

# ➤ looking forward

After the market roller coaster of 2008 and 2009, the first quarter of 2010 has been blessedly uneventful by comparison. The US markets gained about 5% in the first quarter, the best start to the year since 1998 - the US market ended up about 60% from its lows of a year ago. Canada did well also, up almost 3% in the first quarter. That said, there is still a cloud of uncertainty that is making many investors nervous.

## Causes for concern ... and for optimism

Even with the stabilization of the global economy, there's no shortage of short term causes of concern:

- Continued questions on the direction and timing of the economic recovery in the United States and Europe and the timing of higher interest rates.
- US housing prices that are staying stubbornly low and unemployment levels in North America and Europe are stubbornly high.
- In late March the deputy director of the International Monetary Fund made headlines as he talked about the need for advanced economies to cut spending in order to reduce deficits.

Here's a New York Times article about the IMF's (International Monetary Fund) views:

<http://www.nytimes.com/2010/03/22/business/global/22imf.html?scp=1&sq=lipsky%20imf&st=cse>

The good news is that there are offsetting positives, even if the media headlines that feature them aren't quite as prominent:

- On Monday March 22, the Wall Street Journal ran a story about dividend hikes as a result of rising profits by US companies. The article also mentioned that cash on hand on US corporate balance sheets was at the highest level since 2007.
- On the same day the Financial Times ran a similar story about dividend increases in Europe.
- There's growing attention to the impact that Germany's emphasis on manufacturing productivity had in sheltering it from the worst of the economic downturn - and questions about whether this might be a model for other countries. In March the Economist ran a 14 page feature on how Germany positioned itself for success.

## Forecasting the future

Whether you choose to focus on the positives or the negatives, there's broad agreement that the steps taken by governments stabilized the financial crisis that we were facing a year ago - and there is almost no talk today of a global depression.

So the issue is not whether the economy will recover, but when and at what rate - and whether there might be another stumble along the way.

If you look for investing advice in the newspaper or on television, the discussion tends to revolve around what stocks will do well in the immediate period ahead ... this week, this month, this quarter. We refuse to participate in that speculation - when it comes to short-term predictions, whether about the economy or the stock market, there's one thing we can say with virtual certainty: most of them will be wrong. Quite simply, no one has a consistent track record of successfully forecasting short term movements in the economy and markets.

Which is why in uncertain times such as today, one of the people I look to for guidance is Warren Buffett.

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## Advice from Warren Buffett

In an investment industry poll a couple of years ago, Warren Buffett was voted the greatest investor of all time; among the runners up were Peter Lynch, John Templeton and George Soros.

Buffett's returns are a testimony to the power of compounding. From 1965 to the end of 2009, the growth in book value of his investments averaged 20% annually. As a result, \$10,000 invested in 1965 would currently be worth a remarkable \$40 million. By contrast, that same \$10,000 invested in the US stock market as a whole, returning just over 9% during this period, would be worth \$540,000.

In one of his annual letters to shareholders, Warren Buffett wrote that it only takes two things to invest successfully - having a sound plan and sticking to it. He went on to say that of these two, it's the 'sticking to it' part that investors struggle with the most. The quote at the top of the letter, made at the height of the financial crisis, speaks to Buffett's discipline on this issue.

Myself and my team try to apply that approach as well - putting a plan in place for each client that will meet their long term needs and modifying it as circumstances warrant, without walking away from the plan itself. Boom times such as we saw in the late 90's and scary conditions such as we've seen in the past two years can make that difficult - but those conditions can also represent opportunity. Indeed, in his most recent letter to shareholders Buffett wrote that "a climate of fear is an investor's best friend."



*"I have no idea what the stock market will do next month or six months from now. I do know that, over a period of time, the American economy will do very well and investors who own a piece of it will do well."*

Warren Buffet in an interview on CNBC on Friday, October 10, 2008

## Five core principles that shape our approach

On balance, I share Warren Buffett's mid-term positive outlook, not least because many of the positives that drove market optimism two years ago are still in place, among these the continued emergence of a global middle class in developing countries like Brazil, China, India and Turkey. This educated middle class will fuel global growth that will make us all better off.

In the meantime, here are five fundamental principles that we look for in money managers and that drive the portfolios that we believe will serve clients well in the period ahead.

### 1. Concentrate on quality

The record bounce in stock prices over the past year was led by companies with the weakest credit ratings. Some have referred to last year as a "junk rally", with the lowest quality companies doing the best. That's unlikely to continue - that's why I'm focusing my portfolios on only the highest quality companies, those best able to withstand the inevitable ups and downs in the economy.

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## 2. Look to dividends

Historically, dividends made up 40% of the total returns of investing in stocks and have also helped provide stability through market turbulence. Two years ago, quality companies paying good dividends were hard to find - one piece of good news is that today it's possible to build a portfolio of good quality companies paying dividends of 3% and above.

## 3. Focus on valuations

Having a strong price discipline on buying and selling stocks is paramount to success - history shows that the key to a successful investment is ensuring that the purchase price is a fair one. Investors who bought market leaders Cisco Systems, Intel, and Microsoft ten years ago are still down 40% to 70% - not because these aren't great companies but because the price paid was too high.

## 4. Build in a buffer

Given that we have to expect continued volatility, we identify cash flow needs for the next three years for every client and ensure these are set aside in safe investments. That buffer protects clients from short term volatility and reduces stress along the way.

## 5. Stick to your plan

In the face of economic and market uncertainty, another key to success is having a diversified plan appropriate to your risk tolerance - and then sticking to it. It can be hard to ignore the short-term distractions, but ultimately that's the only way to achieve your long term goals with a manageable amount of stress along the way.

In closing, let me express my thanks for the continued opportunity to work together. Should you ever have any questions or if there's anything you'd like to talk about, my team and I are always pleased to take your call.

*Christine*

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