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A S S A N T E F I N A N C I A L M A N A G E M E N T L T D .

International Investing: Five Good Reasons to Spread Your Wealth

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An excerpt from the National Best Selling Book, *The Empowered Investor: A Guide to Building Better Portfolios* by Keith Matthews (www.empoweredinvestor.ca).

The recent appreciation of the Canadian dollar has convinced some investors that, by putting a large share of their savings into domestic investments, they will be able to ride a wave to great returns. As exciting as our strong economy is, this white paper highlights the benefits of also keeping a healthy dose of international investments in your portfolio mix. We will investigate why Canada forms a relatively small part of global markets and discuss why allocating long-term wealth in foreign equities is sound, prudent, and makes good sense.

Understandably, Canadians feel comfortable investing in our local companies. It is human and natural to feel more at ease when we invest in companies that we know and recognize. Interestingly enough, individual investors around the world often favour investing in their local economies, in essence building a “home bias” into their portfolios.

This being said, it is well known that geographic, industrial, and currency diversification can improve long-term investment returns while decreasing the risk/volatility of a total portfolio. Asset allocation that includes U.S. and international companies (both large and small) over long periods of time will improve your financial position and increase the odds of successful returns. Allocations to these equity markets may vary depending on each investor’s profile, tolerance to risk, and time horizon, but all investors should have some form of international diversification in their portfolios.

Five good reasons to spread your wealth:

- ◆ the Canadian equity market is still only a very small percentage of all investment opportunities;
- ◆ the Canadian S&P/TSX composite lacks diversification;

- ◆ important industries that should be included in investment portfolios are simply not found in the Canadian S&P/TSX composite;
- ◆ productivity remains high in international markets; and
- ◆ including international exposure in a portfolio reduces risk.

The Canadian equity market is still only a very small percentage of all investment opportunities.

The Canadian equity market represents approximately 3.5% of the world’s total stock market capitalization. This means that, by investing only in Canadian equities, by default you are not taking advantage of the other 96.5% of opportunities available to investors. The way institutional investors allocate their assets proves that they recognize that many long-term investment opportunities exist outside Canada. As of 31 December 2006, the average Canadian pension plan¹ invested 19.9% in Canadian equities and 32.0% in international equities (8.3% U.S., 8.9% EAFE, 13.9% global, and 0.9% emerging market). The large weightings in foreign companies clearly show that institutional pension plans across the country feel there is sufficient evidence to warrant this portfolio allocation.

The Canadian S&P/TSX composite lacks diversification.

The Canadian equity market has historically been known as a very concentrated market relative to other markets around the world. Our equity markets have traditionally been heavily concentrated in companies that derive their revenues from natural resources and financial services. As of 30 September 2007, financial services, oil and gas, and natural materials (metals and mining) comprised 30.09%, 26.52%, and 17.52%

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Table 1: Industrial Sector Weightings in Various Asset Classes

	S&P/TSX COMPOSITE	S&P 500 INDEX	U.S. SMALL COMPANIES*	MSCI EAFE INDEX	INT'L SMALL COMPANIES*
Financial	30.09%	19.38%	13.50%	27.35%	13.59%
Energy	26.53%	10.91%	7.14%	7.52%	4.41%
Materials	17.52%	3.09%	5.87%	9.75%	8.68%
Industrial	5.69%	11.40%	16.38%	12.02%	29.52%
Telecommunication	5.50%	3.64%	1.13%	4.84%	0.95%
Consumer†	7.53%	20.35%	20.05%	19.21%	25.06%
Technology	4.58%	16.35%	19.13%	5.75%	10.53%
Health Care	0.60%	11.37%	14.27%	6.28%	5.48%
Utilities	1.58%	3.37%	2.52%	5.11%	1.69%

* U.S. small companies and international small companies are represented by DFA U.S. Small Company Fund and DFA International Small Company Fund, respectively; † Combination of Consumer Discretionary and Consumer Staples industry weightings

Source: Standard & Poor's, MSCI, Dimensional Fund Advisors, as of 30 September 2007

of our equity market, respectively. In comparison, many other equity markets are more diversified among various industries.

Important industries that should be included in investment portfolios are simply not found in the Canadian S&P/TSX composite.

While Canada has some great investment opportunities, there are certain industries that investors should include in their portfolios that are not found in the Canadian equity market. Including these other industries—such as health care, industrial, consumer, and technology companies—in your portfolio will create the proper diversification required to grow your wealth over time. It not only exposes you to interesting investment opportunities, it also protects your wealth from the cyclical nature of natural resources. Table 1 compares the industrial weightings of

various international asset classes to the broad Canadian equity market (as of 30 September 2007). It is striking how dissimilar the industry weightings are for Canadian equity markets relative to other foreign asset classes. Canada is heavy in natural resources and banking, while some other foreign asset classes seem to have a completely opposite industrial sector makeup.

What about the idea—promoted by many—that the price of natural resources can continue to appreciate for a long time to come? Maybe it can and maybe it can't. To read the press, an investor might think that the increased demand for natural resources from China, India, and other developing nations makes investment in these industries a sure bet; in the last five years, it is as if the entire world has wanted exactly what Canada has to offer—oil, gas, materials, and other commodities. It seems reasonable to assume, however, that as globalization

increases, bringing more wealth and prosperity to more people around the world, the demand for industrial goods, health care, and consumer goods will also increase. A well-diversified portfolio should therefore include exposure to resources as well as to companies that produce finished goods and services.

Productivity remains high in international markets.

Productivity is a measurement related to the concept of efficiency. Productivity improves when the quantity of output (goods and services produced by companies) increases relative to the quantity of input. All else being constant, improving productivity benefits all companies by lowering costs over time and, in turn, improving the company’s ability to compete and make profits. Many economists and capital markets researchers believe that the massive increase in worker productivity in the United States during the 1990s fueled economic expansion. Figure 1 shows that productivity was greater in Japan, the United States, Great Britain, and Germany than in Canada from 2002 to just past 2006. This bodes well for long-

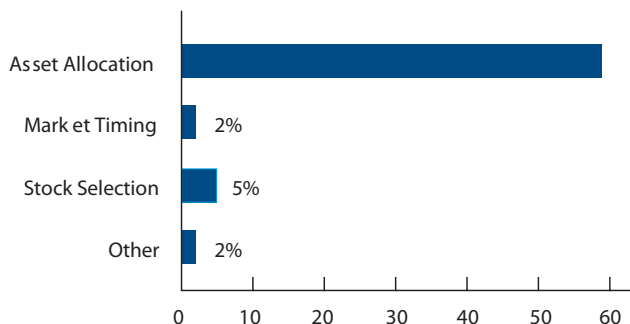


Figure 1: Productivity Levels

Source: Haver Analytics, TD Economics

term investors willing to invest a portion of their portfolio in these highly-productive regions.

Including international exposure in a portfolio reduces risk.

Asset classes of various international equities do not go up and down together. By adding non-correlated international assets to a domestic portfolio (S&P/TSX), the overall portfolio will benefit from the interaction of all the asset classes. International

Table 2: Correlations between S&P/TSX Composite and International Asset Classes

	2003	1999	1993	1988	1980	1970
S&P 500 Index	.40	.63	.64	.62	.66	.68
U.S Small Companies*	.57	.67	.67	.65	.69	.70
MSCI EAFE Index (net dividends)	.57	.66	.61	.52	.49	.49
International Small Companies*	.50	.46	.45	.39	.39	.38
MSCI Emerging Markets Index	.70	.70	.68	.56	n/a	n/a

* U.S. small companies and international small companies are represented by DFA U.S. Small Company Fund and DFA International Small Company Fund, respectively.

Source: Bloomberg, Dimensional Fund Advisors, monthly equity returns from the given date through 30 September 2007

currencies also act as a diversifier. Industrial diversification from investing in international equities also acts to lower risk in a total portfolio.

Table 2 shows the correlation levels of the S&P/TSX group of Canadian companies to other international asset classes. Over the past few years, the Canadian equity market has become more disconnected from, and perhaps less correlated with, other international asset classes than ever before. The heavy concentration of Canadian equities in energy and materials relative to other international asset classes with different industry sector weightings may explain much of this effect. Differences in industrial sector weightings, geographic regions, and currencies within the various asset classes help to explain the changes in the correlations.

While we would love to have a crystal ball to assess where the currency and asset class returns are headed, it seems highly unlikely that investors will be able to predict which asset classes will be the winners in the next five, ten, or even twenty years. Diversification as a tool to ultimately grow and protect your portfolio applies within our domestic market, as well as in foreign markets. The old adage “Don’t put all your eggs in one basket” holds as true now as the day it was coined—and the wise investor will act accordingly.

What About the Canadian Dollar?

The Canadian dollar broke through parity against the U.S. dollar in the autumn of 2007. As a result, many Canadians might be rethinking and questioning the personal and financial aspects of the currency changes. What will these new currency levels mean for our work and career prospects? Are we currently working in the right industries? Is our

prosperity and quality of life going to improve? Will we travel more or less? In 2007 investors have seen their Canadian-dollar investments increase in value, while their U.S. and international holdings have gone down or, at best, held steady. Not surprisingly, some investors have begun to question the merits of investing in the United States or in international equity markets.

Don’t Let Recent Experience Cloud Your Judgment

Before we consider the evidence and the reasons why you should allocate some wealth to foreign companies, let’s take a look at what has been happening lately with the Canadian dollar. Canadians most commonly refer to the U.S. dollar when discussing the value of our dollar; however there are many other currencies that can help us understand global currency movements. Table 3 (see following page) highlights the currencies of various regions of the world in order to give us some context. The time frame represents the period from 2001/2002, when the Canadian currency was at an all-time low with the U.S. currency, to its current all-time high in October 2007.

It is interesting to note that while our currency has risen relative to the U.S. dollar, it remains virtually unchanged relative to the Euro. Compared to the Australian or New Zealand dollars, the Canadian dollar has actually depreciated during this period. On average, however, the Canadian dollar has done remarkably well against most currencies. Remember that this table essentially shows the two extremes of the Canadian dollar—from the doghouse to the star, all within five years. In late 2001, some experts argued that the currency was artificially low; now others claim that the current 2007 levels are ahead of themselves.

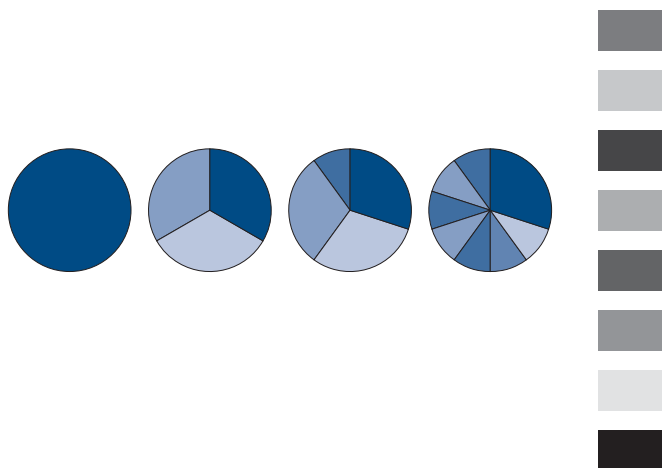
Table 3: Canadian Dollar Relative to International Currencies

\$1 IN CANADIAN DOLLARS EQUALS	31 DEC. 2001	15 OCT. 2007	GAIN/LOSS
Australian dollar	1.23	1.14	-7.3%
U.S dollar	0.63	1.02	61.9%
Euro	0.70	0.72	2.9%
New Zealand dollar	1.51	1.34	-11.3%
Swiss franc	1.04	1.21	16.3%
U.K. pound	0.43	0.50	16.3%
Japanese yen	82.26	120.28	46.2%

Source: Bank of Canada

Figure 2: Canadian Dollar vs. U.S. Dollar (Long-Term)

Source: Thomson Datastream



Hindsight is 20/20

Figure 2 provides a longer-term perspective on the Canadian dollar vs. the U.S. dollar. As the press has highlighted, the recent Canadian dollar high was the first time since the early 1970s that the Canadian dollar was at parity with the U.S. dollar. But what about the period in-between? Were the Canadian dollar's gyrations with the U.S. dollar related to how well Canadian—or, for that matter, non-Canadian—asset classes would do?

Table 4 (see next page) divides the last thirty-seven years into periods of appreciation or

depreciation of the Canadian dollar relative to the U.S. dollar. The results are neither obvious nor intuitive. Since 2002, the Canadian dollar has appreciated dramatically against the U.S. dollar, as has our equity market performance compared to the U.S. equity market in Canadian dollar terms. The performance of our currency and our equity market have moved hand-in-hand during this period. Since we have just lived through this, it would be natural to think that this relationship has always held true. But has it?

Ironically, it has not. The appreciation of the Canadian dollar relative to the U.S. dollar that we

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A S S A N T E F I N A N C I A L M A N A G E M E N T L T D .

Table 4: Asset Class Returns During CAD\$ Appreciation and Depreciation to U.S.\$

CAD\$ vs. U.S.\$	1975–1985	1985–1991	1991–2002	2002–2007
	Depreciates	Appreciates	Depreciates	Appreciates
Canadian CPI	7.93%	4.68%	1.77%	2.14%
Canadian Companies	15.50%	7.32%	8.11%	18.51%
U.S. Large Companies	16.68%	13.64%	13.33%	2.18%
U.S. Value Companies	22.01%	11.31%	15.01%	6.50%
U.S. Small Companies	26.83%	6.12%	13.85%	7.79%
Int'l Large Companies	16.88%	16.23%	6.54%	9.99%
Int'l Small Companies	28.12%	22.47%	5.02%	16.56%

Source: Annualized returns for Canadian and international asset classes in Canadian dollars (from August through September of the stated period). See Sources of Data and Methodology, page 7.

observed from 1985 to 1991 did not actually translate into higher Canadian equity returns during that period; Canadian equities significantly lagged behind most other U.S. and international asset classes. Likewise, from 1975 to 1985, the Canadian dollar depreciated from just over \$1.00 U.S. to just over \$.70 U.S., while Canadian equities actually did much better than you would expect relative to U.S. and international asset classes. This analysis is somewhat one-dimensional in that we are just looking at the Canadian/U.S. relationship. It does, however, highlight quite nicely that currency and equity performances do not always move together.

Asset classes and currencies have moved in and out of favour for decades now. Often a currency can be positively correlated with that currency's equity market returns, but not always. The 1970s were led by international small companies and U.S. value and small companies. The 1980s saw very strong returns from international small and large companies, while the 1990s was the decade for American companies, most notably those found in the S&P 500. Canadian companies and

international small companies have dominated the last five years.

What about other scenarios? How have Canadian equity returns fared relative to U.S. and international asset classes over a period when the Canadian currency has been neutral to the U.S. dollar? Table 5 highlights several periods that could be considered currency neutral (i.e., the Canadian dollar ends the period approximately equal to where it started, relative to the U.S. dollar). In almost all of these periods, the foreign equities have performed better than Canadian equities. While Canadian equities have done well during some of these periods, on average foreign equities have done better.

Perspective on Currencies and International Investing

While the past five years provided investors with very strong returns in Canadian equities, it would be erroneous to think that this strong performance relative to U.S. and international markets can

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A S S A N T E F I N A N C I A L M A N A G E M E N T L T D .

Table 5: Asset Class Returns During Neutral CAD\$/U.S.\$ Periods

	1970–2007	1980–1990	1985–1995	1991–2006
Canadian CPI	4.77%	5.81%	3.32%	1.87%
Canadian Companies	11.02%	8.10%	8.17%	10.79%
U.S. Large Companies	11.95%	14.87%	14.98%	10.24%
U.S. Value Companies	15.18%	16.26%	14.55%	12.20%
U.S. Small Companies	13.65%	10.83%	11.88%	12.68%
International Large Companies	11.39%	17.62%	15.16%	7.45%
International Small Companies	17.12%	25.08%	18.18%	7.98%

Source: Annualized returns for Canadian and international asset classes in Canadian dollars (from August through September of the stated period). See Sources of Data and Methodology, below.

continue unabated. Although our biases may be anchored to this recent period, we need to remember that, not too long ago (the late 1990s right up to 2002), many investors were chasing the large cap U.S. companies—the star-performing asset class of that period. At that point, our Canadian dollar was nicknamed “the northern peso” and the opportunity for great returns in Canadian equities seemed like a fairytale.

How times have changed: the Canadian dollar has been booming and there is no end in sight. By all means, invest in Canada. However, if the past thirty or forty years of varying market cycles, geopolitical trends, and industry changes are any indication, there is ample evidence to prove that diversifying into foreign asset classes alongside our domestic investments is—quite simply—smart investing.

NOTES

1. Statistics from the Pension Investment Association of Canada (PIAC).

SOURCES OF DATA AND METHODOLOGY

Not all the indexes mentioned are available for direct investment. The figures given represent total returns in Canadian dollars. **Canadian Large Companies/Canadian Companies:** S&P/TSX Composite Index. **U.S. Large Companies:** S&P 500 Index. **U.S. Value Companies:** DFA Canada U.S. Value Index, November 2003–present; DFA Canada U.S. Value Fund, Class F, April 1993–October 2003; Dimensional’s U.S. Large Cap Value Portfolio (offered in the United States only), February 1951–March 1993; Fama/French U.S. Large Value (excluding utilities) Simulated Portfolio. **U.S. Small Companies:** DFA Canada U.S. Small Cap Index, November 2003–present; DFA Canada U.S. Small Cap Fund, Class F, April 2001–October 2003; DFA U.S. Small Cap Portfolio (offered in the United States only), April 1992–March 2001; DFA U.S. 6–10 Small Company Portfolio, October 1988–March 1992; DFA, CRSP Database (AMEX, NYSE, and NMS), January 1973–September 1988; CRSP Database (AMEX, NYSE, and NASDAQ), July 1962–December 1972; CRSP Database (AMEX and NYSE only), February 1951–June 1962; NYSE, rebalanced semi-annually. **International Large Companies:** MSCI EAFE Index (net dividends). **International Value Companies:** DFA Canada International Value Index, November 2003–present;

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DFA Canada International Value Fund, Class F, March 1994–October 2003; DFA International Value Portfolio (offered in the United States only), July 1993–February 1994; DFA International High Book-to-Market Portfolio (offered in the United States only), April 1993–June 1993; MSCI EAFE Index, January 1975–March 1993; International High BtM (Value) Val-Wtd Unhedged \$ (Top 30% BtM), simulated DFA strategy (max Japan 38%), courtesy Fama/French and MSCI, includes Japan, Great Britain, France, Germany, Switzerland, the Netherlands, Hong Kong, Australia, Italy, Belgium, and Spain (rebalanced quarterly). **International Small Companies:** DFA Canada International Small Cap Index, November 2003–present; DFA Canada International Small Cap Fund, Class F, October 1996–October 2003; DFA International Small Company Portfolio (offered in the United States only), January 1970–September 1996; Various Wts DFA Japan, Continental Europe, United Kingdom, Pacific Rim (international data). **U.S. REITS:** Dow Jones Wilshire REIT Index.

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SOURCES & DISCLAIMER:

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Since 1994, Frank Danielson has built a reputation for attentive, client-focused service and valued advice. He currently serves as personal CFO for a number of high net-worth individuals, families, and professionals. Frank assumes responsibility for coordinating and managing the evolving needs of each of his clients, from portfolio strategy to risk management, estate and trust planning to financial planning and modeling.

Born and raised in Nanaimo, Frank attended the University of Victoria and obtained his Bachelor of Education in Biological Sciences. After two years in the teaching profession, Frank decided to focus on his passion for finance and embarked on his career as a financial planner. Since then, he has worked exclusively through referrals from his clients and a select group of CAs and lawyers. Frank, his wife Petra, and young son Dylan live in the UBC area. In addition to serving on several community boards, Frank is a strong supporter of the “Raise a Reader” literacy program. In his spare time, Frank enjoys golf, fitness, photography and expanding his personal knowledge.

Our Approach

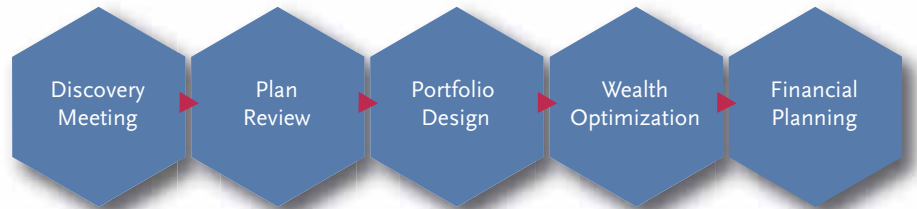
At The F. Danielson Group we are passionate about providing our clients with the highest level of wealth planning services through the creation of a trusting, long-term relationship. Our commitment to your financial success and well-being is reflected in our unique consultative approach and client-centered process.

To ensure we are consistently adding value to our clients’ overall financial plan we have developed our personal CFO process that continually aligns our ongoing advice and recommendations with your unique financial situation. Our consultative approach is based on a series of five meetings: discovery, planning review, portfolio design, opportunities, and implementation:

Discovery - discovery leads to clarity

The main objective of the Discovery Meeting is to learn more about your financial objectives, personal values, and key financial concerns. Together, we will also determine if there is a mutual fit and if we can add value.

We believe it is important to understand your financial personality, since human behaviour impacts every aspect of building your successful financial plan. We call this assessing your Financial DNA.



Plan Review - your financial roadmap

The main objective of our Plan Review phase is to confirm your financial objectives, then compare those objectives to your probability of achieving them. Most important, this meeting clearly reflects, in a written plan, your aspirations and creates the roadmap for achieving your goals.

Portfolio Design - implement

The main objective of our Portfolio Design phase is to review your unique investment objectives, liquidity needs, growth expectations, tolerance for risk, income requirements, investment time horizon, anticipated changes in lifestyle, tax considerations, and economic variables such as, inflation and market volatility.

These objectives will be reflected in your own Investment Policy Statement (IPS), which provides an account of your investment objectives and describes the strategies that we will employ to meet them.

Wealth Optimization - implementation leads to results

The main objective of the Wealth Optimization phase is to focus on wealth planning opportunities that will have the largest impact on your achieving your most important financial goals.

Using our Diagnostic Checklist (which covers nearly 100 tax, estate, corporate, and risk management opportunities), we ensure you are optimizing and protecting your overall wealth plan. Once the Checklist is complete, together we'll prioritize the results, then create an action plan that assigns realistic timelines for completion.

Financial Planning - implementation is not a “one time only” event

As your life evolves, so will your financial plan and investment portfolio. That is why we hold semi-annual meetings and conduct conference calls throughout the year to learn about the changes going on in your lives, monitor investment performance, and keep your overall wealth plan on track.

We would be pleased to discuss our process with you in person. Contact us at fdanielson@assante.com or by telephone at 604-638-0345.