

# Investment Outlook

An exclusive quarterly report from TD Waterhouse® Private Investment Counsel Inc.

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## In this issue

What to expect next in Canada's housing market

..... 3

Your Private Investment Counsel portfolio

..... 3

Our environmental cleanup: Think green for spring

..... 4

## How to meet your need for income

BY R.J. GORMAN, CFA, VICE PRESIDENT, MANAGED INVESTMENTS, TD BANK FINANCIAL GROUP<sup>1</sup>

Recently, when thumbing through our past newsletters, I came across one in particular that struck a responsive chord. Written for the Fall 1995 edition, "In Search of the 10% Solution" addressed the need for Canadians to adopt a new approach to meet their future requirements for retirement income.

Investors, accustomed to rolling over T-Bills that had an average return of 11.9% in the '80s and a yield of over 13% as recently as early 1990, were grappling with declining interest rates and an inability to generate the 10% returns they had taken for granted — and on which their retirement plans were based.

The answer for many of these T-Bill refugees was to add some modest equity exposure to their fixed income portfolios — perhaps 25% — to achieve their goals. Many investors did exactly that and the strategy generally proved effective.

### How times have changed!

Today, inflation and return expectations are lower than they used to be and the idea of a 10% T-Bill is nothing more than a fond memory for conservative Canadian investors.

Nonetheless, many take heart from the fact that the bond portion of their portfolios has generated returns anywhere from 5%–7% per year over the past five years, depending on the average term of the bonds held.

This is still not bad, given an inflation rate



Planning for your retirement can be a bit more challenging in our low interest rate environment, but there are ways to succeed.

averaging about 2%.

The problem facing income-oriented investors today is that some of those 5%–7% average returns were capital gains, as bonds increased in price to reflect declining interest rates. Those capital gains were one-time events and will not likely recur unless interest rates decline notably, which seems unlikely.

Today, those bonds are generating a stream of income of perhaps 4%, which will approximate their total return. That 4% figure is reduced further by income taxes. The result is that many conservative investors, with

*Continued on Page 2*



## Meeting your need for income

*Continued from Page 1*

predominantly fixed income portfolios, are finding it increasingly difficult to meet their income requirements. The question for conservative investors is how to increase income while not taking on excessive risk.

### Focus on your asset mix

Begin by thinking of your savings as your personal pension plan, which should generally have an asset mix similar to other pension plans. Canadian pension plans typically have a long-term asset allocation of 55%–60% equity and 40%–45% fixed income.

This asset mix has generated solid growth over time, while not exposing investors to undue volatility. Your own investment horizon and tolerance for risk will dictate if this is appropriate or not, but it is a good place to start.

For many conservative investors, the idea of increasing stock market exposure makes them decidedly un-

easy as memories of the 2000–2002 bear market are still fresh.

To address this understandable concern, the second step is to seek out types of equity that will deliver a high proportion of their returns in the form of income, that can increase that income over time, and that have historically not been too volatile.

### Emphasis on dividends

For income-oriented investors who want to avoid currency risk, seek out Canadian common stocks that pay out relatively high dividends and, very importantly, have both a history and the prospect of increasing those dividends on a regular basis.

This achieves several objectives. First, the current dividend will generate income. Second, the dividend tax credit will often make the shares' yield reasonably similar to that of bonds on an after-tax basis. Third, an increase in dividends would increase

your stream of income over time and generally support a higher share price, so you could achieve both income and capital appreciation.

Let's illustrate with an example, using one of our core, long-term holdings of this type. Had you purchased common shares of Bank of Nova Scotia on January 1, 1996, each share would have cost \$7.47 and paid dividends amounting to \$0.31 per year. (Both figures are adjusted to account for a pair of two-for-one stock splits that occurred in 1998 and 2004.)

By December 31, 2005, the dividend had increased to \$1.44 per year and the share price had risen to \$46.14. So, the dividend more than quadrupled over the period and the share price sextupled. As a result, you would have received a rising stream of income and seen the value of your portfolio grow at the same time.

### Risk management

Sounds good, but what about risk? While all stocks are subject to some degree of market volatility risk, a well-diversified portfolio of stocks with higher-than-average dividends has typically entailed less risk than stocks in general.

To illustrate, the chart on the left depicts the volatility, or risk, of our Dividend Portfolio compared with that of Canada's S&P/TSX Composite and Scotia Capital Bond Universe indices. As indicated, the volatility of the Dividend Portfolio is greater than that of bonds but below that of the stock market as a whole.

In short, by taking on some degree of greater volatility, income-oriented investors can better meet their needs for income.

To learn more about these strategies, contact your Private Investment Counsel Portfolio Manager. ■

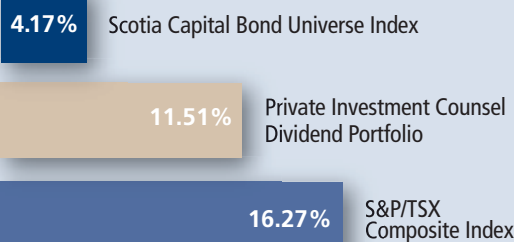
## Risk management using higher-yielding common shares



You can keep risk and volatility at manageable levels — while receiving income — by investing in Canadian common stocks that pay out solid dividends.

The chart below shows the different risk levels (annualized) of our portfolio compared with Canadian bond and equity indices.

### Annualized Standard Deviation (Risk)<sup>2</sup>



# What to expect next in Canada's housing market

BY CARL GOMEZ, ECONOMIST, TD BANK FINANCIAL GROUP

After another stellar year that saw home prices continue to climb and existing home sales smash one record after another, there seems to be little disagreement among economists, builders, and real estate execs that Canada's hot housing market is finally due for a protracted slowdown in 2006.

But amidst widespread reports of a bursting housing bubble south of the border, many homeowners and potential homebuyers in this country are wondering what an impending slowdown in Canada might look like. In particular, they want to know whether house prices may tumble the way many high-flying technology stocks did back in 2000.

## No bubble to burst in Canada

Fortunately, the answer is a resounding "no." That's because fundamental factors like solid affordability, and strong job and income growth have been responsible for much of the robust housing activity on this side of the border, in contrast to the excessive speculative buying evident in many major U.S. markets. This is a key reason why national home price in-

creases of around 9% in Canada have been much lower than the double-digit gains seen in the United States. It's also a key reason why a "correction" in Canada's housing market is unlikely.

## Canadian homeowners' wealth should remain intact

Over the past few years, the swift pace of the rise in house values has far outstripped the pace of growth in mortgage debt. As a result, the amount of equity that most Canadians have built up in their homes, defined as the market value of their residences minus their mortgages, has grown for five straight years after trending downward during most of the 1990s. Correspondingly, rising home prices have been a big reason why the net worth, or wealth, of Canadian households has grown by more than 20% during the same period.

The good news is that as Canada's housing market slows this year, the wealth that existing homeowners have recently accumulated should remain as safe as the foundations their homes are built on. As we noted above, that's because the expected slowdown in



Despite a slowing housing market, the equity that Canadians have built up in their homes in recent years should remain intact.

housing activity should merely result in a better balance between supply and demand. Therefore, house price gains can be expected to slow to a more sustainable rate, with only a slim chance of outright price declines in most major markets of the country.

In short, although Canada's housing market is poised to come off its peak in 2006, the slowdown will simply amount to what economists deem a "soft landing." ■

## Your Private Investment Counsel portfolio

### Portfolio weighting

- Modest overweight in equities
- Slight underweight in bonds, with a somewhat shorter term than benchmarks
- Overweight corporate bonds, where mandates permit
- Where applicable, income trust holdings focus on higher-quality issues with stable, sustainable distributions
- Overweight Asian holdings within international equities

### Percentage return for indices

(For period Dec. 15, 2005 – Mar. 15, 2006)

Scotia Capital Universe Bond Index	0.5%
S&P/TSX Composite Index	9.2%
S&P 500 Index	2.8%
MSCI EAFE Index*	8.0%

\* Morgan Stanley Capital International Europe, Australasia and Far East Index

# Our environmental cleanup: Think green for spring

**W**e all benefit from a clean environment. It helps us to live healthier and potentially longer lives. And everyone can play a role in keeping the environment healthy: governments, corporations, and you.

Spring is a great time to think “green” and get involved. This is when the 2006 calendar of environmental activities really gets rolling.

TD Bank Financial Group (TDBFG) is pleased to sponsor many of these efforts through our **TD® Friends of the Environment Foundation™**. Here are a few of the Canada-wide events we support. We hope you’ll consider joining us.

## NATIONAL WILDLIFE WEEK® APRIL 9–15

Millions of Canadians take part every year to explore the wonders of Canada’s watershed. To learn more about this weeklong program, visit the Canadian Wildlife Federation’s website at [www.cwf-fcf.org](http://www.cwf-fcf.org)

## EARTH DAY® APRIL 22

More than six million Canadians join 500 million people in more than 180 countries to heighten awareness of local environmental issues.

TDBFG also sponsors Earth Day Canada’s Hometown Heroes. This program recognizes people who have



Help keep our shorelines sparkling clean: Join our annual Great Canadian Shoreline Cleanup, September 16–24, 2006, and do your part. For information, visit [www.vanaqua.org/cleanup](http://www.vanaqua.org/cleanup)

made significant environmental contributions in their communities. To learn more about these programs, visit [www.earthday.ca](http://www.earthday.ca)

## CANADIAN ENVIRONMENT WEEK JUNE 4–10

Educational events and family outings raise public awareness of the environment and the need to protect it. Learn more at [www.ec.gc.ca/e-week](http://www.ec.gc.ca/e-week)

## CLEAN AIR DAY® JUNE 7

This is a day of activities encouraging Canadians to take action on clean air

and climate change. To learn more about what is being done and what you can do, go to [www.ec.gc.ca/cleanair-airpur](http://www.ec.gc.ca/cleanair-airpur) and follow the “Taking Action” link.

To learn about other environmental events near you, visit the TD Friends of the Environment Foundation website at [www.td.com/fe](http://www.td.com/fe) and click on the link to your province on the right side of the page.

You can also join the Foundation and lend your financial support to projects that will benefit your community and the Canadian environment.

Remember, no environmental effort is too small. Anything you do to keep Canada green can help to make our country a better place to live. ■

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1 TD Bank Financial Group means The Toronto-Dominion Bank and its related companies that provide deposit, investment, loan, securities, trust, insurance and other products and services.

2 Standard deviation is a statistical measure of the range of a fund’s performance. When a fund has a high standard deviation, its range of performance has been very wide, indicating that there is a greater potential for volatility than those with low standard deviation.

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