

# PERSPECTIVES

An exclusive report from TD Waterhouse® Private Investment Counsel Inc.<sup>1</sup>

## Positioning Your Portfolio in Turbulent Times

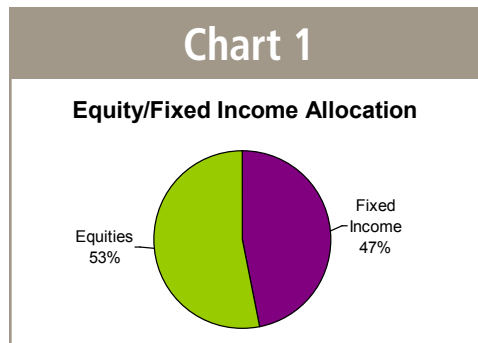
BY R.J. GORMAN, CFA, CHIEF PORTFOLIO STRATEGIST, TD WATERHOUSE

After staging a recovery throughout April and May, based in part on some easing of the credit crisis that has afflicted global financial markets, stock markets have seen renewed weakness in June and July. This has reflected two factors. First, there has been further concern about the U.S. financial sector in general and large mortgage providers in particular. Second, the continued escalation in the price of oil has weighed on the economies of major oil importers such as the U.S., Europe and Japan, causing downward pressure on their stock markets. This financial roller coaster has, not surprisingly, proven exasperating for investors.

### Allocating Assets in Your Portfolio

The past several years have generally been lackluster for Canadians investing in balanced portfolios, with returns below the historical average. This has largely been a function of currency movement and foreign market performance. Let's examine how we have been allocating your funds in the various asset classes to seek to safeguard your funds in this tumultuous period and position you for the future.

First, let's outline the big picture. While client portfolios differ depending on individual needs and objectives, we generally have slightly more in stocks than in bonds and money market holdings. As illustrated in Chart 1, a typical middle-of-the-road balanced



portfolio has about 53% of its assets in stocks and 47% in bonds and cash equivalents. **The equity weight was reduced from 58% several years ago, reflecting our more cautious outlook at the time. While early, that cautionary call has proven beneficial over the past year. We are maintaining this allocation for now as we believe stocks should outperform bonds but not by a margin that would justify a more substantial overweight in equities.**

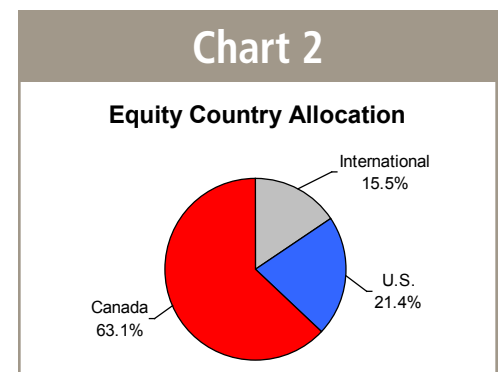
### Your Equity Positions around the Globe

Next, let's examine how the stocks making up 53% of the typical portfolio, as cited above, are allocated among countries around the world. Chart 2 depicts the country allocation based on June 30, 2008 data, with 63.1% invested in Canadian stocks, 21.4% in the U.S. and 15.5% in other international countries.

The 63.1% allocated to Canadian stocks is a very high figure by most standards as Canada represents roughly 3% of world

stock market capitalization. **We have historically employed a relatively high Canadian weight, reflecting clients' higher level of comfort with familiar, Canadian companies, our research expertise, lack of currency risk and the benefits of the Canadian dividend tax credit<sup>1</sup>. Our Canadian equity weight was as high as 70% in early 2007, which proved beneficial as both our stock market and currency had been strong performers. We reduced that figure to its current level to both reduce the risk of being so highly concentrated in Canada and to take advantage of potential opportunities elsewhere.** This has not helped portfolios to date but we expect this to change as we see a shift into less cyclical sectors and the Canadian Dollar feels further downward pressure as Canadian economic data weakens.

<sup>1</sup> Not applicable to foreign corporations



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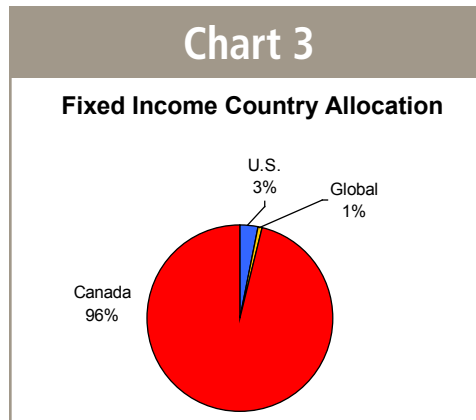
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U.S. stocks comprise 21.4% of equity exposure, a low figure considering that American stocks represent about 45% of global markets. **This is the area that has caused problems for investors around the world and Canadians in particular. The principal issue has been currency, with our Loonie rising from the 62 U.S. cents low reached earlier this decade to roughly par today. This has meant a corresponding decline of about 40% in the value of the greenback, expressed in Canadian Dollars, which has effectively knocked 40% off the value of U.S. assets for Canadians. This has been compounded over the past year by the poor performance of the U.S. stock market.** The net effect is that any U.S. exposure, however modest, has been a significant drag on portfolio performance. For example, though our flagship U.S. Large Cap equity portfolio out-performed the U.S. stock market by a substantial 5.50% over the year ending June 30, 2008, its value fell 11.90% when expressed in Canadian Dollars. While this will not likely persist as our currency should not continue to appreciate and U.S. equities recover, U.S. exposure has been a major problem for Canadian investors of late.

International stocks, principally in Europe and Asia, constitute 15.5% of our portfolios and have represented middle ground, performing better than the U.S. stock market but not as well as Canada's. The major overseas story of late has been the Chinese stock market, which has fallen by half from its peak last year and in which we have fortunately had little direct exposure.

### Your Fixed Income Asset Mix

Since most clients look to the fixed income portion of their portfolios as a source of both stability and income, the vast bulk of bond and money market



holdings are Canadian Dollar-based, to minimize currency risk. As Chart 3 indicates, about 96% of fixed income holdings are in Canadian Dollars, 3% in U.S. Dollars and 1% in global bonds. For the most part, U.S. Dollar exposure is in U.S. Dollar-based portfolios of those clients who want to match U.S. Dollar income with their U.S. Dollar requirements.

Within the Canadian bond component, we are, where permitted by the client, emphasizing high quality corporate bonds, which currently pay significantly more interest than government issues. This enhances your income in the current low interest rate environment.

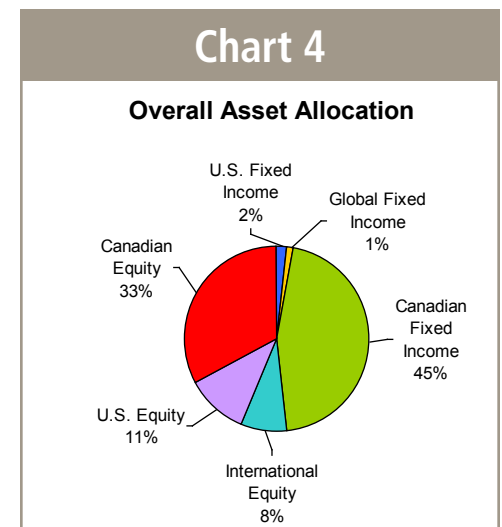
### Overall Asset Mix

Chart 4 summarizes Charts 1 – 3 and provides an illustration of a typical portfolio, though your portfolio may well differ due to your unique needs. As indicated, about 78% of an average portfolio holds Canadian stocks and bonds, with U.S. and International stocks making up most of the balance.

### Asset Allocation Outlook

There will be **two principal asset mix issues to address in the coming months. First, should we maintain our current, relatively cautious 53:47 split between stocks and bonds, which has been beneficial in**

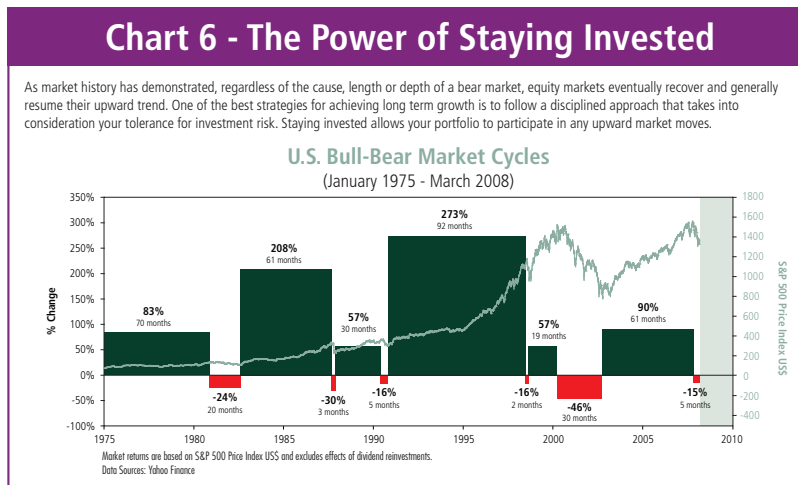
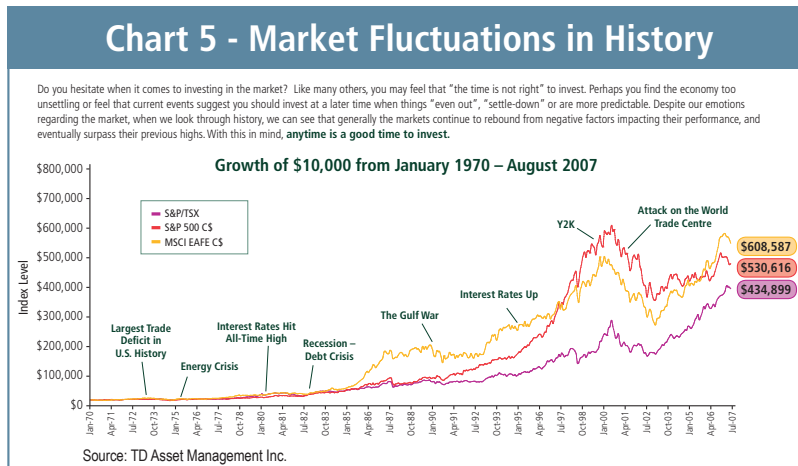
**a difficult environment, or alter the equity weight?** If so, when and by how much? **Second, should we change the mix between Canadian and foreign assets, especially within the equity component of the portfolio?** While our fairly high Canadian equity weight has minimized, though not eliminated, the damage done by the weak U.S. Dollar and stock market over the past several years, Canada's out-performance may not prove indefinite and some refinement of your portfolios may be warranted. In both cases, we shall continue to be guided by the twin needs to preserve your capital in trying times and seek to maximize growth when opportunities are presented.



Meanwhile, it is worth remembering that, as illustrated in Chart 5, our current financial and energy crises, while significant, will likely seem much less so in time and that equity markets rise over time. Chart 6 acts as a reminder that while the U.S. equity market goes through periodic downturns, the profitable periods are much longer and more significant, currency issues notwithstanding. While the current environment is challenging, the investments made on your behalf are of high calibre and should make renewed progress in the times that lie ahead.

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The information in this newsletter is as of July 18, 2008.

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