

2009 Annual Review: Global Value Funds vs. other categories

All charts provided by globeadvisor.com

Purpose: The purpose of this report is to review the long term merits of investing in global equity funds managed using a value style when compared to several other investment options. The distinguishing feature of the value style is that the managers seek to invest in companies which can be bought with a substantial margin of safety, below their fair value. This may entail sifting through companies other investors consider to be poor investments or seeking to identify hidden assets in the companies. A good value fund typically performs okay in a rising market, but will not lead the pack. When the market turns down a value manager usually sees a smaller decline since he already owns companies priced at a discount. After seeing hundreds of different money manager presentations, I believe that true value investing is the best choice for most investors, whether they are 25 or 85 years old.

Note: For a detailed review of investment market performance in 2009 and the context of the last ten years, please see my “2009 Review of Investment Markets” and also reviews of individual funds.

For context, the past ten years have been extraordinarily poor for global equities – in fact the worst ten years in history – since the decade began with the end of a period of very high returns and has ended just after the second worst year ever, 2008. Chart 1 shows the last 10 years of the MSCI World Index and it shows the last few months of the tech boom ending in the spring of 2000 followed by a 50% decline in 2000-2003, a recovery back to the starting level by early 2007 and then a second 50% drop in 2007-2009. For five of the last ten years the world market index has been negative, when on average it is negative two or three out of ten years. In other words, this time has been as challenging as we could imagine for long term investors. Despite this, human ingenuity in its infinite variety has adapted to change and eventually solved the problems it faced in business and the economy in general. It is important to see that while many governments have made a real mess of things by interfering in the economy and consequently have large debts and deficits, the average business has taken strong measures to reduce debt and expenses and is in a better financial position than it was ten years ago.

Table 1. MSCI World Index over the last 10 years

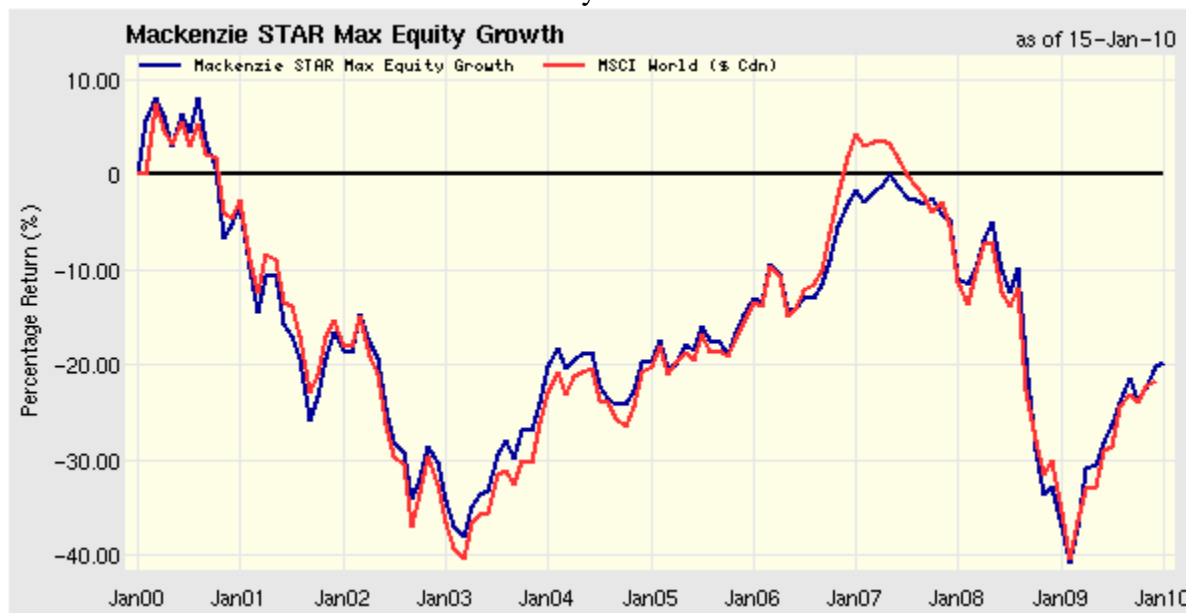


Table 1 shows how the global value funds I most recommend have done over the last 10 years when compared to the MSCI World Index. Remember that an index is a cost-free virtual investment used as a benchmark and is not attainable in real life, while mutual funds have significant operating costs of 2% to 3% that include compensation for the financial advisor, research, trading, marketing, administration, reporting and taxes. When a fund outperforms an index, it is a clear demonstration of value-added work by the fund company.

All seven of the funds have managed to add value during the last ten years, though with an index return of -2.94% it is accurate to say that even these quality funds have seen performance well below their longer term averages. Fortunately, equity investments revert to the long term average so it is likely we are in for a period of much better performance in the decade ahead.

Table 1.

Selected large global equity funds vs. MSCI World Index

Data from Globeadvisor.com as of Dec. 31, 2009

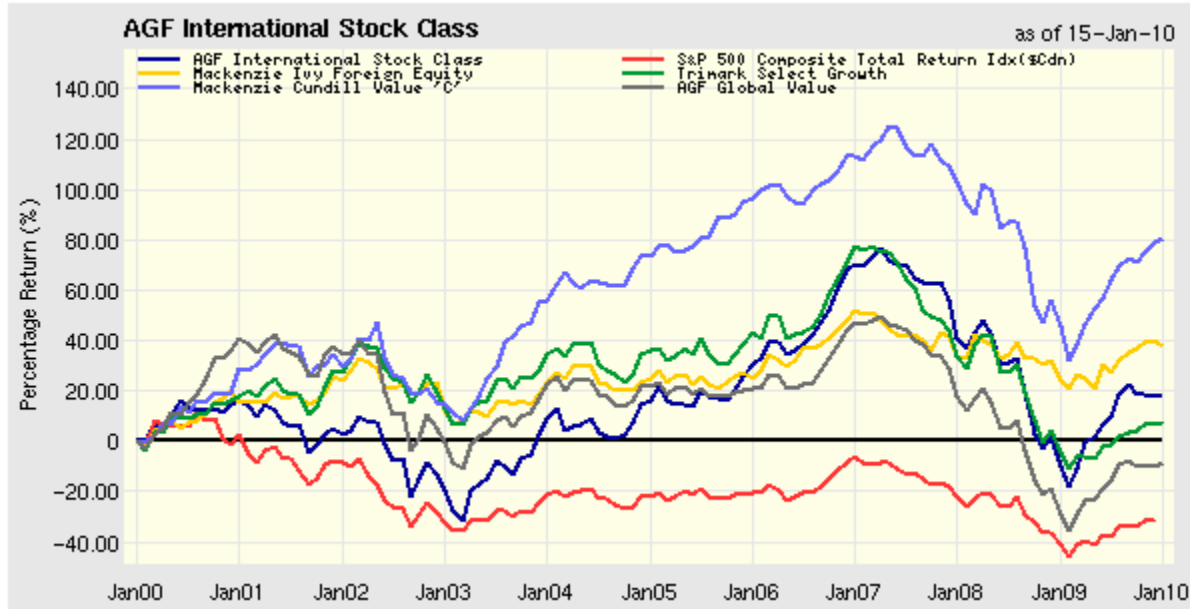
Fund name	Assets \$millions	10-year return	10-year fund outperformance	10-year standard deviation
MSCI World Index (\$Cdn)		-2.94%		13.52
Mackenzie Cundill Value	\$4,967	6.06%	9.00%	12.55
Mackenzie Ivy Foreign Equity	\$1,966	3.07%	6.01%	10.35
Trimark Fund	\$1,254	2.20%	5.14%	14.28
AGF International Stock	\$900	0.51%	3.45%	19.14
Trimark Select Growth	\$2,136	0.17%	3.11%	14.11
Templeton Growth	\$2,067	-1.10%	1.84%	14.43
AGF Global Value	\$1,392	-1.69%	1.25%	16.69

Note: 10-year and outperformance numbers are compounded annual average returns

Global Value funds vs. US market: The US market is the world's largest, representing about 40% of the world stock market value. Over the last ten years the S&P500 index (in Canadian

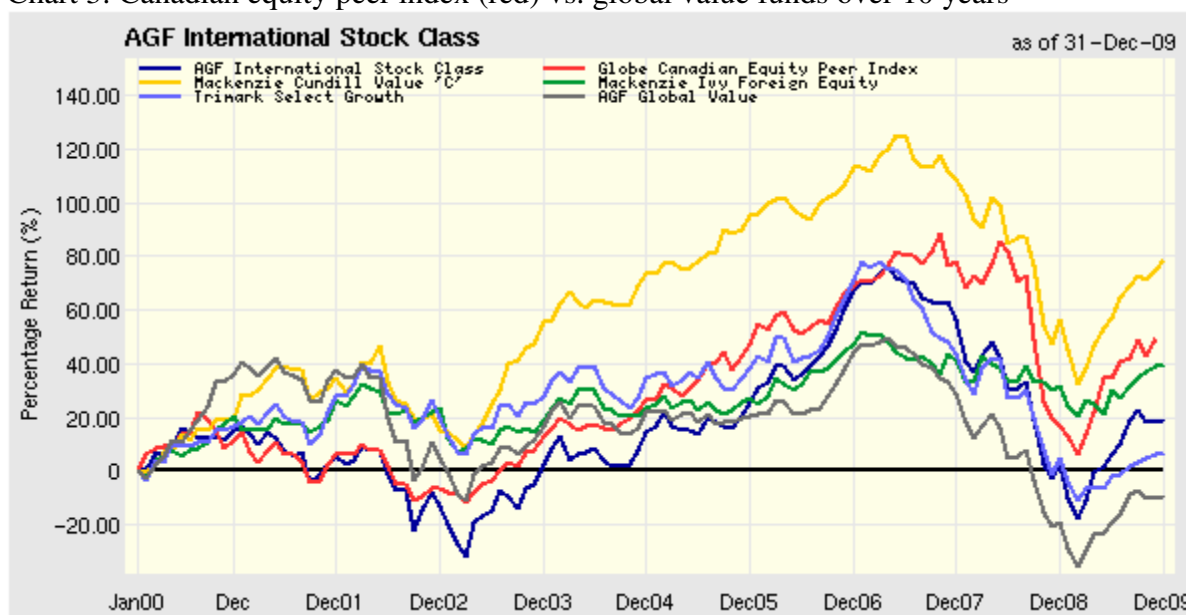
dollar terms) has actually declined about 30%, its weakest period in history. Of the five global funds shown for comparison, all have outperformed, some by a wide margin (Chart 2). I conclude that these global value funds have been a good choice for investors when compared to investing in the US market only.

Chart 2: S&P500 Index (red at bottom) vs. global value funds over 10 years



Global Value funds vs. Canadian Equity funds: Over the last 10 years Canadian funds have gained an average of about 50% (chart 3). The Canadian stock market represents only about 4% of the world market and is extremely concentrated in resources and financials. It does not represent a diversified equity portfolio. One of five global funds has exceeded the index and one has about matched while three have lagged. Note that the Canadian market has seen higher than normal performance in several recent years due to a boom/bubble in resources. Since Canadians typically have a high home country bias – your Canada pension plan, OAS pension, work income and most of any other pension is heavily weighted in the Canadian market - I recommend that investors allow global managers to choose from among any companies on Earth that represent good investment value.

Chart 3: Canadian equity peer index (red) vs. global value funds over 10 years



Global Value funds vs. Natural Resources funds: From 2002 to 2007 the resources sector showed huge gains and well outperformed the five global value funds shown. These huge gains in resource prices amidst speculation about the effects of hurricanes, war in the middle-east, demand by China and India, and the supply of oil were not sustainable. Looking back over the decades, there are occasional bursts of strong interest in resources and this sector goes through dramatic booms and busts, both of which are driven by fear and greed. Demand rises and is followed by higher profits, then businesses invest in higher production capacity and competition drives out much of the profitability. Global value managers tend to have little or no exposure to energy companies when they are exciting since these businesses sell products whose price is beyond their control and who are in a sector where competition tends to be fierce. They prefer to invest in more stable businesses with more predictable long-term growth and are less susceptible to wild speculation.

In 2008 resources prices crashed in a most dramatic fashion, with oil prices down from their high of \$147/barrel to \$37/barrel, a decline of 75%. In 2009 they rebounded strongly as speculation returned to resources and oil prices rose to over \$80/barrel. As you can read elsewhere from the 200 year chart assembled by Prof. Jeremy Siegel, the price of gold has risen way above its long term trend line and he believes it will eventually revert downwards. Similarly, a global money manager who has an investment in Shell Oil has said that oil can be produced for about \$40 per

barrel and the higher price is based on speculation and worry. While there is no telling how long a speculative trend can run, I believe the global value managers I speak with when they say they have a hard time finding sound long term investments in commodity-based companies.

Chart 5 shows that over the last three decades the value managers have provided much higher gains than by investing in resources only. If global managers see enough merit in a resource company, then they are free to buy it and we should not substitute our judgment for theirs in the industry or stock selection process.

Chart 4: Globe natural resources index vs. global value funds over 10 years

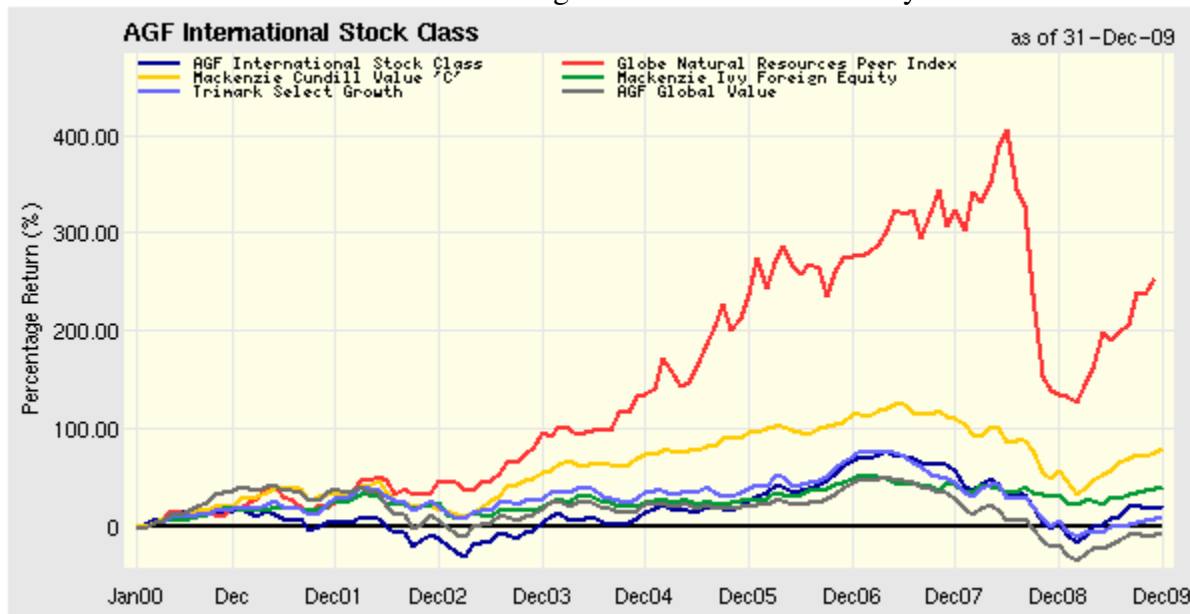
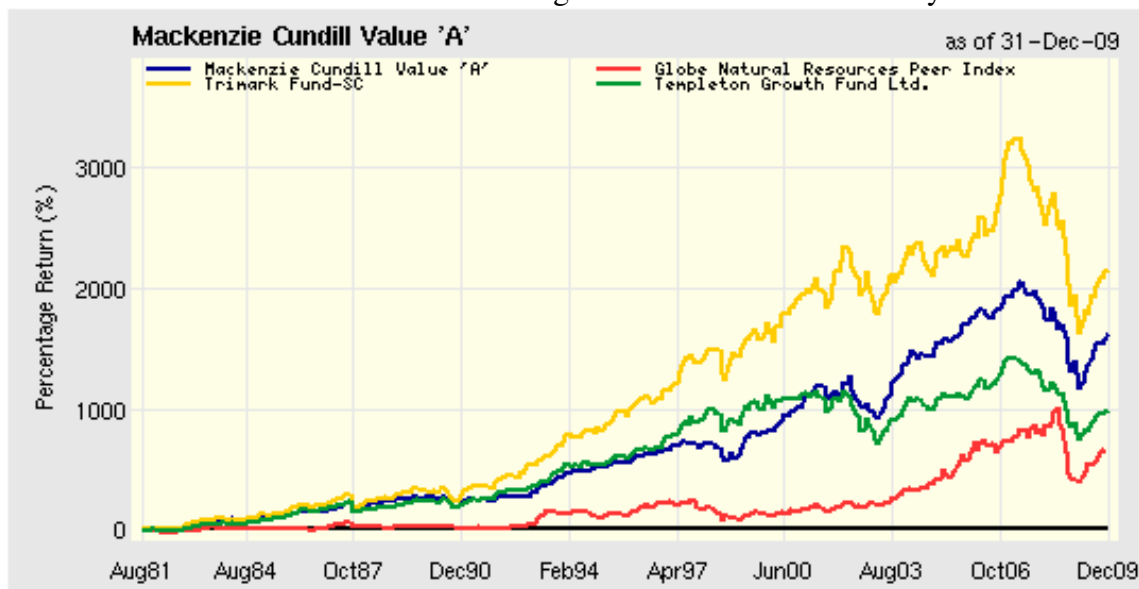
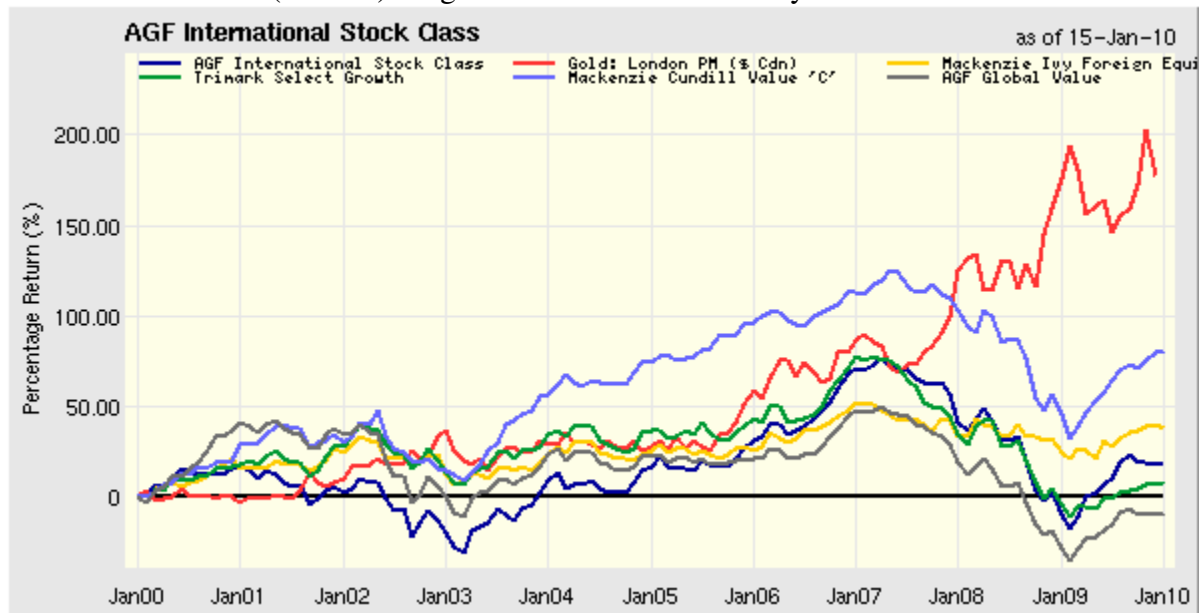


Chart 5: Globe natural resources index vs. global value funds over 28.5 years



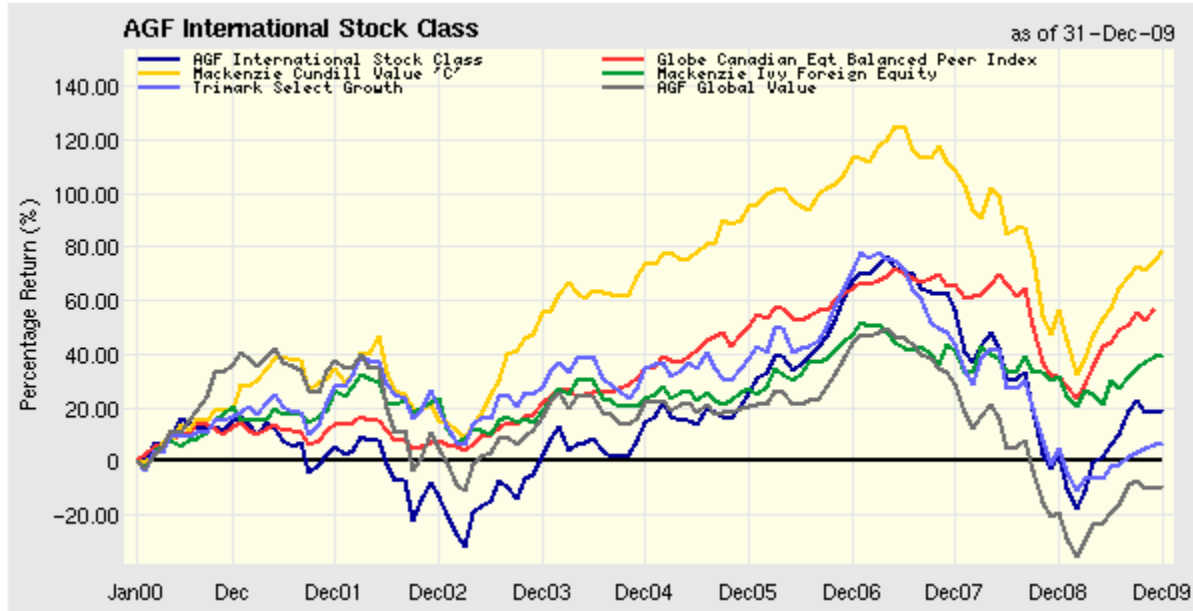
Global Value funds vs. Gold: Over the last 10 years the price of gold has actually gained about 180% in Canadian dollar terms (chart 6) and outperformed the global equity funds. Students of investment history know this is an extremely unusual occurrence seen only once before, in the 1970's. In the longer term gold is simply a commodity, a thing, an object. It does not produce income and is not a dynamic and adaptive investment. I view an investment in gold companies as a better choice and these companies MAY be bought by global value managers as they see fit. Over the last 207 years the price of gold has done nothing more than match the rate of inflation (source: Stocks for the Long Run, Jeremy Siegel, 2007) and I see no reason why this should change in the long run ahead.

Chart 6: Gold index (red line) vs. global value funds over 10 years



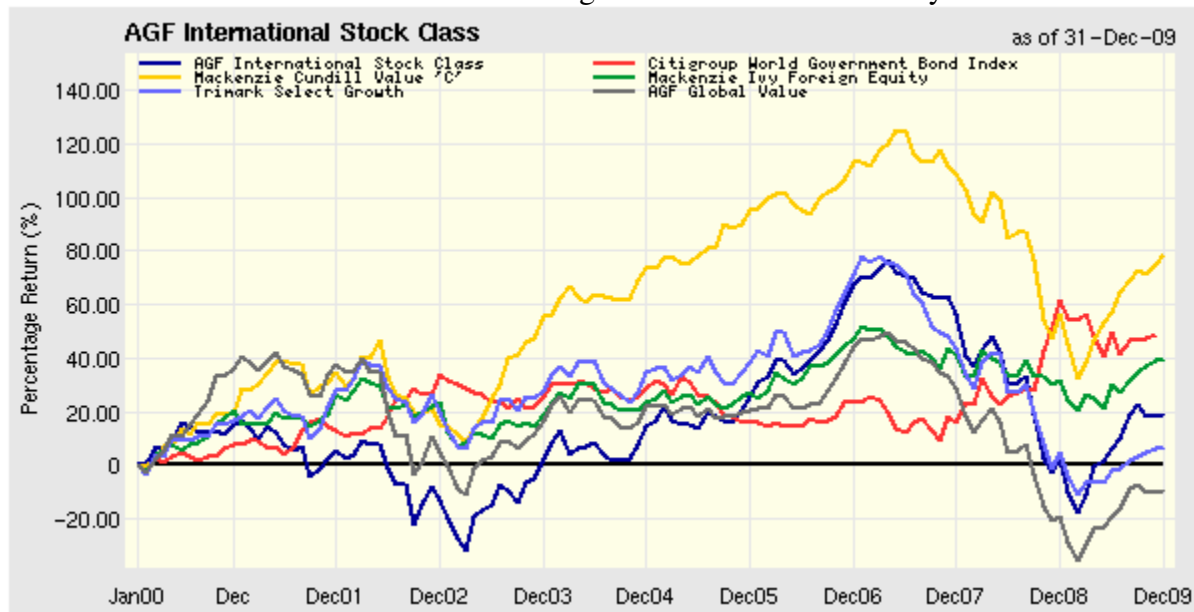
Global Value funds vs. Canadian Balanced funds: Over the last 10 years the average Canadian Balanced fund has outperformed four of the five global value funds (Chart 7). The relatively good performance of Canadian balanced funds over this time period can be attributed to the unusually low performance of the global stock market and the fact balanced funds contain about 40% in bonds. Balanced funds can invest in stocks or bonds and they have certainly had more modest price fluctuations than global equity funds but have also (and should) produced lower results over long periods. For investment time horizons of one to five years, a balanced fund may be a better choice than a global equity fund, but the longer your money will remain invested, the more important it is to own equities.

Chart 7: Globe Canadian Balanced Peer Index (red line) vs. global value funds over 10 years



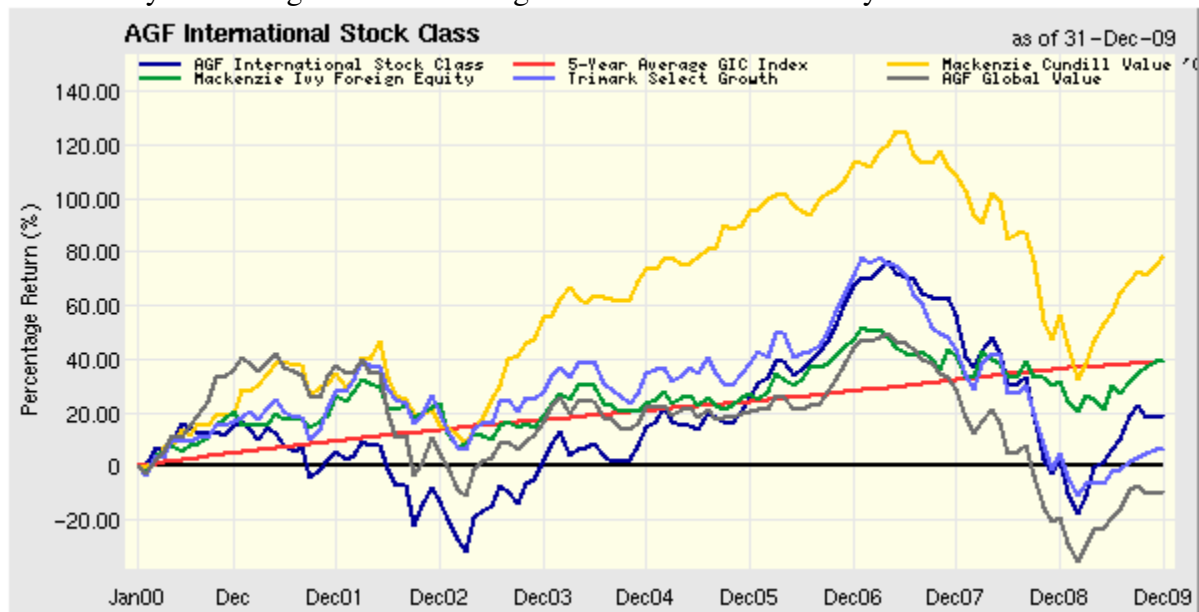
Global Value funds vs. World Government Bonds: Due to the historically poor equity markets in the last 10 years, the average government bond has actually outperformed four of the five global value funds (Chart 8). Bond yields have now fallen to about 3% to 4% so the outlook for the average bond fund can really be no better than about 2% for the next decade. Bonds do not grow as do equities and are most suitable for shorter term objectives or to reduce portfolio variability while reducing returns. Over a ten year period stocks normally outperform investments like bonds 80% of the time (source: Stocks For The Long Run, Jeremy Siegel, 2007).

Chart 8: World Government Bond Index vs. global value funds over 10 years



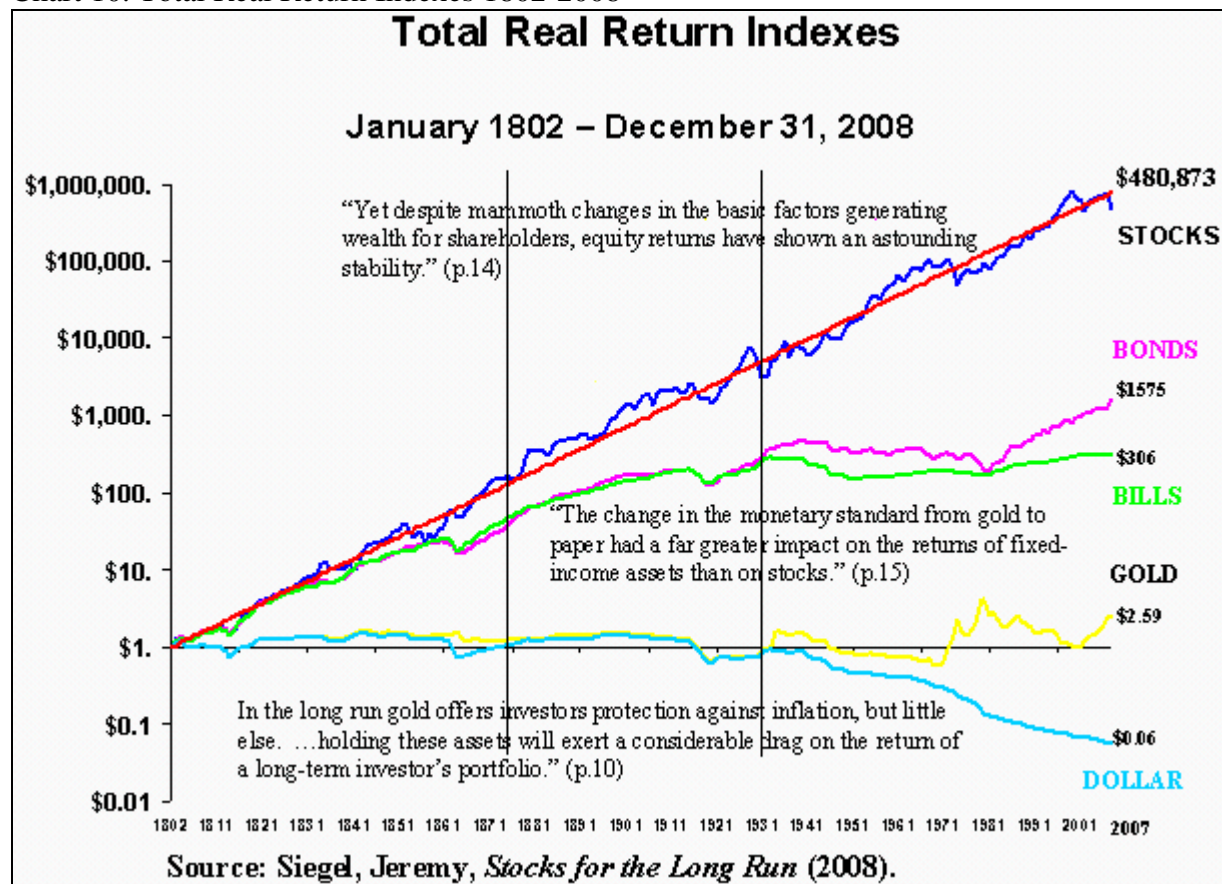
Global Value funds vs. 5 year GIC index: Over the last 10 years the GIC index has provided a total gain of 40% (chart 9). Due to the historically poor performance of equity markets, the GIC index has outperformed three of the five global value funds. Like bonds, GICs are most suitable for short-term objectives and should not be viewed as hard-working long-term investments, especially since when inflation and taxation are considered they have produced a negative wealth effect. Over a ten year period stocks normally outperform investments like GICs 80% of the time (source: Stocks For The Long Run, Jeremy Siegel, 2007).

Chart 9: 5-year Average GIC Index vs. global value funds over 10 years



Concluding comments: Logic implies, the evidence very strongly supports and I continue to believe that, for long term investment goals, it makes sense to own mostly equities, diversify globally, and use a conservative value investment style, especially for Canadians who tend to have a very strong home country bias and invest mostly in local companies. The Canadian market represents only about 4% of the world market and a market neutral portfolio mix would only contain a tiny fraction in Canadian companies, yet Canadians have about 80% of their investments in Canada. Chart 10 shows the history of the US investment markets as compiled by Prof. Jeremy Siegel. The chart is adjusted to remove the effects of the rising cost of living and so it shows the Total Real Returns of the different asset classes.

Chart 10. Total Real Return Indexes 1802-2008



Every few years there is another fad which hits the investment community and gathers huge amounts of investment dollars with much of this coming late in the fad's life. In the past fifteen years we have seen short term manias in the areas of: resources (ended 1993), emerging markets (bubble burst in 1998 with currency crisis), Canadian small companies, bonds, large US companies and tech companies (bubble burst in 2000), income trusts (bubble burst by legislative change in 2006), real estate (bubble burst in 2007) and resources again (bubble burst in 2008). Every one of these has garnered terrific media attention and attracted huge amounts of money from Canadians only to see disappointing negative results for some time afterwards. It appears there may now be a bubble in government bonds, gold and perhaps real estate.

Earlier in my career as a financial advisor, I followed the typical recommendation to diversify by owning several different types of funds. Over the years, and in particular since the historic decline of the world markets in 2000-2002, I have recommended that the majority of most clients' assets be invested in global value funds that are good complements to each other. I have done research to find an effective combination of two or three such funds so as to produce good results with high consistency and have found that this is possible. Please read about my three-fund equity model or ask me to explain it to you.

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