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February 2014

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Investment Products: The Devil can be in the Details



Whenever there is a human need, there is someone who is going to find a way of fulfilling it. Today, many investors remain in a fragile psychological frame of mind as a result of their experience through the financial crisis, and who are equally desperate for more investment income from their savings than is available from conventional investments. The investment industry is meeting those needs with several investment products that are attractively wrapped in guarantees and accompanied by compelling annual cash payments. But scratch beneath the surface and you might find something other than what you initially thought.

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- Cash distributions may include a return of capital component (that is, a return of your principal) that will erode the value of your investment over time.
- Underlying securities in which you wouldn't knowingly invest due to their low quality or poor credit ratings. In order to achieve the attractive yield (7% in one example), incremental risk has to be taken. Bonds with credit ratings of BB and lower are often found in these portfolios (AAA is the highest credit rating). Some debt securities (certain debentures, for instance) do not carry credit ratings and the guarantee is based solely on the soundness of the issuer.
- Guarantees that only cover your principal (e.g. 5% cash payments guaranteed for 20 years = 100% of your principal returned over the life of the investment, possibly with little left at the end.)
- Income for life that equates to annual payments of 4% of your investment, but reset every three years according to the amount of principal remaining. You can live to infinity, and it'll still be paying you something!

The point is not to avoid these products entirely, as there may be situations where they are indeed suitable, but it certainly is to urge investors to make certain they have an understanding of the mechanics of how an investment product works and be clear about the true nature of any guarantee that is attached.

Now We Know Who The Real Enemy Is!

The study of behavioural finance is the study of investor decision-making and related behaviour. It is a fascinating area and has empirically proven time and again that investors can be their own worst enemies. Often without knowing it, investors allow their decisions and behaviour to be guided just as much by emotion as by reason, and even sometimes their reasoning is faulty.

Investor sentiment is something many investment experts watch and measure closely. Bullish and bearish investor sentiment readings are what we refer to as "contrary indicators". The belief is that investors let their feelings of euphoria or panic rule their investment behaviour, causing them to invest eagerly at or near the top of a market cycle (when they feel confident and bullish after markets have advanced significantly) and sell at or near the bottom (because the mood has turned pessimistic). Legendary investment manager Sir John Templeton dryly noted, "*Bull-markets are born on pessimism, grow on scepticism, mature on optimism and die on euphoria*". From his point of view, investor sentiment is what determines the various phases of a market cycle.

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A sophisticated investor will act contrary to popular sentiment by selling as investor euphoria rises and buying when panic has set in.

Complacency about where we are in a market cycle and what are the risks at that point can also work against an investor's interests. Failing to anticipate a hostile turn in the market (or in the fortunes of a particular investment) can quickly change that complacency into something destructive (ie panic selling).

Not acting when action is required is a decision in its own right. Not being vigilant when vigilance is required can move one to a state of panic very quickly, and too often with no strategy for dealing with the unexpected. As a former colleague once noted, "panic is an emotion for the unprepared".

***"We Have Met
The Enemy
And He Is Us."***

Pogo By Walt Kelly

Prescribed Rate Loan Update

Effective January 1st, 2014 the prescribed interest rate set by CRA for non-arms length loans was reduced to 1%. After a brief increase to 2% the rate once again sits at its lowest level. This presents investors with an attractive hurdle rate for their investments if they are using or considering using either a spousal loan strategy or family trust for income splitting purposes. If you have any questions about these please feel free to contact Brad, Clare or Chris.

Our Complementary Review Service

Periodically, clients ask us if we would sit down with a friend or family member to go over their financial position and investments. Sometimes, they just want an objective "second opinion" to make sure they are on-track with their current advisor. Other times, they are actively seeking a new advisor and would like to know more about what we offer. Whatever the situation, we would be pleased to sit down with anyone you refer to us and provide a confidential review at no obligation or cost.

Davidson Professional Wealth Management

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Canadian Sector Performance	2013	2012
Energy	9.9%	-3.63%
Materials	-30.6%	-6.9%
Industrials	34.9%	12.67%
Consumer Discretionary	39.5%	18.67%
Consumer Staples	21.4%	20.35%
Health Care	71.7%	24.13%
Financials	19.1%	12.78%
Information Technology	36.2%	-3.21%
Telecommunication Services	8.1%	6.38%
Utilities	-8.6%	-0.83%

Number Crunching

Year to date performance as of December 31st, 2013 of select currency and equity indices. All returns are in local currencies.

Equity Indices	2013	2012
S&P/TSX Composite Index Total Return	13%	7.19%
Dow Jones Industrial Average	26.5%	7.26%
S&P 500	29.6%	13.41%
NASDAQ Composite Index	38.3%	15.91%
MSCI EAFE	19.4%	13.55%
Currencies (in Cdn \$)	2013	2012
US Dollar	8.1%	-2.86%
Euro	12.3%	-1.07%

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