The past several weeks have seen unprecedented events in the financial sector and economy of not only the United States, but globally as well. As a result, investment markets have been very volatile, with some of the wildest swings in history. There has been a lot of anxiety among investors, investment industry professionals and even regulators. No one can predict exactly what lies ahead in the next few days, weeks or months.

There are six principles that guide your investment strategy:

1. *Well chosen stocks outperform every other asset class over the long term*

   The U.S. stock market is the one that provides the best data over a lengthy period of time, with good information going back to 1925. If we go back to that time (which includes the great stock market crash and depression of the 1930s), stocks of large U.S. companies have outperformed the bonds of those same companies by a margin of roughly 1.75 to 1.

   That means the money made from stocks was almost twice that on bonds over 5 years and with compounding nearly three times that of bonds over a 20-year time-frame. If you'd like more information on this, we can recommend the definitive book on long term returns, *Stocks for the Long Run*, by Jeremy Siegel of the Wharton School of Business.

2. *The price you pay for that superior performance is volatility*

   Along with superior performance comes volatility. Going back over 80 years, the U.S. stock market has made money roughly three out of four years. That means, of course, it has lost money that fourth year – the reason stocks are a good long term investment is they do well enough in the 75% of the time they make money to offset the 25% of the time they lose it.

   Academics call the margin of outperformance for stocks over cash the *equity risk premium*. In fact, academics say that if stocks were not risky, they would not provide a superior return – stocks have to provide higher returns over time to compensate investors for their volatility. If they weren't volatile, their return would be the same as GICs. If you'd like to discuss the principle of the risk premium in stocks and what it means when we talk next, we'd be happy to do so.

3. *Volatility cannot be avoided in the short term*

   All of us would love to own stocks when they rise and to be on the sidelines when they fall. Unfortunately, that's simply not possible.

   If you were to ask a group of investment professionals to name someone who did a consistently great job of picking stocks over a long period of time, a number of obvious candidates would emerge – John Templeton globally, Warren Buffett in the United States, Bob Krembil who ran Trimark Funds until 2000 here in Canada.
   Ask those same professionals to name someone who has consistently predicted when to get into and out of the stock market and you'd draw a blank. Lots of people have made one, two or even three good calls on when to get out of the market. However, no one has demonstrated the ability to get this consistently right – and people who have tried to time getting into and out of markets have typically been wrong at least as often as they're right.

Markets like these remind me of an advertising campaign for oil changes some years back that had the theme "You can pay me now or you can pay me later."

Investing always entails a combination of pain and gain – the only question is when they occur. When we have weeks like the ones recently, the pain of investing is immediate, the gain is in future. If you avoid stocks, the gain in peace of mind is immediate; the pain in lost opportunity and retirement lifestyle is down the road.

In times like these, sitting on the sidelines can be tempting and that's certainly an option if you truly can't live with the volatility we've experienced of late. Let us remember, however, that history shows that when stocks recover from a significant drop, they tend to do it very quickly – being out of the market can mean missing a rise of 25% or more.

4. *Volatility decreases the longer you invest*

The good news about volatility and risk is that the longer your time horizon, the less of an issue it is. Looked at over periods of five or ten years, the variations in returns are reduced to a fairly modest level.

Based on historical experience, for investors with a time horizon of ten years or more, volatility decreases to the point that it's almost a non-issue. The next time we meet, I'd be pleased to share some charts that illustrate this point.

5. *Investing based on fads and emotional reactions to events can be devastating*

The investment industry has seen fads come and go – and we have observed how they can devastate portfolios. Avoiding "flavour of the day" investments that are hot one day and plunge the next can generally insulate portfolios from the effects of the market bubbles and the resultant crashes. An investor may miss some of the run up, but will also miss the bloodbath that may follow.

Similarly, emotional reactions can be fatal to a well-balanced portfolio. There's a well known expression that most investors fluctuate between fear and greed – excessive optimism dominated in the period until recently; today it's fear and pessimism that rule the day.

Making decisions based on fear and greed can destroy value in a portfolio. We see our role in part as being an emotional anchor for clients – preventing the emotional highs from being too high, the lows from being too low. Until recently, our struggle with some clients was avoiding an overly optimistic viewpoint, throwing caution to the winds – today, for some of those same clients, it's preventing an excessively pessimistic and negative outlook.

6. *Based on history, the right managers will prove their worth over time*

It is important to invest with money managers with strong investment convictions and discipline, deep teams of investment professionals, consistent outperformance over an extended period of time and a track record of containing losses in downturns.

I believe we have a strong team of managers in place that will serve us well over time. As we write this, those managers are looking for bargains among the stocks that have been beaten down by recent events.

Some clients have expressed the concern that we are standing pat in the face of turbulent markets. It's important to understand that while we may not be making changes in the managers we work with, beneath the surface your portfolio is being modified as these managers realign the stocks they hold to capitalize on opportunities.

The outlook for the period ahead

It is almost certain that stock markets will continue to see unusually high levels of volatility in the period ahead – and without question it will take some time for U.S. and Canadian markets and economies to work through the excesses of the recent past, whether from the U.S. housing bubble or the run up in commodity prices.

The good news is that markets have overcome similar challenges in the past – often more quickly than anticipated at the time. As we look past the current environment and ahead to the mid term, despite the ups and downs (especially the downs) of the past while, there are a number of things from which we can take encouragement:

1. Central banks around the world have made it clear that they will intervene as required to keep markets functioning – as happened several times over the last few months.

2. The ban announced in the US, the UK and other countries on short selling of financial institutions (a tactic used by some predatory investors to put pressure on the stock prices of those companies) is likely to reduce the extreme volatility in that sector.

3. To this point, this has been a financial crisis rather than an economic one. While economies in Canada, the U.S. and elsewhere have slowed, and while to date there are no signs of a steep recession, the fact that the U.S., Canadian and other central banks made a coordinated interest rate cut shows they are taking steps to try and avoid a significant downturn.

4. A number of very positive forces are in place for the mid-term. Among these are generally low inflation, the continued positive impact of technology and innovation on productivity, the overwhelmingly beneficial effects of increasing global trade, good economic and political news from most of Eastern Europe and South America and the inexorable momentum towards opening up of markets in China, India and other parts of the developing world. Importantly, while declining oil prices have hurt stocks in the oil patch, they are helping boost consumer confidence and wallets.

5. Good money managers are finding exceptional values today. As a result of the run up in financial stocks, some managers with a superior track record for picking stocks largely avoided the U.S. financial sector because of overheated valuations; in some instances, these managers are taking advantage of depressed prices to now start buying these stocks.