NEW RULES

THE NEW RULES

Making money seemed automatic as recently as 2007. If you'd invested in just about anything over the previous two decades and held on, you were ahead of the game. Stocks, bonds, real estate, oil, gold, China, India, Donald Trump—all were climbing up, up, up. Risk? The only risk was not getting in the game. And then it all came crashing down and the only certainty was uncertainty. Do we need new rules for new investment realities? Or do some traditional maxims still offer hope? The answer is a bit of both. **By Scot Blythe and John Daly**

RULE

If you're taking a risk, you deserve a premium for it

In 2008, the dividend yield on Standard & Poor's 500 index stocks climbed above the bond yield on 10-year U.S. Treasuries for the first time since 1958. As investors seeking safe harbour stampeded into government bonds in 2008 and yields tumbled, baby boomers hungry for income sought out higher dividends in stocks.

Where will gold go in 2010?

STEADY ($1,500) **"Gold stocks have been a big part of our portfolios, but are down from where they used to be....It would surprise me to see it beyond $1,500 [this] year."** *Normand Lamarche, portfolio manager, Front Street Capital (November, 2009)*

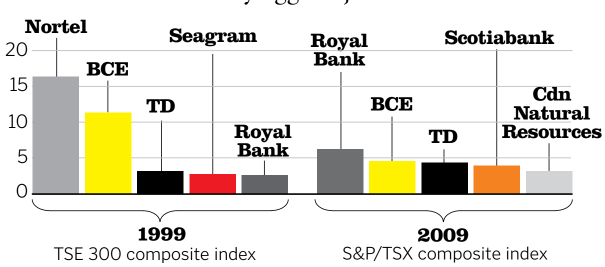
UP ($2,000) **"The [U.S.] dollar can only go lower, and gold can only go higher."** *John Ing, president, Maison Placements Canada Inc. (November, 2009)*

DOWN **"Gold gets dug out of the ground in Africa or some place. Then we melt it down, dig another hole, bury it again and pay people to stand around guarding it....Anyone watching from Mars would be scratching their head."** *Warren Buffett, CEO, Berkshire Hathaway (April, 1998)*

RULE

TAKE A CLOSER LOOK AT THE INDEX

Individual investors tend to use indexes such as the S&P 500 as benchmarks, and as an easy way to diversify by "buying the index." At the end of 1999, however, more than a quarter of the value of the Toronto Stock Exchange was accounted for by BCE Inc. and its offspring, Nortel Networks Corp. Is it ever a good idea to have so many eggs in just a few baskets?



RULE

Yes, there are alternatives to income trusts

The tax advantage of income trusts will end by 2011. Where are you gonna go?

1) Dividend-paying stocks
S&P/TSX composite index stocks have been averaging a 2.8% dividend yield lately.

2) Real Estate Investment Trusts (REITs)
Cap rates (the minimum rate of return buyers will accept on property transactions) are back over 7%—where they were in the second quarter of 2005. REITs are also paying out distributions of 7%.

3) Preferred shares
Canadian preferreds are still yielding about 5.8%. Given the favourable tax treatment of dividends, that's equivalent to an 8.2% interest rate, says the website PrefBlog.

4) Corporate bonds
Not the bargain they were, but corporate bonds are still yielding about 6%, or roughly 220 basis points (bps) over similar Government of Canada bonds. That's much better than the historic differential of 100 bps to 150 bps.

RULE

Growth is cheaper than value

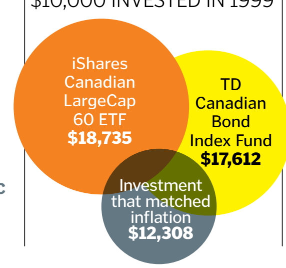
Peter Hodson,
Manager, Sprott Growth Fund

"Value companies are trading right now at 28 times their earnings per share, and growth companies are trading at 15 to 16 times. The historic multiple for growth companies is 23 to 24. So even if things just went to normal, you'd get a 50% increase in valuation for growth companies. People have been paying way too much for value companies because they are perceived to be safe, stable and less risky. Those companies have also tended to pay more in dividends. That remains true. So people are paying up for safety and they're paying up for yield. Historically, growth companies have been more expensive than value companies. That makes total sense, because if a company is growing by 100% a year, it should be worth more than a company growing at 2% or 3%. So growth companies were worth more, but now they trade at a big, big discount to value companies."

RULE

STOCKS STILL BEAT BONDS AND INFLATION (AT LEAST UNTIL THE NEXT CRASH)

TEN-YEAR RETURN ON $10,000 INVESTED IN 1999



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