



Markets This Week

April 29, 2006

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Investment Idea

Question:

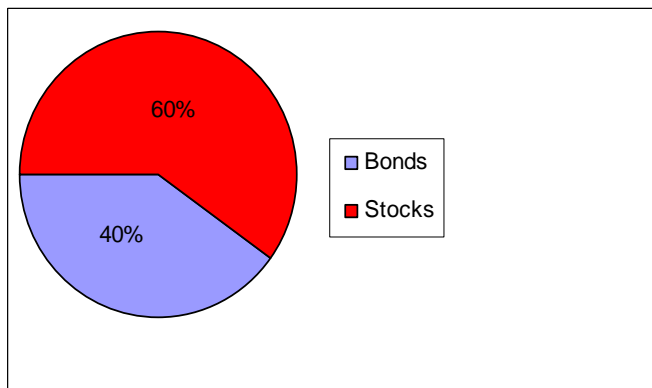
How can I take advantage of core-satellite investing?

Answer:

Core-satellite investing is not for beginners or risk-averse individuals. But as you gain greater knowledge over time (or have someone helping you), you become better suited to actively manage your portfolio.

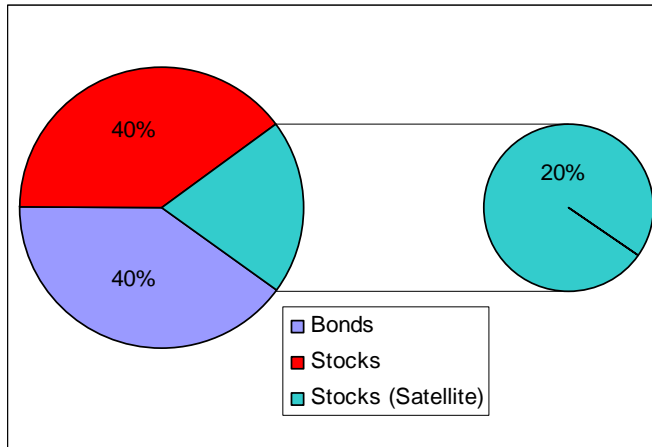
Let us begin with the core. Core investments are based on one's investment profile and take into account personal situation, risk tolerance, etc. Core investments are typically different proportions of stocks/bonds/cash which are invested for a long-term, and rebalanced only periodically (e.g., once a year). The most typical core portfolio consists of 60% stocks and 40% bonds (Chart 1).

Chart 1. Typical Core Portfolio



Core-satellite investing still uses a solid core as a base but adds an active element (i.e., the satellite) to complement the core. Thus, core-satellite investing combines the best of both worlds - a long-term solid core that relies on the market efficiency, and a satellite which takes active tactical bets aimed at adding value to the core (Chart 2).

Chart 2. Core-Satellite Portfolio



Quiz

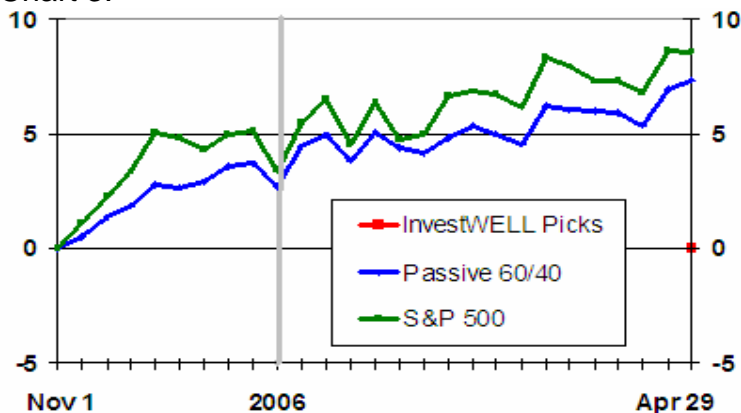
Why would an investor use the core-satellite strategy?

- A) Risk reduction
- B) Potential for return enhancement
- C) Benefits of style diversification
- D) All of the above
- E) None of the above

Answer at the bottom of the newsletter.

Our Returns (Cumulative %)

Chart 3.



Last week, our passive and conservative 60/40 portfolio went up while the S&P 500 index declined. Next week, we will introduce **InvestWELL Picks** (currently set at zero), a pool of investments shared exclusively with members.

Market Highlights

April 23 – April 29, 2006

- This week, the US market managed to recover from a sell-off earlier in the week. It appears that every time the market drops, buyers re-emerge from everywhere. We are not too optimistic about the short-term prospects for the market (please see our Behavioral Finance Indicators section).

Charts 4 & 5. S&P 500: 10 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The Canadian markets lost some steam due to the rise in interest rates in China and decline in commodity prices. Since the start of 2003, the performance of the Canadian equities has been quite incredible.

Charts 6 & 7. TSX Canada: 10 Years and Last 10 Days



Charts courtesy of StockCharts.com

- The U.S. economy snapped back in the first quarter, growing at an annual rate of 4.8%, the fastest growth in more than two years.
- Gold is on a roll. Right now it costs \$653 per ounce. It is hard to believe that just over two weeks ago, it was at \$593 (a 10% jump). The current gold “rush” is driven by geo-political instability and fear of inflation spilling over from commodities.
- The Canadian dollar has climbed to 0.894 per US\$1, the highest since 1978. The rise is related to high commodity prices, strong macroeconomic fundamentals and weakness in the US buck.
- China's central bank unexpectedly raised a key lending rate to 5.85 per cent from 5.58 per cent to cool the blistering economic growth (up 10.2% from a year ago!). In an editorial, a newspaper run by China's central bank said that the interest-rate hike may have been the first in a series. We believe it is worth listening to newspapers, especially those run by the government.

Worth Watching

- The recent housing sales data has been much stronger than expected. However, there are significant weak spots, e.g., inventories of new homes on the market are up to 5.3 months of supply (up from 4 months a year earlier), while the supply of available condos is up to 6.9 months (up from 3.7 months a year earlier). In addition, mortgage applications are at the lowest level since November 2003, and would-be home buyers are being priced out of the market by rising interest rates.
- This week, Business Week magazine published an article about several investment clubs that admit only the rich (a.k.a. High Net Worth or HNW). The minimum wealth required to join is \$10M. The members started these clubs because they felt that the financial advice they were receiving was “tainted.” If multi-millionaires complain about the sales-bias and the quality of investment advice they receive, they should check out the conflicts of interests and quality of advice faced by the Non-HNW.

Behavioral Finance Indicators (see explanation)

Equities appear unable to penetrate the resistance level (1315 on the S&P 500). At the same time, buyers re-emerge on every dip. The indicators are somewhat mixed with AAll actually close to a bullish signal.

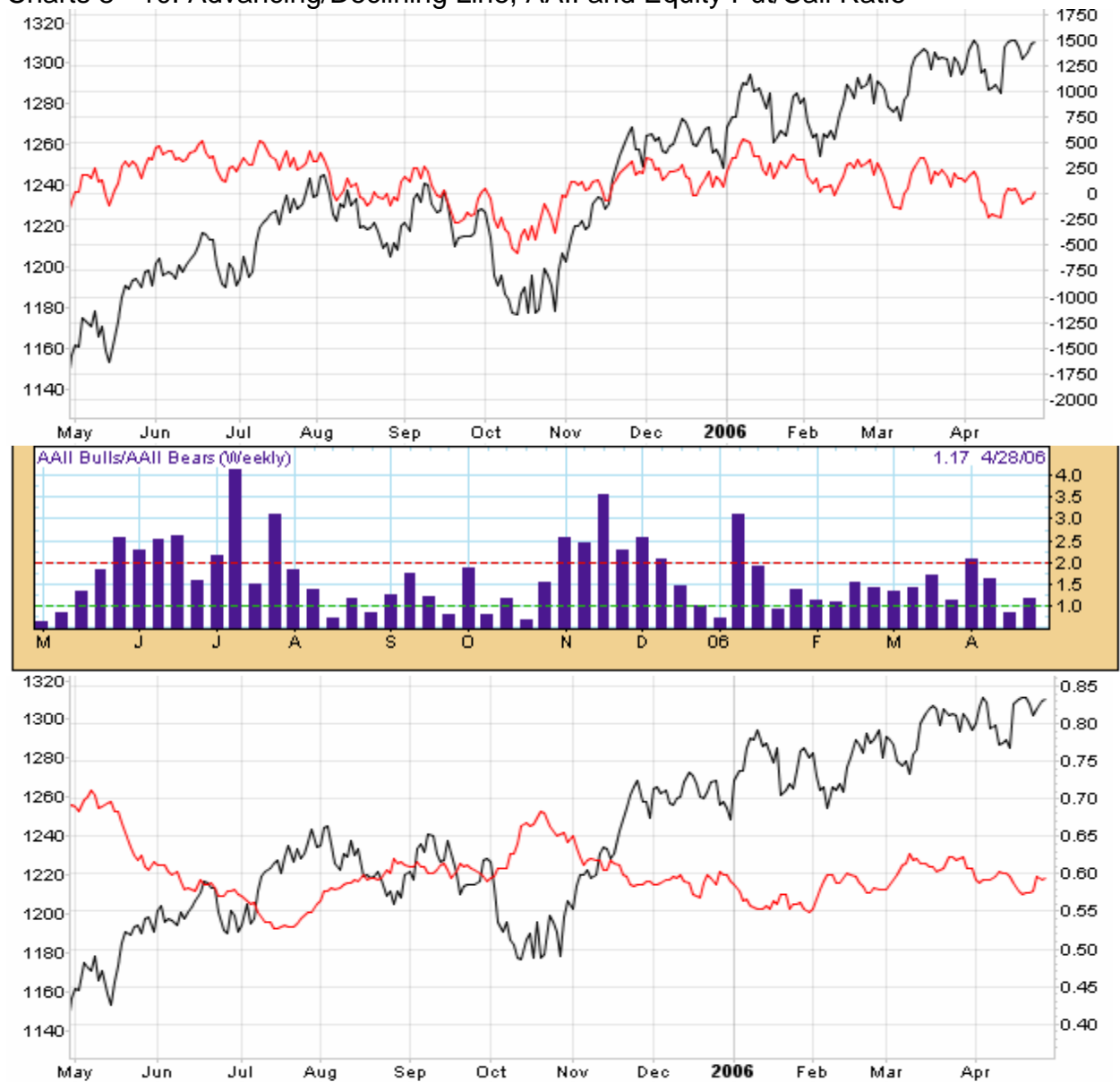
The market may attempt to test the resistance level again, perhaps in a blow-off phase, but we continue to believe we have reached an important market top.

For an historical comparison, please look at August 2005 on Charts 8, 9 and 10.

Please consider the following factors:

- Chart 8 – the divergence between prices (black line) and the advancing/declining line (red line) since January 2006
- Chart 9 – the confidence of small investors (as represented by AAll, i.e., the ratio of bulls/bears). This indicator provides a signal which contradicts other indicators (i.e., low confidence of small investors)
- Chart 10 – the declining put/call ratio indicates that small investors have confidence that the market will advance (red line)

Charts 8 - 10: Advancing/Declining Line, AAll and Equity Put/Call Ratio



Charts courtesy of StockCharts.com and DecisionPoint.com

Answer to the Quiz:

D is correct.

- Risk reduction with a lower correlation between core and satellite
 - Return enhancement when the satellite adds extra return
 - Benefits of portfolio diversification as the core uses passive investing and the satellite uses active investing.
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