InSite

News and views for the online investor

JAN/FEB 2005

What's Ahead: The Outlook for 2005

by Dr. Sherry Cooper

Economic momentum has picked up sharply in Canada in recent quarters as we have recovered from the devastating effects of SARS. The economy is running so close to full capacity that the Bank of Canada has been raising interest rates, and will likely continue to do so in 2005. Inflation has bottomed, but will remain moderate next year, particularly with import prices declining and the Canadian dollar strengthening. For this year, the TSX has outperformed the S&P 500, especially in U.S. dollar terms, and Canadian stocks have outperformed bonds. We expect to see more of the same in 2005.

Canada is the only economy in the G-7 with a surplus in both the government budget and the current account. While both surpluses are likely to diminish next year, there should continue to be some upward bias on our currency as the U.S. dollar drifts lower. The U.S. has a record current account deficit as a percent of the economy, and combined with a huge budget deficit, the greenback has been falling for nearly three years. Over that period, the euro is up about 50% and the Canadian dollar has risen around 35%. In 2005, we expect the loonie to edge higher still, to about 86 or 87 cents U.S.

This will put pressure on our exporters to cut costs to maintain profit margins as domestic labour costs rise. Expect, therefore, to see further layoff announcements and a slowdown in employment growth. Nevertheless, Canadian growth is likely to hover in the 3% to 3.5% range, which will rival the U.S. for the top spot in the G-7. Although global economic growth is slowing due to the rise in oil prices, oil might well have peaked. Currency adjustments will continue to mitigate the negative effects of oil prices on domestic prices. Moreover, China could well begin to moderately re-value its currency in 2005. Hopefully, the adjustments in currency values will be orderly, but certainly this remains a risk for the economic outlook.

> *"The economy is running so close to full capacity that the Bank of Canada has been raising interest rates, and will likely continue to do so in 2005."*

The Bottom Line: Canada is likely to enjoy non-inflationary growth next year. While interest rates will rise in response to central bank tightening and the large U.S. budget deficit, the spread between Canadian and U.S. bond yields will continue to diminish in a rising rate environment. Global commodity markets will likely remain strong, although oil prices might well edge downward. The stock market in Canada will show positive single-digit gains, surpassing those in the U.S. on an exchange rate-adjusted basis. So stocks will outperform bonds, and the Canadian stock market will continue to outperform, albeit more modestly than this year. ■

Dr. Sherry Cooper is Global Economic Strategist and Executive Vice-President, BMO Financial Group and Chief Economist of BMO Nesbitt Burns.

Feature of the Month

Did you know you can make RRSP contributions by adding BMO InvestorLine to your list of registered bills using your online or telephone banking service? To learn more, log on to **bmoinvestorline.com** and visit *Frequently Asked Questions* in the "Education Centre" section.

Know Thyself

In Hamlet, Shakespeare wrote, "to thine own self be true." In today's world, it's important to know yourself as an investor.

Knowledge is power and knowing what type of investor you are is essential to creating a successful investment strategy. It's one of the first steps in financial planning and key to a disciplined approach to investing.

To gain an understanding of your own investor profile, there are several factors to consider: your current financial circumstances, risk tolerance, goals and objectives, investment time frame, life stage and return expectations.

Asset allocation is based on your investor profile and is important for several reasons. First, it's an aspect of investing that you can control and influence. Second, it also helps

determine your choice of investments. Lastly, your long-term portfolio performance partially depends on having the right mix of investments.

If you're primarily saving for retirement, and it's 20 years down the road, you will want to make more aggressive, growth-oriented investment choices to stay ahead of inflation and achieve maximum portfolio performance. If you're planning a major purchase or funding a child's education five years from now, lower-risk investments may be more prudent to ensure the funds are available when you need them.

You have to know where you're going in order to get there. Knowing yourself as an investor will help you reach your financial goals and objectives with confidence. ■

Contributor's Note

With every new year we have the opportunity to pause and reflect, take stock, and sketch out a plan for the year ahead. No new year would be complete without resolutions. You will appreciate this issue of InSite if you've resolved to take a more disciplined approach to your investing.

You can read about how to ease back into the market—with a strategy. Learn what's ahead for the economy in 2005 with Dr. Sherry Cooper, and review the Heavy Hitter Select Funds with leading mutual funds analyst Ranga Chand. Of course, we've also included information on planning tools and time-saving tips.

The new year would not be complete without the promise of BMO InvestorLine's Ultimate Golf Getaway. Building on the great success of past Ultimate Golf Getaways, we've made this year's contest even better than ever. The contest starts February 1st—it's your chance to test your investment knowledge. Get a head start earning ballots—update your email address in your Account Profile by March 31, 2005 and you'll earn an extra ballot for your chance to win.

We want to make InSite a resource you can keep and reference while you're planning your investments. Your feedback is important to us, so please send us your questions, comments and story ideas. Our goal is to continually improve InSite to serve you better.

Cheers to a great year!

Tom.

Thomas A. Flanagan
President & Chief Operating Officer

What's Your Investor Profile?

BMO InvestorLine offers Guided Investing® – a disciplined approach to investing that provides you with tools and resources to support you in making informed investment decisions. A disciplined investment strategy is based on self-knowledge.

Using BMO InvestorLine's Asset Allocator, you can find out what type of investor you are by answering a short, online questionnaire. Your score helps identify your investment objectives, risk tolerance, and time horizon. It also helps you to find the optimum asset mix for your portfolio.

Knowing your investor profile and having the right asset mix in your portfolio will guide you as you refine your investment decisions, make appropriate portfolio selections, and stay on track to meet your financial objectives.

Use the Asset Allocator at **bmoinvestorline.com** to find out if your portfolio needs rebalancing to match the asset mix that accurately reflects your goals. ■

2005 Outlook for Mutual Funds

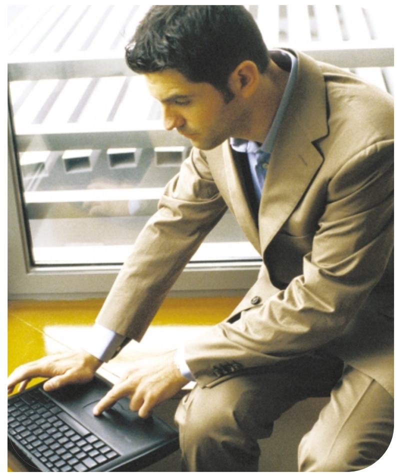
by Ranga Chand

After expanding by a solid 3% last year, the Canadian economy's average growth is expected to be more than 3% in 2005. With the economy on a self-sustaining growth path, rising corporate profits should continue to underpin the stock market and support Canadian equity funds.

On the interest rate front, the Bank of Canada is expected to follow a 'gradualist' approach in raising rates as low inflation and a strong Canadian dollar mitigate the need for an aggressive tightening of monetary policy. As a consequence, bond yields are projected to increase modestly this year and, despite the prospect of lower bond prices, broadly diversified bond funds should post positive total returns in 2005.

"...broadly diversified bond funds should post positive total returns in 2005."

Internationally, growth in the world economy is expected to moderate in 2005 as higher energy prices, a still vulnerable U.S. dollar, weak domestic demand in Europe, and a projected slowdown in China cast a shadow over future prospects. Nevertheless, solid earnings growth and still attractive valuations, especially in emerging markets, should lend support to international equity funds.



Given the inherent unpredictability of financial markets, especially in the short-term, the best investment strategy is, as always, to be well diversified across the major asset classes. Here, investors may want to take a look at the seven Heavy Hitter Model Portfolios that have been designed to provide maximum diversification with the minimum of risk. ■

Positive Results for All Heavy Hitter Select Funds

by Ranga Chand

The Heavy Hitter®* Select Funds, like all mutual funds, need to be monitored regularly. Some funds will slip out of the Heavy Hitter category temporarily because of a lapse in performance – which is normal. As investors, we must accept that every fund will have periods of underperformance from time to time. A few may drop out completely because of a systemic problem that results in a continuous performance decline. Equally, it's important to remember that no fund will deliver above-average returns every single month. Many funds will - and do - underperform for an extended period before bouncing back.

So, how have the Heavy Hitters been performing since they were introduced onto the BMO InvestorLine website last year? In our annual review of the 50 Heavy Hitter Select Funds, I am happy to report that as of September 30, 2004 all 50 funds have delivered positive returns over the past year.

Returns have ranged from a high of 37.2% for the Mackenzie Universal Canadian Resource Fund – a sector fund – to a low of 0.8% for the Dynamic Canadian Technology Fund - also a sector fund.

In contrast, out of a universe of over 5,500 funds, one out of ten mutual funds posted negative returns over the past year. Returns ranged from a high of 64% for an alternatives strategy fund to a low of–92.5% for a U.S. equity fund.

In aggregate, the Heavy Hitters posted an average return of 12.7% over the past year compared to 8.2% for the average mutual fund. Moreover, returns were also significantly higher for the Heavy Hitters in all the major fund categories over the past 1, 3 and 5-year periods (Table 1).

In terms of relative performance, year-to-date, only four of the 50 Heavy Hitters are underperforming in their respective categories and are tracking as quartile 4, or the bottom 25%, performers. These funds are the Burgeonvest Hirsch Opportunistic Canadian Fund (Canadian equity), the RBC O'Shaughnessy U.S. Growth Fund (U.S. small cap), the Talvest China Plus Fund (Asia ex-Japan) and Saxon High Income Fund (Canadian income trust). However, except for the Saxon High Income Fund, the relative performance of the other three funds rebounded in September and they are now back in the winners circle (Table 2, see pg. 6).

> *"...of the 50 Heavy Hitter Select Funds, I am happy to report that as of September 30, 2004 all 50 funds have delivered positive returns over the past year."*

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Heavy Hitter Select Funds

Average annual compound returns (%) (to September 30, 2004)

Table One	1 yr	3 yr	5 yr
Heavy Hitter Select Funds	12.7	10.5	9.2
All Funds	8.2	2.8	2.4
CANADIAN EQUITY			
Heavy Hitters	16.7	11.6	11.8
Category Average	15.3	7.2	6.1
GLOBAL EQUITY			
Heavy Hitters	10.6	8.2	7.1
Category Average	7.3	-1.4	-2.4
U.S. EQUITY			
Heavy Hitters	15.0	5.6	6.3
Category Average	3.2	-4.9	-6.1
CANADIAN BONDS			
Heavy Hitters	4.3	6.6	6.8
Category Average	3.5	5.2	5.4

Source: Chand Carmichael & Company Limited; Globe HySales

Plan: Get What You Want

With every new year comes the opportunity to make plans for the year ahead. Planning is the thread that ties together so many parts of our lives. No matter what we plan, we do so for the same reason: to increase the odds of getting what we want. The same goes for investing. By tailoring your investment strategy to your financial goals, you are far more likely to get what you want down the road.

As an investor, you know that a healthy portfolio starts with a financial plan. Your plan provides you with the confidence and peace of mind that all of your financial resources are working together toward achieving your long-term financial goals.

However, goals can change. That's why about every six months or so, it's a good idea to check in on your investments. Do they still fit your goals? Do you need to make a few alterations? It's fairly easy to get the answers you need. Just follow this simple plan.

The Seven Steps of Effective Planning

1 Size up where you are

Take a good look at your current situation by reviewing your personal documents and statements. A simple spreadsheet will let you calculate your Net Worth and Cash Inflow/Outflow statement.

2 Re-set your goals

Make a list of the important events that happened to you in the past year, plus those you expect in the coming year. Do any of them require financing? If so, when – in the short term? Mid-term? Long-term? This makes it easier to prioritize. For example, paying down a loan may seem less important than buying the perfect townhouse – but if you don't take care of the first, you may not qualify for the second.

3 Weigh the options

As an online investor, you have access to many effective planning tools. Take advantage of them! Retirement planners and asset allocators are readily available online. They can help you: calculate how much you need to save to get the retirement income you want, realize how much risk you can handle, test different scenarios and investment strategies, determine the correct mix of taxable investments, RSPs and other assets for your portfolio, and align investment performance targets to your retirement timing.

> *"By tailoring your investment strategy to your financial goals, you are far more likely to get what you want down the road."*

4 Test assumptions

Assumptions made in the past may not be relevant to your current or future situation. By checking your assumptions regularly, you can determine whether your financial plans are still achievable.

5 Make your picks

Now you are ready to make your final asset selections. Your asset selections should match your investor profile and investment goals. Selecting investments can be fun or at the very least, a way to experience that great feeling of control over your own financial destiny.

6 Set a learning goal

If you run across an unfamiliar investment term, make it your business to find out more – not just about what it means, but what it can mean for you and the returns you enjoy. Take advantage of the online "Education Centre" and online tutorials available to help you learn.

7 Make a date with yourself

You know your life patterns better than anyone. So, set a date for your next investment planning session. It may be two months later, when your loan is paid up – or six months down the road. Either way, setting that date will increase your sense of control over your future and give you a truly disciplined approach to investing.

Just think of planning as a means of getting one step closer to getting what you want. ■

Explore Our Site

With Retirement Planner, you can create a customized plan and see whether you are on track to reach your retirement dreams. Go to **bmoinvestorline.com** today.

Positive Results for all Heavy Hitter Select Funds

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Given the performance of the Heavy Hitter Select Funds over the past year, all are being retained again for the next year. To help you stay on top, all the Heavy Hitters are monitored on an ongoing basis and their performance is posted on **bmoinvestorline.com** every month. ■

Ranga Chand is widely recognized as one of Canada's leading economists and mutual fund analysts. He is also the Founder and President of the research and consulting firm Chand Carmichael & Company Limited.

Quartile Performance
(to September 30, 2004)

Table Two	September 2004	Year-to-date
Burgeonvest Hirsch Opportunistic Cdn	2	4
RBC O'Shaughnessy U.S. Growth	1	4
Talvest China Plus	1	4
Saxon High Income	4	4

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