

Insights

WINTER 2009

STRATEGIES FOR YOUR FINANCIAL SUCCESS

Steering your portfolio through turbulent times

The fall of 2008 was a period of unprecedented volatility in world equity markets. Investors in Canada and around the world saw significant change to their portfolio value, sometimes in a single day. However, while short-term upheavals may scare some investors away from the markets, turbulent times can also pave the way for future gains — if you maintain a disciplined, long-term investing plan.

What happened?

Volatility is a normal part of market behaviour. However, the hyper-volatility experienced during 2008 was exceptional. Markets were taken down by some extraordinary events. For Canadian investors, the housing crisis in the U.S. and the “freezing” of world credit markets, combined with a slowing U.S. economy and falling resource prices, created an extremely difficult market environment.

The leveraging used by hedge funds and other professional investors greatly exacerbated the turbulence. As share prices fell, they were forced to sell quality assets along with their speculative holdings in order to pay investors who were redeeming their units and leaving the market. All of these pressures led to market volatility that was more than twice as great as historical averages.



Some of these factors were short-term and will soon pass into memory. However, others are more fundamental. For example, the U.S. economic weakness will continue to affect Canada significantly in the months ahead, as a result of slower trade with the U.S., falling retail sales, and a softening housing market.

What's next?

U.S. weakness is likely to mean further slowing of the global economy as well. Economic growth is expected to falter in the high-flying BRIC countries (Brazil, Russia, India, and China). However, even with a slowdown from its previous

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On June 18, the federal government passed its 2008 Budget bill into law. This was a milestone for investors because it meant that the new Tax-Free Savings Account (TFSA) would be available to millions of Canadians beginning in January 2009. No doubt you have seen and heard a lot about this new savings vehicle in some way, shape or form.

- Capital gains and other investment income earned in a TFSA will not be taxed.
- Withdrawals will be tax-free.
- You can withdraw funds from the TFSA at any time and for any purpose.
- The \$5,000 annual contribution limit will be indexed to inflation in \$500 increments.
- The amount withdrawn can be put back in the TFSA at a later date without reducing your contribution room.

Call us today to find out how you can take advantage of the new Tax Free Savings Account in your savings strategy.



Steering your portfolio

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double-digit growth rate, China's GDP may still rise 8% in 2009, enough to maintain its role as a driver of the world economy.

Market history

The good news for investors is that periods of market turmoil are rarely long-lived. History has shown that the markets tend to come back, often stronger than before. For example, after falling 20.2% from more than 4,000 in July 1987 down to 3,191 in the October 1987 Black Monday sell-off, the then TSE 300 Composite Index (now the S&P/TSX) came back by rising 25.4% in less than two years to close above 4,000 in August 1989. And following the technology crash of 2001-2002, the S&P/TSX Composite Index rose 57.9% — from less than 5,700 — to 9,000 in just over two years.

Investors with diversified holdings and sound portfolio management principles can come through these periods in a good position to make healthy gains as the markets resume their normal upward course.

Steering your portfolio

Here are some considerations to help you put the recent market volatility into perspective and plan your investment strategy for 2009.

- **Take a long-term view.** Investing for the long term is the best way to limit damage from short-term market volatility. Over extended periods of time, market corrections become relatively insignificant dips in a long, upward price rise (see chart).

- **Diversify your holdings.** Holding a targeted mix of stocks, bonds, and cash allows you to participate when the market is rising, yet protects your capital during periods of volatility. Diversifying your holdings by sector and country can also help spread the risk.

- **Rebalance your portfolio.** To stay diversified and limit risk, it's important to rebalance your assets when significant market moves cause your asset mix to stray from your targets. For example, if you're a long-term growth investor with 70% of your portfolio in equities and 30% in bonds, a drop in the stock market may bring your equity allocation below its target weight. As part of a disciplined periodic rebalancing program, you might consider selling your "excess" bonds and reinvesting the money in stocks, to bring your asset allocation back on target. This would allow you to lock in any gains on the bonds and take advantage of new growth opportunities.

- **Focus on fundamentals.** Much of the activity during the 2008 sell-off was due to the unwinding of leveraged positions, rather than fundamental weakness in the companies being sold. This has created opportunities to invest in high-quality companies at reduced valuations. Taking advantage of these opportunities can create long-term value as the stocks recover over time.

- **Keep a defensive core.** During times of market volatility, it's often

wise to remain defensive in existing portfolios, holding quality stocks in less economically sensitive sectors such as gold, utilities, and consumer staples. These can produce steady long-term gains and help you weather volatility. When markets are down, consider enhancing this core with selected stocks in sectors that have been oversold.

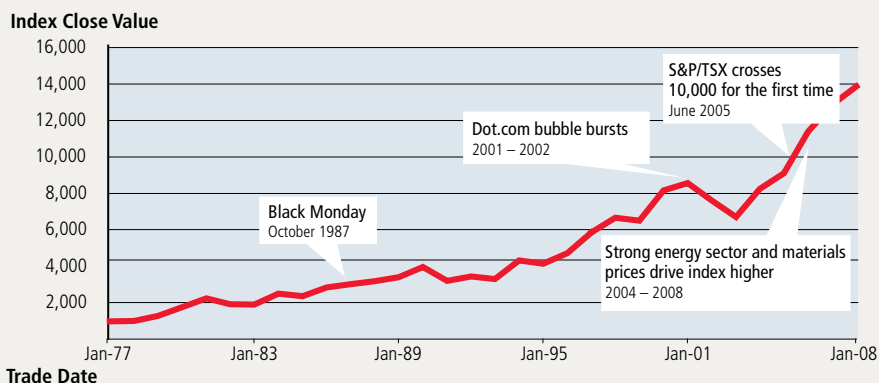
- **Don't invest on emotion.** In investing, emotion is your enemy. When trading is volatile, focus on maintaining your strategy rather than selling into falling markets. In these times, the winners are usually not those who sell their positions, but those who buy them for the long term.

The troubles in the U.S. financial system may take months to work out. We're here to answer your questions and review your portfolio at every step of the way.

Staying disciplined and focusing on your longer-term goals can be trying during times like these. If you have questions about the current market conditions and how they may affect your portfolio, please do not hesitate to contact us. ■

Why you may want to ride out market downturns

Despite temporary declines, Canadian equities have historically followed an upward trend. The chart below is based on data for the S&P/TSX Composite Index (formerly the TSE 300 Composite Index) from January 1977 to January 2008.



Source: TSX

Retirement savings: How much will you need?

You've spent many years saving and investing for retirement, in line with your objectives and risk tolerance. But when was the last time you stepped back and asked yourself how you want to spend your retirement? Perhaps you've developed a new interest or are keen to change your career direction later in life.

Surveys show that today's retirees plan to be more active than their parents, engaging in travel, continuing their education, or starting a small business. However, these activities may affect your cash flow requirements during retirement.

Take some time to think through the following questions. Then come in and speak with us about how to ensure your income needs are met in retirement.



Where will you live?

Many retirees find that the family home is no longer appropriate for their needs. If you expect to move, your choice will have significant financial implications. Downsizing to a condo in the city, for example, could free up some cash for investment purposes and help you reach your savings targets quicker. On the other hand, investing in a winter retreat in the U.S. could introduce significant extra costs and complicate your estate plan.

How active will you be?

An active retirement can be significantly more expensive than a stay-at-home lifestyle. Perhaps you're thinking of going back to university to pursue a passion or to prepare for a second career, or maybe you'd like to start a business.

Will you travel?

Travel ranks high on many Canadians' retirement wish lists. Depending on the scope and extent of your plans, you might want to start building a vacation fund. The new Tax-Free Savings

Even modest inflation of 2% a year can increase your costs significantly over the 20 to 30 years you may spend in retirement.

Account is an ideal place to save for an extensive stay abroad. You can contribute up to \$5,000 a year, earn tax-free returns, and withdraw your money at any time with no tax implications.

Have you factored in inflation?

Even modest inflation of 2% a year can increase your costs significantly over the 20 to 30 years you may spend in retirement. This means it's important to structure your portfolio with a prudent mix of equities. Historically, equities have outpaced inflation by a greater margin than fixed-income and cash-equivalent assets.

Will your family need help?

Many Canadians want to help their children or grandchildren financially

after retirement. And with today's longer lifespans, you may also find yourself caring for elderly parents while you are in your 60s or 70s.

What about health care costs?

It's important to plan for future health needs, especially in your later retirement years. It's possible that you or your spouse may need an extended stay in a nursing care facility. This can involve a significant cost. With extra savings or long-term care insurance, you can cover these expenses without drawing on your retirement savings.

What will you leave behind?

You may wish to leave a sizeable estate for your loved ones. This means you'll need to live on your recurring income without touching these assets. This can affect how you allocate your assets, and the total savings you'll need.

We can work with you to build an overall retirement plan and calculate your financial needs to fund the retirement you envision. ■

Stick to the basics in an uncertain housing market

With a cooling housing market and uncertainty about the direction of interest rates, there's much to think about if you're buying a larger home, downsizing to a condo in the city, or even helping your children with their first purchase.

Home prices have indeed softened as the economy has slowed. But if you're buying with the intention of living in your home or condo, and follow some sound real estate principles, short-term market events shouldn't be a reason to put your plans on hold.

Here are a few of the principles to keep in mind.

Look for value

Resale value will probably play a major role in your decision. You can boost your long-term return by looking for a home in a neighbourhood with upside potential, or buying a less expensive house on a good street and upgrading it.

Know what you need

If you're trading up to a larger home, your wish list may be longer than it was when you purchased your first home. But luxuries, such as a pool, may not always translate into better resale value (renovated kitchens and bathrooms add much more to a home's resale value).

If you're downsizing, be sure to consider access to shopping, transportation, healthcare facilities, and entertainment. Be aware that "smaller" doesn't necessarily mean "less expensive." A luxury condo or a small home in a high-demand area may cost more per square foot than your current home.

Know your limits

Seek professional mortgage advice, and take advantage of online calculators that can help determine how much you can spend without straining your budget.

Get preapproved

If you're not ready to buy and interest rates are on the move, don't forget to get preapproved for a mortgage. This can allow you to lock in a preferred interest rate.

Consider variable rate

Locking in an interest rate is a better strategy when rates are low. However, when they are relatively high, a variable rate mortgage can allow you to benefit from future rate decreases.

Your home is part of your overall financial plan. Our team of experts at ScotiaMcLeod can help you determine how to fit a new home purchase into your long-term plan. ■

Threatened by inflation?

Despite a slowing world economy, inflation has become a threat in a number of countries, including Canada. But, while attention is focused on monthly inflation figures, it's important to understand what they mean, and how they affect your finances.

Headline vs. core inflation. The overall or "headline" inflation figure reflects changes in the Consumer Price Index (CPI); the "core" inflation figure strips out volatile elements such as energy and food, giving a clearer picture of economic conditions. However, these more volatile items also contribute to total consumer costs.

The effects. Prices for fuel, food, and transportation have been rising recently. However, costs for many consumer goods have been falling for years, and wage inflation is relatively tame.

Interest rates. The Bank of Canada attempts to keep core inflation within a band of 1% to 3% by controlling interest rates. These changes affect borrowing rates and can slow or accelerate the economy, resulting in new inflation trends.

Your portfolio strategy. Gold and commodities can offer some shelter for investors in an inflationary environment. Real-return bonds also provide an inflation hedge, as they promise a return over and above the CPI rate. It's important to keep in mind that equities have traditionally outpaced inflation over the long term. ■

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