RBC Wealth Management
Dominion Securities

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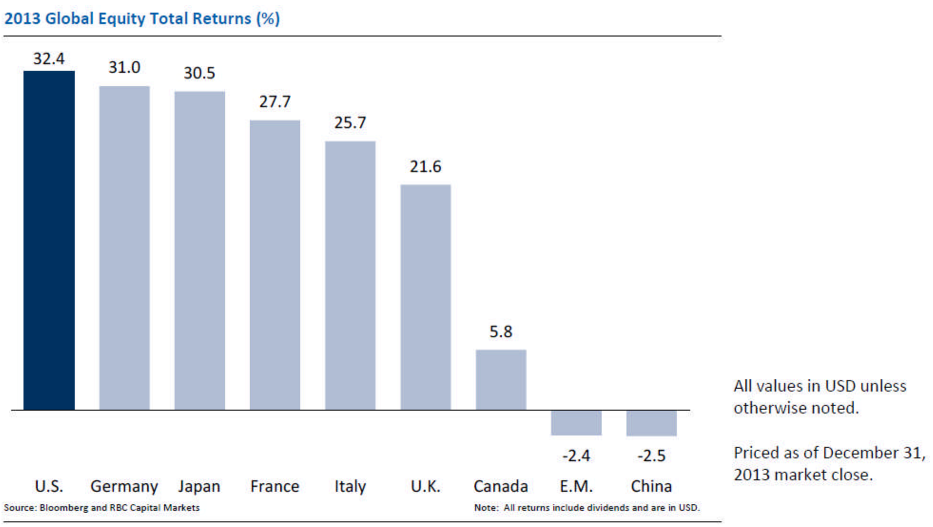
Year End 2013

Markets in 2013 reminded me of my favorite Clint Eastwood western – The Good, the Bad and the Ugly. Cash was trash and the long heralded Great Rotation from bonds to stocks unfolded.

The Good investments were represented especially by the S&P 500 Index which had a total return of 32.4% in U.S. dollars and a whopping 41.7% when measured in Canadian dollars. That was the S&P's best year since 1998 and one of its all time best 10.



The Bad were not only bonds, which had a total return in Canada of -1.2%, but interest sensitive stocks like Real Estate Investment Trusts (REITs) and utilities. Canadian REITs had a total return of -5.52%, utilities lost 4.1%, including dividends.

The Ugly were in the materials sector of the S&P TSX Composite Index and, of these, the Golds were horrendous. The gold index is down 60% from its 2010 close.

Head office in Toronto sends you unconsolidated account statements separately for the Canadian side and U.S. side of your accounts. Comparing the two you might think there was something awful about Canada and, conversely, something splendid about America. You might have felt quite the opposite in 2006. But it was not about geography so much as it has been a question of sectors.

Most investments made for current income, those in The Bad category, including bonds, are in your Canadian account for three reasons;

1. Presumably, eventually it will be mostly Canadian income that you require.
2. Buying bonds in a foreign currency would be almost nothing but a currency speculation and currencies are notoriously hard to predict.
3. Dividends from Canadian corporations receive a generous tax credit so utility type stocks tend to be in your Canadian account.

The Ugly stocks, commodity producers, also tend to be in Canadian accounts. Although for instance, U.S. gold mining stocks have done every bit as badly as Canadian miners, we tend to own Canadian ones, partly just out of familiarity and because I think Canada tends to grow pretty good commodity producers.

There were some of The Good stocks sprinkled through Canadian accounts. Many are very small capitalization, local companies and small company stocks were the standout performers in 2013.

The U.S. accounts were generally not as impeded by The Bad and The Ugly and therefore did much better. As bond yields rose, investor demand turned more towards growth from income and there are many large and growing companies in our U.S. accounts.

Thinking back over the years, I can't get over how investor fashions change. It was as recently as my Year End 2011 letter that I featured Utilities as that year's top performer. Seems like just a few years ago I was marveling in a skeptical kind of way the seemingly unceasing demand from emerging markets for typically Canadian commodities.

Observing the tremendous outperformance of the Canadian stock market from 2002 to 2008 and its underperformance vis à vis the U.S. or World Stock Market since, it is tempting to conclude that that trend will continue. But I think quite differently, that that variability is an argument for diversification.

I have been fretting about the potential risks in bonds for more than a couple of years already; about since central banks introduced their zero-interest rate policy in response to the crash of 2008-2009. Bonds offer return free risk, not risk free return as the saying goes.

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But bonds are like anchors and although anchors slow you down they can stop you from going aground.

On a completely different tack, here at the office, we've been subjected to many new procedures and requirements over the years. Time was in this business, we used to take pride in being able to do deals big and small with just a phone call and at most a handshake. Then we entered a brave new world of bureaucracy and electronic communication. We jumped on the immediacy and certainty of email. When fraudsters started using email we countered by asking security questions and for scanned signatures.

Recently I had the experience of receiving from a client via email, a letter of authorization (LOA), to wire cash to a bank account in the Channel Islands. Remarkably, the LOA included the client's account number here with us as well as his signature. Imagine my client's surprise when I called to confirm. His whole email account had been hacked. Until then I thought the following example email chain that was circulated through RBC was apocryphal. A banking colleague received a LOA to transfer money. The email said the client couldn't be reached in hospital. An email interrogation followed about where he had his holiday, who he met, etc. – the fraudster answered half a dozen personal questions before the banker balked. The fraudster had all the client's emails and knew all about the client.

So it's back to the future. We must now confirm all requests to transfer money by voice, whether accompanied by a handshake or not. Voice is now our only secure media.

Finally, on a personal note, in our household, Kristin Middleton and I took some notice of the birth of Prince George, to Prince William and the former K. Middleton. My brother pointed out that our mother Elisabeth named her oldest son Charles, who was followed by William and then me. This is so uncanny, we should royally succeed to the throne.

Sincerely,

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