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### **Autumn 2010 Newsletter**

“A government that is big enough to provide everything you want is also big enough to take everything you have”.

I heard someone on the radio attribute this quote to Thomas Jefferson though I cannot verify it. Nonetheless, in light of this era of entitlements and bailouts, I felt it an appropriate opening line for this letter, but cannot take credit where credit is not due. And speaking of credit (or outrageous debt levels), herewith is my autumn letter.

It's been some time since I last wrote a note for public display. Even though I don't have a set schedule per se, I like to get them out seasonally. So much for summer!

In the last 6 months I have travelled to Brandon Manitoba, Quebec City, Lake Placid, caught a river boat on the Rhine with dear friends and went from Basel Switzerland to the Netherlands. There were stops in France and Germany and then just a few weeks ago I came home from New Orleans where Erin and I had been attending an investment conference. What a dramatic diversity of culture, history and lifestyles I've seen in such a short period of time. Such an extensive itinerary as this would not have been possible a mere one hundred years ago, a few moments in the grand scheme of history.

I wonder what the world will look like in twenty years, let alone in a hundred years. It's been about 20 years since the break up of the Soviet Union and the embracement of capitalism by Russia and China. Once upon a time if you bought a pair of jeans in Russia for \$10 and sold them for \$20, it was a crime; my, what a dramatic change we've been witness to.

We have also been living through a period where the empire of debt, the United States, has been losing its footing as the outright leading economic power. Paradoxically, their currency is the dominant “reserve currency” and their dollars are the primary medium of exchange for goods. What seems so clear when I look in the rear view mirror is that the emerging nations of the world, (read major players referred to as “BRIC”- Brazil, Russia, India and China), are consuming more now than before and will likely increase dramatically in the next 10 or 20 years. The market capitalization of these markets and their economic growth appear to have only an upward direction longer term.

Our populations are relatively static and our government and personal debts are extreme as compared to the BRIC nations. China is now the number one purchaser of automobiles. Can it be far off that their consumption of oil and gas doesn't follow too?

You don't necessarily have to own investments directly in the aforementioned emerging markets to participate in their growth. Owning things that they need, such as resources, are a reasonable way to

profit from the expansion. The more they consume, the more precious our limited resources become, thereby appreciating in value.

South of the border, the central bank of the USA is embarking on another round of "Quantitative Easing" referred to as QE II. I prefer to call it for what it really is-money printing. These freshly minted dollars are used to purchase US government bonds which helps to "quantitatively ease" the interest rates but such action is artificial.

Whether the intent of the policy is to keep the US Dollar down relative to other currencies (called "competitive devaluations"), an attempt at avoiding deflation or to artificially keep interest rates low, I'll bet there will be unintended consequences to such extreme intervention. The Americans can print all the money they want but they cannot control where it will go. Apparently a couple trillion dollars of previous money printing didn't do what it was suppose to so Federal Reserve Board Chairman Ben Bernanke thinks doing more of the same will have a different outcome. Honestly, I just don't get how debasement of one's currency and going deeper into debt will have positive results. At the risk of being sarcastic, Central Planning at its finest by someone who has never run a business and wasn't elected directly by the people, Ben Bernanke and his predecessor Alan Greenspan have perpetuated more bubbles than a soaped up hoop on a windy day.

It could be argued that the Federal Reserve Board policies have captained this mess. From the bailouts of the stock market crash in 1987 and hedge fund Long Term Capital Management in 1998, the Y2K (year 2000) scare, the Technology and Dot Com bust to the housing fiasco and sub-prime debt crisis, the Fed has been there every step of the way. Alan Greenspan seemed oblivious to the bubbles he was helping to blow as he said he didn't know there was one until it had burst. This last bubble in the credit markets was the biggest one yet but there are some who believe that we are in the midst of a truly gargantuan one in the government bond market. This is not as illogical as it may appear as the government has become the lender of not only the last but first resort too.

If money printing were the solution, why hasn't it worked yet? Surely you should get better results for \$2 Trillion. Why is the unemployment rate in the States so high, the housing market in shambles and the number of people dependent on food stamps rising?

Around the world we are seeing belt tightening and with that a disgruntled public. We've seen tensions rising publicly in Europe as most are in agreement to cut spending everywhere except where it affects them directly. The bottom line is that a whole bunch of people have been living beyond their means for a very long time.

Back at the New Orleans Investment Conference there was a perception that Canada has been doing well dealing with the global financial crisis and by extension, government debt. It was pointed out that we too had our federal government debt crisis of sorts back in the early 1990s. We took our medicine and did some belt tightening and luckily the commodities and emerging markets started to expand just in time to help supply the wind under our wings. All of the additional revenue and tax dollars that this created for the Canadian economy helped us produce budget surpluses which in part went towards paying down our accumulated deficit. In hindsight, it was brilliant and helped us to be better prepared for the global financial crisis.

According to our national Department of Finance website, our outstanding Net Federal Debt as at March 31<sup>st</sup> 2009 stood at \$463.7 Billion US Dollars (interesting it's stated in US Dollars, isn't it?). Compared to our annual Gross Domestic Product of \$1.375 Trillion Dollars, it represents a Debt to GDP ratio of 33.72%. In other words we have 33 cents of debt for every dollar of goods and services

we produce. Compared to the other Group of Seven nations, which includes the likes of the States and Japan, we are faring very well. But this doesn't mean we should be complacent as there are signs we too are living beyond our means. Today, our province of Ontario coffers are stretched as is the debt of the average citizen. We have been taking advantage of exceptionally low interest rates and inflated home values. More and more, Canadians are tapping into the increased equity in their homes but not so much here in Windsor and Essex County as home prices are still quite low compared to the rest of the country. The projected accumulated Ontario debt for 2011 is \$154 Billion and as the baby boomers age, we'll have significant funding issues to deal with, especially in health care. One thing is for certain, we cannot expand our deficits indefinitely and economic forces will eventually cause us, too, to make some tough decisions.

### So where do we go from here?

Being that no one truly knows what the future holds, I remain steadfast in my belief that we have to continue with investment and financial planning strategies that protect us from either inflation or deflation. To not have a view to either possibility is a risky proposition. High quality interest bearing investments of a shorter term (daily interest accounts and "laddered" bonds or GICs) help to somewhat protect from deflation while commodities and well run companies who provide goods or services that are necessities help to offset the effects of inflation. One thing is for sure; we live in one of the most interesting times in history so enjoy the ride.

### Final Notes

As 2010 draws to a close, I will be available to assist with year end tax and investment planning. For some it might be cashing in some Registered Retirement Savings Plans or Registered Retirement Income Funds to take advantage of lower tax brackets, while others might like to make last minute contributions to Registered Education Savings Plans. Also remember that with the arrival of 2011 we'll be able to add to Tax Free Savings Accounts and for those who are still contributing to RRSPs this years deadline is March 1<sup>st</sup>, 2011.

To all of you who have sent your friends and relatives to see us, Erin and I are humbled and thank you as it is a true compliment. We will continue to do our best to warrant your trust and confidence.

I do not anticipate being away from the office for any significant length of time until March when I will be meeting with several other RBC Dominion Securities' Investment Advisors from across the country. Beyond that my only secured travel arrangement is to Omaha for the annual Berkshire Hathaway Shareholders meeting to see Warren Buffett and Charlie Munger. Last year, several clients made the trek with me and this year I'll expect even more to come. They're both getting on in age so I'll enjoy the gatherings while I can.

As always, if you have any questions or would simply like to have a review, please give us a call or drop us an email. I still do evening and weekend meetings. On behalf of Erin Hooper, myself and the rest of the crew at Dominion Securities, I wish you a very Merry Christmas and a Happy and safe holiday season.

**Sincerely,**

**John Davies, CFP  
Investment Advisor**

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