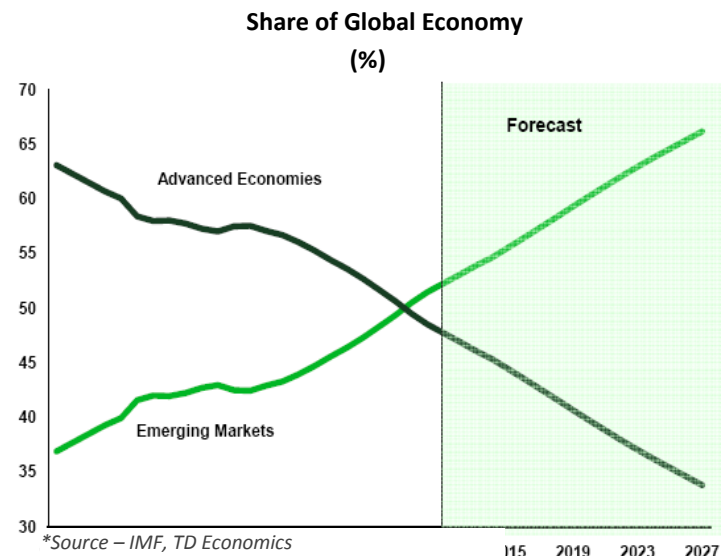




An ode to what ails us – Financial markets worldwide continue to oscillate erratically between euphoria and panic and back again; amidst an ever-incessant barrage of “what if analysis” reported on by mainstream media – the prospect of sluggish economic growth ahead, notwithstanding a *now* heightened concern that Europe’s sovereign debt misery could lead not only the **euro zone** into a (deep) recession, but perhaps “talk” the rest of the world into following suit has prognosticators working the *abacus* overtime. Trying to make sense of ever-changing market dynamics and ensuing “noise,” can at times both be polarizing and **paralyzing** – while recurring market analysis can be found at [swanprinciple.ca](http://swanprinciple.ca), what follows is an abstract of key economic and market-oriented themes likely to influence our investment thesis ahead...

Shifting trade-winds – the prevailing *secular* shift in social, political and economic influence from developed (western) economies (US, Europe and Canada etc.) to emerging markets (China, India, Brazil, Russia *and others*) over the preceding decade will *no doubt* continue in the years ahead, perhaps even accelerate... Exporting nations rich in commodities (Canada and Australia for instance) will remain principal beneficiaries of strong (increasing) demand for *hard assets* (energy, base materials and precious metals resources;) which *perhaps* lends insight too into Canada’s own *internal* shift (in terms of socio-economic and political relevance) from its manufacturing center (Ontario and Quebec) to the *more resource-centric* western/prairies provinces, but also helps explain the meteoric rise of commodities; the price of **oil** for instance having increased 550% since 1998, *but more on this later...*






























De-risking and retrenchment – *sovereign* debt; not just *peripheral* Europe but seemingly all western nations (Canada included,) have a propensity to spend beyond their means – *rarely* (if ever) do economics *align* with the political agenda... Moreover, *too often* the *magic elixir* for excess indebtedness has been ...err, well, **more debt!** *Continuous* budget deficits ultimately (always) lead to **default** in some way, *shape or form*; through a **forced restructuring** of debts, the promoting of **hyper-inflation** (in situations where a nation’s debt obligations are held predominately by its own citizens) or by way of currency **devaluation** (where a large portion of the debt obligations are owed externally,) or some combination thereof?

While Ireland, Portugal, and more recently the US, Italy, Spain *and France too* have (all) been the focus of central bankers, bond ratings agencies and policy makers alike, the challenges ahead for **Greece** in particular, *perhaps* can be viewed as a kind of *metaphor* for the “crisis of confidence” presently overshadowing the global economy. With proposed austerity measures targeting Greece’s *bloated* public sector (representative of 40% of GDP,) notwithstanding the *ongoing* civil unrest; which has since *decimated* Greece’s tourism sector (another 15% of Greece’s economy,) any capacity to manufacture inflation (internally) is most certainly *constrained*... What’s more, though a significant portion of Greece’s debt is in fact held by foreign interests (external debt,) its sharing in the **€uro** precludes any potential for the aforementioned devaluing of Greece’s *former* home currency (the drachma) ...*this time ‘round* – **YES, Greece has indeed defaulted before; 5 times in fact!**

*And right on cue*, another **cool \$8 billion** in new loans in an effort to ward off financial/economic *collapse* ahead of Greece’s proposed debt restructuring; *preferably* an “orderly,” and “voluntary” *write-down* (50%) of Greece’s outstanding debt, though *still* requiring the *recapitalization* of numerous European banks (those with excessive exposure to Greek bonds) – *that is provided the 17-member (multi-party) Euro zone (and the Greeks themselves) can actually follow-through with implementation of such a plan?* But austerity, by its very definition, requires *variation* of *deep-seated* socio-economic and *cultural* predispositions – *there is little sense in passing legislation to raise taxes, if no mechanism exists for tax collection!*

Ultimately a workable solution to *Europe's* sovereign debt (and banking) woes will require not only a *script* for Greece, but additional *ring-fencing* of Italy, Spain, Portugal and various others on the periphery. Unfortunately, synchronized policy efforts are hard-fought – all too often *compromise* (in the interest of *all* stakeholders) can only be achieved in the 11<sup>th</sup> hour; *staring into the abyss...* Whether a ratcheting-up of already proposed bailout/support measures, *intervention* by the International Monetary Fund and European Central Bank (in the form of *additional* interest rate cuts and buying support for European bond markets,) and/or perhaps a *further* shift in the direction toward complete *fiscal integration*, it is apparent that a more highly coordinated policy response is needed, *and soon* – dysfunction and waning confidence in political leadership throughout the region has already toppled the governments of Greece, Italy and Spain... Moreover, inaction has *gutted* \$13 Trillion from global equity markets these past months; *to defend (initially) a mere \$250 Billion of Greek bonds???*

Closer to home, while certainly also *strained* by an over-extended consumer, *weak* housing forecast and stubbornly high unemployment, the situation south of the border appears *still* nowhere near as ominous as that of Greece (or Europe at large) – though a US Congress stymied by bipartisan rhetoric may *yet* (again) hold the world's financial markets *hostage* as obligatory cuts to government spending (forecast *next year* to be 25% higher than back in 2007, prior to the *financial crisis*,) and the potential for new/increased taxes will most certainly be debated ahead of (and beyond) the 2012 Presidential election... And while Canada's financial circumstance is perhaps in better form than its G7 cohorts, and considering Canada's *advantaged* position as exporter of all things *drilled, mined or grown*, the fact of the matter is that upwards of 75% of Canada's trade (exports) is *still* conducted with our US cousins – notwithstanding latent “guilt by association,” Canada's banks too, *though well-capitalized* (and perhaps some of the safest financial institutions in the world,) are certainly not immune to the possibility of “contagion” in global banking and credit (*the lifeblood of economic growth*,) should it extend beyond Europe, and perhaps *even* morph into a *2008-like* freeze of credit markets – *evidence* of a marked improvement in *inter-bank* lending (*amongst major European financial institutions and not just with the ECB; acting as lender of last resort*,) would be a *leading indicator* of a rekindling of economic growth in the region, and perhaps a catalyst for financial markets.

	Est. GDP 2011 (\$Billion)	GDP per Capita	Debt to GDP (2010)	Budget Surplus (Deficit)	Inflation Rate	Unempl oyment Rate
 EU	\$15,608	\$24,440	80.0%	-6.4%	2.1%	9.7%
 USA	\$15,227	\$48,665	94.4%	-10.3%	3.4%	8.6%
 China	\$11,174	\$8,288	33.8%	-2.5%	4.2%	4.1%
 India	\$4,448	\$3,608	71.8%	-5.1%	9.3%	9.4%
 Japan	\$4,418	\$34,645	220.0%	-7.4%	-0.5%	4.5%
 Germany	\$3,048	\$37,428	84.0%	-4.3%	2.1%	5.5%
 Russia	\$2,356	\$16,840	11.8%	-3.9%	7.0%	6.4%
 Brazil	\$2,294	\$11,767	66.8%	2.2%	6.6%	5.2%
 UK	\$2,233	\$35,645	75.5%	-10.4%	3.3%	8.0%
 France	\$2,205	\$34,858	82.3%	-7.1%	2.5%	9.9%
 Italy	\$1,812	\$28,888	119.0%	-4.6%	3.3%	7.9%
 Mexico	\$1,658	\$15,113	42.9%	-2.3%	3.5%	5.6%
 Korea	\$1,541	\$31,410	33.4%	-1.1%	4.2%	3.1%
 Spain	\$1,395	\$30,233	60.1%	-9.2%	2.9%	21.8%
 Canada	\$1,382	\$39,981	84.0%	-2.1%	2.9%	7.4%
 Australia	\$919	\$40,816	20.5%	-4.3%	3.5%	5.3%
 Netherlands	\$695	\$41,691	63.7%	-5.1%	2.6%	4.8%
 Sweden	\$372	\$39,847	39.7%	0.2%	2.8%	7.5%
 Hong Kong	\$347	\$48,347	34.6%	4.1%	5.7%	3.4%
 Switzerland	\$336	\$42,847	54.5%	-1.3%	-0.5%	3.1%
 Greece	\$312	\$27,843	142.8%	-10.5%	4.7%	18.3%
 Singapore	\$311	\$59,123	96.3%	-2.6%	5.7%	2.0%
 Norway	\$266	\$53,738	55.4%	10.6%	1.2%	3.3%
 Portugal	\$246	\$23,078	92.9%	-9.1%	4.0%	12.3%
 Denmark	\$203	\$37,585	43.7%	-2.6%	2.6%	7.6%
 Finland	\$185	\$35,885	48.4%	-2.5%	3.4%	7.8%
 Ireland	\$174	\$39,311	94.9%	-32.4%	2.9%	14.6%

\*Source – IMF, WorldBank

\*\*Estimate as of April, 2011, adjusted for Purchasing Power Parity

New normal – Rome ...err Athens wasn't built in a day, and so too *de-risking* will most likely prove to be a long, arduous and *no doubt* embattled process... And while economists deliberate on the *nearer*-term prospects for the global economy; from “soft-landing” (muddling-through) to “double-dip” (falling *back* into recession,) the deleveraging *hangover* will most certainly be felt for a number of years *yet*, manifesting in *sluggish*, though likely *still* positive growth (in the range of 1-3% per annum) for the *western* (developed) economies. What's more, without the *tailwind* of a three decades long decline in interest rates (and resultant *four-fold* expansion of the use of financial leverage,) *and* notwithstanding an already significant retrenchment by the consumer (representative of 70% of the *US* economy,) *future* fiscal *and* monetary policy response from governments and central bankers *both* will most likely *continue* to reflect an *accommodative* stance – with resultant interest rates to remain *lower, longer*; in a sense *rewarding* borrowers with *easy* access to low cost credit, though *punishing* savers with the prospect of nil/negative “real” (adjusted for inflation) returns and *continued* erosion of purchasing power.

However administered, whether by increasing the *money supply*; through central bank purchases of government securities or simply *printing* dollars, the product of a more accommodative monetary policy (*quantitative easing #3*) will be a further flooding of the financial system with *cheap* capital; to *encourage* lending to *businesses and consumers both*, and to buoy liquidity in the credit/capital markets. But there are *opportunity costs*; in the form of an **increased inflationary bias for one**, though this assumes (*of course*) that banks will *eventually* want to get back into the lending *game* and that (*qualified*) borrowers will *again* want to borrow – it seems that *easy credit*, even when paired with historically low borrowing costs does not automatically translate into new/increased loans demand; **confidence** is *key* and must *somehow* be restored...

Kick the can – but so-called “*quantitative easing*” (printing) puts currency devaluation on the *fast-track* – perhaps by design, US policy makers (for instance,) have allowed the all-mighty Greenback to drift lower against a basket of foreign currencies, in fact lower by more than 25% over the preceding decade (35% against the Loonie;) helping in the *arrest* of what was previously years and years of continuously expanding *balance-of-payments* deficits, but also promoting the *deferral* (and discounting in “real” *inflation-adjusted* terms) of *future debt repayments*... Moreover and notwithstanding too its *perceived* “safe-haven” status, the expectation that growth ahead from emerging (developing) markets, will be *exceedingly* more robust than what is achievable by *western* (developed)

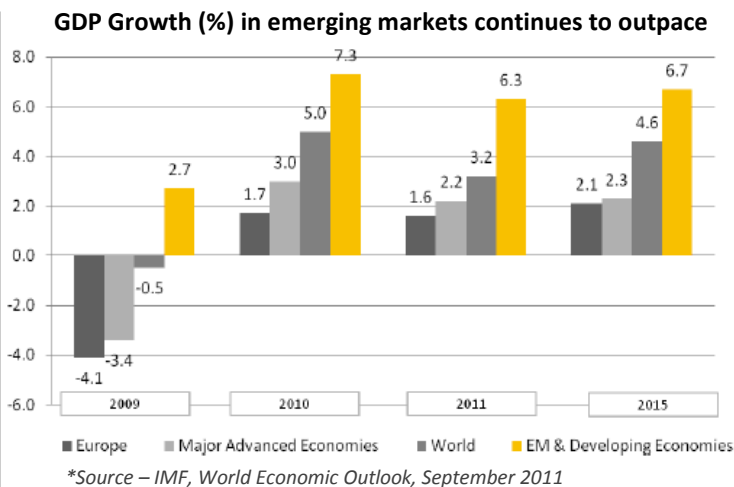
economies (*likely by a factor of 2-3 times more*;) it *might* be reasonable to imagine that the US dollar could (continue) to underperform, *though* interestingly a weaker (home) currency may *in time* (actually) be a *boon* for the US economy as goods/services produced at home would eventually become more affordable relative to foreign imports; *swaying* business and consumers to again “buy American,” an in turn prompt (new) investment, job creation and the *rekindling* of growth?

The other shoe – perhaps it makes sense then that China (and others with *burgeoning current account surpluses*) have recently been more vocal in their *aversion* toward amassing *even more* US dollars, instead eyeing *any* opportunity for trade concessions (*access to Greece’s ports infrastructure for instance*;) though commodities (energy/oil, copper, iron ore, metallurgical coal, potash/nitrogen, so-called “rare earths” and precious metals/gold) will remain the primary focus – though not only to satisfy increasing *physical* emerging markets demand, but as a *hedge* to future (US dollar) fluctuations. But “safe-haven” status can perhaps (also) be achieved with considerably less risky/volatile *insurance* – the debt/**bonds** of more fiscally responsible governments; those with lower relative debt/GDP (Canada and Australia for instance or Norway, for it in fact is the **only** western economy presently in *surplus*;) are viewed as the new “*gold standard*,” along with other “**AAA**” rated credits of various “blue-chip” **multi-national** corporations (those benefiting from the aforementioned shifting trade-winds,) particularly **dividend growers** including McDonald’s, Procter & Gamble, Johnson & Johnson, and Scotiabank...

Beyond our borders – and while demand for resources has indeed been a boon for Canada’s economy, the *cyclicality* and *economic sensitivity* of the energy and materials sectors *in particular*, perhaps lends insight as to why the S&P/TSX; with its emphasis on resources (and banking,) has (more recently) underperformed the broader (US) S&P500. While diversification outside of Canada may seem *somewhat* counter-intuitive given the aforementioned challenges related to sovereign debt, the prospect of (more) robust growth from *developing* markets, notwithstanding strong Loonie makes the case for foreign exposure (*perhaps as above through ownership of select multi-national corporations*) even more relevant.

A cup *half full* – contrasting the aforementioned *macro-economic* headwinds, *sluggish* economic growth from western (developed) economies and lower interest rates, *longer*, the financial position of *many* (large) corporations (*here at home and even more-so south of the border*) are *today* arguably in the best shape they’ve been in for many years – and notwithstanding recent (continued) reports of *robust* earnings, the amount of debt outstanding on corporate balance sheets (today) is similar to that reported back in 1980; though the economy has since more than doubled in size... Moreover, the companies comprising the broad S&P500 index (for instance,) show more than **US\$2 Trillion** today in liquid (cash) assets on their respective balance sheets; the most in 50 years and more *even* than Canada’s entire Gross Domestic Product (C\$1.574 Trillion in 2010.) While in times of uncertainty, cash-on-hand (liquidity) can indeed be beneficial; Chief Financial Officers (CFOs) are generally not aiming to be *long-term* custodians of cash earning nil/negative “real” (taxable) returns – *excess* liquidity will *in time* be put to work; either reinvested in the underlying business, or perhaps used to fund *mergers and acquisitions* (*though consolidations can weigh on unemployment*) or returned to shareholders as increased (or *special*) dividend payouts and/or stock repurchases – in whatever form, as above, renewed **confidence** will be the catalyst...

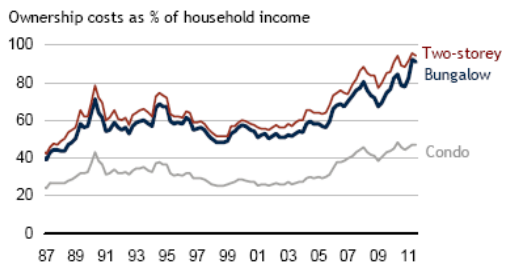
A corporations ability to *self-fund* operations with *excess* cash-on-hand perhaps also helps to explain the relative lack of *new* (corporate) bond issuances (and *lowest-ever* corporate bond default rates) – while aggressive fiscal management and financial leverage were indeed traits of the 1980s and ‘90s (a *windfall* for economic expansion and for broad equity market returns,) **deleveraging** by governments and consumers both, and the resultant, expected *fiscal drag* on economic growth ahead is perhaps more *supportive* of corporate bonds and other **yield-oriented** investments; including select *high yield* bonds, preferred shares and Real Estate Investment Trusts (**REITs**;) as scarcity, demographics (*Baby Boomers transitioning* into retirement for instance) and continued aversion to risk, foster demand for *anything* paying a *fixed* return/cash-flow.



- Apple's **U\$75 Billion** in cash-on-hand is more than the entire market capitalization of Royal Bank
- GE is negotiating with the US Government and the IRS to repatriate upwards of **U\$94 Billion** held offshore
- At the current rate of stock repurchase, just **1** Walmart common share will remain in 15 years time

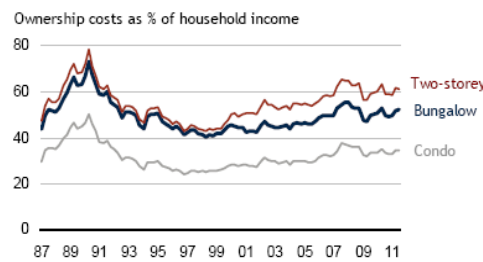
And while there have more recently been musings as to whether local residential real estate is overdue for *correction*, the fact Vancouver ranks *worst* in the nation in terms of its *poor* housing *affordability* (measured as the proportion of median pre-tax household income required to service mortgage payments, property taxes and utilities;) with related ownership costs in some instances approaching 100% of average family income, and with corresponding home prices today more than 2½ times the national average, the prospect of earning sufficient enough rental income to offset related *carrying costs*, let alone support an expectation of a *reasonable* return on investment is perhaps (now) somewhat more *challenged*...

### Vancouver

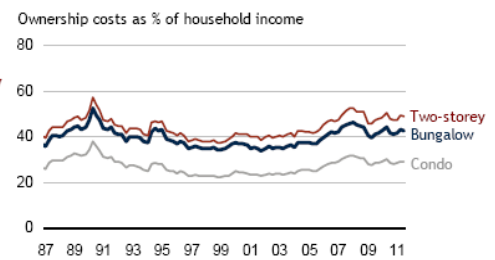


\*Source: Stats Canada, Royal LePage, RBC Economics

### Toronto



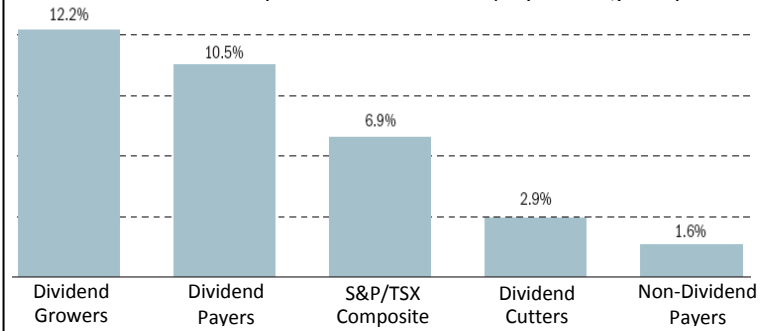
### Canada



More with less – and with what some are calling “*the lost decade*,” with major equity markets *more-or-less* the same today as back in 2000, amidst various burst “*bubbles*” and seemingly one *crisis* after another, *and* with prevailing interest rates likely to manifest ahead in nil/negative “*real*” returns, company *dividends* and the familiar mantra of “*getting paid to wait*” are perhaps *even* more relevant today, and going forward, likely representative of an even larger proportion of a *well-diversified* portfolios’ *total return*. Though not just *yield*, *dividend growth* – businesses which tend to be *less economically sensitive* (consumer staples and services, utilities, infrastructure, pharmaceuticals and telecom,) and which have the capacity to increase dividend payouts (an indication of relative financial strength) will continue to be favoured by investors seeking income; [Telus](#) for instance, with its current yield of over **4%**, notwithstanding management’s commitment to increase its dividend payout by yet another 10% in 2012.

### Dividend growers lead the way...

Total Returns (Dec 1986 – Jun 2011, equal weighted)



### Dividends 1990-2010 – An increasing proportion of overall return

Years ending Dec 31, 2010	S&P/TSX Total Return	Dividends Reinvested	Capital Gains	% From Dividends
5 Years	6.50%	2.92%	3.58%	45%
10 Years	6.56%	2.39%	4.17%	36%
20 Years	9.80%	2.46%	7.34%	25%

\*Source – Sentry Investments, RBC Capital Markets

Winning by not losing – and while *systemic* risk can at times overshadow company fundamentals, profitability, earnings growth and *dividends* ultimately *still* (always) matter in the long-run. Unfortunately “*headline risk*” has a tendency to perpetuate *sometimes* extreme market (price) volatility – even *opposing* “*asset classes*” can become highly correlated during bouts of *panic-selling* (*where there are many sellers but few buyers*) and/or during periods of *euphoria* (*competing buyers anxious about the prospect of being left behind*) with resultant *whipsaws* fueled *further* by financial leverage, so-called “*program trading*” and “*short-sales*” (the *speculative* selling of shares not otherwise owned;) any/all of which having the potential to undermine *conventional* (passive) “*buy and hold*” investment strategies. Attempting to capitalize on market (pricing) inefficiencies is the goal of “*active*” *portfolio* management. Moreover and beyond traditional (*proven*) tenets of successful *long-term* investment practices – **diversification, asset allocation, rebalancing and time-in** – *perhaps* a more *pro-active, tactical* (opportunistic) investment management approach *should* be pursued concurrently; in an attempt to harvest *incremental returns* amidst *on-going* market volatility, and with *further* emphasis on **preservation of capital!**

In pursuit of *absolutes* – thus there are perhaps times when a more “*open mandate*” is indeed desirable – *active* money managers who foster a (more) regimented buy/sell discipline, with emphasis on **market leadership** characteristics, *funds flows* and various other *trends* analysis (to bolster fundamental research,) and with the ability to more readily **recognize** and

**respond to** shifting market dynamics; by repositioning portfolios as necessary (*into cash where appropriate*) and/or by applying various other **non-traditional “hedging”** techniques, perhaps *should* be adopted along-side other favored *conventional* investment strategies and as part of a well-diversified *portfolio approach*. In particular, smaller, more nimble, and more concentrated portfolios; those which appear *less* like the broader market indices, and comprised of *high-conviction*, best-in-class securities holdings, *perhaps* offer the greatest opportunity for *absolute* (positive) returns...

Have your cake – notwithstanding the focus on **yield** and the benefits derived from diversification and active portfolio management, particularly for *income-oriented* investors, the *ideal* of “*pension-like*” cash flows can be achieved by way of a **Variable Annuity**; which provides *not only* for a **guaranteed minimum income-for-life**, but the potential for capital appreciation and increasing cash flows, though without relinquishing flexibility, liquidity or control. Moreover, when tapped for non-registered savings, income earned enjoys the lowest income tax *inclusion* rate; thus these kinds of solutions are suitable for all types of registered and non-registered savings accounts, as well as inside corporations and trusts – *more*

Step out from the crowd – acclaimed investor Warren Buffett once mused “...*best to be fearful when others are greedy and greedy when others are fearful!*” While market (pricing) inefficiencies can (and often do) manifest in potentially *highly* lucrative re-investment (trading) opportunities, one should always take heed, as the *market* (and shifting investor sentiment) has a tendency to swiftly *punish* even the largest and most successful companies (including *former* market darlings,) for unfulfilled expectations... Moreover, as investors we **all** tend to experience the disappointment from *loss* (even unrealized) far more than the joy (expectation) derived from *gains* – perhaps this explains the aforementioned cash hoard (but not only by corporations, money socked away by individuals in bank accounts and between mattresses,) and why investors are willing to pay a hefty **premium** for the *perceived* certainty of a fixed yield (*and for local real estate too?*)

But waiting on a resolution to Europe’s sovereign debt problem (*and the next “crisis,” and the next one...*) could mean passing on many worthwhile (re)investment opportunities – the world’s troubles; whether economic, geo-political or *what-have-you* are nothing new, nor recent, and as such are likely to take just as long to resolve as create. Moreover, and while it may “*feel*” (more) *comfortable* to be part of a *crowd*; maintaining (too much) cash on the sidelines or perhaps focusing (solely) on fixed income-*only* securities, especially when considering that current interest rates are hovering at/near *60-year* lows, let alone the aforementioned inflationary bias (and taxes too,) what appears to be a path of *least resistance*, may in fact serve only to accelerate the erosion of one’s buying power. Opting for a nil/negative real return *seems* somewhat like an irrational choice, especially when many competing investment (yield) alternatives presently trade at a discount **on sale!**

“**BREAKING NEWS**” – know that the role of the media is not solely to inform, but to *captivate*; “**increasing the volume**” by any/all means necessary to sell advertising. When it comes to investment matters however, the throngs of “talking heads” insistent on being heard, serve only to fan the flames of uncertainty; unfortunately leading some (investors) to abandon even the most well-conceived financial strategies. History shows however, that even during bouts of extreme pessimism, investors (in the long run) are typically better off maintaining their (diversified) portfolios – *choosing when to sell rather than following the panicked herd...* What’s more, those able to set emotions aside and (*continue to*) deploy new moneys (by way of dollar-cost-averaging-in or perhaps “*buying the dips*” etc.) have generally achieved more favorable outcomes than would-be speculators *attempting* to time the market – but operating against the grain requires an iron-will, a well-defined re-investment **process** (*as above,*) and *realistic* expectations – **ask yourself; what would Warren would do?**

A final word – and so it seems we’ve come full circle – clearly there are *a few* obstacles to economic growth ahead, though in spite of the sometimes *dire* prognostications reported on by mainstream media, and notwithstanding too the occasional bouts of acute market volatility, the sun somehow still manages to rise each morning and so too the realization that your personal financial needs also remain. Taking steps to ensure that your various financial strategies currently in play continue to be aligned with your objectives, time horizon and risk tolerances is fundamental – please call me directly so we may revisit your goals and portfolio in detail and where appropriate, update your mix to echo the aforementioned themes...

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