The David Miner

Communiqué

Fall 2014

"A jug fills drop by drop."
The Buddha

AUTUMN IS HERE!

It has been a busy year! Daughter Amelia got married to Kiran Naidoo on September 19. Bam, the wonder dog, was the ring bearer. Some clients will remember Amelia as my assistant for many years. Amelia's husband Kiran is a Chartered Accountant, *a profession we eagerly welcome into the family.*

Gorgeous bride Amelia with lucky groom Kiran at their wedding in September.

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Daughter Victoria left the day after the wedding to return to Glasgow, Scotland to finish her last year in a Master of Social Work Program. She continues her studies at the University of Strathclyde.

Mark Brownell from our office just got back from India. He adapted a novel into a play entitled "Three Men in a Boat" which won "Best of the Fringe" at the Toronto Fringe Festival last summer. The play was picked up in Mumbai and Mark and a crew of actors were invited to India for a number of performances.

Market Commentary

Bam the Wonderdog performs ring bearer duties at Amelia and Kiran's Wedding.

At the time of this writing, stock markets have been through a period of volatility. Canada has been particularly impacted as the price of oil and the Canadian dollar have both been weak. Fortunately, global securities in portfolios, which are denominated in currencies other than the Canadian dollar, have softened volatility and added to return.

Looking to the future, it is always wise to remember that corrections and some volatility are normal. At the time of this writing, balanced portfolios are up solidly year-to-date 2014. As discussed in our last Communique, stock markets tend to go up on average three years out of every four. It is the law of large numbers, being invested for many years, that builds wealth.

As we have often discussed and as studies have shown, it is investor behavior – the buy high, sell low reaction to market fluctuation – that is the biggest detractor to building wealth. Dalbar, a leading U.S. financial services research firm, has produced research which indicates that typical U.S. investors are not disciplined about staying invested. Adjusted to Canadian dollars and for the 20 year period ending December 31, 2013, the average annual compound return for the Canadian S&P TSX was 8.3% and the U.S. S&P 500 was 8.0% (per Morningstar). The "typical" undisciplined investor tended to buy high and sell low and experienced a return of only 1.5%. Note that $100,000 invested for 20 years at 8.0% grows to $466,000. At 1.5%, the portfolio grows to only $135,000. It pays to not be a "typical" investor and stay invested at all times.

Mark at the Taj Palace Ballroom in Mumbai with stage managers Hilary and Neha.

Active vs. Passive Management

Active managers construct unique portfolios and securities are selected to optimize return consistent with portfolio risk. Actively managed portfolios do not resemble an index (such as the Canadian S&P/TSX Composite or the U.S. S&P 500). *Active share* is an industry term which refers to the level at which a portfolio resembles an index. Actively managed portfolios have high active share because they do not resemble an index.

Passive portfolios refer to portfolios that resemble an index. Passive portfolios can be obtained by buying index funds or Exchange Traded Funds ("ETF's"), which closely emulate an index return. It is impossible to exactly replicate any index, so performance of these passive approaches will not be exactly the same as an index. Furthermore, Index Funds and ETF's have underlying fees and commissions, which reduce returns over time compared to an index, all else being equal. Passive portfolios are less expensive to manage because there is no securities research involved, so management fees are typically lower than actively managed portfolios. Passive portfolios have low active share.

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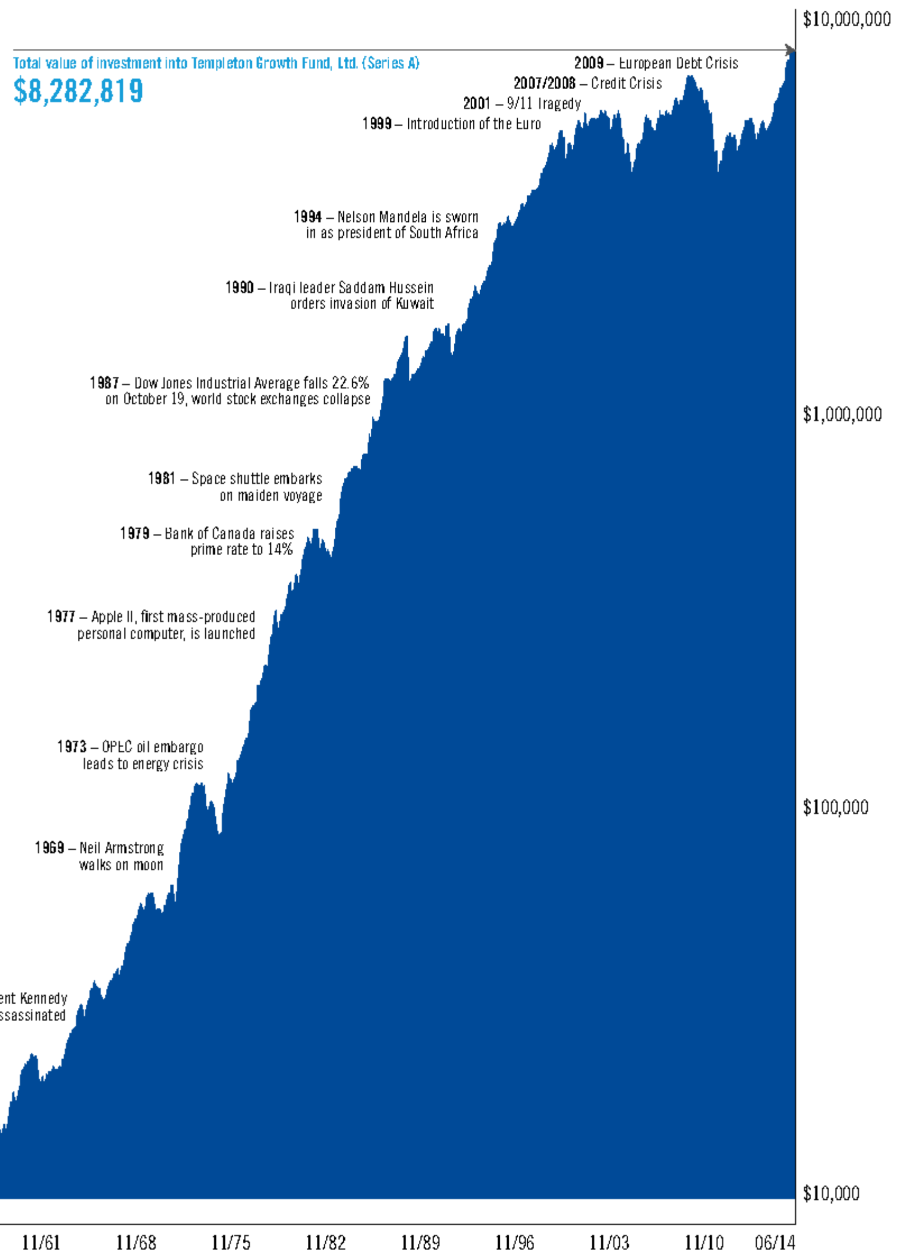

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Source: Morningstar Research, Inc. as of June 30, 2014. The historical annual compounded rates of return for Templeton Growth Fund, Ltd. (Series A) as of June 30, 2014 are: 1 year 25.5%, 3 years 14.7%, 5 years 12.2%, 10 years 4.0% and 12.0% since inception (November 29, 1954). Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the Franklin Templeton Investments prospectus before investing. The indicated rates of return are historical annual compounded total rates of return, including changes in share value and reinvestment of all dividends, and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

Closet indexers are fund managers that hold themselves out as active, but their investment fund portfolios still closely resemble an underlying index. Closet index portfolios have low to medium active share.

Good active management style will always have some periods of underperformance, but will generally outperform an underlying index over longer periods of time. Good active managers will also apply risk management disciplines when constructing mutual fund portfolios. Risk management is totally absent in passive portfolios. For that reason, I always look to actively managed fund portfolios with high active share when making recommendations.

Dorinda and David

A great example of mutual fund management style with high active share is Templeton Growth Fund (a global equity fund), because it has been around since November 29, 1954. A "mountain chart" on page 3 shows growth of $10,000 invested at inception through to June 30, 2014. $10,000 grew to $8,282,819 during that period after all management expenses have been paid by the fund. It is clear that there were periods of negative performance, but investors who stayed the course did very well.

Let's compare that to the underlying index of Templeton Growth Fund, the MSCI World Index, which began in 1969. The MSCI World Index has low (i.e., nil) active share because it is a passive index and there is no active securities selection. From January 1, 1970 to June 13, 2014, the MSCI World Index grew to about $634,750. Templeton Growth Fund with professional securities selection and high active share grew to $1,369,422 during that period. This example is a classic instance whereby a passive approach would have reduced an investor's wealth by more than 50% over a few decades. (Source: Franklin Templeton and MSCI)

To be fair, this is not proof that active management style is better than passive investing over time; although, I can cite other examples. My conviction is that active management with high active share is the way to go. To that end, I try to avoid funds with closet indexing or pure index strategies like ETF or index portfolios when making recommendations. Active risk management and active security selection are the way to comfortably optimize wealth over the long term. And after almost forty years in the financial sector, that is how I invest my own money.

For full disclosure, more recent annualized performance of Templeton Growth Fund to October 31, 2014 is: 1 yr. 11.35%, 3 yr. 17.29%, 5 yr. 10.68%, 10 yr. 4.93%, and since inception (Nov. 29, 1954) 11.88%.

"Life is simple, but we insist on making it complicated." - Confucius (attributed)

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