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1. Investment Idea

Q: In terms of investment strategy, is it better to buy the last year's best or worst performing asset?

A: Diversification appears to outperform both of these strategies and the same results hold for stocks, mutual funds and asset classes (see **Chart 1**). In this example, Templeton Investments researched the outcome of the diversification vs. moving money within 3 asset classes (i.e. stocks, bonds, and cash). The results indicate that diversification between asset classes was the most optimal solution.

Chart 1: Annual Investments of \$10,000 (1984 - 2004)



Source: Templeton Investments

2. Question of the Week

Assume that you buy a stock for \$100 in year 0. If the stock increases 100% in year 1 and declines 50% in year 2, how much money will you have made?

- A) -25%
- B) 0%
- C) 25%
- D) 50%

Click [here](#) for answer

3. In the Markets

Jan 9 - 13, 2006

- This week, many of the Asian stock markets have reached their 10-year highs while there was little change in the US and Canadian markets
- European retail sales rose by the most in 2 years as the region's economy is gaining momentum. Government reports show that consumer confidence rose to the highest since 2002, while growth in services and manufacturing accelerated
- The average bonus on Wall Street was \$125,000 (up 10% from the previous year), with top bonuses going to mergers-and-acquisition bankers. As we know, New York City is an expensive place and we are happy for mergers-and-acquisition bankers
- Canadian accountants decided not to adopt the US accounting rules but will be switching to international rules within 5 years

Worth Watching

- China announced it may "re-weight" future purchases of foreign currencies to diversify its holdings. In other words, if China currently holds close to 100% of its reserves in the US dollar, it will buy other currencies instead. Clearly bad news for the dollar, especially if other countries decide to follow China's example
- Venezuela's Hugo Chavez is buying debt of other South American countries. For instance, last October, international investors refused to buy Argentina's debt if the yield was set below 9.75%. Venezuela stepped in and bought \$800 million with yield of 8.75%. Four weeks later, Venezuela sold it making 10% profit. Venezuela's purchases of South American debt may have profound influence on the region's political landscape as it lessens its dependence on IMF and the US model of development
- In Canada, the campaigning for the January 23rd election continues, as we stand by our prediction of a minority Conservative government. The results of the election are not expected to have a significant influence on capital markets

4. S&P 500 Chart

Chart 2: 5 Years



Chart 3: 1 Month



5. Canada TSX Chart

Chart 4: 5 Years



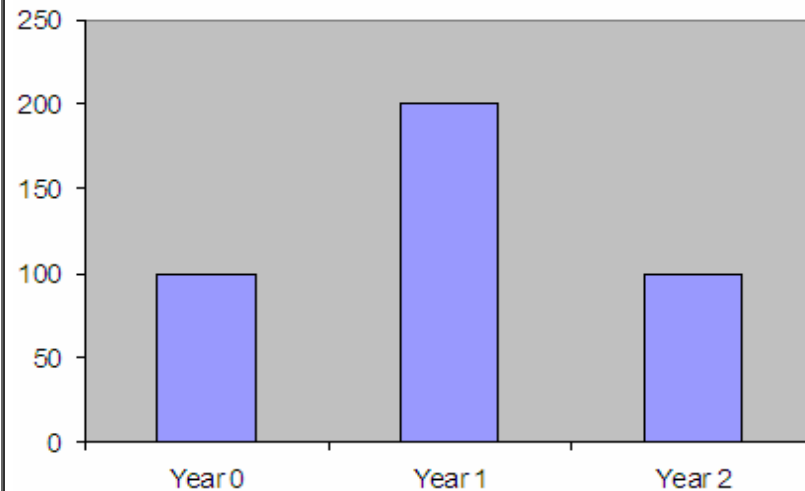
Chart 5: 1 Month



6. Answer to the Question

B is correct (see **Chart 6**). In this question, many people try to average 100% and 50% and arrive at an incorrect answer. In order to correctly measure investment returns, we need to use geometric average (which allows for compounding over time) instead of arithmetic average.

Chart 6: 100% Up, 50% Down



Source: InvestWELL Financial

InvestWELLFinancial.com

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