A&Q Update

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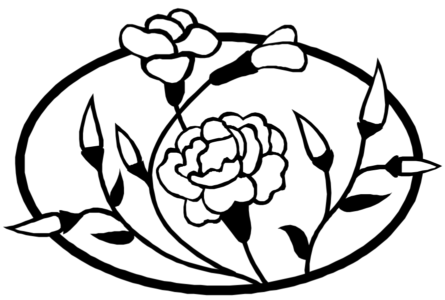
Should I Be Doing Something?

Three years of poor investment performance have left many investors wondering if they should be taking some sort of action to address their beleaguered portfolios. This is an issue we have dealt with before in our newsletter. We felt it worth revisiting based on the length of time that investors have patiently been waiting for markets to stabilize.

Portfolio decisions should always be made within the context of the financial plan. Fundamental considerations like investment timeframes, the need for current income, and investment tax treatment are still key. Before making any portfolio changes it is necessary to revisit the financial plan.

After assessing the validity of the financial plan and making adjustments as necessary, consider how your portfolio fits into this plan. It is at this point that factors like asset allocation must be considered. The type of assets held in a portfolio are the single most important factor in determining the success of that portfolio. It is also the main lever for influencing portfolio volatility.

Market conditions over the last few years have caused many investors to reevaluate their tolerance for investment risk. This can be a positive thing as long as it is based on rational consideration of the circumstances rather than on



an emotional reaction to market uncertainty. Investors may indeed feel that their circumstances do not require a high degree of investment growth and that the volatility required to achieve a high degree of growth is not warranted.

Realigning a portfolio to match investor risk tolerance must be viewed as a long-term shift rather than a temporary change. The new and more conservative approach should then be maintained, even after markets have started to perform favourably. The danger lies in trying to time the market, leaving equity investments with the intention of re-entering after markets have revived. Market timing relies on luck and should be considered speculation rather than investing. The chances of getting the timing right are slim.

Adding new asset classes for further diversification may be an appropriate action in revisiting a portfolio. Things like income trusts and alternative strategies investments have the potential to actually increase portfolio performance while decreasing volatility. This newsletter includes articles on both of these asset classes.

Portfolio review is always a good idea. Although you may not want to abandon an asset class that has been beaten down, you do want to ensure that the investments you hold within that asset class offer the best potential for recovery. This means evaluating the money managers held within your portfolio.

Inside this issue:

Save those Notice of Assessment Statements...

Canada Customs and Revenue Agency issues this summary document after receiving and processing your annual tax return. If you received a refund cheque this statement will be included with it. Your position in terms of RRSP contribution room is detailed on this statement. It also states any Pension Adjustments you are subject to. Bring this statement with you whenever you come to the office to review your financial and investment plans.

Dealing with the Loss of a Spouse — A First Hand Account

The following piece was graciously written at my request by one of our clients. In our meetings following the death of her husband, I was struck by the test the human spirit goes through in dealing with such a fundamental loss, and by the many complications society forces on an individual in this situation. She and I agreed that publishing an account of her experiences may be beneficial to other clients. These are topics that most of us avoid. We present this story to you as food for thought and possibly as a catalyst for family discussion. This article gives a brief glimpse into the kind of issues that surround dealing with a death. For those interested, we would be happy to make available a more detailed account (also provided to us by this client) of the gamut of issues she faced in dealing with the financial and bureaucratic implications of a death. Some of us may benefit from her experience.

To the credit of this individual and her family, she has handled this adversity with courage and resolve. I would like to thank her very much for sharing her experiences with us. Sometimes a little bit of good can come from tragedy. We hope that this article offers the reader a valuable perspective on one of life's most difficult challenges.

"If anything happens to me, you will have to sell the house."

Those words flashed through my brain with varying degrees of pain over the months that followed my husband's death. I knew what he meant. He was always the major wage earner. He had the knowledge and willingness to take care of all the "money". Without his paycheck, how could I possibly afford the upkeep of the house?

I went to many offices over that first month. Federal, provincial and banking establishments all seemed to want copies of his death certificate, some wanted copies of his birth certificate, CPP wanted a copy of our marriage certificate.

The most frequent visit I made was to the bank. I needed to know where I stood and where I might be standing in 6 months. The first thing I had to establish was how much money was leaving the bank accounts each month. The account manager at the bank was very helpful with this. She gave me printouts and explained what the cryptography meant. Wayne had arranged that all regular amounts were deducted directly from the account. Hydro, gas, city, phone, internet and all the other things that make up 21st century life came to a staggering amount per month. This gave me barely enough to feed and clothe myself not to mention feed the car!

Wayne was a very careful, meticulous worry wart. Soon after we married he signed us up for life insurance. After Anne was born he bought more life insurance. Every time we took a trip he bought the top-of-the-line trip and health insurance, the theory being that if we did, then nothing would happen. Well, eventually, it did happen.

Surprisingly, the insurance companies paid out fairly promptly. At the bank I said what I thought was fairly obvious "I need monthly income".

You read it all the time or hear it from people telling widows - "don't do anything in a hurry", "don't make any big decisions in the first year". Well, they kept telling me that while I was looking at my small income. I had to do something or lose the house. Whether I did something or not, either way, a big thing was going to happen.

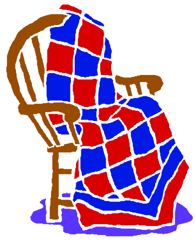
When the first big insurance cheque came in and the agent said "Let me put it in GICs for you, it will give you a monthly income", I could have kissed him. Remember, I knew nothing about money. I still do not understand much.

The account manager at the bank made arrangements for me to talk to their investment planner. They were not happy that all this insurance money that was potentially an investment they could make for me was being frittered away on GICs. (When no-one wants to "rush" you and you are panicking, what would you do?)

I talked to John. He was busy reorganizing my portfolio to include my husband's investments. We had been working with John for about four years preparing for retirement by investing anything we could in RRSPs etc. By the time I talked to John I already knew the amount of money that would be coming from Wayne's insurance. I had an amount equal to that already invested in the GICs, and a sum to buy a new, small, fuel-efficient car and a bit left over for home repair emergencies.

John very snappily invested the money in Monthly Income Plans with Talvest and three other companies I had never heard of before. (Apparently I own a couple of inches of the Trans-Canada Pipeline.) It was amazing to me that after a miserable couple of months of shock, fear, tears, panic, and having to deal with ideas and concepts previously unimaginable, suddenly things settled out.

Now, every month the little ATM outside my bank happily zips out a record of all the dollars David's insurance has provided me. Like the quilt I have made of his favourite old shirts, it keeps me warm and snug in our home.



Bear Markets to Bull Markets: A Historical Perspective

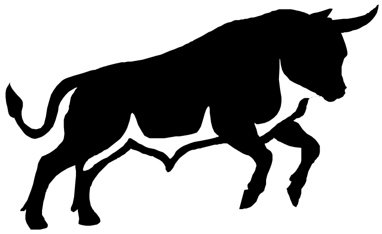
A bear market is defined as: *A declining financial market. A prolonged period of falling stock prices, usually by 20% or more.* The current bear market will eventually give way to the next bull market (which incidentally is the exact opposite of a bear market), but when will this happen? In the past several months markets have shown signs of improvement. Earnings numbers reported by many companies have either met or exceeded expectations resulting in strengthening stock prices. The following summary of historical information gives us an idea of what to expect in future.

Average Duration of Bull Market 1901-1998 — 1.1 years
Current Bear Market March 2000-May 2003 — 3.2 years

In 6 of the last 7 recessions since 1950, the stock market recovered significantly earlier than the economy.

Average equity returns in a Bull Market 1900-2001
First Half of the Bull—43% Second Half of the Bull—17.9%

The Bull can reappear at any time. The early stages of the Bull are significant.



In Search of Yield

Investors seeking reliable income have been stymied by plummeting bond yields. While lower interest rates are generally good for the economy, they create a quandary for investors—safety comes at the expense of returns. Still, there are higher-yielding asset classes, and income trusts are one of them.

For the past two years, income trusts have performed better than just about every asset class except volatile gold stocks. Trusts have dominated the new offerings calendar on the Toronto Stock Exchange. Now Standard & Poor's is creating indexes to track the performance of two segments of the income trust market: oil and gas royalty trusts and real estate investment trusts (REITs).

That marks a coming of age. The number and market capitalization of income trusts has doubled since 1998, with 87 income trusts now comprising a $40 billion market, says Barry Morrison, a principal at Morrison Williams Investment Management in Toronto. He thinks the sector may double again. "I could see, in three to five years, 120 issues and perhaps $70 billion to $80 billion in market value."

Why the attraction? Income trusts are based on operating businesses. As businesses, they can deliver potentially higher yields than bonds because they disburse almost all of their earnings to investors. In contrast, most corporations distribute a small portion of earnings as dividends and retain the rest for takeovers or expansions.

Income trusts also provide a tax advantage for investors in non-registered accounts. A portion of the distributions is treated as return of capital. That's not taxable. Instead, it lowers the investor's adjusted cost base. As a result, when shares of an income trust are eventually sold, the proceeds might trigger a larger capital-gains bill. Still, there's a lower tax rate on capital gains than on the interest earned from bonds, or on dividend payouts.

Income trusts are a relatively new asset class. Just over half the trusts have an established five-year track record. As the trust sector expands, it gains legitimacy, says Morrison. That makes trusts more attractive for a broader spectrum of investors who would normally have steered clear of what they perceived to be an illiquid sector.

That's not to say trusts are without risk. There was a meltdown in 1998 as energy prices plunged. In the current environment, Morrison says, returns are primarily dependent on interest rates. If rates spike higher, yields will fall as investors pile into safer government securities.

Still, because income trusts are based on operating businesses, there is potential resilience against higher interest rates, some analysts say. Higher interest rates may signal higher profits for some trusts, reflecting an uptick in economic activity-just as it may spell losses for other kinds of trusts involved in interest-sensitive businesses.

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Armstrong & Quaile
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"Providing Sound Financial Direction"

John Armstrong is a Certified Financial Planner. Financial planning and financial planning education are his key areas of interest and expertise.

Achieving balance in our lives is critical; a balance between work and family, a balance between living for today and planning for the future. Because we all have competing goals, striving for balance influences many decisions in our day-to-day lives. One thing is certain, the juggling act we do requires a long-term view. Sometimes we need to take a step back to put things into perspective.

It may sound cliché, but having a plan in place goes a long way in helping to achieve both our long and short-term goals. Simply put, planning assistance is the service we provide. We are committed to helping you find that long-term view for the good of today and tomorrow.

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Further Diversification Through Alternative Strategies Investments

Alternative strategy investments, also known as hedge funds, are getting an increasing amount of attention in the Canadian investment community. Simply put, these terms are used to describe any investment fund that produces return for the investor using a method other than the conventional approach of holding stocks, bonds, cash etc. in the expectation that the assets will either increase in value or produce income.

It takes a board definition to describe the alternative investment category because there are so many different strategies employed in managing these funds. Unlike mutual funds, there are very few limitations put on how these funds can be managed. This flexibility can be a strength, but it also means that an increased amount of attention must be paid to the specifics of how each fund is run and what the manager has the ability to do.

Things like short-selling (speculating that the price of a stock will go down) and the use of leverage (borrowing to increase the funds available to the manager) are often used in alternative strategies funds. Neither of these options are available to a mutual fund manager.

The risk potential of these funds ranges from very conservative to very aggressive. Understanding both the objective of the fund and the means available to the manager in pursuing this objective is very important. The Offering Memorandum or Information Statement issued by the investment will specify these things.

Conventional investment funds rely on movement of the financial markets. Alternative strategies investments rely more on the manager and less on the markets.

Conventional investment funds rely on movement of the financial markets. Alternative strategies investments rely more on the manager and less on the markets. For this reason, diligence in understanding and selecting the appropriate alternative strategy fund is critical. Mutual funds target a relative return (a return relative to a particular market index). To give an example, a Canadian equity fund would seek to outperform the TSX index. An alternative strategy fund, on the other hand, attempts to produce an absolute return, a targeted return which is not tied to any financial market or index.

Until recently, these funds were available only to high net worth investors because of the high minimum purchase amounts and restrictions on who can purchase them. These restrictions are set out by the Ontario Securities Commission in their accredited investor/ sophisticated investor rules. Several companies have recently started offering alternative investments as 'structured product'. These programs have much lower minimum purchase amounts and guaranteed capital protection if held until maturity. They are also not subject to the accredited/sophisticated investor rules and are therefore accessible to many more investors.

Many clients are familiar with the Tricycle BDC Managed Futures Notes. This is one example of an alternative strategies investment structured around a guaranteed note. Using alternative strategies for a portion of a client's portfolio provides additional diversification due to the non-correlation many of these investments have to other asset classes held within the portfolio.