



Balanced View

WEEKLY COMMENTARY

October 26, 2007



A class \$9.70 | F class \$9.71 | X class \$9.67

Bay Street to Sesame Street

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On Wednesday, February 23, 2005 Ralph Goodale, the then finance minister for the minority Liberal government, made a budget announcement that significantly altered the investment landscape in Canada: foreign content restrictions were eliminated. All of a sudden investors were able to own as much American, European, and overseas content as they wanted in their RRSP.

Imagine if you climbed out of bed the next day and an idea occurred to you as you brushed your teeth and watched CNBC: "Wait a minute; I can invest where I want with almost no restrictions". At the time markets in Asia and South America were on a tear and those folks on CNBC sound so darn positive about investments in the United States, it's got to be a good idea. So quicker than you can say *Carpe Diem*, you take all your investments outside of the Great White North.

Two years, eight months and two days later you surf the internet to check in on your returns. Boy they look terrific the S&P is up 24.68%, the MSCI is up 38.3% and Nikkei 43.22%. Just then you hear the trusty clang of your mail box. You run to retrieve your mail, wave to your mailman, smile at your neighbor elated with the satisfaction of knowing you invested all your money outside of Canada and they, because they have never had your financial foresight, did not. You then open your statement, unfold it, place your reading glasses on the tip of your nose and discover that clearly something has gone awry: the great returns you thought you had have not materialized on your statement: the S&P 500 is down 2.53%, the MSCI is up only 8.12% and the Nikkei is up only 1.62%

Disbelieving your own eyes, you call to your spouse to verify the statements before you, he/she does not respond and as you walk past the family room you hear the sound of Sesame Street blaring on the television, which reminds you that they have gone out for the day, a shopping trip to the United States to take advantage of your family's new found spending power due to the incredible appreciation of the Canadian dollar. As you ask your grandchild to turn down the volume on the TV, the song playing, *Some of These Things Belong Together*, rings through your consciousness and a thought occurs to you, *maybe these two things are connected?*

Connected they are, the ascent of the Canadian Loonie has been nothing short of looney. Since February 23, 2005 the Canadian Dollar has appreciated about 30% versus the US dollar. To put it in perspective, an investor could have put their money in the S&P 500, watched it appreciate 24.68% or put it in a money market fund that was paying 4.75% and once translated into Canadian dollars, been better off in the money market fund.

Returns Since Budget Announcement

	RETURNS IN		
	local currency	CAD\$	annualized ROR
Hang Seng	110.31%	64.41%	20.9%
S&P500	24.68%	-2.53%	-1.0%
MSCI World Index	38.30%	8.12%	3.0%
FTSE 100	31.39%	11.05%	4.1%
Nikkei 225	43.22%	1.62%	0.6%
MSCI EAFE	49.51%	16.88%	6.1%
TSX	44.82%	44.82%	15.2%

In terms of capital return potential and risk management, investing outside of Canada makes a lot of sense; this fact is why the Canadian Government's announcement over two and a half years ago was met with such approval.

To many us, two and a half years ago is a faint memory. Human beings are hardwired with something psychologists like to call, "recency bias." This is simply the tendency for humans to place greater importance on more recent experience. Recency bias leads to bad decisions and overreactions. We're all susceptible to it to one degree or another. It's the stuff that makes for bubbles, may they be stock-market, real estate or in this case, currency.

Recency bias is powerful. Today it is compelling Canadians who are invested all in Canada to stay that way and it is tempting those who chose to diversify outside of Canada to rethink their strategy. We here at Barlow are human, we understand the temptation. Consider this: year to date foreign currency has hurt the returns of our diversified TrueBalance™ portfolio by 2.25%, eroding most of our peer group outperformance. Does this mean we throw in the towel, forget all we know about risk management and jump on the band wagon? Our overall portfolio strategy remains unchanged. We wish to be well diversified by asset class and within each asset class. We look for investments that are not correlated, which is a fancy way of saying that we look for investments that don't move in the same direction. Simply put: more often than not, having money outside of Canadian currency is a good way to reduce risk.

Mr. Goodale's announcement was met with broad approval because it was the good decision for investors. In the past few years Canadians would have been better off having all their investments in Canada. In the short term poor decisions can produce positive results, but over the long term it becomes less and less likely that poor decisions will deliver desired results. Recency bias aside, investment in securities and currency outside of Canada is critical for investors who want to maximize returns and minimize risk.



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