Davidson Professional Wealth Management

Portfolio Matters

By: Brad Davidson, CIM, CFP Vice President & Portfolio Manager
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April 2011

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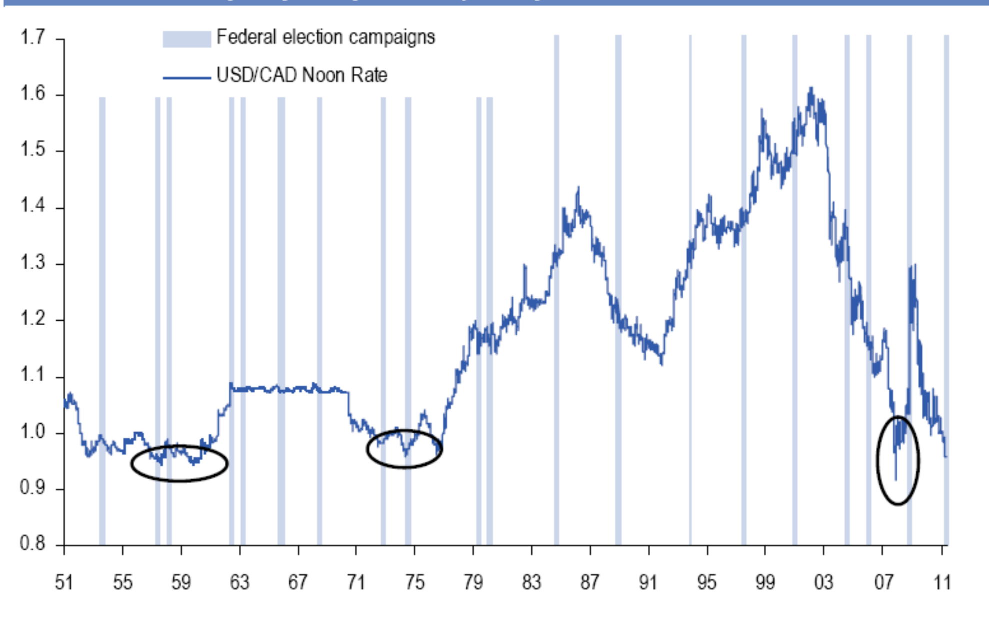
The Loonie Takes Flight

The Canadian dollar's meteoric rise over the past 8 months has garnered much media attention for both the positive and negative impacts. Canadians wintering abroad are overjoyed as their vacations have become significantly less expensive while Canadian businesses who export to the US grimace and tighten their belts as their profit margins are squeezed. While most Canadians will recall the last time the Canadian dollar was at this level back in the fall of 2007 far fewer will recall the previous occasion some 35 years ago back in the 1970's. The chart below shows just how rarely the Canadian dollar has been at these levels, and then for only brief periods of time.

1. USD/CAD has only very rarely and temporarily been at current levels



Source: RBC Capital Markets, Bank of Canada

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Professional Wealth Management Since 1901

RBC Dominion Securities

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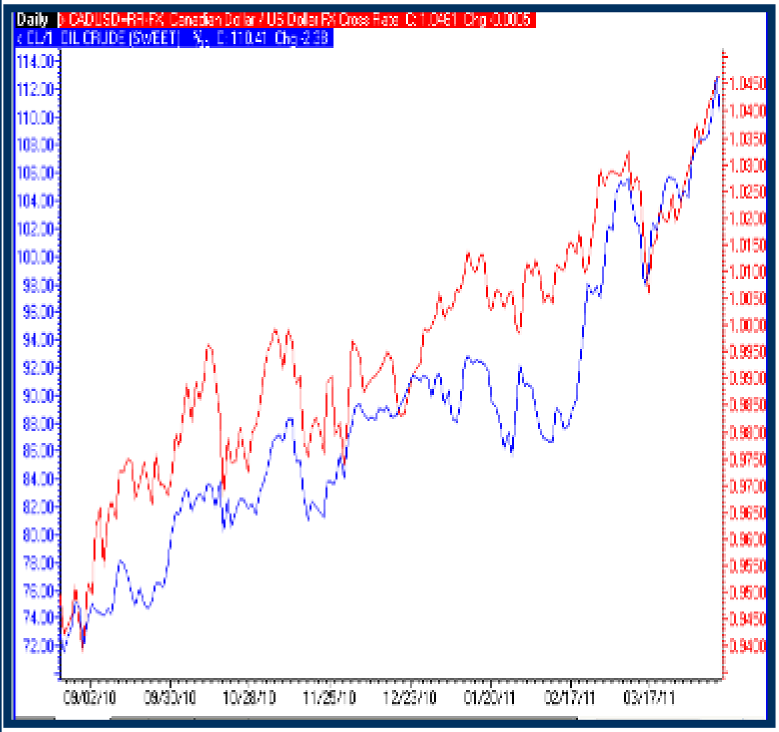
What is the cause?

There are many factors that influence the relative value of the Loonie. The future direction of interest rates, the relative health of the government, budget and economy, the price of oil and other natural resources among other things. Lately it seems that the rising price of oil has been the main cause of the increase. The chart below illustrates the high degree of correlation exhibited by the Loonie (red line) and the price of oil (blue line).



What does the future hold?

The few incidents in post WWII history where the Canadian dollar has traded for above the USD for lengthy periods of time were the late 50's to early 60's when interest differences between Canada and the US made the Canadian dollar more attractive and the 70's when there was a broad commodity boom and the Arab oil crisis drove oil prices higher. Both of these scenarios bear striking similarity to today's economic and fiscal environment. RBC Capital Markets has forecast that the Loonie will stay at or above the USD until the late summer of 2012 so don't be surprised if the Loonies continues to soar for some time.

* * *

Where we are now: new bull market or the middle of a bear market? (And, what can we do about it?)

The economy appears to be on a self-sustaining path to recovery, capital markets are returning to functioning normally, equity markets are significantly off their lows, and investor confidence is improving. All these factors combined should put investors in a pretty comfortable place.

That the market will have its ups and downs there can be no doubt. But, looking to the future the question of the moment is: have we entered a new secular bull market that will advance over multi-years (reminiscent of the 1980's and 1990's), or are we simply enjoying a brief rally in the midst of a longer-term bear market (more akin to the decade of the '70's)?

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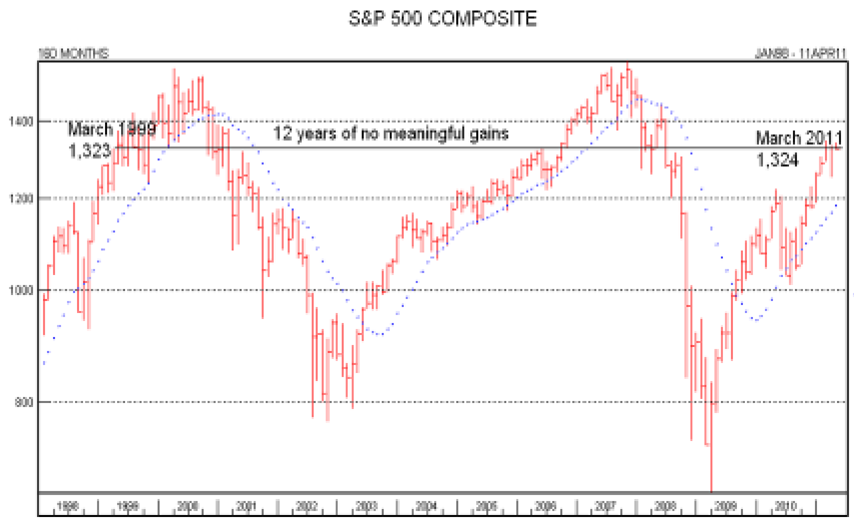
As it turns out, the US equity market has been suffering through an extended bear market of its own since the late 1990's. Fortunately, bear markets, just like bull markets, do eventually run their course. Identifying when this is about to happen is never as simple as we think it should be.



Several factors favouring a return to a secular bull market:

Interest rates are low, economic activity is picking up, employment appears to be improving, corporate profits are growing at a healthy clip and cash is sitting on corporate balance sheets and in short term deposits waiting to be spent or invested. A continuation of these factors could support a multi-year rally in the global equities markets.

Factors suggesting a continuation of a secular bear market:

Interest rates will eventually rise, challenging economic growth as well as equity valuations; unemployment will not improve fast enough to put consumers back to where they were in terms of household finances and consumption any time soon; the US housing market will remain stuck for several more years and this will tie the hands of financial institutions for extending credit.

Given that we won't know the true nature of this market for several more years, we look to history to identify investment strategies that have historically performed satisfactorily in both types of markets. Actively-managed dividend growth strategies have proven to deliver commendable returns through the combination of regular dividend payments, dividend growth, and price appreciation. During the 10 year period of 1972 – 1982, during the last secular bear market, the non-dividend paying segment of the S&P 500 returned 2.4% pa, while the dividend paying segment generated annual returns averaging 7.9%. An additional benefit is that the stocks of dividend paying companies tend to be less volatile than non-dividend payers, thereby delivering a more attractive risk-adjusted return as well.

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Canadian Sector Performance	YTD	2010
Energy	8.7%	10.0%
Materials	-1.4%	35.8%
Industrials	8.7%	14.4%
Consumer Discretionary	-1.8%	21.8%
Consumer Staples	2.7%	8.3%
Health Care	51.2%	50.3%
Financials	9.1%	6.3%
Information Technology	1.0%	-4.7%
Telecommunication Services	4.1%	16.2%
Utilities	1.2%	12.6%

Number Crunching

Year to date performance as of Mar 31st, 2011 of select currency and equity indices. All returns are in local currencies.

Equity Indices	YTD	2010
S&P/TSX Composite Index Total Return	5.6%	17.6%
Dow Jones Industrial Average	7.1%	11.0%
S&P 500 Index	5.9%	12.8%
NASDAQ Composite Index	5.0%	9.6%
MSCI EAFE	3.4%	4.9%
Currencies (in Cdn $)	**YTD**	**2010**
US Dollar	-2.7%	-5.2%
Euro	2.9%	-11.5%

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E-Newsletter!

We are pleased to now offer our quarterly newsletter in electronic format. If you would prefer this method of delivery please email us at chris.emms@rbc.com.

Source: RBC Dominion Securities

Tax Planning Update:

2011 RRSP Contribution Limit: 18% of earned income to a maximum of $22,450