

MARKET UPDATE

March 31, 2017

IN THIS ISSUE:

- 1 **Year-to-Date Performance:** Performances for stocks, currencies, bonds, and preferred shares.
- 7 **Fun with Math:** It's all about the income!
- 10 **Client Q&A:** David Driscoll answers your questions.

YEAR-TO-DATE PERFORMANCE

- 1 Equity Markets
- 4 Currency Markets
- 5 Bond Markets
- 6 Preferred Shares

The Markets – January 1st to March 31st, 2017

Equity Markets

When some returns are negative in one year, it often leads to a reversal in the next. This is called “reversion to the mean” and how investors get

2017 Returns – Q1

COUNTRY	STOCK INDEXES	TOTAL RETURN (with dividends re-invested in native currency)	TOTAL RETURN (with dividends re-invested in Canadian Dollars)
Brazil	Ibovespa	+7.89%	+10.33%
Mexico	Mexican Bolsa	+6.65%	+16.03%
India	S&P BSE Sensex 30	+6.49%	+5.24%
Europe	Stoxx 600	+6.29%	+6.62%
United States	S&P 500	+6.07%	+4.91%
Australia	S&P / ASX 200	+4.81%	+9.83%
China	Shanghai Composite	+3.85%	+3.64%
Canada	S&P/TSX	+2.41%	+2.41%
Japan	Nikkei	-0.38%	+3.25%

Data Courtesy of Bloomberg LLP

hurt because they're always chasing the highest past returns instead of buying the ones down the most.

Last year, the TSX was up 21% and now it's lagging most major stock indexes. Meantime, those indexes that fared poorly in 2016 are off to a solid start this year. Mexico is up 6.65% and 16.03% in Canadian dollars because the Peso versus the Loonie was down 20% last year and has since rallied back (see below).

Among developed countries, Europe posted a first quarter return of 6.3% (it was down 9% last year) and outperformed Canada, the United States, Australia and Japan.

In a Reuters article by Jonathan Cable, "Businesses across the euro zone marked the end of the first quarter by ramping up activity at the fastest pace in almost six years to meet burgeoning demand that came despite sharper price rises, a survey found."

This is good news, especially if the United States wants to follow a closed, protectionist economy with heavy import tariffs, because it leaves Europe free and clear to sell goods and services to the other 8 billion people on the planet.

Finally, from the same article, "Economists in a Reuters poll had predicted the manufacturing and services PMIs (Purchasing Managers Index) would both fall to 55.3 but instead they were above even the most optimistic forecasts."

Economists are usually wrong, not because of their abilities but because economies are so complex that A + B rarely equals C. Always take their comments with a grain of salt.

Or heed the old joke that if you spend 10 minutes with an economist, you've wasted 9 minutes of your time. Only the introduction and the exchange of business cards has any value.

Speaking of numbers, here are the latest price-earnings ratios for the following indexes:

Price/Earnings Multiples				
INDEX	COUNTRY	P/E RATIO Current	P/E RATIO Before Outstanding Items	P/E RATIO 2017 Estimated
S&P TSX	Canada	22.47	26.01	16.94
S&P 500	United States	21.77	24.76	18.32
Euro Stoxx 600	Europe	26.42	26.72	15.63
MSCI World Index	Global	22.01	24.06	17.28

Data Courtesy of Bloomberg LLP

Current P/E multiples (price divided by earnings) remain high above 24 times earnings, especially on a GAAP basis (Generally Accepted Accounting Principles). It's reflected in the column "Before Outstanding Items". This usually signals a market peak.

The far-right column above headed, "P/E Ratio 2017 Estimated" anticipates an irrational 20% to 60% rise in earnings this year.

There are three reasons why the stock market has rallied:

1. Instead of GAAP earnings, companies are choosing to use "Adjusted Earnings" on which the analysts now base their valuations.

This is a misleading practice because companies are deducting anything negative from their income statements (acquisition costs, depreciation and amortization) to make the numbers appear better than they should.

The oversight regulators are not happy with this move – not only is it an unfair practice but it's also helping the executives reach their incentive targets more easily to take home higher bonuses.

2. U.S. equity markets have reached new, all-time highs on the expectation that three Republican fiscal policies - corporate tax cuts, repatriation of capital and industry de-regulation - will help reduce a firm's tax expense and raise its underlying profits. Since the new Republican healthcare bill wasn't

tabled, it remains to be seen if Republican partisans will be able to work together to get the tax bill enacted. If not, market gains could slow or a stock correction could occur.

3. Money has been flowing in huge quantities into Exchange-Traded Funds (ETFs). These are units that represent the stocks in the underlying country indexes. While the U.S. market was the benefactor of ETF cash inflows in 2016, the first quarter of 2017 saw a surge of US \$13 billion into emerging market ETFs.

Brazilian ETFs led the way, with China and Hong Kong ETFs following closely. Given the Brazilian stock market has been the best performer in the past 15 months, it's no surprise that investors are chasing returns. Unfortunately, that doesn't usually lead to outperformance. Our full opinion of ETFs can be found in the last newsletter of 2016.

For the Liberty global stock portfolio, the 5 best/worst performers for the first quarter of 2017 were:

<i>Year-to-date Price Performance</i> <i>(dividends not included)</i>			
TOP 5	% GAIN	BOTTOM 5	% LOSS
Cognex Corp.	+32%	Novo-Nordisk A/S	-6%
Unilever NV	+19%	Gemalto NV	-5%
Jardine Matheson	+16%	Paychex Inc.	-3%
Femsa	+16%	Balchem Corp.	-2%
Coloplast	+14%	Alimentation Couche-Tard	-1%

Data Courtesy of Bloomberg LLP

It's been a good start for the year as we're ahead of all the equity benchmarks by about 2%. Some comments on the stocks noted above:

- The first purchase for Cognex was at \$29 a share last January and it's now over \$83. I never made it a "Top Pick" on BNN because I thought it was always too expensive. Imagine my surprise when the company

announced a doubling of both sales and earnings for the 2016 fiscal year, well above expectations.

Cognex makes machine-to-machine vision systems (they're the eyes of the robots) for assembly lines – Apple is its biggest client. This price movement has caused us to watch it closely. If its stock price keeps rising, we may have to re-balance the position.

- Unilever has moved higher because of an unsolicited bid by KraftHeinz as the latter doesn't have access to emerging markets like Unilever does. If the takeover had occurred, we would have sold our shares in the market because we have no desire to own KraftHeinz stock.
- Jardine Matheson shares have increased because its businesses are in emerging markets, notably Indonesia and China. From the first chart above, emerging markets have provided solid returns this year.
- Fomento Economico de Mexicano (Femsa), is the largest Coca-Cola bottler in Mexico, Latin America and South America. It also owns Oxxo convenience stores and gas stations in Mexico and pharmacies throughout Latin and South America. After the U.S. election, Femsa's share price had been driven lower with the drop in the Peso, despite not having any business in the U.S. The turnaround from the lows in the mid-\$70 range supports its valuation.
- For the stock names on the negative side, they're all down on valuation issues. Their share prices rose too far, too fast and are in what's known as a consolidation phase.

It may be a few quarters before they bounce back to life, which is why I like to accumulate their shares during this "quiet" period. It's also nice to have cash available to take advantage of these types of opportunities.

Currency Markets

Canadian Dollar vs.			
CURRENCY	DEC. 31, 2016	MAR. 31, 2017	GAIN/LOSS %
US Dollar	\$1.3435	\$1.3312	+ 0.9%
Norwegian Krone	\$0.1555	\$0.1549	+ 0.4%
New Zealand Dollar	\$0.9305	\$0.9320	- 0.2%
Euro	\$1.4153	\$1.4199	- 0.3%
Danish Krone	\$0.1904	\$0.1909	- 0.3%
Swedish Krona	\$0.1479	\$0.1486	- 0.5%
Swiss Franc	\$1.3215	\$1.3300	- 0.6%
British Pound	\$1.6594	\$1.6718	- 0.7%
South African Rand	\$0.0978	\$0.0992	- 1.4%
Japanese Yen	\$0.0115	\$0.0120	- 3.8%
Australian Dollar	\$0.9677	\$1.0150	- 4.7%
Mexican Peso	\$0.0648	\$0.0711	- 8.9%
Average Gain			- 1.7%

Data Courtesy of Bloomberg LLP

The chart above is determined as follows: On December 31st, 2016, one U.S. dollar bought \$1.3435 Canadian Dollars. By March 31st, 2017, it bought only \$1.3312, meaning the Canadian Dollar strengthened by 0.9% against the US dollar.

The U.S. dollar has also lost ground against most major currencies since the October election, so it's not really a story of Canadian dollar strength but more an issue of a declining U.S. dollar.

Against a basket of global currencies in the first quarter, the Loonie fell 1.7%. This year, it has been following the ebbs and flows of the price of oil – through the first quarter, oil is down 3%.

In 2017, the direction of the Canadian dollar should be based on these factors:

→ If oil prices rise, the Canadian dollar should go higher.

- If the United States enacts a border tax or import tariff, the Canadian dollar should weaken.
- If the United States continues to raise interest rates and Canada doesn't follow, the Canadian dollar should weaken.

Regardless of the movement, investors should understand that currency risk may exist in the short-term but is benign in the long-run (10 years or more). Below is a chart of annual currency movements of the Canadian dollar versus the U.S. dollar since 2000.

Canada – U.S. Currency Movements since 2000			
YEAR	PRICE ON JAN. 1	PRICE ON DEC. 31	PERCENT CHANGE
2000	\$1.4461	\$1.4991	3.7%
2001	\$1.4991	\$1.5930	6.3%
2002	\$1.5930	\$1.5718	- 1.3%
2003	\$1.5718	\$1.2970	- 17.5%
2004	\$1.2970	\$1.2019	- 7.3%
2005	\$1.2019	\$1.1620	- 3.3%
2006	\$1.1620	\$1.1657	0.3%
2007	\$1.1657	\$0.9984	- 14.4%
2008	\$0.9984	\$1.2188	22.1%
2009	\$1.2188	\$1.0532	- 13.6%
2010	\$1.0532	\$0.9980	- 5.2%
2011	\$0.9980	\$1.0213	2.3%
2012	\$1.0213	\$0.9921	- 2.9%
2013	\$0.9921	\$1.0623	7.1%
2014	\$1.0623	\$1.1621	9.4%
2015	\$1.1621	\$1.3839	19.1%
2016	\$1.3839	\$1.3435	- 2.9%
2017	\$1.3435	\$1.3312	- 0.9%

RED = C\$ is stronger

BLACK = C\$ is weaker

Data Courtesy of Bloomberg LLP

When the Canadian dollar weakens (percent moves in black), it really crashes, like the violent moves lower in the oil price in 2008 and 2015. It strengthened (moves in red), on the back of oil price increases in 2003, 2007 and 2009.

If 80% of the portfolio is in other currencies, there would have been currency headwinds in those red years which would have hurt overall portfolio performance.

However, the net impact over 17 years has been negligible (about 0.7% a year) which is why we don't waste a lot of time on currency risk.

Bond Markets

A *BloombergView* commentary on March 31st indicated that the 10-year U.S. Treasury yield has “traded in a broad range of about 2.30 percent to about 2.63 percent since the end of November.”

“Partly due to the reduced outlook for inflation following the recent drop in oil prices, the perceived risk of holding long-term Treasuries has diminished. The 10-year premium, a measure of the extra compensation investors demand to own that maturity instead of rolling over a series of shorter-dated obligations, is the least since November 9th.”

That shows in the table below as 10-year yields have dropped among all these countries:

10-Year Bond Yields		
COUNTRY	MOODY'S SOVEREIGN CREDIT RATING	CURRENT YIELD
Greece	CCC-Low	+ 6.81%
Brazil	BB-Mid	+ 4.77%
Mexico	A-Low	+3.69%
New Zealand	AAA-Mid	+ 3.17%
Australia	AAA-Mid	+ 2.69%

Because the costs of hedging (buying or selling currency forward contracts and currency options) are so expensive, companies would better serve their shareholders if they didn't spend millions on currency hedging. That's why, at Liberty, we don't use currency hedges for our client portfolios. Over time, it saves money.

For long-term investing, a better strategy is to buy foreign stocks when the Canadian dollar is strong (you can buy more foreign with a strong Loonie) and sell foreign stocks and buy more Canadian when the Loonie is weak.

United States	AAA-Mid	+ 2.39%
Canada	AAA-Mid	+ 1.62%
United Kingdom	AA-High	+ 1.14%
Germany	AAA-Mid	+ 0.32%
Japan	A-High	+ 0.06%

Data Courtesy of Bloomberg LLP

Returns for most bond funds were around +1.50% for the first quarter to reflect the change in yields. Equity returns, therefore, were much stronger as investors have decided that low bond yields make the stock market more attractive.

The U.S. 30-year yield, however, has risen above 3% on the anticipation that the U.S. Federal Reserve will stop its Quantitative Easing programmes and flood the market by selling U.S. Treasuries. As bond prices drop, yields rise, raising borrowing costs for companies and, for individuals, causing mortgage rates to jump.

If the spread between U.S. and Canadian interest rates widens further, either Canadian interest rates will have to follow higher or the Canadian dollar will fall. If the former, leveraged investors in real estate could get

pummelled. If the latter, Canadians' spending power will decline as imported goods will cost more.

Finally, the current problem buying bonds is finding yields of 4% and higher for a holding period of 10 years or less. That's why we've been buying some longer-dated investment grade bonds, especially in the United States. Long-term yields in Canada remain in the 3% range for maturity dates longer than 20 years so the risk-reward isn't attractive.

Preferred Shares

TYPE OF PREFERRED SHARE	YEAR-TO-DATE PRICE CHANGE
Canadian Perpetual Preferred Shares	+3.50%
Canadian Variable Rate Reset Preferred Shares	+6.82%
BofA Merrill Lynch US Perpetual Preferred Index	+5.21%

Data Courtesy of Bloomberg LLP

Unlike the paltry bond returns seen in Q1 of 2017, the preferred share market continued to outperform as the rate reset preferred shares moved decidedly higher compared to their perpetual counterparts.

The reason for this move was caused by higher implied interest rates in the United States, thus steepening the yield curve at the short-end. It caused the 5-year Government of Canada (GOC) yield to jump from 0.50% last summer to 1.09% today.

As always, the best strategy for investors is to own a laddered bond portfolio. For example, a ladder might consist of owning bonds that mature every year between 2020 and 2030. If interest rates rise during that time, something will mature each year that can be re-invested at higher coupons.

So, when the 2020 bond matures, buy one that matures in 2031 to keep the ladder in place.

Rate reset preferred shares are reset based on a formula of the 5-year GOC rate plus a premium. Since rate resets were first issued in 2012, many are re-setting in 2017 at a higher coupon, leading to a price rise.

Unfortunately, they no longer trade at much of a discount to fair market value so the attraction has faded. For the rest of 2017 and in 2018, we don't anticipate returns to replicate the table above. Investors will earn their income but make little in the way of capital appreciation.

It's All About the Income!

We're often asked why we're so enamoured about dividends and dividend growth. It's because roughly two-thirds of all stock market performance comes from rising dividends and the re-investment of those dividends, not stock price movement.

It's also an easy source of income that, if done right, can provide all the income retirees need to live on without having to eat into their capital. Or, in other words, they can continue to live their lifestyle in retirement without running out of money.

However, it's not just a question of a company paying a dividend. We're tired of hearing people mention that Company A has paid a dividend every year for 108 years because that's totally irrelevant.

What's more important is how the income grows each year after inflation. For an employed person, they have an opportunity to enjoy a growing annual salary with perks such as bonuses or commissions.

For the retiree, the working game may be over but they still have to find a way to beat back the inflation monster.

Enter the world of dividends. Dividends are simply the percentage of profits that a company pays to its shareholders each year. The more successful the business, the higher the dividends should grow. For retirees, this is their form of an annual pay raise.

The power of time and compounding

If investors own shares in a company that doesn't suffer from losses or drops in profits, life should be good. A dividend increase each year should provide not only more income but better long-term portfolio performance.

Consider, for example, an investor who bought CN Rail shares in 1997 with no subsequent purchases. Since CN's dividend has risen an average of 20% per year, the yield-at-cost is now over 20% (dividend income divided by original investment).

“
If done right,
[it] can provide
all the income
retirees need to
live on without
having to eat
into their capital.”

“

This means that based on the original purchase price, the client is earning 20% on that investment plus or minus the stock price move each year. This is important because:

- A. It provides a steady and growing income stream each year, reducing the amount of capital that is needed to live on (if any).
- B. The dividend income provides protection during years when stock markets fall. The total performance is price appreciation plus income minus fees, taxes, transaction costs and inflation. The higher the income, the better should be the performance.

Here's an example to explain points A & B.

An investor retires with \$1 million and needs \$50,000 of annual income to live on. They could just buy investments that yield 5% or greater but there are dangers involved:

- The company's dividend yield could be artificially high because the stock price is dropping.
- The company may not generate enough profits to pay for the dividends. This could lead to a dividend cut (both Telus and TransCanada Corp. faced this situation in the early 2000s) or a stagnant dividend (BCE Inc. from 1992 to 2008) that remains the same for years.

Instead, the goal is to find companies that generate consistent, growing free cash flows so the dividend rises each year to help the portfolio grow at a faster rate. And, as the dividends rise, the share prices should follow higher. And that's the best of all situations: Growth and income.

The rate of compounding is important

Given that current stock market yields are in the 2% range, a retired investor with \$1 million to invest who needs \$50,000 a year to live on would generate just

\$17,500 in dividends in Year 1 and would have to use another \$32,500 in capital to make ends meet. At this pace, the money could be gone within 30 years, sooner if the stock market drops 40% in any of those 30 years.

Eventually, the dividend growth will create income to cover the \$50,000 (plus 3% inflation) annual spending needs which will stop the capital deterioration.

The rate of increase, therefore, determines how quickly the income needs will be covered by the dividends alone.

Here are three scenarios to illustrate the situation using the following inputs:

- \$1 million in capital to start.
- Current dividend yield of 2%.
- Inflation rate of 3%.
- Stock market returns that range from +20% to -20% and average 5% a year.

The historical dividend growth rate for stocks globally is 7% annually.

However, companies that generate consistent and rising free cash flows have generated growth rates of 10% and 15% over a 20-year time horizon. The differences, naturally, are eye-opening because the higher the growth rate in dividends, the sooner the income pays for all the living expenses:

Scenario 1: Dividends growing at 7% per year with 3% inflation.

In this scenario, the investor eats into their capital for 24 years. If this is a 65-year old retiree, they'll be 89 before the income finally offsets the living expenses.

Scenario 2: Dividends growing at 10% per year with 3% inflation.

Dividend growth at 10% erases the shortfall in 14 years.

Scenario 3: Dividends growing at 15% per year with 3% inflation.

This is rarefied air so I don't put much into this. However, dividend growth at 15% creates a cash flow neutral situation in just 8 years.

How dividends compound over time

Here's a chart that shows the compounding of dividends. It illustrates the importance of keeping portfolio turnover low (the rate of buying and selling of stocks). The lower the turnover, the greater is the opportunity to compound income faster.

Naturally, there are many caveats to this simplistic exercise. The important ones are:

YEAR	Dividend Yield Growth		
	AT 7% PER YEAR	AT 10% PER YEAR	AT 15% PER YEAR
0	2.00%	2.00%	2.00%
1	2.14%	2.20%	2.30%
5	2.81%	3.22%	4.02%
10	3.93%	5.19%	8.09%
15	5.52%	8.35%	16.27%
20	7.74%	13.45%	32.73
25	10.85%	21.67%	65.84%

- Transaction costs – Active buying and selling reduces income needed to live on.
- High ticket purchases – Buying cars or houses results in a bigger drawdown than just living

expenses and can lengthen the time needed for the dividend income to pay for itself.

- Health and/or longevity – the earlier you retire and the longer you live, the greater income you'll need.
- Stock market returns – Massive losses can reduce capital quickly.
- Asset mix – An all-stock portfolio will have greater market volatility, putting the capital at greater risk.
- Taxes – The higher the portfolio turnover, the more taxes may be paid, reducing the compounding effect.
- Gifting – Parents on a fixed allowance giving money to their children is a no-no. Retirees are going to need all their money.
- Changing portfolio strategies – Hitting the reset button wipes out previous gains made from time and compounding.

Regardless of the caveats, it's important to understand and appreciate the power of time and compounding of dividends. It's the difference between retiring comfortably or running out of money.

QUESTIONS

- 10 How do you deal with changes to U.S. fiscal policy?
- 10 Do we have stock exposure to deal with the recent disruptive or destructive technology trends?
- 11 Is there an easy way to consider if my advisor is earning their keep?
- 12 Why don't you own any Real Estate Investment Trusts (REITs) in your portfolios?
- 12 What are the keys to long-term investment success?

How do you deal with changes to U.S. fiscal policy?

The new U.S. fiscal policy changes that would affect U.S. corporations would be:

- Tax cuts that would reduce the U.S. corporate rate to 15% or 20%.
- Repatriation of capital from U.S. subsidiaries doing business overseas at a low tax rate.
- Import duties or tariffs for parts or components that aren't made in the United States.
- Loss of interest deductibility but greater tax cuts for depreciation and amortization.

The feedback we've received from U.S. companies has been that the tax cuts would create substantial profits and leave them flush with cash. Investors could expect higher dividend payouts, greater stock repurchases and more acquisitions.

Companies that have little interest expense but large depreciation deductions would be clear winners, as would firms that sell most of their products or services within the United States because they wouldn't face import taxes.

If Congress enacts these laws, the following Liberty stocks should show the greatest profit growth:

- Balchem Corp.
- Lindsay Corp.
- Raven Industries
- Dr. Pepper Snapple
- Mesa Laboratories
- RBC Bearings
- Globus Medical
- NextEra Energy
- J.M. Smucker
- Heico Inc.
- Paychex Inc.

Do we have stock exposure to deal with the recent disruptive or destructive technology trends?

The short answer is yes.

A few months ago, Jeff Bezos, the CEO of Amazon.com, was asked a question by a reporter, "What will the economic landscape look like in 10 years?" His response was, "The better question is what will still be around in a decade."

In other words, what companies can Liberty investors own today that will still be around in 10 years to benefit from the growth in their free cash flow and dividends? And what sectors should be avoided?

The sectors we are currently avoiding are energy, telecoms and most utilities that don't have much exposure to renewable energy.

Their growth could wane quickly – if it is 5, 10 or 15 years from happening, investors should do a discounted cash flow valuation of these stocks. If the valuation reaches that price, they should sell the stock.

Or they could face the “Last Man Standing” scenario, whereby the last purchaser of Nortel or Valeant stock at its peak saw the stock move only lower.

Below is a table of the current investment trends for the future. Unlike the bubble that burst in 2000 that sent technology

stocks plummeting, these companies all have real and growing revenues, profits and free cash flows:

TREND	LIBERTY STOCKS INVOLVED IN THESE SECTORS
Water	A.O. Smith, Lindsay Corp., Danaher Corp.
Agriculture	Agrium, Lindsay Corp., Raven Industries
Healthcare - Pharma	AmerisourceBergen, Novo-Nordisk NV
Healthcare - Medical Devices	Becton Dickinson, Atrion Corp., Coloplast A/S, Globus Medical, Stryker Inc.
Healthcare - Other Medical	Balchem, Mesa Labs, Envision Healthcare, Steris
Financials	Chubb, Fairfax, Great-West, TD Bank, First Cash Financial, Paychex
Robotics	Cognex Corp., Danaher Corp.
Life Sciences	Danaher Corp., Thermo Fisher Scientific
Logistics	C.H. Robinson Worldwide, Dassault Systemes, Roper Technologies
Artificial Intelligence	Dassault Systemes, Gemalto NV, Open Text, Shopify Inc., Cognex Corp.
Cybersecurity/Encryption	Gemalto NV, Shopify Inc.
Government Regulations	Halma plc., Intertek Group, Spectris plc.
Renewable Energy	NextEra Energy, TransCanada Corp., Novozymes A/S
Infrastructure	Toromont Industries, Stantec, Roper Technologies
Aerospace	Heico Inc., MacDonald Dettwiler, RBC Bearings, Ultra Electronics
Automotive Computerization	Littelfuse Inc.

Is there an easy way to consider if my advisor is earning their keep?

This is currently the hot topic in the industry as mutual funds with their high fees are being replaced by Exchange-Traded Funds (ETFs) and index funds. These units are charged a lower fee but there are the usual caveats attached – see our previous newsletter for a list of them.

The best way to consider the impact of fees on performance is to compare the percentage fee and divide it into the 5-year or 10-year performance of the advisor or fund.

For example, if an investor put \$100,000 into an investment that grew 10% a year for 20 years, they'd have \$800,000. However, tack on a 3% fee and the

7% return reduces the dollar value in two decades to \$400,000. This means the fees cut the investor's growth in half.

Or put another way, divide the 3% into the 10% total return and 30% of the performance was gutted by management fees. What's worse, those mutual fund fees aren't tax deductible for the investor.

If you can find an advisor or fund that charges low fees with performance that regularly beats the benchmarks, you've found the proverbial golden goose.

For Liberty, our fees are deductible and, unlike the industry, will be falling as we reach certain levels of

assets under management (\$250 million, \$500 million and \$1 billion). Ultimately, when we reach \$1 billion in assets under management, we'd like our fees to average between 25 and 75 basis points.

When that occurs, a 0.50% fee on a 10% return would be only a 5% reduction in performance because of fees, not the 30% discussed above.

Why don't you own any Real Estate Investment Trusts (REITs) in your portfolios?

We have no desire to own REITs in our portfolios for the following reasons:

- Most of our clients already own houses, cottages and income rental properties. They don't need added correlation risk.
- The REIT business is highly leveraged and sensitive to changes in interest rates.
- The dividend growth is limited – in many cases it's lower than inflation rates.

- Some REITs don't pay pure dividends from operations – it may be a mix of dividends, interest and return of capital.

If you must own REITs, beware some of the REIT funds or ETFs. The makeup of the ETF may be an overweight holding in regional malls at a time when retailers in these malls are struggling and occupancy rates are falling.

What are the keys to long-term investment success?

In my experience over the past 38 years, the simple formula for long-term investment success has been:

- A. Invest in companies that enjoy consistently growing free cash flows.
- B. Keep the fees as low as possible.

- C. Keep the portfolio turnover low – under 10% a year is the desired rate.

The lower the fee and transaction costs, the greater the portfolio will grow.

If you have any further questions, let me know.

David Driscoll

President & CEO

Liberty International Investment Management Inc.