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## 2010 Fall Newsletter

### **Economic Recovery Underway**

After a lacklustre summer, stock markets in North America picked up steam and closed out the third quarter on a high note. In Canada, the S&P/TSX gained 9.5% and the US benchmark S&P 500 gained 10.7%. In spite of recent gains, investors remain nervous and uncertain against the backdrop of extremely negative news which the media continue to highlight over and over again.

To be sure, economic recovery and job creation is not happening quickly enough for many Americans and their frustration was evident in the most recent midterm election but it's important to balance disproportionately negative news with hard facts. Consider the following survey results from McKinsey & Company, a leading strategy consulting firm. McKinsey surveyed 2,000 executives around the world in early September.

- Almost 60% said their country's economy is in recovery.
- Most expect profits to rise from last year.
- And nearly 40% expect to hire employees by the end of 2010.

At the September Big Sky Conference in Montana attended by 2000 business and political leaders, Warren Buffett, Microsoft's Steve Ballmer, and GE's Jeff Immelt shared these positive sentiments.

#### **Warren Buffett**

- "I'm a huge bull on this country...we won't have a double-dip recession. I see our businesses coming back almost across the board... It's night and day from a year ago."

#### **Steve Ballmer, Microsoft**

- "There soon will be more technological advancement and invention than there was during the Internet era, and that will help drive business growth."

#### **Jeff Immelt, GE**

- "Business at GE is improving. Signs across the world show growth improving, as evidenced by a rise in GE's orders."

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It's not realistic to suggest there won't be challenges ahead, both for economies and stock markets across the globe. And given fragile market psychology, it's entirely possible that we'll see a market correction in the next 12 months. **I do however encourage clients to remain focused on long term goals, stay invested and to continue investing on a regular or systematic basis.**

A recent study underscores the importance of staying invested. It found that while the S& P 500 returned 8.35% over a 20 year period ending in 2008, the average equity investor earned just 1.87%, which was less than the inflation rate of 2.89%.<sup>1</sup>

One key contributor to investor underperformance is the “feel good/bad” strategy of buying equity funds when feeling “good” and selling when feeling “bad.” The problem is that investors only feel good after the market has already had a good run and they often miss out on the biggest upswings. Conversely, investors only feel bad after a significant downturn and they bail at the most inopportune times.

### **Equities over Bonds**

Since the low of March 9, 2009, the Canadian equity market S&P/TSX has rebounded a sharp 67%. The same index is 16% higher over the last 12 months but many investors have not stayed invested. In fact, Canadian investors withdrew a staggering \$8.5 billion out of Equity funds while pouring \$11 billion into Fixed Income funds.<sup>2</sup> Some of the world's most successful investors have recently made strong endorsements for equities.

*“It's quite clear that stocks are cheaper than bonds. I can't imagine anybody having bonds in their portfolio when they can own equities, a diversified group of equities. But people do because they lack confidence. But that's what makes for the attractive prices. If they had their confidence back, they wouldn't be selling at these prices. And believe me, it will come back over time.”*

**Warren Buffett, October 6, 2010, Rational Walk**

*“Investors are not jittery – they are scared. They should own equities. Instead, they are buying bonds. Higher interest rates aren't good for bonds. It's a good place to hide, but it's going to hurt you.”*

**Ned Goodman, CEO Dundee Corporation, October 25, 2010, Globe and Mail**

*“Let's suggest the economy looks good, that risk assets – whether it's high-yield bonds or whether it's stocks – have a decent return relative to the potential of declining bond prices. I'll go with the stock market.”*

**Bill Gross, CIO, PIMCO, March 24, 2010, CNBC**

## RRSP Corner

### Spousal RRSPs

A spousal RRSP is an effective tool for splitting income between spouses and reducing future tax bills. For example, a family with 2 spouses both earning \$50,000 will pay much less tax overall than a household with just one spouse earning \$100,000. Although legislation changed a couple of years ago to allow pension splitting in retirement, a spousal RRSP is still a good idea because it's difficult to predict if one may retire early, or may need emergency funds, or whether government policy will hold.

The main drawback with spousal RRSPs is that the lower income spouse cannot withdraw from the plan until 2 calendar years (Jan 1-Dec 31) after the last contribution. Otherwise, the withdrawal will be taxed in the hands of the contributor. These rules are referred to as attribution rules.

**Tax Tip:** Make spousal RRSP contributions before December 31 so that withdrawals could be made in just over 2 years instead of 3 years without triggering "attribution rules."

### RRSP Home Buyers Plans (HBP)

The maximum amount that can be borrowed increased to \$25,000 via the Federal 2009 Budget. The budget also introduced a new \$5,000 First-Time Home Buyers' Tax Credit (non-refundable). Remember that borrowed funds must be repaid over a maximum of 15 years, starting the second year following the year in which they are withdrawn.

**Tax Tip:** Remember to report repayments to your RRSP HBP by completing Schedule 7 on your tax return.

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#### References

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2. IFIC Monthly, September 2010

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