

October 2002

Dear Client,

Let's get the bad economic news out of the way right up front. The S&P 500, that broad index of large capitalization stocks in the US, is down more now than it was in the 1973-1974 recession, which was the second worst in the last century. The calendar year 2000 witnessed a 10% drop in the index, followed last year by a 13% decrease and this year-to-date an additional 27% down. That adds up to a lot of bad news!

Why did this happen?

The stock market bubble was a worldwide phenomenon fuelled by ridiculous valuations, lack of dividends, unprecedented volumes of initial public offerings, aggressive accounting and earnings manipulations. Add to this a frenzy in technology capital spending, overwhelming capacity build out in hardware and telecom equipment and you have all the ingredients necessary for this 'bear of bears' market. These excesses must now be purged, many of which were 'once in a generation' excesses. Purging of these excesses is likely going to take some time, though the process has been well underway.

Where are we now?

As Michael Den Tandt recently wrote in The Globe and Mail, "we may not yet have reached "capitulation," the quasi-mystical state in which bear market sentiment hits a nadir and stock markets at last hit bottom. But it feels like we're close." Jeremy Siegel, the author of "Stocks for the Long Run", recently wrote amidst all the gloom there was reason for optimism. He cited the proposed new standard for earnings reporting will be much tougher. He referred to these earnings as "core earnings" that indicates the ongoing profitability of a company's core business. His research has suggested that the overall P-E ratio of the S&P 500 Index is now at an attractive historical level.

What should we expect to happen?

Does this suggest that stocks cannot fall any further? The answer is a definitive no because the market is not entirely a rational beast. Due to emotion, either greed on the upside or fear on the downside, the price of stock can get out of whack with their real value to an investor. This, however, is when opportunity knocks. I liken markets to the weather; therefore, I've come to expect the unexpected. What I do know is that in the aftermath of the six major bear markets of the past century, when the market has dropped by 40%, subsequent five year returns have averaged 8.6% per year above inflation and none have been negative.

What should I be doing?

Would you have sold your house in Quebec the week before the last referendum? The answer is probably not because the market was depressed and you wouldn't have received good value at that time. Pushing the clock forward, I believe most homeowners in Quebec would be pleased with the appreciation they could realize on the sale of their

home today. I liken today's market sentiment to that experienced in housing the week before the last referendum. So, my general advice is to hold on to what you've got because selling in a depressed market has not historically proven to be a good way to build your wealth. However, there are some contingencies here. If you are retired and need income from portfolio we suggest you put enough into liquid assets that are not subjected to the vagaries of the market. If your portfolio has proven to be outside your tolerance for risk, perhaps some reallocation is in order.

Are there any reasons for optimism?

Accounting scrutiny is likely going to make earnings much more conservative going forward, restoring investor confidence. The fact is that corporate earnings in general are getting better. Surprised? In a recent survey of 800 publicly traded companies good news in earnings announcements outnumbered downside surprises two to one. Inflation and interest rates have approached forty year lows and expect them to remain low going forward. This means that the cost of living is increasing very gradually and it's a good time to borrow. The income tax rates have been slashed both federally and provincially, which leaves us with more money in our pockets and helps offset the negative growth of most investment portfolios. Be sure of one thing, markets will bounce back into positive territory; it's only a question of time.

How am I doing?

Obviously this question must be answered on a one-on-one basis. The first part of the answer lies within you, how are you doing? Rule number 1 is to stay positive. Your attitude measures your altitude in life, so if you stay positive, invariably you'll experience success in whatever endeavours you undertake. Also buy into the abundance theory of life. There are many more facets to your wealth than just monetary. Acknowledge the abundance of blessings, such as your family and friends, health, freedoms, and all other things in your life that bring you joy.

It has been truly gratifying to review our clients' situations over the past few years, because the portfolios and strategies we've put in place on your behalf have held up very well in what are truly difficult circumstances. I strongly urge each of you to come in for your annual review. My observation is that those clients that take advantage of this vital step in the planning process, generally feel more relaxed and more in control of their overall planning situation. We want to assure each and every one of you that your secure financial well-being is at the top of our planning agenda and we will continue to be vigilant in helping you make it come about.

Sincerely,

A handwritten signature in black ink, appearing to read "David", written in a cursive style.

David D. Humes