Daniel Hulak's

RandomComments...

Views and opinions
for the clients and friends of

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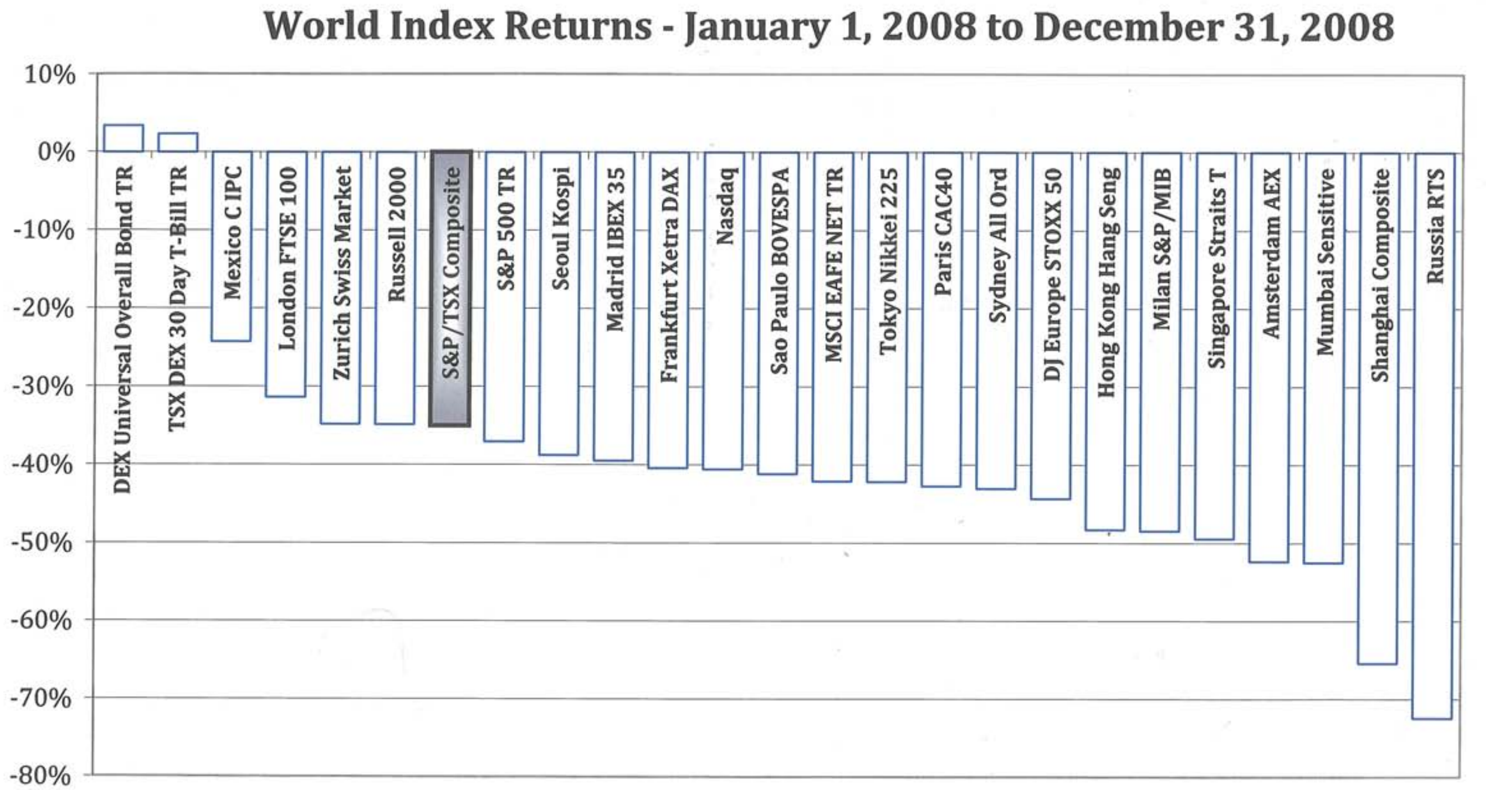
Please note that my intent with these 'Random Comments' is not to create a regular newsletter, but instead to offer you periodic updates as we navigate through these challenging economic times. The following is once again a random, non-cohesive jumble of facts, thoughts, opinions and interesting tidbits...

January 26th, 2009

•We are ALL happy to have 2008 behind us in terms of equity markets! ‘08 was a year that our Children, Grandchildren and Great-Grandchildren will learn about in school for years to come.

•The TSX in Canada declined by 33% in 2008 (and nearly 49% peak to trough) and the S&P500 in the United States declined by 37% for the year (and nearly 54% peak to trough), yet those performance numbers were good enough to keep both near the top of the list relative to other major equity markets around the globe (ie – the Shanghai Composite in China was off approximately 63%, and the RTS in Russia was off approximately 70%!).



Data from Thompson, shown in Native Currency

•So where do we go from here? In my last commentary (in October) I quoted Nick Murray as saying: “A bear market is a period of time during which people who think this time is different sell their common stocks – at prices that will never be seen again – to people who know that this time is never different!”

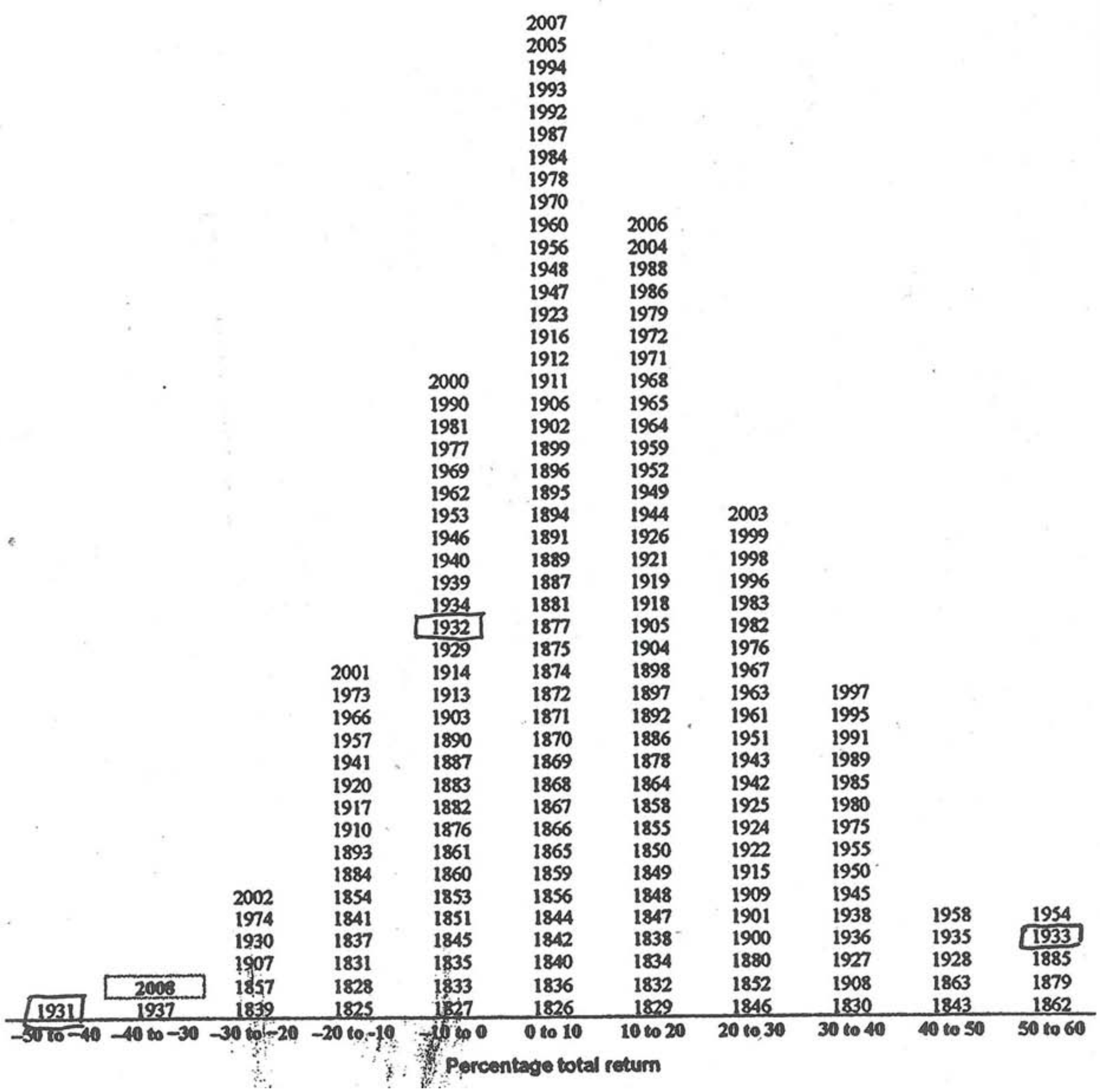
•Although things have deteriorated far quicker and far more severely than anyone expected, I firmly believe that the above statement still holds absolutely true!

•Please take a moment to flip to APPENDIX ONE and read the article entitled “Experts: Bank Crisis Risks Turning Recession Into Depression”…

•Did you read it? Now note the date on the top of the page…this article appeared in the Seattle Times on Sunday, December 16th, 1990! Does the content within sound familiar? Now note the following: On that date the S&P500 in the United States was at 326 points. About a month later it bottomed at 312 points and has never been that cheap since! As I write this, even after the massive sell-offs we've seen recently (remember the nearly 54% peak to trough decline), the S&P500 is trading around 850…nearly triple where it sat in 1990!

•I have no idea whether or not the lows that we saw on November 20th, 2008 will hold - I don't ever profess to be a market timer – but I do know that there is absolutely incredible value in stock markets right now, and if I had to bet where markets will be 2, 5, and 10 years from now I would say: higher…likely quite a bit higher! Why do I say that?...

•Look at the graph below depicting annual S&P returns since 1825. Have a look at where 1931 sits on the chart (look way left). Then find 1932 (not great, but certainly better). Then find 1933 (look way right). Now find 2008. Where do you think 2009, 2010 and beyond will fall on this graph???



•Refer to APPENDIX TWO…all of the major markets in the world are trading at or below the bottom end of their fair value bands in terms of normalized p/e ratios. That very rarely happens, and typically when it does, it bodes extremely well for returns in the future.

•Refer to APPENDIX THREE…remember that since WWII (post war era) we've seen 13 bear markets (characterized by a 15% decline or greater). This leads us to assume that they occur on average every 5 years or so. They've lasted an average of 13 months and plunged an average of 28.0%. The average time it takes to recover all of these losses is 19 months! And the average two year return from the end of the bear market has been 39.6%. This time around the market (S&P500) has declined from Oct.9th 2007 to Nov.20th 2008 by 53.8%! What will the recovery be two years out? Five years out? Ten years out?

•It would have been nice to have had a crystal ball in early 2008 (or now in early 2009, or before last Saturday's lotto 6/49 draw for that matter), but unfortunately no one knows tomorrow's headlines. We can set the sails, but we can't control the wind. Make sure your sails are set, so that you're properly positioned when the wind inevitably blows again!

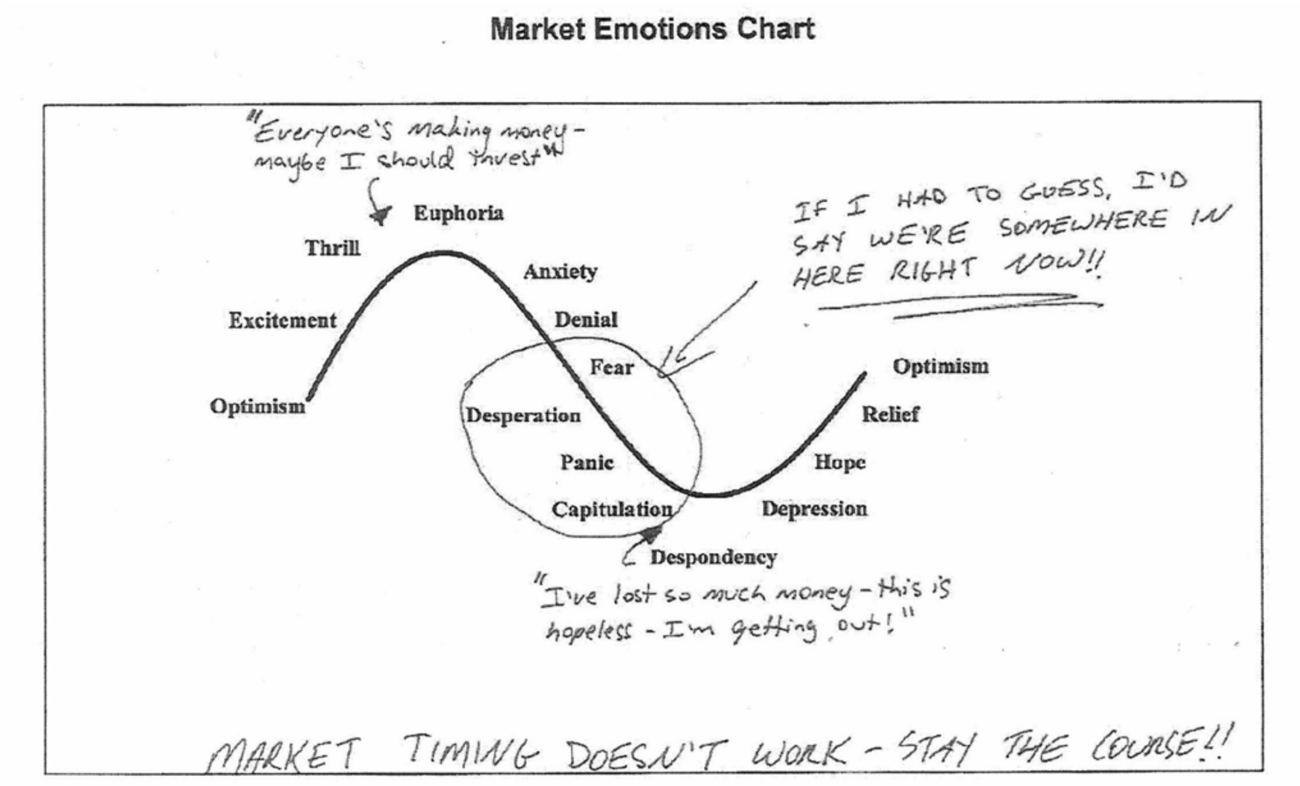
•Stock markets are like a beach ball…they can be pushed under water for a while (quite a long while even), but eventually they will want to pop back up. Stock markets have to pop back up for capitalism to work – 'owners' (of common stock) must make more than 'loaners' (holders of bonds, GICs, etc) over the long-term for our capitalist structure to work.

•Take the 20th Century for example: over that 100 year span you had 2 world wars (and many smaller ones), you had the Great Depression, you had the flu epidemic, and you had countless recessions and crises, and yet during that time period the Dow Jones Industrial Average increased from 66 to 11, 497! <u>Declines are temporary, the advance is permanent!</u>

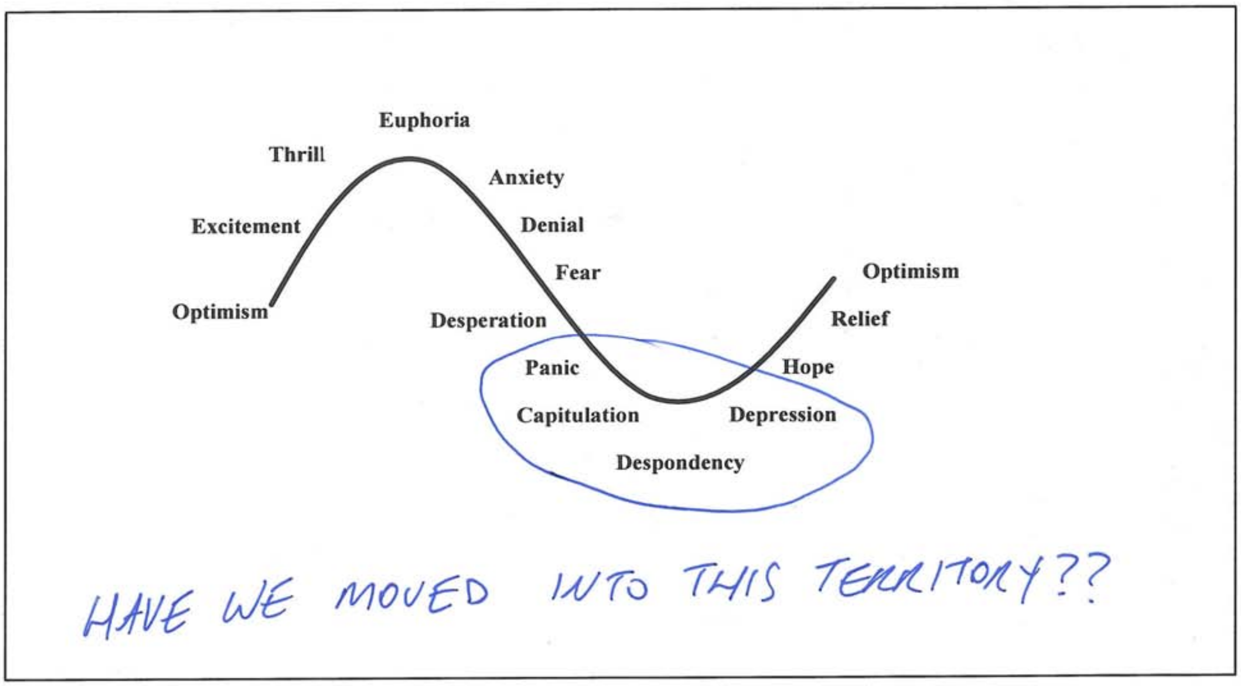
•Please understand that I am NOT saying that everything is rosy right now. The global economy is now undoubtedly deeply entrenched in a very severe recession, and I would expect that we'll see even further deterioration in the economy in the coming months (more doom and gloom in the headlines and poor numbers with respect to lagging economic indicators – probably until at least the back half of 2009 or even early 2010), but remember that stock markets are forward looking, and they historically bottom long before the economy does. The markets sold off dramatically before we saw the extent of damage done to the economy, and I believe that the markets will rebound long before we see substantial recovery in the economy.

•The system is 'cleansing' itself right now. We're seeing Financial Darwinism! I have no doubt that the strong will once again survive, they'll adapt, they'll evolve, and they'll be better off for it on the other end (more efficiencies, greater market share, etc)

•On October 1st, 2008 I put out the following market cycles emotions chart in my Random Comment's…



•Have we now moved down the cycle some?? Ask yourself: do you feel any of the listed emotions? Do you feel like giving up on the whole idea of investing? Are you afraid to even open your statements??…



•Be sure to look at your own personal 'Relative Portfolio Performance' sheet that we've included with this quarter's reports in order to keep your returns in the proper perspective. Our disciplined investment strategies are working!

•So what should we be doing now? **Stick to the 5 elements of Wealth Management** (I explained these in detail in the October edition of Random Comments – if you'd like another copy please let me know - here's a refresher):

1. Ensure You Have An Asset Allocation That Makes You Most Comfortable
2. Stick To Quality
3. Stick to a Disciplined Investment Process
4. Be Properly Diversified
5. Concentrate on Your Financial Goals

•Remember that emotions are detrimental to the long-term success of a portfolio. Don't get absorbed by the doom and gloom in the media!

•"Every lesson that history teaches us about the stock markets tells us to buy now. Being a market contrarian is always difficult, but being one in a historically volatile market is even harder. Expect those with the fortitude to let reason and history guide their decisions to do much better than those driven by emotion and fear."

Jim O'Shaughnessy – January 2nd, 2009

Reminders:

•We are now opening Tax Free Savings Accounts. Please let me know if you think a TFSA would be beneficial to you.
•RRSP Contribution Deadline is March 2, 2009. This year's limit is 18% of earned income to a maximum of $20,000.

This is a great year to make a TFSA contribution and/or to catch up on RRSP contributions!

And as always, if you have any questions, concerns, or if you just want to chat please don't hesitate to be in touch at any time!

Dan

APPENDIX ONE

Sunday, December 16, 1990 - Page updated at 12:00 AM

E-mail article Print view

Experts: Bank Crisis Risks Turning Recession Into Depression

Knight-Ridder Newspapers

WASHINGTON - People are starting to make nervous jokes about pulling their money out of shaky U.S. banks and stashing it under their mattresses instead.

But the banking crisis is no joke.

It is real - so real it risks turning the emerging recession into the biggest economic nightmare since the Great Depression of the 1930s.

``My own view of this tends to be apocalyptic - that we are on the threshold of a '30s-like experience," said David Cates, chairman of Ferguson & Co., bank consultants based in Dallas.

``The banking system is under tremendous strain. Should it begin to unravel, recession could easily become an economic disaster," said a recent editorial in Business Week magazine.

Not since the Great Depression have U.S. banks been so weak as the economy entered a tailspin. Banks are trying to strengthen themselves by cutting back loans to reduce their risks. But that is creating a ``credit crunch" that makes the economy even weaker, because the crunch is denying many companies the money they need to conduct or expand their business.

``The risk here is it's going to feed on itself. As the recession gets worse, it compounds the banking problems," and vice versa, said Lawrence Chimerine, senior economic counselor to DRI/McGraw Hill, consultants of Lexington, Mass.

To be sure, the crash of the U.S. economy is not necessarily imminent, nor even likely. But for the first time in 60 years, the shadow of that fearsome specter is visible and growing.

How great is the risk?

To deposits, absolutely none, if they are in federally insured bank accounts. A senior Treasury official and a dozen independent financial experts that were consulted stressed that. Insured deposits are safe because they are backed by the full faith and credit of the U.S. government.

But ultimately that means they are backed by taxpayers - who unfortunately are at rising risk.

Taxpayers may have to bail out the sinking federal bank insurance fund, experts warn, just as they must pay up to $500 billion over the next 30 years to bail out deposits in failed savings and loans.

``The banking industry has not reached the dire straits of the savings and loan industry, but the potential risks are there," the Congressional Budget Office concluded earlier this fall.

Those risks are rising - both for banks and the economy. What is of concern are trends like these:

-- Almost 900 banks have failed since 1985, more than twice the number closed between 1934 - when federal deposit insurance began - and 1979.

-- More than 1,000 banks are on the Federal Deposit Insurance Corp.'s problem list - four times as many as in 1981, the last time the U.S. economy entered recession.

-- The emerging recession is driving loan defaults up and bank profits down.

-- The federal Bank Insurance Fund (BIF), which insures deposits, is at record low levels and sinking fast. It is projected to fall to $10.2 billion by Dec. 31, providing only 51 cents of coverage for every $100 in insured deposits, far below the $1.25 per $100 ratio prescribed by law. Failure of any one of the top 10 U.S. banks alone could wipe out the BIF, the Congressional Budget Office concluded.

-- Consumer confidence - the cornerstone of banking - is plunging, surveys show; experts fear public faith in banks could be shaken dangerously if any major bank should fail in this climate.

-- Stock values of the biggest U.S. banks, such as Citicorp and Chase Manhattan, have plummeted 50 percent since July.

-- To shore up profits, banks are cutting back loans even to credit-worthy businesses, shrinking the already-slowing economy.

When assessing these risks, most experts agree with James Barth, an Auburn University finance professor who witnessed the S&L debacle from the front lines as chief economist for the main federal S&L watchdog agency.

``There is no clear evidence right now that we are headed for a recession that would be anything like the one in the 1930s," Barth said, adding: ``Having said that, not too many years ago I would have simply dismissed (such talk) . . . I would have just said, never again could there be a Great Depression. Now I don't say that.

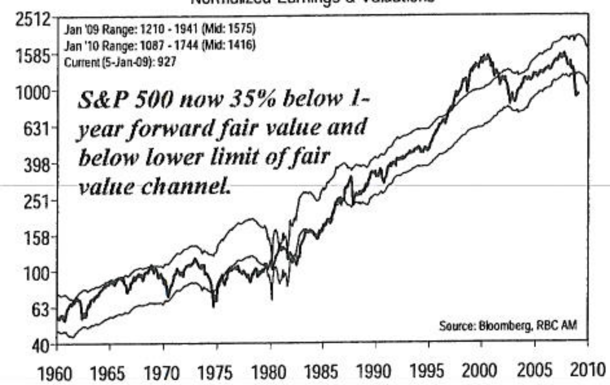
``We could have major financial failures that adversely affect the economy. . . . Now I might say that's on the order of 5 percent (probability) or so. Not very high, but high enough to concern me."

High enough to also concern President Bush, Treasury Secretary Nicholas Brady and Federal Reserve Board Chairman Alan Greenspan. Each has met recently with groups of bankers, imploring them to boost loans to the credit-hungry economy before it starves and shrivels. In exchange, they promise regulatory relief for banks, which they already have begun to deliver.

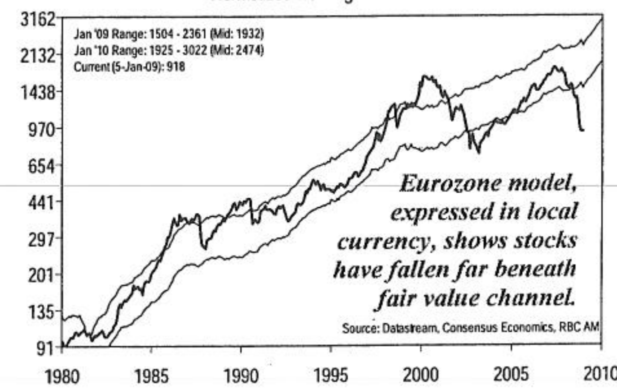
APPENDIX TWO

***EQUITY MARKETS:* MAJOR EQUITY MARKETS SHOW MASSIVE RISK PREMIUMS/GOOD TOTAL RETURN PROSPECTS AS CONFIDENCE IS RESTORED**

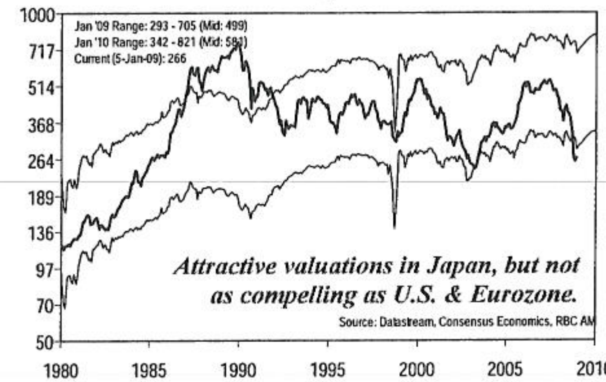
S&P 500 Equilibrium
Normalized Earnings & Valuations



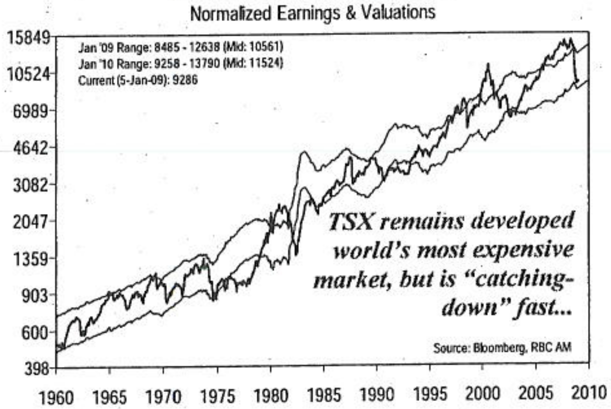
Eurozone Datastream Index
Normalized Earnings & Valuations



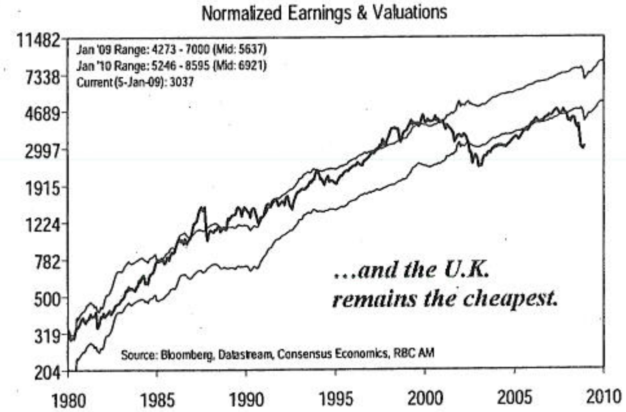
Japan Datastream Index
Normalized Earnings & Valuations



S&P/TSX Composite Equilibrium
Normalized Earnings & Valuations



United Kingdom Datastream Index
Normalized Earnings & Valuations



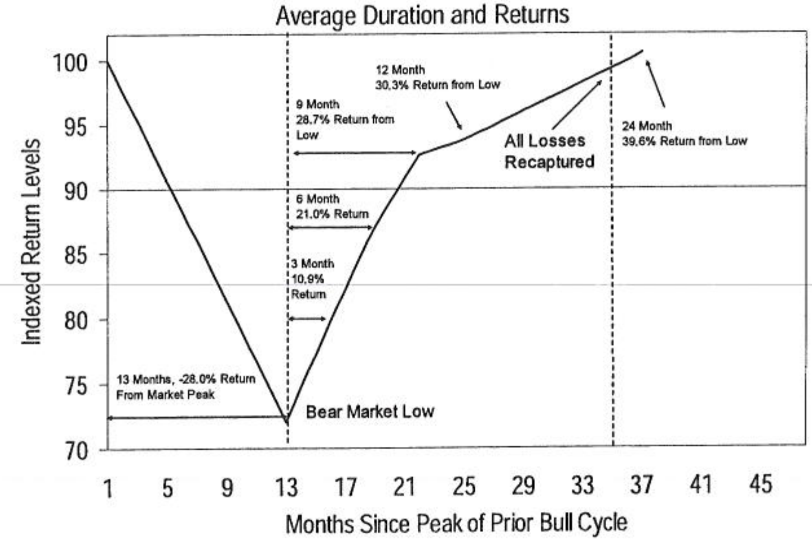
As the credit crunch clears and the economy ultimately stabilizes, attention will return to equity market valuations. Fair value is the minimum price level consistent with mild inflation/low interest rates. Expect stocks to move within upper ½ of bands as cycle matures, inflation/interest rates remain mild. Moreover, opportunity exists as valuations in the biggest markets lie far below their minimum expected levels.

RBC Asset Management

APPENDIX THREE

CAPITAL MARKETS: BEAR MARKETS & RECOVERY PERIODS

The Market Through Bear Periods:
Average Duration and Returns



Bear markets last an average of 13 months, plunge 28.0%, but all losses are restored an average of 19 months after the bear's end.

US Bear Markets

Bear Market Began	Economic Backdrop	Inflationary Environment	S&P 500	Peak % of Fair Value	Bear Market Ended	% Decline through Bear Market	Length of Bear market	3 Month Return from End of Bear Market	6 Month Return from End of Bear Market	9 Month Return from End of Bear Market	12 Month Return from End of Bear Market	2 Year Return from End of Bear Market
1-Jul-56	Recession		49.4	n/a	Dec-57	-19.0%	17	5.3%	13.1%	25.2%	38.1%	49.8%
12-Dec-61			72.6	120.3%	Jun-62	-24.6%	6	2.8%	15.3%	21.6%	26.7%	5.9%
18-Jan-66			94.0	123.8%	Oct-66	-22.1%	9	4.9%	17.8%	18.4%	26.3%	34.1%
14-Nov-68	Recession	High	108.4	124.2%	May-70	-36.1%	19	15.8%	26.7%	37.9%	37.1%	47.3%
11-Jan-73	Recession	High	120.2	107.0%	Oct-74	-48.2%	21	7.9%	31.2%	49.8%	32.0%	65.6%
21-Sep-76		High	107.8	74.9%	Mar-78	-19.4%	18	11.7%	18.7%	8.8%	10.6%	31.0%
13-Feb-80	Recession	High	118.4	104.6%	Mar-80	-17.1%	1	11.9%	22.9%	33.0%	33.2%	40.7%
28-Nov-80	Recession	High	140.5	125.2%	Aug-82	-27.1%	21	11.2%	35.7%	53.5%	51.8%	50.2%
25-Aug-87		High	336.8	114.4%	Dec-87	-33.5%	3	16.3%	13.8%	13.6%	18.8%	37.7%
16-Jul-90	Recession	High	369.0	103.9%	Oct-90	-19.9%	3	13.1%	23.5%	27.6%	29.1%	58.5%
17-Jul-98			1186.8	162.7%	Aug-98	-19.3%	2	21.5%	29.3%	36.0%	37.9%	36.7%
24-Mar-00	Recession		1527.5	189.3%	Oct-02	-49.1%	31	7.9%	4.0%	19.5%	22.2%	17.7%
Average				*122.8%*		*-28.0%*	*13*	*10.9%*	*21.0%*	*28.7%*	*30.3%*	*39.6%*
Median				*120.3%*		*-23.4%*	*13*	*11.5%*	*20.8%*	*26.4%*	*30.6%*	*39.2%*
9-Oct-07	*Recession*		*1565.2*	*102.9%*	*Market Low 20-Nov-08*	*-53.8%*						??

Note: Bear Market defined as Peak-Trough correction exceeding 15.0%
Data based on daily close prices
High inflationary environment defined as inflation exceeding 4.2% (long term average inflation since 1960)

RBC Asset Management