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Client Letter – Spring 2013

"Central Banks and policymakers are acting like barbers; they haircut your portfolios."
Bill Gross, Founder and Co-Chief Investment Officer of PIMCO, May, 2013

We often hear in the Spring "Sell in May and go away" as it's not uncommon for stock markets to be ripe for the picking. This year, it didn't hold true.

Central bankers, the keepers of the elixir for the punch bowl, are doing what they can to keep rates down and the markets buoyant. And while valuations of financial assets keep floating along swimmingly well, Captains of Finance keep an eye on the waters for icebergs. But the trouble with icebergs is that they're mainly under the surface and are less obvious, even to the keenest of observers.

In today's exceptionally low interest environment, many shy away from the discomfort of the life boats of cash, Guaranteed Investment Certificates and short term investment grade bonds. You see, with rates as low as they are, the safest seaworthy vessels are taking on water in the form of inflation. The boats are tightly moored and when the inflation tide rises, a subtle but true confiscation of wealth occurs. Many investors, though grudgingly, have abandoned the good ship "Guaranteed" in search of higher yields and the promise of better returns while hoping for continued smooth sailing. No worries for them as Admiral Ben Bernanke (Chairman of the Federal Reserve Board) and captains of the various Central Banks will do all they can to ensure a safe voyage.

One tool deployed to help keep interest rates low is the electronic printing press. Some Central Banks print money out of thin air and purchase all sorts of assets but in particular government backed securities such as mortgages and government bonds. As an example, the Central Bank of the USA is printing $85 Billion per month (that's about $1 Trillion per year) which is used to sop up securities. Even though such demand is as artificial as Sweet N Low it keeps a lid on interest rates. The more demand there is, the lower the rates go.

A little back of the envelope math may help to explain the logic of low rates. The current accumulated US government debt is around $17 Trillion. Their thinking is that if they allow rates to go up, the cost to carry the debt will be too expensive. Moreover, the tepid economic recovery may well be jeopardized should rates increase too quickly.

That the annual fiscal deficit in the USA has shrunk from plus $1 Trillion to $850 Billion per year reflects this modest recovery and better tax position the US Federal Government has in the short term. When one considers the ever-increasing transfer payments directly in front of them (Social Security, Medicare, Drug Plans etc..), it is clear the government has a vested interest in low rates.

Here in Canada we have not yet overtly kept rates low through the printing press. Our accumulated Federal debt is not quite as high on a relative basis but our costs of senior care will rise dramatically too. By visiting our Canada Pension Plan website, you can see that the number of people collecting CPP and Old Age Security is starting to increase more quickly, not to mention the expense associated with health care.

So here we are today where the one-way street of wisdom suggests that rates won't go up. I look both ways when I'm crossing a street-any street, especially ones I haven't been down before. I'm not so convinced that higher rates aren't around the corner.

Low rates have unintended consequences. It punishes savers who have socked away some money, particularly seniors. You see, little Mrs. Muzentuch just can't seem to support herself with GIC rates at 1 or 2 percent. She's forced to cash in her investments or chase higher yields in markets that aren't as predictable or guaranteed. But one day when rates move upwards, these alternate insertions in her portfolio could become most unpredictable.

Simplistically, don't expose yourself to undo risk and diversify investments to mitigate big shocks.

<u>In Case You Missed It</u>

Testamentary Trusts, a very efficient arrangement people use in the transfer of assets at death through their Wills, may soon be under attack. In the latest Federal budget, the government announced that they will be taking a closer look at this mechanism as there is tax "leakage". Often times, because these types of Trusts are treated as separate tax payers, it results in significantly lower taxes than if assets were bequeathed directly to heirs. That's a burr in the saddle of our Finance department so stay tuned and I'll send out a separate letter if there are changes.

<u>Glitter Gone From Gold?</u>

That the price of gold has whipsawed so violently it makes one wonder about it being a store of value. Gold's price in US Dollar terms went from a high of around $1,900 to $1,350. That's about a 28% decline from its September 2011 peak. There are no guarantees that the price has bottomed out (though at writing there has been a bounce to over $1,400/oz). There has been a bigger decline in the value of mining shares. I still believe it is prudent to hold a portion of one's wealth in precious metals but it is indeed currently out of favor. According to John Doody, often quoted and author of the Gold Stock Analyst, mining shares are trading at a 44% discount as at May 31st, 2013.

E Statements

Many clients have switched over to E Statements. Not only are they available 24 hours a day, it helps to cut down on unnecessary paper usage, postage and misdirected or lost mail. If you'd like to switch to E Statements, simply email Erin at erin.hooper@rbc.com and she'll be happy to get you going.

Final Notes

The summer is a great time of year to review one's tax, estate and financial plans. It's never too late for a check up so if you'd like to talk over the phone or face to face, give us a call and we'll set something up.

I won't be taking a lengthy vacation over the summer but Cathi and I will be taking our grand children to Ottawa, likely the first week of August. Besides that, there is a weekend trip to the NHL Entry Draft at the end of June and fishing with my brothers.

Hopefully you will be able to spend some quality time with your friends and loved ones over the summer too. Thanks again for your continuing support and if you need anything, we're as close as the phone.

On behalf of myself, Erin Hooper and the crew at RBC Wealth Management, I hope you have a happy and safe summer.

Sincerely,

John Davies, CFP
Investment Advisor