Peter Besler

The Bull's Pen

Intelligent Investment Strategies Fall 2012

Economic Update:

While central banks around the world believed they had done enough to restart their economies, it now appears more likely that further stimulus may be needed. The euro-zone recession is expected to continue through the end of the year which is discouraging for its trading partners. This fiscal drag is already having an effect on the US economy as businesses are cutting back on investments and deferring further hiring decisions due to uncertainty.

In September, the US unemployment rate fell to 7.8% according to the Household Survey. While this is the lowest rate seen in 4 years, further analysis reveals continuing weakness in manufacturing, where employment declined by 16000 jobs, and only tepid job creation in construction (+5000 jobs). The report paints a picture of a job market strong enough to support domestic demand but weak enough to justify further quantitative easing.

The outcome of the pending election in the US is uncertain but the consensus is that either party will continue to support quantitative easing through further rate purchases. In comparison, Europe, which investors have fled to find safety in North American debt, is undergoing far more economic reform and adjustment. This leaves the possibility that investing in Europe today may prove to be more of an opportunity than a risk.

Investment Climate:

Having been an investment advisor for over 26 years, I have been witness to many tremendous money-making opportunities. Most of these opportunities arose when investor opinion was clear cut and widely accepted. During most of these cases, most investors were proven to be wrong and the money-making opportunity went to those few investors who went against the consensus. I recall February 28, 2001 when the Government of Canada decided to sell all of its remaining gold bullion (1.2 million oz). At that time gold was at $267 per oz and some of the brightest minds were making predictions of further price declines to $50. Within 10 years gold appreciated over 700% to above $1800. The Government of Canada finished selling 99.5% of our gold reserves just prior to gold experiencing the largest price increase in world history. Yet at the time, investor consensus agreed with this decision.

Today investors have a number of similar widely accepted beliefs. The consensus view is not necessarily wrong but most often, if something is clear and widely accepted, it's already been factored into prices. So what are investors most sure of today and why might they be wrong?

1) Growth in China

It is commonly known that annual GDP growth in China has slowed to 7%-8% but there are few analysts who are predicting a more serious decline.

Money Facts:

Apple shares 10 yrs: **+822%**

Silver Oct 10 yrs: **+768%**

Gold Oct 10 yrs: **+554%**

TSX total return 10 yrs: **+155%**

TTC fare 10 yrs: **+57%**

Avg Inflation rate 10 yrs: **+2.2%**

Avg GIC rate 10 yrs: **+1.6%**

Dow Jones:

Great Depression '35: **104**

Pearl Harbor: **111**

Cuban Missile Crisis: **652**

Energy Crisis '73: **851**

Crash Black Friday '87: **1939**

Asian Crisis '98: **9374**

Oct 1 '12: **13515**

Yet, there are many signs that should concern investors in Asian markets. Inventories are building and many industries have excess production capacity. Labour costs are rising sharply which may have an effect on competitiveness. Further, loose credit policies have fuelled a real estate development boom while vast numbers of commercial, retail and residential buildings remain empty. Government-funded capital spending is so complex that understanding the true numbers is impossible. Such conditions usually exist prior to a meltdown. Investors who invested in the Asian markets with expectations of higher growth would pay a severe price for their media-supported miscalculations if this occurred.

2) Low interest rates

While most investors agree that interest rates are unsustainably low they also agree that interest rates won't go up anytime soon. The rationale is that major economies, such as the USA, cannot afford higher rates. This argument does not consider that buyers of bonds ultimately determine yields through demand. If the current mania to find safety in North American debt reverses, because of improving conditions in Europe or other reasons, then North American rates may quickly surge two to three percentage points higher. This would have serious consequences for income focused investors who have currently made investment decisions based on low yield scenarios.

3) Dividend dementia

Today, nearly every investor agrees that buying stable, dividend-paying stocks will provide them income, capital gains and the ability to sleep at night. It is true that banks, utilities and REITs have done well but it is unlikely that they will continue to outperform a broadly diversified growth portfolio. These stocks may face two challenges which may hurt their investors. First, is the major headwind they may face caused by a rising-trend in interest rates for the first time in 31 years. Second is that current valuations of these stocks may already reflect their popularity. Globally it is hard to find many stocks that are at historically high valuations other than those favoured by dividend lovers. Investors who feel safe in owning these stocks should rethink their decisions in case normal historical valuations return to these securities and quickly destroy their portfolios.

While there is no assurance that any of these scenarios will come to pass, history gives me confidence to invest against the consensus. I simply can't recall a time when following the crowd was the correct decision.

Current Investment Focus:

Ford	**Alcoa**	**Manulife**	**Bank of America**
Intel	**Oracle**	**Microsoft**	**Research in Motion**

To discover if any of our current recommendations are appropriate for your portfolio please do not hesitate to contact me.

Peter Besler
Branch Manager
Investment Advisor

Phone: 416-594-2257
Toll Free: 1-888-565-5503
Web: www.beslerfinancial.com
Email: pbesler@mgisecurities.com

Real Estate Myths:

GICs, real estate and gold have had what I believe are the best 30 years ever. Even at the bottom of the 2008 stock market decline, Canadian stocks have still had total returns 2.6 times GIC returns, 4.3 times real estate returns and 4.6 times the growth in gold.

From 1977-2007, the stock market returns were 6.5% times the growth in real estate.
In the last 60 years, $100 would have grown to $49,000 in the MSCI World index (global stocks) compared to only $6,000 in GICs and $7,000 in Canadian bonds . This is a huge factor for retirement planning. This is why stock market investments are generally recommended for the core of any long term investment portfolio.

I am always surprised how many people actually believe real estate returns have been higher than stock market returns, when in fact they are lower than GIC returns! People do tend to make money in real estate, but that is almost entirely because the leverage factor from having a significant mortgage. Almost every story I have heard over the years of people making money in real estate in the Toronto area (other than flipping) is really a story about borrowing to invest. For example, putting $80,000 down on a $400,000 home.

The actual growth of real estate has been about 2% over inflation, which is far less than the stock market.

SECURITIES

26 Wellington St. East
Suite 900
Toronto, ON
M5E 1S2