon after.

September Auto Sales

While we are hearing lots of doom and gloom, September car sales have been released. September 2011 sales compared to September 2010 sales were up 10% in the U.S. market. The average vehicle on the road in the U.S. is now 10.7 years old, and people are being forced to replace them. This is the natural dynamic of the business cycle that will eventually lead us to recovery.

Recommendation

Today we have to balance the valuation of equities, which seem cheap, with the direction and momentum of the markets, which is clearly down. We can't ignore the European sovereign debt issues, the potential for China to stumble, or how these events may spill over to Canadian markets. That being said, radical shifts from equities to cash during times of economic crisis is usually not a good way to earn a decent longer term return.

Investors who carefully accumulate equities while others are throwing in the towel will likely come out ahead over the next 12 to 18 months.

If you'd like ideas as to what might be attractive for your portfolio, please call.

All the best!

B. Holmes. L. Edgett

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