

MARKET AND INVESTMENT REVIEW ----- September 3rd, 2009

- Let us be one of the first publications this September to talk about seasonality and investing. Be forewarned: over the next few weeks financial hacks all over the world are going to devote considerable print space to this topic. At the beginning of this week stock markets globally declined somewhat (in spite of decent economic news) perhaps because investors are already bracing for a bad autumn.

- September and October have earned a reputation for being the worst months of the year for stocks. 'Google' the subject and you will find that since 1929, stocks have declined an average 1.2% in September; October is the most volatile month of the year and the largest stock market decline ever took place in October; conversely April is the most up month on average, December the most stable and January has yielded the single biggest return. If you invest using a season-based strategy ('go away in May' etc.), this is important information. If you invest a balanced index-based portfolio with a 3 year horizon, it isn't really all that important. More about that later.

- Why is September such an underperformer? Part of the reason is a seasonal slowdown in the flow of money into capital markets, so there's less new money to push up prices. Also, for some mutual funds October is fiscal year-end, and mutual fund managers like to sell their losing positions from mid-September until mid-October for tax and other advantages. Other investors may also sell for tax reasons in November and early December. In all this, there is no suggestion that inherently the underlying value or future prospect for stocks has changed.

- And a big part of the reason for this seasonal underperformance is 'post traumatic memory': in case you forgot about the crash of 1929 or 1987 (both occurred in October), then there are the traumatizing events of last September to November of 2008 to serve as a reminder.

- So what? In a balanced index-based portfolio with 50% to 70% always allocated to stocks, you would think seasonality would be a big concern, but with a 3 year horizon, it isn't. The value of the portfolio may drift down like autumn leaves in September and October, but indexes typically recover after the tax-loss selling season is over. Dividend yielding stocks continue to pay out, as before, so why forego those returns? Timing the market is more risky: the old patterns are not a sure thing nor is it easy to pick the optimal moment of re-entry to actually realize a profit. You might want to play the timing game with 5% of the portfolio, but not with the whole stock position which should be already invested in positions where the goal is to generate value over 18 months or more. So, don't worry --- just ride the seasonal volatility out.

- This autumn may actually prove to be surprising and not follow the expected pattern. As we've alluded to numerous times before, production levels and inventories of everything (except oil and gas) have fallen and September - November could provide a significant jump in U.S. economic activity with a concomitant impact on GDP. For the 'post-traumatic' investor still holding on to a lot of cash, this turn of events may come as an unwelcome surprise.

- Here is another "reality check" for investors: the current yield on 3 year government bonds is 1.40% in the US and 1.90% in Canada. The current yield on the **S&P 500** Exchange Traded Fund (ETF) is 2.24% while the current yield on XIC (**TSX Composite** ETF) is 3.04% providing a generous spread over risk free assets just on a cash basis. (T Bills currently yield at most 0.25% so there is no comparison there.) In three years an investor will receive par (\$100) for the bonds but stocks could be higher than today's levels. For example, **John Aitken** at **TD Newcrest** estimates 2012 **S&P 500** earnings at \$95 per share. Historically, the **S&P 500** trades at 16.5x operating earnings suggesting a 3 year target of 1500 on the **S&P 500** or 50% higher than today *or about the same place it was 10 years ago*. For arguments sake, let's say that Mr. Aitken is too bullish so that the **S&P 500** finishes 2012 at 1250 or only 25% higher than today's level, an investor will still be significantly better off owning stocks than bonds. The story is similar in Canada. The bottom line: expand your investment horizon and buy broad stock indexes for a superior combination of cash income and capital gain over the next three years.

For more info call Mark Kryzan or Terry Shaunessy at 403-802-3108.

DISCLAIMER: Readers are advised that information contained in newsletters, email correspondence or the web site published by Shaunessy Investment Counsel Inc. ("Shaunessy") should be used solely for informational purposes. Shaunessy cannot be held liable for any loss or damages arising directly or indirectly as a result of a reader's reliance on information provided by Shaunessy. Our opinions and analyses are believed to be accurate at the time made and are written in good faith, but no representation or warranty, expressed or implied, is to be made as to their accuracy or completeness. We are not responsible for errors, omissions or for providing future updates. All information should be independently verified and readers should seek professional advice prior to making an investment decision. The information provided by Shaunessy also does not constitute a representation or a solicitation for the purchase or sale of securities or form part of an offer to provide investment management or advisory services.