THE WALKER REPORT

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All That Glitters...
Gold's dark secret

By Adrian Walker

Following the banking collapse of 2008 and the subsequent financial straits that many countries have found themselves in, a number of prominent economists began to openly mull the idea of returning to the gold standard. At its heart is a nostalgia for a bygone era that seemed (especially from today's vantage) to be one of great global economic stability. But like many nostalgic ideas, it longs for a past that isn't truly there.

Proponents for a gold standard argue that gold is still the only *true* measure of wealth, and that a return to this standard would stabilize global currencies, limit the ability of politicians to recklessly print money and generally prevent another great economic crisis. The last time that the gold standard was seriously embraced in the post WWI era, it ended with the great depression. In some ways the overall complexity of the gold standard has masked gold's role in creating the worst economic downturn in history, but the fact remains that it was gold, and not a fiat currency (as we have today) that was the most significant player in prolonging the economic troubles of the1930s.

After the gold standard was suspended to help pay for the Great War, many prominent economists wanted to return their countries to a fixed exchange between gold and their currency. For many that meant one of two difficult choices. War time inflation had yet to be fully resolved, and countries had a choice to make. Either accept the previous exchange rate, and thus honor your debts at their original value, or devalue your currency for the betterment of your domestic economy while short changing your creditors.

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All that Glitters...

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Britain and France chose opposing paths after the war, although both started in the same position. France devalued its currency, making it attractive to investors and allowing their industries to be highly competitive. Britain opted to look after its debts, badly hurting the domestic economy, but earning the phrase "sound as a pound". The outcomes here could not be more different to their respective economic health. France's exchange rate made their products very competitive on the open market, and quickly had bountiful trade surpluses that translated into significant and growing gold reserves.

Between 1926 and 1932, France went from having 7% of the world's gold reserves to 27%, making its reserves almost as large as the United States, while being only about a quarter of the economic size. Much of this gold was never monetized (that is new currency being printed). The same was true in the United States, which pursued policies designed to reduce speculation which had the unintended effect of transferring gold to American coffers while failing to monetize the growing reserves.

These choices were significant, since by the 1930s almost 60% of the world's available gold was now in the hands of two countries. Other countries were desperate to build their own reserves and had to continually raise interest rates to remain competitive, but this caused serious damage to the domestic economy, as local banks could not keep up with the high interest rates and simply stopped lending. Many countries began to suffer deflationary pressure, worsening the general economic prospects and pitting countries directly against one another. In the end, a system that we think of today as having great stability rapidly destabilized the global economy.

Like all systems, whether it be our own fiat currency (now widely reviled for its excesses) or the gold standard, their success depends on following rules. Don't print too much currency in our case, or under the gold standard make sure that imbalances within the system are dealt with. The gold standard is not exempt from this, and what could have helped the situation in the 1920s would have been more sensible policies from countries (like Britain, who could have devalued their currency), more international cooperation, and less reactionary economic ideas. Given our economic climate, it is unlikely that our salvation will be found in gold, but in wisdom and cooperation.

In our first video blog, we look at our hesitation around gold and other better alternatives for investors.

Adrian Walker

Mitt Romney stills seems within grasping distance of the Presidency despite calling 47% of the American population a waste of time.

The Republicans Are Laughable,
That makes us nervous

By Adrian Walker

Typically, a business like ours tries to avoid political discussions. Why get distracted by opinions when we have bigger fish to fry? With this election year in the United States, we are actually growing nervous that Mitt Romney might win.

Regardless of how you feel the United States has faired under the stewardship of Mr. Obama, the presidency of Willard Mitt Romney could be disastrous, especially if he does what he says.

It's possible that Romney is a very capable leader and politician, but if the last four years have taught us anything its that the president of the United States has an extreme challenge bringing people on board to even the most sensible legislation (this used to be called governing, which seems old fashioned now). Romney, accused frequently of being a "flip-flopper", has not only changed most of his own views to win the votes of Republicans, but even denounced some of his best legislative achievements.

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The Republicans
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The Republican platform now looks like a bizarre mishmash of testosterone fueled American feudalism. Tax cuts to the very wealthiest Americans (whose taxes have been dropping for the last thirty years) will be offset, although not fully funded, through closing loopholes to the bottom 50% of Americans. The original Bush tax cuts will be kept in place (also unfunded), and Medicare and Medicaid will undergo significant changes for the next generation, while those elderly voting for Mr. Romney can expect nothing to change for them at all. Defense spending, already so expansive that it eclipses the entire budget for Indonesia will be raised to 4% of total GDP, for no other reason that the Republicans now view the army as the only truly sacred cow worth protecting.

To cap it off, the Republicans have added one final element to their platform. A promise to return to the Gold Standard. Well, its not a hard promise, a commission will be convened to see if they should, but its mere addition should be enough to see that the party has wandered very far away from the idea of sensible government for all. A Romney presidency now looks like growing deficits and corporate governance.

It's hard to believe that at the end of Bill Clinton's term, it was predicted that the United States could pay off all of its debt within a decade. That was before an enormous tax cut, two unfunded wars in the middle east and the total collapse of the global banking system, followed by the great recession. Today, America is facing an enormous economic test, and while we may disagree with the Democrat's current approach, sadly we can't turn to the Republican's for help.

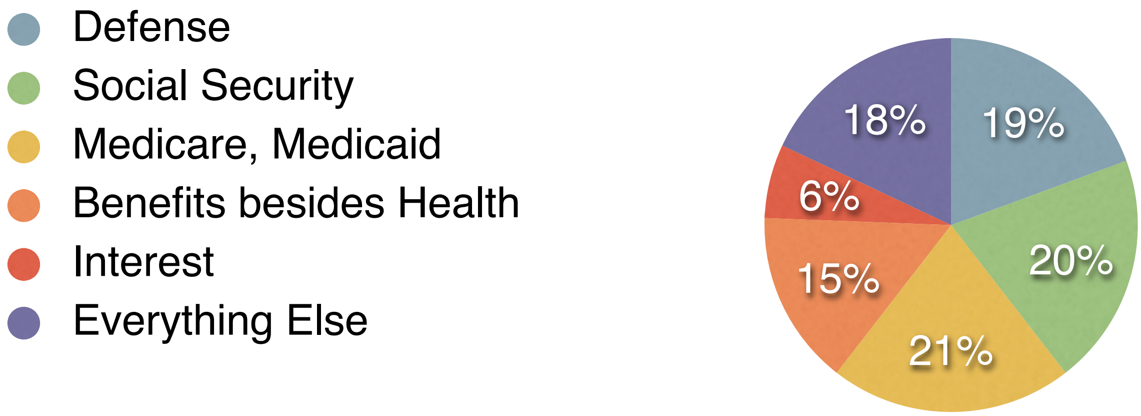
How big is this test? Currently America has the luxury of borrowing for almost nothing, which is a great help to the economy now, but a combination of factors including an aging population, low taxes, high spending and unfunded commitments in Medicare and to the military are pushing the

"A Romney presidency now looks like growing deficits and corporate governance."

American economy into a state far worse than we find Greece today. Right now America spends nearly $0.20 of every government dollar on the military. This is followed closely by Social Security (20%) Medicare & Medicaid (21%) and Benefits besides Health (15%). That's 76% of the budget covered without requiring a single vote! When we throw in interest paid on debts that brings us over 80% of the budget. When it comes to dealing with "corruption" or "government waste" frequently they are only talking about less than 20% of the budget.[2]

These are significant problems, and these challenges can't be ignored simply with popular phrases, or silly ideas about the gold standard. America's strength comes from an ability to be the kind of economy that can pay its debts and retain a strong dollar. Like many people are finding out in Europe, when there's no room to maneuver the prescription for financial health can be very restrictive and painful. If Romney wins we could be looking at a very different financial America in a few years.

Budget for the United States, 2011



What Got Us Here
Won't Get Us There...

By Brian Walker

I've had a number of calls asking what Adrian is up to. He has, after all, been here two months with hardly a peep which is, I admit, unusual. Adrian's six years at Franklin Templeton Investments provided him with skills and information that we decided to put to good use right from the get go.

The bear market of 2008 hurt many of us and since then, we have been working on building our accounts back to previous highs. Although it has recovered substantially from its 2009 low of around 7000 points, the TSX was at 12,317 as at September 30, 2012, and needs to grow nearly 3000 points (or 25%) to return to its previous high.

Recognizing that one of our primary goals should be reducing volatility, Adrian took on the task of building four new portfolios specifically designed for RRSP accounts. He created these with one focus in mind: to create portfolios that investors could match to their risk tolerance, which would be sustainable through turbulent markets. These portfolios aim to stem the temptation to move to cash during volatile markets, which only locks in losses and decreases growth possibilities.

Though we sailed through the 1990s and early 2000s with excellent results, 2008 has changed the investing world in a great many ways. Adrian's view on this is a saying from his time at Templeton: What got us here won't get us there! While I want to work another 5 years, both Adrian and Mike are looking for considerably longer careers than that, and in order to achieve results that we consider acceptable, we need to make some changes to the way we approach investing.

Adrian feels that the best way to provide acceptable portfolio results is to instill investors with sufficient confidence in the performance of their portfolio to ensure that they will never choose to revert to a cash position. Two months into his new career, he has constructed four model portfolios using the very best funds, by closely examining consistency, history in the market, investment styles and historical performance. The portfolios range in their alignment to risk tolerance levels from a Conservative Portfolio with 53% in fixed income, to a Growth Portfolio with a modest 26% in fixed income.

Adrian back-tested these model portfolios to determine how they would have performed over the last ten years, and we were particularly interested in how each would have performed in 2008, as the TSX was down 34%.

Here are the individual model portfolio results for 2008:

Model Fund Portfolio	Model 2008 Returns
Conservative	0.6%
Conservative-Moderate	-2.9%
Moderate-Growth	-7.6%
Growth	-16.1%
S&P/TSX Index	-34.0%

We think we can maintain this performance adjusted risk because each portfolio has common elements. For example, the TD Canadian Bond fund is featured in varying amounts in every portfolio. This allows us to more closely monitor and evaluate performance of these holdings, in order to ensure that we are consistently providing you with a well-constructed investment vehicle.

Please feel free to contact us for more information on these portfolios, and to learn how we can help you to get there from here.

This unique solution is designed to protect you during your prime income-earning years...a critical time in your financial lives.

From Mike's Desk
A 3-in-1 Solution

By Mike Vamvakaris

Out of the hundreds of people I would like to say I've helped, almost nothing is a greater risk to a family's long term plans than befalling some illness or suffering some injury that leaves them incapacitated. Suddenly every plan, be it long term financial planning, a vacation, or their house is up in the air.

Worse, if the injury affects the primary bread winner it can be difficult for their partner to find equal paying work. If it is a two income household that depends on both incomes to maintain their standard of living, a sudden critical illness or disability can lead to a rapid change in their lifestyles.

What stops people from pursuing the right kind of insurance to protect their families in exactly these situations? Quite often it is the cost and the cumbersome nature of buying and maintaining three separate forms of insurance (life, disability and critical illness), but the good news is that there is a simpler and more affordable option available that I can now provide.

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From Mike's Desk
A 3-in-1 Solution for your Insurance Needs

This unique solution is designed to protect you during your prime income-earning years, what I consider to be a critical time in your financial lives. The all-in-one package offers a life insurance policy, a disability insurance policy and a critical illness insurance policy, which means there's only one application, one plan to manage and one amount to pay.

You can buy a minimum of $100,000 and up to $500,000 of coverage, which becomes an emergency pool of money from which you can be supported if you suffer an injury or an illness. The amount of insurance you buy is called your **available amount** and whenever a benefit is paid your available amount is reduced accordingly.

If you need to make a claim this is how it would work. The insurance would pay a disability claim with a monthly benefit of 0.5% of your amount of insurance, a critical illness claim with 25% of your amount of insurance and a life claim with 100% of your **available amount** of insurance. This pool of money design provides different benefits than owning three stand-alone insurance products at an affordable price that is easier on the budget.

I am not only strongly in favour of this program because of its simplicity (and necessity) but also because it offers some other forward-thinking benefits such as paying your premiums for you if you're on claim for a disability and providing you with access to Health Service Navigator, a comprehensive health and online resource centre. In addition there is a world class medical second opinion service that's built into every plan.

If you don't yet have disability or critical illness insurance, please give this some thought. With its simplicity and manageable premiums there is no reason why you should have ever risked your financial future, your family's lifestyle or your earning potential. Give me a call at 905.859.5995.

Water, Water Everywhere...
The return of environmental investing

By Adrian Walker

If nothing else, the recent warnings about a potential bacon shortage will have alerted you to the enormous drought that has been plaguing the United States this summer. For those of us who like to see the numbers, over 60% of the contiguous US is suffering from a lack of water; this drought is the worst in 17 years; and the month of July 2012 was the hottest on record since the National Oceanic and Atmospheric Administration started maintaining records in 1895.

The inclement weather isn't limited to the United States, either. Europe and India have both been suffering from similar shortages of water, and this summer has seen regular reductions in the estimates of food supplies and grain production.

How bad is it? American crop production estimates were slashed throughout the summer, reduced by 15% for corn and 8% for soybean. Dry weather in Europe, Brazil and Argentina has hindered crop production, while a poor monsoon season in India has reduced rice paddy production by 7.8 million tons, according to the UN Food and Agriculture Organization.

The situation looks quite grim, especially since experts are predicting that next year will be even hotter, with the arrival of El Nino. The effect of this drought will be to push up food prices, first in the emerging markets, and then here in the developed world. In the Financial Times last month, economists discussed the larger impact this will likely have on emerging economies.

We don't often discuss the environment in financial planning, but as we can see, even small fluctuations in the climate can have dramatic impacts on our most basic needs. The fallout from this year's drought means increase food prices, decreased beef and pork in the market, and inflationary pressures across the world during an economic slump. These are not issues that can be ignored, which brings us to an issue that frequently is – while economists debate whether gold and bonds or stocks represent the best value for money, the truth is that we are ignoring one of our most precious resources: water. Fresh water is a commodity which can neither be manufactured, nor easily moved about, and is needed in such great quantities that when it becomes scarce it demands huge investment.

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Water
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In 2007, when the environment had less competition in the news cycle, Criterion Mutual Funds launched two green infrastructure funds to great fanfare. But a few years later, they were merged out of existence as infrastructure products took a back seat to the total collapse of the global financial sector. However, environmental investing may return in the near future, as rising costs in food production, and requirements for water and cheaper energy become recurring concerns. With the newfound wealth and growing needs of the emerging world, attention will be turned back to new infrastructure projects with a focus on these issues.

Market Numbers

Indexes	Q3	YTD
S&P/TSX - Toronto	+ 7.0%	+ 5.4%
Dow Jones - New York (US$)	+ 5.0%	+ 12.2%
S&P 500 - New York (US$)	+ 6.4%	+ 16.4%
Morgan Stanley World (US$)	+ 6.8%	+ 13.6%
Morgan Stanley EAFE (US$)	+ 7.0%	+ 10.6%

Source: Morningstar Research Inc. (as of September 30th, 2012)

Market Summary
Q3 Review

The third quarter of this year ended on what we might consider a positive note. After some early declines all the major equity indexes rallied through the summer months, posting substantial returns in the TSX, the S&P 500 and the MSCI World Index.

As we had stated back in July (Keep Calm and Carry On Europe) the initial downturn in European markets was overstated and it was too early to say what steps the European Central Bank (ECB) might take to secure the Euro. Forceful commitments by Mario Draghi in late July to do "whatever it takes" followed by a bond buying program to help significantly indebted members of the EU, contributed to strong returns in France, Germany and Great Britain.

In the United States strong returns came on the heels of the new Quantitative Easing measures (QE Infinity) which gave a substantial bounce to the US markets through the remainder of the quarter. In addition, general economic trends continued upwards trajectory, showing improved consumer confidence, lower unemployment numbers, and the lowest GDP to Debt ration in six years.

Bonds continued to post negative news however, as yields on 10 year Government of Canada Bonds dropped to 1.7%, however the bond market continued to show positive returns on general market uncertainty.

Looking forward we feel that the first big hurdle that must be cleared is the US election. As we have stated already in this newsletter, we are concerned about a Romney presidency and the long term effects that might have on the US economy. However, with news that housing numbers continue to rise (a trend that started back in July) and improving economic numbers we are very encouraged by the immediate prospects for the U.S. economy. We are however still watching for the "fiscal cliff" which could either be avoided entirely by Congress or be a repeat of last summer and be a needless showdown between the President and the House of Representatives.

Europe also concerns us. Despite consistent and repeated attempts to bring an end to the debt crisis, countries do not seem able to shake off these problems. This is in part due to the very austerity measures that Germany and the ECB seek to impose on debt-ridden nations in exchange for financial aid. Capital flight, as investors seek safer havens, and general German reluctance to write a blank cheque to stave off disaster also contribute to our unease.

Lastly, Canada remains our most uncertain market. The relative strength of the TSX and the overall Canadian market mask some serious issues. The most obvious of them being our housing market. The consensus is that the Canadian housing market is overheated, and could implode. Efforts by the Bank of Canada to cool down lending are being thwarted by the economic climate and low borrowing rates.

The Canadian economy also has a number of structural weaknesses. Alberta has yet to figure out how to move vast amounts of oil to new markets. The U.S. government nixed the Keystone pipeline earlier this year, and there is yet to be a deal to move oil through British Columbia. The government of Canada is also seemingly reluctant to give a thumbs up for the sale of Nexen to China, walking a tightrope between much needed foreign investment to the Oil Sands and legitimate concerns over giving a country with terrible human rights issues access to a strategic natural resource. Lastly, America's persistent quantitative easing is lowering the value of the American dollar, and the Loonie's continued strength has been ongoing punishment to the manufacturing sector.

The next quarter could be dominated by one of two large themes. The first is some economic step back. If we return to debt ceiling conversations in the United States and hit the "fiscal cliff" we very well might renew global concerns over the markets. If however we see continued positive economic news from the U.S. combined with strong consumer sales numbers towards Christmas, we may start to see the economy pick up as many large corporations begin spending their vast cash reserves.

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Sources

Sources for the Walker Report are collected over the quarter from the following news agencies: Bloomberg, Financial Times, The Globe & Mail, Thomson Reuters, the BBC, Morningstar Research, The Bank of Canada, TD Mutual Funds, Manulife Financial, Slate News, CBC News and the following publications:

The Next Convergence by Michael Spence.
Paper Promises by Philip Coggan.
Red Ink by David Wessel.
Ultra Easy Monetary Policy and the Law of Unintended Consequences by William R. White

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