

August 6, 2008

Economic Indicators Canada

	Dec. 2007	June 2008	
GDP ⁽¹⁾	2.7	0.6 ⁽²⁾	↘
CPI ⁽¹⁾	2.4	3.1	↗
Unemployment	5.9	6.2	↗

United States

	Dec. 2007	June 2008	
GDP ⁽¹⁾	2.2	1.8	↘
CPI ⁽¹⁾	4.1	5.0	↗
Unemployment	5.0	5.7 ⁽³⁾	↗

(1) Year-over-year % variation
(2) May 2008 (3) July 2008

Sources: Statistics Canada, U.S. Dept. of Commerce, U.S. Dept. of Labor Statistics.

Equity Indices

% Change	2008 in local currency	2008 in C\$	
S&P/TSX	-2.5	-2.5	↘
S&P 500	-12.2	-7.5	↘
Russell 2000	-5.3	0.1	↗
Nikkei	-13.4	-6.8	↘
S&P 350 Europe	-21.4	-12.2	↘

THE ANATOMY OF SAVING AND INVESTING – PART 1

The media has been filled with bad economic news this past year. The headlines repeatedly describe deep trouble in the banking sector, rising energy prices, and a severe decline in the U.S. housing market. These situations have led many investors to question whether they should invest in equities at all. This series will try to shed some light on this question.

For those of us who are investing to save for our retirement, our financial life can be boiled down to a trade-off between saving and risk-taking. Let's take the example of a 24-year-old debtless worker at the start of his career. If he saves 18% of his gross income (the RRSP limit) and earns an average investment return of 4% in excess of inflation, then, according to our calculations, he can expect to retire at age 60 with a pre-tax income that represents 72% of his final pay. But to obtain a return of 4% in excess of inflation, a significant portion of his portfolio must be allocated to equity. If we reduce the portfolio's equity allocation, just enough to lessen the expected return by 1%, our investor now needs to save 22% of his income rather than 18%, which then cuts into his lifestyle.

This trade-off between saving and investment risk is just as relevant for the situation of an older investor, who has a more complex situation that includes a family, a mortgage, an investment portfolio and other specific characteristics. Moreover, retirees don't escape the need to take investment risks either, because long-dated provincial bonds yield less than 5%, which in many cases is not enough of a return to cover their lifestyle needs.

For most investors, young and old, portfolio risk is a necessary evil. Many will view this reality as a grim one—especially in the light of the recent stock-market decline. However, they shouldn't. In our view, taking calculated risks is the essence of life. Attending university, having children, buying a house, starting a new business, or retiring, all involve some degree of risk. The more investors become familiar with investment risk, the better they will be at managing it and making it pay off.

In Part 2 of this series, we will discuss how the equity market can help to build wealth—despite the risks.

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