



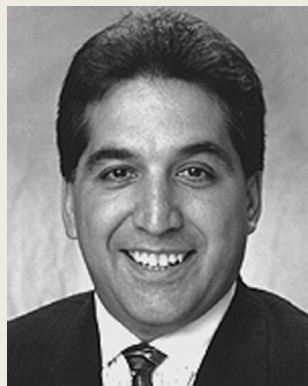
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The Newsletter for the Informed Investor – www.rbc.com/vito.finucci

OCTOBER 2011



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The big Picture



"When you listen to what the Federalists said about the Anti-Federalists, and the names that Jefferson called Hamilton, and back and forth – I mean those guys were tough. Lincoln, they used to talk about him almost as bad as they talk about me. So democracy has never been for the faint of heart." President Barack Obama

As the rhetoric for the U.S. Presidential election in November 2012 ratchets higher, we already have had a supreme struggle between the "left" and "right" which began approximately two years ago, carried through the U.S. mid term elections, the Canadian Federal election, and even saw glimpses of it in the Mayoral elections in Toronto and even London. Even in our own pending provincial election in two weeks, the main talking point is fiscal responsibility. It seems the extremes on both sides now dictate policy, none more evident than in the U.S. political scene as on the left, the extreme small "s" socialists (i.e. tax and spenders) push policy while on the Republican side where the extreme right Tea Party types (i.e. less government, less taxes) seem to be setting the agenda.

The rhetoric has indeed ramped up, and combined with Euro woes caused by decades of accumulated Socialist policies, the one word which keeps coming up is "fair". So this month's commentary is a subject I've wanted to discuss for a while, and have been accumulating data from my many readings for some time. I am simply presenting the facts, most of which come from government websites or information in the public domain.

The Definition of Fair and the Myth of the Rich

I want to discuss what I perceive to be the war on success; the class warfare and intentional divisive rhetoric which seems to permeate every political debate and expand exponentially in media reports. As we head into election mode, it ratchets higher. There seems to be a battle going on to take from people that have achieved a certain level of success, rather than finding ways to really spread the wealth. Taking it seems to be a much easier way to do it than to actually instill determination and set higher standards for working and learning. For me, as a person whose parents' best legacy to me was a strong work ethic, it is frustrating because not only does this nonsense unfairly paint hard-working people and over-achievers as demons, but as a father of four, I don't want it to permeate young people's thinking and have them avoid trying to clear high hurdles, develop a "woe is me" mentality or a sense of entitlement (which is why Europe is in its current state).

"The democracy will cease to exist when you take away from those who are willing to work and give to those who are not." Thomas Jefferson

The Western world and the lifestyles and standards of living we currently enjoy were achieved by sacrifice. By our soldiers who fought two great Wars for a belief in freedom. By long hours put in by self made business men, who often risked everything in order to run with an idea. Through free markets in which the end user...the customer...decided who were winners and losers. Success in the West

has not been a zero sum game where there are limited amounts of prosperity, or only one winner like in a Monopoly game. That success doesn't have to be confiscated, put into a pot and doled out as dictated by the government. Most of those with success did work hard and took risks. But often they were not alone. Many got financial help and guidance from mentors, combined with inspiration and support from loved ones. The current attempts at the redistribution of wealth in the name of "fairness" or economic justice by taking from successful business people building factories will not change the current mess in healthcare, the rate of murders, illiteracy or hopelessness for those in the lower brackets. Instead of raising the bar and graduating more doctors and engineers and so on we seem to be aiming for mediocrity. We need to once again unlock those animal spirits which have made capitalism the greatest improver of standards of living man has ever known.

"I predict future happiness for Americans if they can prevent the government from wasting the labors of the people under the pretense of taking care of them." Thomas Jefferson

If we do end up getting a double-dip recession, it will be a self-fulfilling event. Consumers are hoarding cash. Banks are too scared to lend. Corporations are not investing or hiring because they don't know what the rules to be. In a recent piece in the *Wall Street Journal* (by Robert Frank), the Millionaire Investor Confidence Index is cited. The index in July dropped to its lowest level in years and the reasons were as follows:

24%	Stock Market
21%	Economic Environment
13%	Political Climate
8%	Household Income
8%	Retirement

The actual numbers of millionaires (by net worth, not income) swooned to 237,000 in 2009 from 390,000 in 2007. Now before you go feeling sorry for this group, the point of writing about them is that taxes paid by this group tumbled 42% even as their effective tax rate climbed 24%. The President has mentioned several times that he is able to figure this out on the back of a napkin. I agree, it's not rocket science.

Even President Kennedy, who may be THE icon of the left, way back in the 1960s figured it out:

"...it is a paradoxical truth that tax rates are too high and tax revenues too low and the soundest way to raise the revenues in the long run is to cut the rates now...not to incur a budget deficit, but to achieve a more prosperous, expanding economy which can bring a budget surplus." November 20, 1962 – President's New Conference

"...lower rates of taxation stimulate economic activity and so raise the levels of personal and corporate income as to yield within a few years an increased – not a reduced – flow of revenues to the Federal Government." January 17, 1963 – Annual Budget Message to Congress

"A tax cut means higher family income and higher business profits...every taxpayer and his family will have more money after

taxes for a new car, a new home, new conveniences, education and investment...businessmen can keep a higher percentage of profits in his cash register or put it to work expanding or improving his business...the Federal government will eventually end up with more revenues." September 18, 1963 – Radio & TV Address to the Nation

Going back a little further, the great economist, John Maynard Keynes, wrote in 1942 about the British economy:

"Nor should the argument seem strange that taxation may be so high as to defeat its object, and that given sufficient time to gather the fruits, a reduction of taxation will run a better chance than an increase of balancing the budget."

The 1981 Reagan Tax Cuts cut marginal rates 25% across the board over a three year period. The top tax rate dropped from 70% to 50%. In the four years prior, federal tax revenues fell at an annualized rate of approx. 3% per year. After Reagan's cuts, they increased approx. 3% per year. Tax revenues from the wealthy actually increased.

History time and time again tells us what happens when sensible tax policies are enacted. Tax cuts produce increased tax revenue AND economic growth. But the temptation to raise taxes persists, because it is politically popular. Increasing taxes on the wealthy (the second temptation) has been around since the beginning of time. The reason/excuse is always the same: To bring more "equality" and "fairness". Again, history shows it doesn't work in practice, because those people find ways to reduce taxes paid, change spending patterns and actually pay less in taxes.

Being a music fan, let me remind you of a little band called the Beatles, who in the early 1960s wrote a song called "Taxman", which said "nineteen for you and one for me"...was based on the truth. The top tax rate in Britain at the time for the wealthy was a confiscatory 95%!! So what happened? They left Britain and moved elsewhere. So did the Rolling Stones (in 1971), Elton John, and many top athletes. When Sweden tried the same thing and taxes soared, tennis star Bjorn Borg and IKEA founder Ingvar Kanprad fled the country...and took their money with them.

The political lines are being drawn, which is truly unfortunate, because it is class warfare and divisive. It is difficult to stand against the desire to have government give us the thing we truly need. The focus should be on longer term issues like the massive, growing debts. The solutions for the long term are the same as those for the short term; unlock the greatness of the West and allow those animal spirits that created the Space Program, Home Depot, Microsoft, and Apple Computers, and so on to run wild. I'm talking greatness at every level, not just tax breaks for people who pay very little taxes to begin with. Instead of punishing success with higher taxes, let those willing to work harder and smarter create success by using their skills to unlock the economy. What we have going now is a punitive approach rather than a promotional one.

"It is incumbent on every generation to pay its own debts as it goes. A principle which if acted on would save one-half the wars of the world." Thomas Jefferson

The myth of the “rich” as a static group, or even the so-called middle class is at the heart of misinformation to harm successful people and at the same time make government more powerful. Too often we hear the top earners don’t carry their “fair” share. Consider the following:

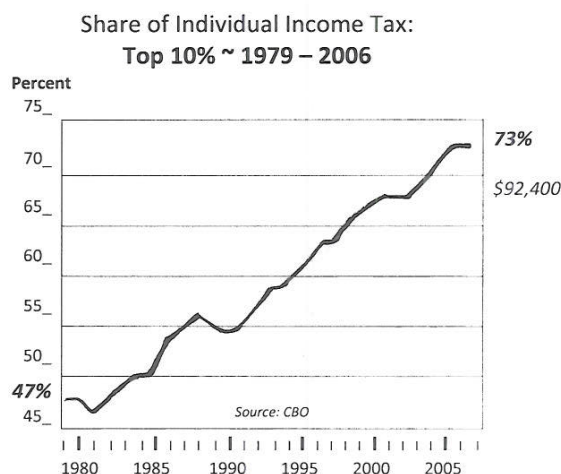
Who Bears the Burden?

America’s top earners share of Federal Income tax revenues are twice as big as their share of National income.

Taxpayer Groups By Income	Share of Federal Taxes	Share of National Gross Income	Average Tax Rate
Top 1%	38%	20%	23%
Top 5%	59%	35%	21%
Top 10%	70%	46%	19%
Top 50%	97%	87%	14%
Bottom	50%	3%	13%

Source: Internal Revenue Service

So let me quickly review the chart. The Top 1% of earners pays roughly 38% of federal income tax. The Top 10% pay 70% of all federal taxes. The bottom 50% pay 3% of federal income tax. So basically...almost half of all Americans now pay virtually zero income tax.



I am not making this point to defend wealthy citizens and to malign the poor. I am simply making an argument for true fairness – not a political or ideological “fairness”. Taxing the top earners whose investments expand the economy and create jobs isn’t the solution out of this mess. It’s a backward one. If taxing the rich was a viable economic solution, then California’s economy should be booming, instead of heading toward fiscal oblivion.

The bestselling book “The Millionaire Next Door” by Thomas Stanley was published in 1996 after 20 years of research. It is perhaps the foremost authority on the habits and a characteristic of America’s wealthy. Most of the findings are opposite to what you’d expect (and what President Obama has been trying to present). They are NOT Bentley driving, mansion owning, Tiffany shopping members of country clubs. Stanley’s research reveals

even the “glittering rich” – those with a net worth of \$10+ million – often meet the description. Stanley found the vast majority:

- Live in a home which costs < \$400,000 (and 50% have lived in the same home for > 20 years)
- Do not own a second home
- Have never owned a boat
- Are more likely to wear a Timex over a Rolex
- Do not collect wine and generally pay less than \$15 for a bottle
- Are more likely to drive a Toyota than a Mercedes
- Have never paid > \$400 for a suit

This is certainly not the traditional image of the “rich”. So who is buying all those Mercedes, Louis Vuitton purses and Cristal champagne? According to Dr. Stanley, he refers to them as “aspirational”, people who act rich, want to be rich, but really aren’t rich. Probably the same types who lived beyond their means helping contribute to the current state of affairs. Reminds me of that Texan line... “Big Hat, No Cattle.” Further on into Stanley’s research:

- Average age of 57, married, with 3 children
- One in five is retired, 2/3 are self employed, 3/4 are entrepreneurs
- Most of businesses are not considered “sexy” businesses – welding, contractors, auctioneers, farmers, owners of mobile home parks, pest controllers, coin & stamp dealers, paving contractors
- Average income is \$247,000 – only 5% make \$1 million or more
- 80% are first generation affluent (i.e. never received an inheritance)
- Only one in five are not college graduates, 18% have Masters, 8% law degrees, 6% medical degrees, 6% are PhD’s
- 2/3 work between 45 and 55 hours per week

“Yes, we take responsibility for ourselves, but we also take responsibility for others.” President Obama

On top of the class warfare, we have changing demographics hitting at the same time. In 1970, the ratio was 5.3 workers to 1 retiree. Today it’s somewhere around 3.5 working age adults per retiree. In 2050 it’s expected to be 2:1. By 2025, at the height of the Boomer retirement cycle in North America, there will be 10 new retirees for each new entrant into the workforce. Combine that with exploding healthcare costs and inadequate retirement savings, and we have a perfect storm. There is no doubt our future generations have already started behind, for they are all already responsible for tens of thousands in national debt in some countries. And as a father of four, this is what worries me most. Today’s political process continues to allow Boomers to pile on new debt for the next generation, leaving a Boomer’s legacy of crippling debt and underemployment.

Deficit spending, by itself, is not a problem. That is, borrowing today to invest in the future to smooth temporary economic shocks is perfectly reasonable. But to spend it on social programs or flat out handouts without creating a job or building a bridge or highway is when serious problems arise. The new socialist utopia can be described as:

"The harder I work, the more I owe society."

"The less I work, the more society owes me."

The crux of the problems we are currently facing have been slow to rectify and address, because the problems we face today exist because the people who work for a living are outnumbered by those who vote for a living, so the political will to do the right thing is absent. The recent U.S. debt discussions are the perfect example. Politicians are more concerned with positioning for next year's election rather than today's realities.

I'll add one personal vignette to the story. My summer holiday this year was a long weekend in August. We went to New York City, saw some money managers and did some tourist things. We all know how much President Obama hates Wall Street and bankers. Every opportunity he has, he kicks them in the groin. But on our first night in the big Apple, the President was holding a Wall Street fundraiser for his re-election campaign. The cost for the dinner: a mere \$76,000 per couple. So while the President bashes the rich, Wall Street and whoever, it's obvious he still likes their cold hard cash. This was more than bad optics. It's what is at the root of bad policy.

He doesn't want to level the playing field. He's trying to make winners into losers. The answer is less government, not more. Invest in education, not hand outs. The solution is more hard work, more elbow grease, not less. It's governments that are broke, not individuals or corporations. To take from the latter groups who have done things right, to give to the former is not the solution. Don't stir the pot with finger pointing and class warfare.

"My reading of history convinces me that most bad government results from too much government." Thomas Jefferson

There is nothing but uncertainty and bad news on the front pages each morning. Pessimism is high, and expectations are low. That usually sows the seeds of great bull markets.

Now is not the time to give up on what made the West great. Once those animal spirits are given the green light to be released, only then will our potential be realized. As the first generation product of immigrant parents from a war torn country who came with nothing, expected nothing, with no social nets and nothing but a work ethic, they built so much with so little. I know that all too well.

NOTES

Europe's Problems Summed Up:

Pythagorean Theorem: 24 Words

Lord's Prayer: 66 Words

Archimedes Principle: 67 Words

The 10 Commandments: 179 Words

Gettysburg Address: 286 Words

US Declaration of Independence: 1,300 Words

U.S. Constitution + 27 Amendments: 7,818 Words

EU Regulations on the sale of cabbage: 26,911 Words

Chasing Performance

Investors tend to buy high and sell low...

Canadian Equity Fund Sales vs. Performance the last few cycles

Sept 1997 Sales \$1.7 billion (market dropped 20%)

Sept 1998 Redemptions \$853 billion



PORTFOLIO CORNER (All prices as of close September 23, 2011)

This quarter's pull back has created another opportunity to buy good name companies at discount prices. For the first time in a while, the Canadian banks look good here (RY \$46, TD \$71, BMO \$56, BNS \$50.50). In commodities, Teck Resources (TCK \$30.70), Lundin Mining (LUN \$3.80). The Insurer's, Manulife (MFC \$11.50) and Sun Life (SLF \$23.90). Energy names, Suncor (SU \$26.30), Canadian Natural Resources (CNQ \$30.25), EnCana (ECA \$20.70) and the "old energy trusts" like Pengrowth (PGF \$9.50), Arc Resources (ARX \$21) and Canadian Oil Sands (COS \$19.95)

In the U.S., too long a list, but some of the names that interest me at current levels (in no particular order) are Goldman Sachs (GS \$95), Morgan Stanley (MS \$13.75), Cienna (CIEN \$11.50), Manitowoc Company (MTW \$6.85), Walter Energy (WLT \$64.50), MGM Resorts International (MGM \$10.25), the ag names (Potash – POT \$45, Mosaic – MOS \$55.25), Deere (DE \$67), Caterpillar (CAT \$74.40)...among others.

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