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We are pleased to provide the latest edition of inFocus, the semi-annual newsletter from our Private Wealth Management team

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We would like to thank all of our authors for their contribution to this edition of inFocus.

# Dividends Are an Investor's Best Friend!

A dividend is a portion of corporate profits that is returned to shareholders. At Morgan Meighen & Associates, dividends represent much more than a welcome yield for our clients. They reflect management's confidence, the capital adequacy of the underlying company, and prospects for improving results. Truly, dividends are an investor's best friend!

When a Board of Directors declares a dividend (and it's the Board, not management that sets the dividend policy), it sends a signal that the firm has excess capital and hence, financial stability. The commitment to pay dividends is a serious undertaking in North America, as a popular quote demonstrates: "Dividends are like marriage, while share buybacks are like dating". A rising dividend signals improving prospects for a company's future cash flow and earnings. To halt or reduce dividends may be interpreted as a message of concern about its capital position. Most companies will only pay 25-50% of net income as a dividend to shareholders (termed the "payout ratio"), the remainder is reinvested in the company's business with the objective of growing earnings. Ideally, this re-investment cycle provides the basis for future dividend growth.

Investing norms and dividend policies have undergone dramatic shifts over time. Within the last century, dividend payouts at one time accounted for almost all of a company's earnings, then it shifted to minimal payouts during the tech mania of the 1990s, and now we are seeing a return to increasing payouts. As the baby boomers entered their wealth accumulation phase in the 1990s, they found dividends to be too stodgy and preferred the allure of growth. Acquisitions were paid for with stock issuance, new valuation methods were conjured that masked the lack of profits, and CEOs were treated like rock stars. Seizing the opportunity, many senior managers were incentivized by massive option programs, and recommended to minimize dividend payments in favour of stock price appreciation - dividends do not

boost the value of options! Inevitably, this period ended badly for investors as they discovered the old rules hadn't changed. Dividends typically account for 40-60% of returns and if reinvested can be the majority of a shareholder's return over time.

	PRICE APPRECIATION	RETURNS FROM DIVIDENDS	TOTAL RETURNS	% RETURN FROM DIVIDENDS
S&P/TSX COMPOSITE INDEX	75.3	48.0	123.4	39%
S&P 500 INDEX	14.9	26.6	41.5	64%

\*For the period from December 1997 – December 2009

For the period from December 1997 to December 2009, dividends comprised almost 40% of the return of the S&P/TSX Composite index. Comparatively, for the S&P 500 Index in the U.S., they represented over 60% of the total return achieved during this period.

**How have dividend-paying companies performed against those firms that do not pay dividends?**

In the U.S., dividend-paying firms as a group outperformed the market, with those firms that increased their dividends performing best. As this chart indicates, stocks that have initiated dividends or subsequently raised them have bested the market since 1972, turning a \$100 investment into \$3,100. This compares to the increase from the S&P 500 Index to \$1,214 and non-dividend payers to only \$161.

# Managing the Economic

**Surinder K. Suri**

PRESIDENT, GLOBAL ECONOMIC MANAGEMENT AND ASSOCIATES

The G-20 faces a difficult and delicate task: How to secure a balanced and sustainable economic recovery over the next two years? After three years of unprecedented economic and financial turbulence, the global economy is on the upswing. Global economic growth is expected to be 3.9 percent this year and 3.2 percent in 2011. Asia, excluding Japan, is forecast to advance by 8.5 percent in 2010, and 7.9 percent in 2011. The U.S. business cycle is poised for a moderate recovery of 3.5 percent in 2010. Canadian economic growth is anticipated at 4.0 percent. The 1.0 percent EU economic growth this year reflects considerable intra-European variation. This sharp economic divergence highlights structural weaknesses which merit attention.

## FISCAL BURDEN DYNAMIC

In 2007-2009 both fiscal and monetary levers were deployed to resuscitate the global economy. The U.S. fiscal deficit-to-GDP ratio, which measures the amount of spending in excess of a country's revenues compared to its level of economic output, has increased from 2.8 percent in 2007 to 10.7 percent in 2010. The Canadian deficit ratio is 3.1 percent. The Euro zone deficit has risen to 8.0 percent. Greece, Spain, Ireland, Portugal and the U.K. are witnessing a precarious increase in their fiscal deficits. Japan's deficit ratio is estimated at 9.0 percent while for the Asian countries it is 3.5 percent. China imparted close to \$600 billion in fiscal measures to sustain its growth. India's fiscal push amounted to 1 percent of GDP and the deficit-to-GDP ratio has risen to 6.4 percent.

The debt-to-GDP ratio in the OECD countries, which provides a measure of how much a country owes cumulatively compared to its overall level of economic output, has escalated since 2007. Sovereign debt concerns have elevated the risk-premium in capital markets. The debt-to-GDP dynamics are a source of instability. Over the past three years the U.S. debt-to-GDP ratio has increased from 41 percent to 62 percent and will move higher to 90 percent, while the Canadian ratio is 35 percent. In the U.K., the deficit-to-GDP ratio is 13.3 percent and the debt-to-GDP ratio is estimated at 94 percent in 2011. For the EU this ratio is about 90 percent and in Japan it is 200 percent. The debt-to-GDP ratio in Greece will escalate to 130 percent. Spain, Italy and Portugal will also see a significant increase in the

debt ratio. These deficits and debt levels are unsustainable.

There is considerable scepticism on the effectiveness of the \$145 billion EU and IMF facility for Greece. Volatility and high risk premiums will continue to prevail in fixed-income markets; and the Euro will weaken. A credible resolution on the fiscal burdens within the EU is essential. In addition, the OECD countries must present plausible deficit and debt reduction plans to remove uncertainty in financial markets. For Asia, the debt-to-GDP ratio is 41 percent and the savings rate is high. The foreign exchange reserves in China and India are \$2.6 trillion and about \$300 billion, respectively.

## MONETARY POLICY

During 2007-2009 the major central banks provided ample liquidity and relief to dysfunctional capital markets, and to financial institutions. With the onset of global economic recovery, the central banks are implementing a gradual "exit strategy". Concurrently, the commercial and investment banks are raising capital consistent with the Basel committee guidelines. The regulatory landscape is also being transformed to protect consumers and to enhance accountability standards.

In the U.S., Federal Chairman Ben Bernanke

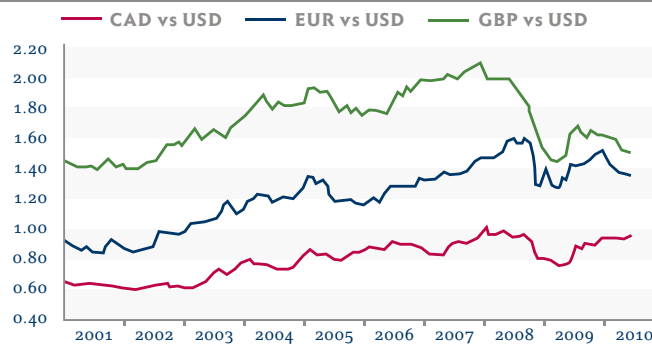
has initiated actions to withdraw reserves and to shrink the Fed's balance sheet. The Federal Reserve Board's supervisory and regulatory functions have been expanded. The normalization of financial intermediation and the resumption of economic growth are constructive developments. Nonetheless, the Fed is also focussed on the inflation trend and

on the sustainability of the recovery. As a result, Mr. Bernanke has been preparing for an increase in the federal funds rate which is likely to come by early 2011.

While the U.S. is considering a move, the central banks in Asia, with the exception of Japan, have already reined in the supply of credit and have increased interest rates. The Reserve Bank of India has increased short-term rates in an attempt to contain inflationary pressures. The Bank of China has also initiated measures to rein in credit growth.

The ECB and the Bank of England are also engaged in restricting quantitative easing and draining liquidity. The Bank of Canada is expected to raise its overnight rate within the next few months in response to favorable financial conditions, a resumption of economic growth and "core" inflation concerns.

FOREIGN EXCHANGE MARKETS  
CURRENCY SHIFT - 2001 TO 2010



Source: Bloomberg

# Recovery : 2010-2011

## FOREIGN EXCHANGE MARKETS

The Canadian dollar is benefitting from the increase in commodity prices owing to an increase in demand from Asian countries. Investments into the resource and other sectors from Asian investors have risen, and the dollar is expected to be at or above parity with the U.S. dollar for some time.

Additionally, other resource-based currencies are forecast to appreciate. A gradual appreciation of the Chinese Yuan is anticipated. This will assist other Asian countries with their exports. Emerging economies with improving fiscal positions will see their currencies appreciate. Conversely, the U.S. dollar is likely to depreciate over the medium-term, and the fiscal risk in the EU and the U.K. is expected to weaken both the euro and sterling.

**“THIS SHARP ECONOMIC DIVERGENCE HIGHLIGHTS STRUCTURAL WEAKNESSES WHICH MERIT ATTENTION.”**

## CONCLUSIONS

Redressing the global imbalances while withdrawing the fiscal thrust and monetary stimulus imparted in 2007-2009 is a challenging task for the G-20 countries. The U.S. budget and current account deficits are troublesome. The immense supply of Treasury bonds will push long-rates higher. Outside of the U.S., China needs to increase domestic demand and a revaluation of the Yuan is deemed desirable. The fiscal dilemma in the EU poses difficult issues for monetary policy. As a result, the ECB is unlikely to tighten in the context of weak economic recovery. In Canada, an economic expansion that is being led by domestic demand and private sector business investment will take hold in the near future.

## BASIC PRINCIPLES OF CONVERTING YOUR RRSP TO A RRIF

Registered Retirement Savings Plans (RRSPs) have become a fundamental building block in retirement planning for Canadians. Investors spend years diligently building up the assets in this tax-sheltered environment only to wake up one morning to discover it is time to begin drawing funds from this pool of investments. There are several practical issues that must be dealt with when liquidating or converting an RRSP account.

First, in the year an investor turns 71, they must choose one of the following options for their RRSP account: **1)** withdraw the funds; **2)** transfer them to a Registered Retirement Income Fund (RRIF); **3)** use the funds to purchase an annuity. This article will focus on the second, and perhaps most popular option, of converting the funds to a RRIF. This is a simple process where the investor signs a new application form to establish the RRIF, and the assets held in the RRSP are transferred to the RRIF. There is no requirement to change the investment holdings or mandate, and there are no immediate tax implications involved with transferring funds. Although an investor can establish a RRIF at any age, they **MUST** convert an RRSP to a RRIF by the end of the year in which they turn 71; however, withdrawals need only begin in the year the investor turns 72.

Once a RRIF is established, a minimum

withdrawal is required each year based on the investor's age, and the funds received are considered to be taxable income. At age 72, the withdrawal rate is 7.38% per annum and is calculated on the portfolio value as at December 31st of the previous year. The minimum withdrawal requirement increases each year; similarly, the rate is lower for those that begin withdrawing at younger ages. For those who do not need the additional cash flow, it may be possible to base the withdrawal rate on your spouse's age, provided he or she is younger than you.

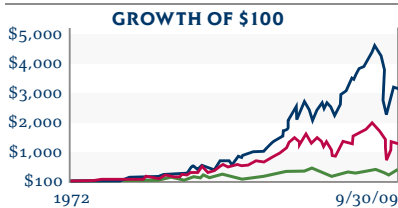
Although the full withdrawal amount is taxable, taxes will only be withheld at source for amounts above the minimum withdrawal. Another notable point with respect to the taxable income from a RRIF is that the payment may qualify as a pension amount for the pension credit under Canadian income tax law. Similarly, you may be able to split the income with your spouse for tax purposes. Finally, for those reluctant to give up contributing to an RRSP; if you have a spouse that is younger than you and you still have earned income (and therefore RRSP room), you can contribute to a spousal RRSP up to and including the year your spouse turns 71. For further advice regarding the implications of deregistering or converting your RRSP, we recommend that individuals speak with a qualified tax professional.

The Canadian experience is similar, with dividend growers achieving 12.2% returns annually since 1986 compared to the S&P/TSX Composite Index at 6.1% and tellingly, the non-dividend payers gaining a paltry 0.3%.

### THE POWER OF PAYOUTS

STOCKS THAT HAVE INITIATED DIVIDENDS OR RAISED THEM HAVE SCORCHED THE MARKET SINCE 1972

- STOCKS THAT START PAYING OR INCREASE THEIR DIVIDENDS\*
- S&P 500 INDEX
- STOCKS THAT DO NOT PAY DIVIDENDS



Returns computed monthly.

\*Includes all S&P 500 companies that began paying dividends or increased them during the previous 12 months

Source: Ned Davis Research

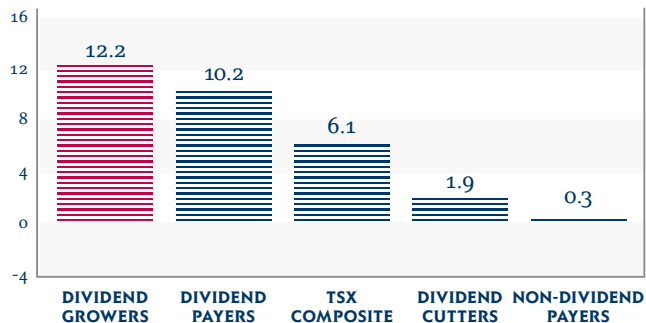
that can exceed the rate of inflation. As an investor who relies on dividend income, having this inflation attribute can equate to significant improvements in one's standard of living. Household names like

When compared to income from bonds, dividends carry the added attribute of inflation protection. As companies mitigate pricing pressures, they are able to raise prices and ideally have dividend growth

Proctor & Gamble have not only paid dividends consecutively since 1890, but have raised them annually for over 54 years!

### SHOWING THE MONEY

TOTAL PORTFOLIO RETURNS (DEC 1986 - DEC 2009, EQUAL WEIGHTED, %)



Source: RBC Capital Markets Quantitative Research

With governments in fiscal duress globally, and consumers deleveraging in the western world, dividends may again be critical for returns in this decade. While Marilyn Monroe may have purred that "diamonds are a girl's best friend" in the 1953 film *Gentlemen Prefer Blondes*, we are sure she really meant dividends!

## IN THE NEWS AT MORGAN MEIGHEN & ASSOCIATES



We are pleased to announce the release of our new introductory package for prospective clients. In addition to providing a history of the firm and our investment process, the included brochure highlights what sets us apart from other investment advisors and the benefits of being a client with Morgan Meighen & Associates.

Also available, as part of the introductory package or on a stand-alone basis, for both prospective and existing clients is a newly created pamphlet which provides an overview of the investment options used by the Private Wealth Management team.

To request a copy of the pamphlet or introductory package for yourself, or someone you know that may be interested in learning more about our services, please contact Shauna George at (416) 366-2931 ext. 229 or [sgeorge@mmainvestments.com](mailto:sgeorge@mmainvestments.com).

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