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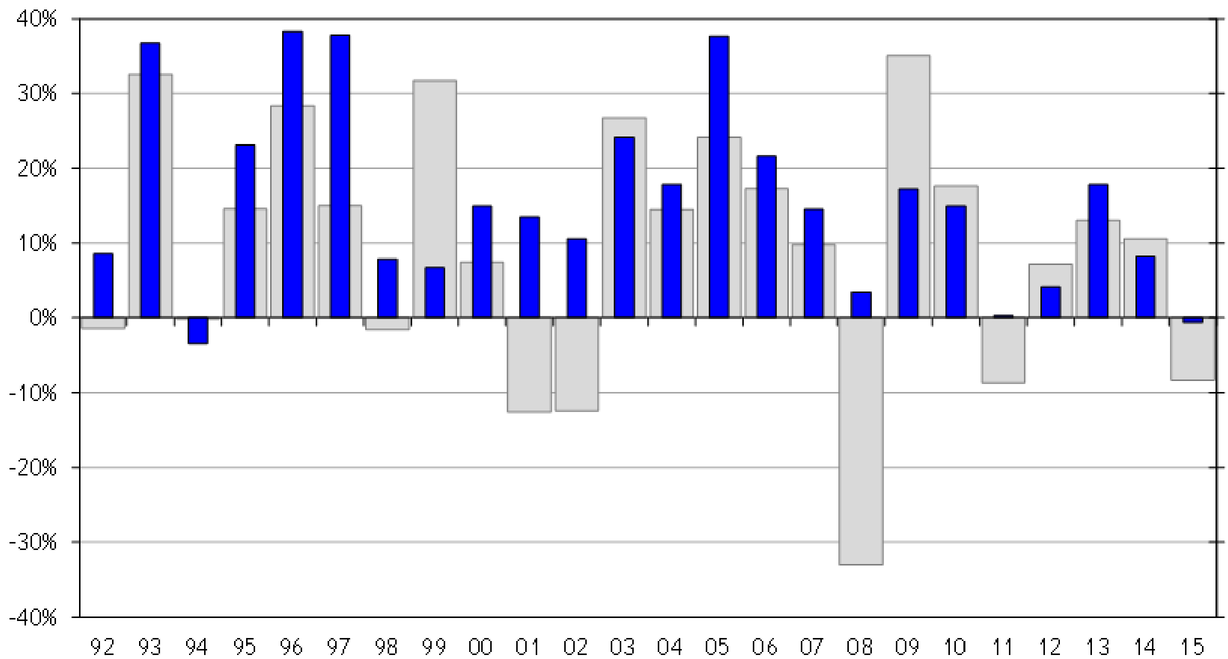
"Won2One" with Nick Foglietta

Tactical Equity Income Model Portfolio Record



Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: 100% stocks
S&P/TSX 60 Closing Value: 14,687
TSX 200 Day Moving Ave: 13,531
% Above/Below 200 Day Moving Ave: **8.50% Above**

Levels for change: 50% stocks - **TSX 14,208** and 100% cash at – **TSX 12,855**

Weekly Quote

The Future?

This section is a short introduction to the details of the Tactical High Income Portfolio. I want to share some of the thoughts and questions that went into the construction of the portfolio. Hopefully it helps you see why the Tactical High Income Portfolio is built the way it is.

1. What if the world is never going to return to a structural economy based upon the majority of young people wanting to "*get married, have a family, get a stable job, buy a home, raise their kids, and retire*"? If the majority of our younger generations value "mobility, flexibility, experiences, and moments" it will not matter if there are a plentiful number of stable jobs available…they won't want them!
2. Given the thoughts in point number 1…*how can the economy recover in any traditional sense if the traditional values are no longer applicable*?
3. If you had to buy a basket of assets and you could not sell them for 5 years…what would you choose to buy?
4. How do you create a "safe-ish" income stream of 4% per year in a world of near zero percent risk free assets?
5. What could cause all of the above to change?

There were more questions…but that gives you the nuts and bolts of where my thoughts have been.

As I pondered, I found myself drawn back to the Hussman charts I posted in the last weekly comment. My bias has always been to the outcome of "*somehow the present economic conditions are unsustainable and, therefore, somehow we find our way back to the economic conditions that have been in place for the past 135 years*."

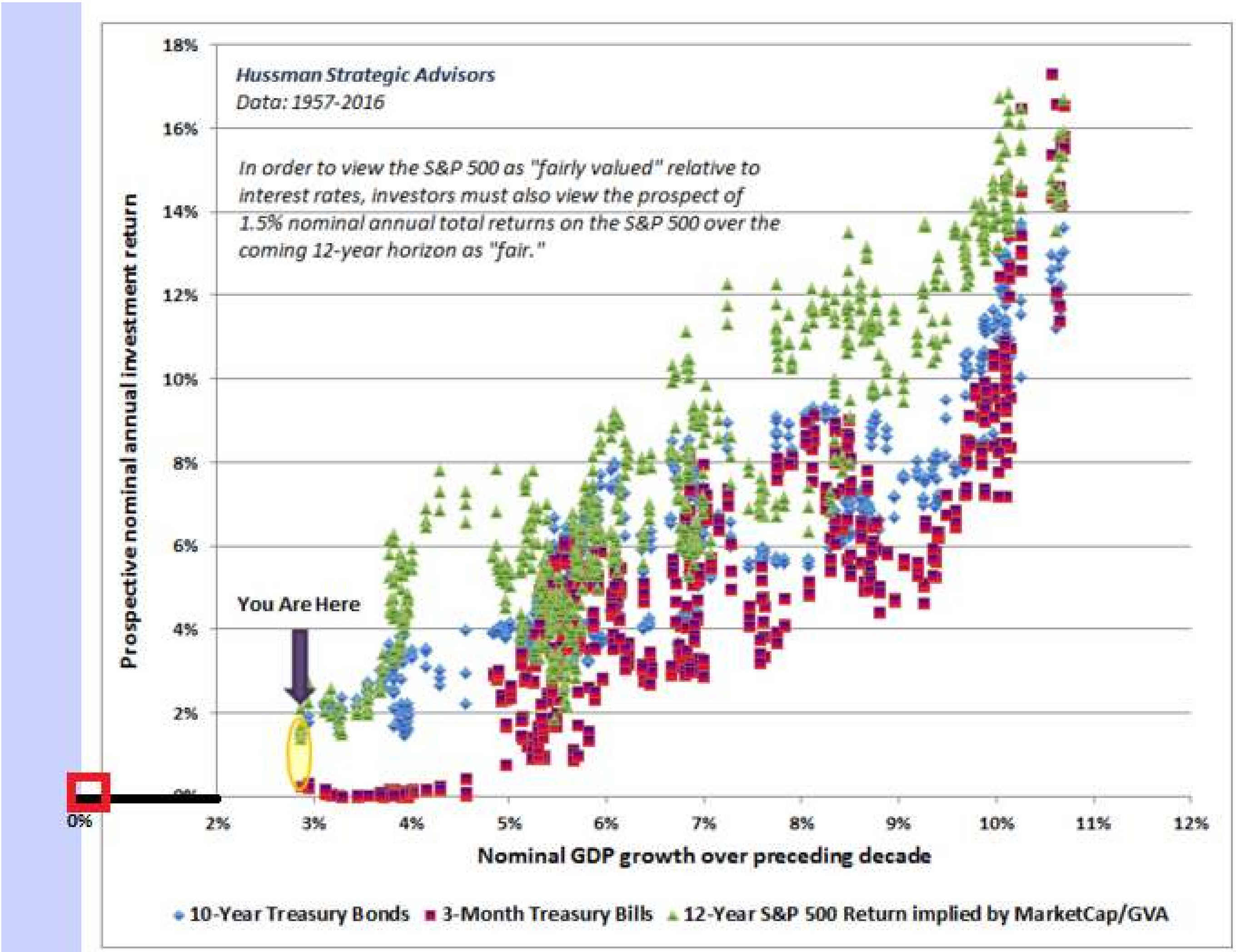
But what if not just the economy has changed…what if society has changed?

If society has changed then three things are true:

1. We are not going back to the old values and economic standards anytime soon.
2. The central banks are fighting a losing battle!
3. There has been a lot of "collateral damage" done by the central banks fighting to bring the world back to the old economic conditions.

To explore these thoughts further I took the Hussman data points and applied them to Japan since I consider that nation the "poster child" for insane monetary policy!

The chart below shows what the same data would plot like for Japan at present.



Note the little red box on the far left of the graphic. That is where **__every present day dot__** on the chart above would exist. (Bond yields, GDP, and expected stock market returns).

Oh my goodness, look how far the U.S. financial conditions __could__ continue to "crush down" without the U.S. Federal Reserve "crying uncle". It happened with the Bank of Japan…it could happen in the U.S. too!

In such a scenario one could build a case for stocks and real estate to go significantly higher in price. It would also be that much more difficult to create an income stream on capital when even longer term interest rates are near zero or negative here in North America.

Or the opposite could happen; asset prices could topple under their own weight and end up significantly lower in a world where GDP growth has been crushed to nothing.

There is no real way to predict the outcome!

This leads me to the introduction of the Tactical High Income Portfolio. The following template outlines the investment discipline the portfolio employs. I cannot show the investments used on my public website but I can tell you the before investment costs rate of return is 5.1% at present. This means the net rate of return to investors **after all costs will be approximately 4%.** (Depending on amount invested.)

Feel free to contact me with questions or to set up a time to come and talk about how this idea fits into your investment strategy.

Tactical High Income Portfolio

The Tactical High Income Portfolio is an account set up to hold high dividend paying common shares AND adjusts the asset mix of common shares/cash based on the technical conditions of the TSX Comp Index.

Investment Strategy Highlights

- A high, tax advantaged income stream
- Asset allocation shift based upon the 200 day moving average. Depending upon the technical conditions the portfolio will hold: 100% stocks, or 50% stocks and 50% cash, or 100% cash.
- Technical conditions are reviewed and asset shifts done on a weekly basis
- Portfolio equity positions rebalanced every June 1^{st} and December 1^{st}
- Equity choices are made based upon "industry diversification" and "dividend sustainability"

Why Choose the Tactical High Income Portfolio?

A better way to ask this question would be to say, ***"Why choose the Tactical High Income Portfolio over a buy and hold high income portfolio"?***

1. Offers protection from a BEAR market in equities.
2. Provides the opportunity to profit from a BEAR market in equities.
3. Creates a non-correlating asset in a portfolio that allows for broader diversification in an investment world where assets tend to move in the same direction.

How Asset Mix Changes are Determined

The Tactical High Income Portfolio remains 100% invested as long as the TSX is trading above the 200 day moving average. The portfolio shifts to 50% equity and 50% cash if the TSX is below the 200 day moving average by 0.1% – 5%. The portfolio goes to cash if the TSX is more than 5% below the 200 day moving average.

Where We Stand Today

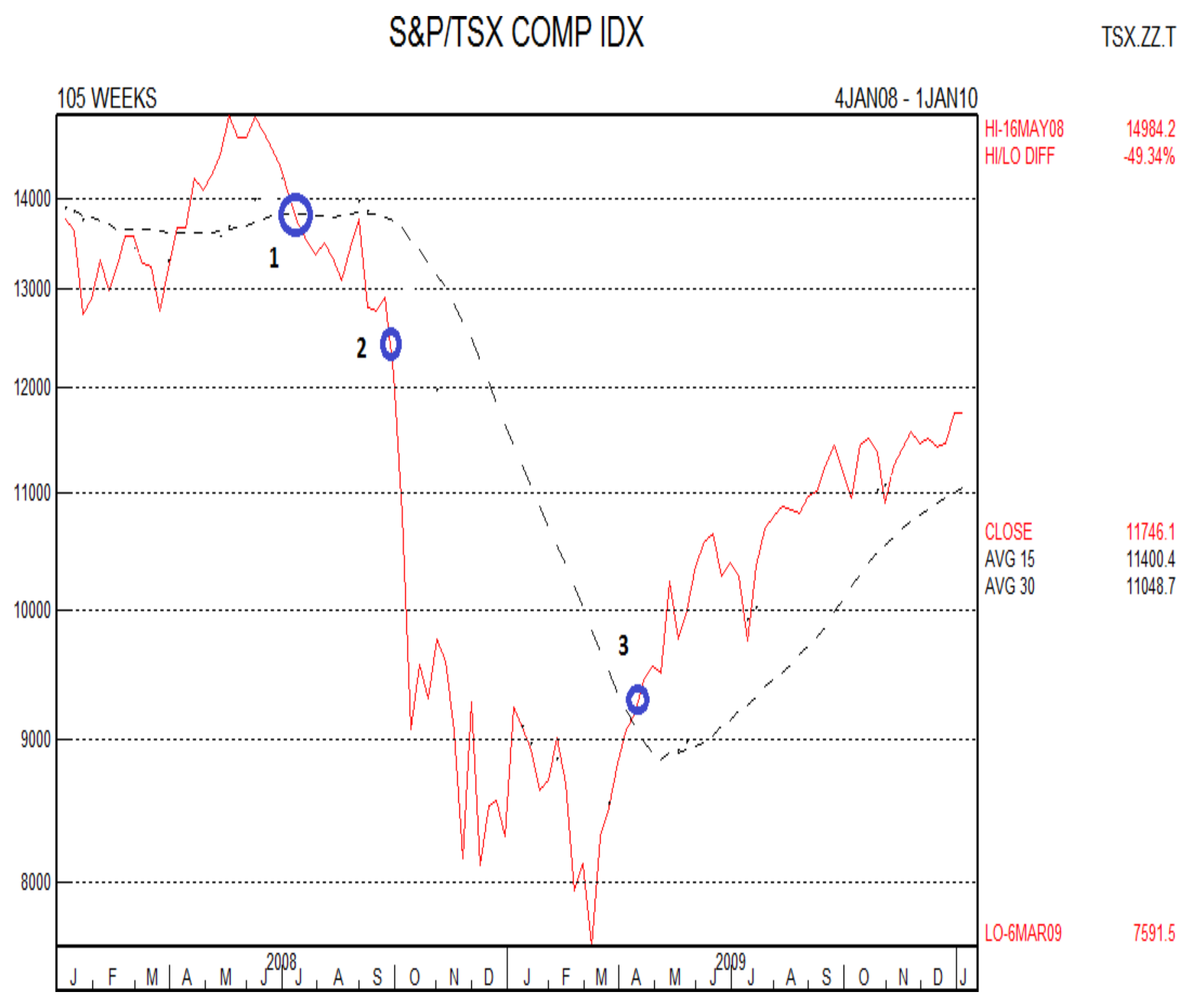
No beating around the bush…everything is expensive! Stocks are expensive, real estate is expensive, bonds are expensive…and the list goes on.

Maybe the world will just stay expensive? Who knows? But maybe it won't?

For those who want to take care of the "maybe it won't stay expensive" part of their portfolio the Tactical High Income Portfolio solves the problem.

Take the example of a portfolio invested 65% in equities and 35% in fixed income. As long as the stock market is in trend above the 200 day moving average the portfolio stays 65% equities and 35% fixed income.

But what happens when the stock market starts to falter? Let's use 2008 as our example.



The red line is the weekly close for the TSX index and the black, dotted line is the 200 day moving average. The blue circles represent the TSX level where the Tactical High Income Portfolio would have shifted the asset mix.

The asset mix for the investor would have been:

- 65% equities and 35% fixed income before circle “1”
- 32.5% equities and 67.5% fixed income between circle “1” and circle “2”
- 0% equities and 100% fixed income between circle “2” and circle “3”
- 65% equities and 35% fixed income again after circle “3”

Based upon a $300,000 portfolio, the $200,000 equity component would have become only $100,000 in early July 2008 when the TSX was at 13,830. The portfolio would have gone to 100% fixed income in September 2008 at TSX 12,290. The equity component would have returned to $200,000 at TSX 9190.

By employing a tactical approach the investor “saved” approximately $68,000 of downside as compared to the “buy and hold” investor.

Thought of another way, the investor had $68,000 more purchasing power to buy “cheap” equity investments after the decline had bottomed and started to go higher again.

Conclusion

Tactical portfolio management is meant to be “defensive” by nature. If an investor does not care about the downside risk in markets then a tactical portfolio offers them no advantage.

Tactical portfolios can be used in conjunction with “buy and hold” portfolios. Using the 65%/35% example above, maybe 35% of the equity component is “buy and hold” and 30% is tactical. (The 35% in fixed income never shifts.)

The objective is to create a portfolio that better represents your risk tolerances and profile. We work with you to establish what that profile looks like in the beginning and then we review how you are feeling when we meet.

The world is running out of quality income. Investors are paying more money for lower quality assets. This trend is now eight years old. It may go on forever…it may not.

The Tactical High Income Portfolio may be a solution for better balancing your income needs and your personal risk tolerance in today’s expensive investment landscape.

About the author: Nick Foglietta is a Vice President, Investment Advisor at RBC Wealth Management in Nanaimo, B.C., Canada. He has been managing money since 1988.