

Portfolio advisor

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Fall 2007



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Seven key investment trends

Investors are often focused on the day-to-day events affecting their investments: what the financial markets are doing, where interest rates are going, which direction the dollar is heading, and so on. This is especially true when the financial markets are going through periods of volatility, as they have been recently.

But what about some of the broader trends that may have an impact on how you invest? In this issue of *Portfolio Advisor*, we look at seven of these trends – including social, economic and demographic trends that have changed the way people invest.



Trend 1: Investing according to your values

People are increasingly concerned about the impact they are having on social and environmental issues through their investment choices. This rising awareness has led to the dramatic growth of socially responsible investing (SRI) over the last decade. In Canada, total SRI assets jumped to \$503.61 billion in 2006 from just \$65.46 billion only two years earlier, largely due to the adoption of SRI screening practices by large pension funds.

There are many different approaches to SRI, but generally it can be defined as taking into account social and environmental considerations when making investment decisions. There are three main components to SRI, according to

the Social Investment Organization (SIO), the national non-profit association for the SRI industry in Canada:

1. Screening.

Negative screens exclude certain companies based on social or environmental values, such as companies involved in tobacco or weapons production. Positive screens identify companies deemed to have a positive impact, such as producers of alternative energy. Bottom-up screens focus on those companies with the best social and environmental practices within a given economic sector, rather than entirely excluding a sector.

2. Shareholder activism.

Instead of simply ignoring companies that don't measure up to SRI standards, some investors try to change them from within as shareholders through, for example, proxy voting practices.

3. Community and economic development.

With this approach, investors actively seek out investment opportunities in companies that contribute to a community's social or economic well-being.

* **With the rapid growth** of the SRI marketplace, there are more SRI products to choose from than ever before. We can help you make the choices that are right for you. Please contact us for more information.



Trend 2: Investing for a cause

In addition to considering the impact they're having on social and environmental issues through their investment practices, affluent investors are increasingly viewing

their wealth as a vehicle for positive change through philanthropic activities. This, in turn, has led to the growth of investment products that facilitate philanthropy, such as charitable gift funds.

With a charitable gift fund, you can donate cash or other assets to a fund administered by a registered public foundation. You can then recommend which charities receive grants from your charitable gift fund, subject to the foundation's final approval. You receive a

tax credit for the full amount of your donations. In addition, donations of appreciated securities are now exempt from capital gains tax, enabling you to potentially make larger gifts.

A charitable gift fund appeals to individuals who want to establish an enduring charitable legacy, but don't require the level of control afforded by a private foundation, and would prefer a more convenient alternative.

* **We recently established** a new charitable gift fund for clients with philanthropic desires. Please contact us for more information.



Trend 3: Going global for greater opportunities

Banks, investment firms and mutual fund companies have been telling their clients for years that they should diversify their investments globally to reduce risk and

enhance return potential. However, until recently, that message seemed to fall on deaf ears, as Canadian investors continued to favour homegrown investments.

But now, the message seems to be getting through. Canadians are steadily increasing their foreign investment holdings, with a particularly big jump since the end of 2005. Canadians currently hold about \$383 billion in foreign stocks, bonds and money-market securities, up from \$292.5 billion at the end of 2005.

There are many reasons why the global diversification message is so compelling, especially now:

- › Diversifying globally reduces your reliance on the performance of any single market. When one market goes down, another market may go up.
- › The strong performance of the Canadian stock market in recent years has left it relatively expensive compared to many other markets, including the U.S., Germany, France, Italy and Japan.
- › Over time, many of these markets have done just as well or better than the Canadian stock market, despite its recent outperformance.

- › Canada's stock market is heavily concentrated in just three major industry sectors – the Materials, Energy and Financial sectors, which together represent three-quarters of the benchmark S&P/TSX Equity Index. As these three sectors go, so does the S&P/TSX Equity Index.
- › Going global gives you greater access to a much wider range of industry sectors – and, as discussed below, diversifying by global sector is actually becoming more important than simply diversifying by country or geographic area.

* **Please contact us** to find out if your portfolio has the right level of global diversification to reduce risk and enhance return potential.



Trend 4: Diversifying by global economic sector

A major trend affecting investors over the last decade has been the rising importance of sector diversification in reducing risk – and the declining importance of geographic diversification.

In the past, you could diversify your investments globally simply by investing in different geographic areas around the world. When the markets in one area went down, another would go up, balancing out your investment returns. But increasingly markets are moving in tandem with each other – especially those in North America, Europe and Asia – making geographic diversification less effective.

As markets in different geographic areas are becoming more harmonized, so are global economic sectors. Companies in a specific sector tend to move more in synch with each other, regardless of their geographic location. However, the different sectors are not necessarily moving in synch with each other. For example, financial services companies perform differently from health sciences companies – and this is happening on a global basis.

As a result, diversifying by global economic sector is now just as important, if not more important, than diversifying by geographic area in reducing risk. And with global economic

sectors continuing to become more harmonized, this trend is expected to continue.

* **At RBC Dominion Securities**, we offer a proven approach to sector diversification. Please ask us for more information.



Trend 5: Breaking with tradition to reduce risk

Many high-net-worth investors, in particular, are diversifying with “alternative” investments – including segregated funds, principal-protected notes and hedge funds.

- › Segregated funds are similar to mutual funds, offering exposure to a diversified portfolio of investments through a single investment vehicle. In fact, many segregated funds are linked to an underlying mutual fund. But being insurance products, they offer some unique features. Up to 100% of the original amount invested is guaranteed at maturity (usually 10 years) and if the fund holder passes away before maturity, the entire original amount is passed onto their beneficiaries.
- › Principal-protected notes (PPNs) have grown greatly in popularity since the late 1990s among investors looking for some relief from the vagaries of the stock markets. Like segregated funds, PPNs also guarantee the initial investment amount at maturity, in addition to offering growth and income potential.
- › Hedge funds can provide additional diversification benefits because they tend to perform differently than traditional asset classes such as stocks and bonds. There are several different hedge fund management styles, including “long-short” which uses offsetting long and short positions to reduce exposure to market risk. However, some hedge fund management styles can involve higher risk. As a result, hedge funds are considered appropriate only for “accredited investors” – high-net-worth investors with higher risk tolerance.

* **We can help you** determine if alternative investments are suitable for your investment portfolio. Please contact us to learn more.



Trend 6: Reaching for greater yield

One of the biggest trends over the last 10 or 20 years has been the increasing demand for investments that produce a satisfactory retirement income. Traditionally, retirees

have depended on interest-bearing investments, such as government bonds and GICs. However, there's often very little left over – after accounting for taxes and inflation. As a result, retirees have turned to other ways to generate income:

- › Annuities provide an income stream comprised of taxable interest income and non-taxable return of capital, effectively providing higher after-tax income compared to conventional bonds or GICs. With an insured annuity, a portion of your annuity payment pays for the premiums on a life insurance policy that provides a death benefit for your beneficiaries.
- › Corporate bonds generally pay higher yields than government bonds. However, they can vary greatly in quality. Income-oriented investors typically look for higher-quality, investment-grade bonds rated “A” or higher, as opposed to lower-quality “junk bonds”.
- › Dividend-paying stocks have also become increasingly attractive among income-oriented investors. Dividends receive preferential tax treatment compared to interest income, helping investors boost after-tax income.
- › Income trusts are publicly traded equities (like stocks) that return most of the cash earned from underlying assets to investors (unlike stocks). On average, income trusts pay 8% yields, making them very attractive to income-starved investors.

The income trust market experienced tremendous growth until October 31, 2006, when the federal government announced that income trusts would be taxed in the same way as corporations.

This effectively ended the tax advantages enjoyed by income trust distributions over corporate dividends, although the change doesn't take effect until the 2011 tax year for income trusts created before October, 2006.

*** Contact us** for a complimentary retirement income evaluation to find out how you can enhance your income.



Trend 7: Investing for a longer lifespan

People are generally living much longer – prompting a new approach to investing for retirement. Thirty years ago, people could expect to live for just a few years after retiring

at age 65 – four years for men and 11 years for women. These shorter life expectancies meant that some modest savings, coupled with government benefits and possibly a company pension, were more than enough to cover living expenses.

But now, people can expect to live for nearly two decades after reaching age 65. This means that most retirees need a much larger retirement nest egg to avoid outliving their savings or having to make unnecessary lifestyle sacrifices. They also need to take a different approach to investing. Instead of investing exclusively in income-oriented investments like bonds and GICs – as in the past – retirees are increasingly allocating part of their retirement portfolios to growth-oriented investments like stocks.

*** With the right balance** of growth and income investments, you can increase the longevity of your retirement savings – without taking unnecessary risks. Please contact us to find out how.



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