



Why Should I Invest in the U.S. Market?

CUMIS Retirement Services is pleased to present this information from investment managers Philips, Hager & North.

Mounting deficits, rising interest rates, surging oil and gas prices, a “frothy” housing market, and destructive natural disasters. On the surface, the United States may not look like an enticing place to invest one’s money. Indeed, most economies would not fare well under such conditions. Add to the mix a sliding U.S. dollar (which serves to reduce Canadian-dollar denominated returns on U.S. equity investments), and many Canadian investors have found themselves questioning the logic of investing in the U.S. stock market, especially given the attractive returns that the domestic market has provided over the past few years.

However, behind the reported gloom, the U.S. economy has shown impressive resiliency. Unemployment is low, companies are flush with cash, spending by businesses and consumers has been robust, inflation remains tame, and economic growth has been strong. In other words, things are not as bad as the headlines may imply. This is not to say that investors should ignore the threats to sustained economic growth. At PH&N, we are keeping a close eye on the imbalances south of the border. Yet, when questioning the logic of investing in U.S. equities over the long term, it is important to look beyond current statistics and to focus instead on the bigger picture.

The world’s largest economy

The United States boasts the world’s largest economy, accounting for over half of world economic activity. This alone is not sufficient reason to invest a sizeable portion of one’s portfolio in the U.S. stock market. However, because the United States is an industrialized nation with a highly educated workforce, a “business-friendly” tax system, sophisticated capital markets, and an efficient legal system, numerous opportunities exist for investors, as the infrastructure is in place for businesses to succeed. In addition, the breadth of companies in which individuals can invest is unsurpassed in the U.S. equity market.

Furthermore, many U.S. businesses operate in the global marketplace, providing investors with exposure to economies all over the world. Companies such as Coca-Cola, McDonald’s, Wal-Mart, and Microsoft sell their products from Boston to Bangkok, thus touching a vast network of end-consumers. The global mindset common to many of America’s corporations encourages growth and expansion into new markets, which leads to a larger and more diversified customer base. Exposure to intense global competition also forces U.S. firms to be as efficient as possible. In fact, over the past 15 years, economy-wide U.S. output produced per hour of work has grown at an annual rate that is about 45 per cent faster than it is in Canada¹. Not only is the U.S. economy highly productive, because many U.S.

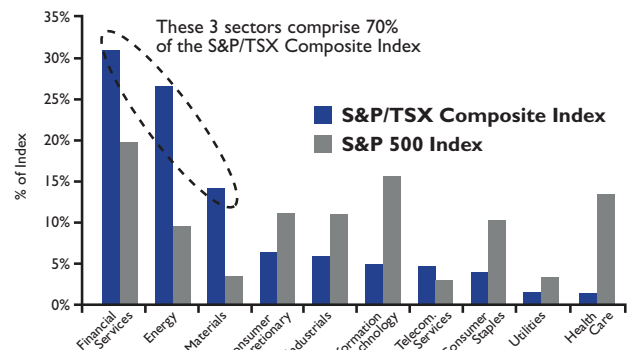
businesses are multinational in scope, they are less susceptible to the impact of an economic downturn in any one particular region.

Along with providing the potential for exposure to the global economy, investing in the U.S. market also provides individuals with a level of investor protection not afforded in many nations around the world. Because of the strict legal and reporting requirements facing companies listed on U.S. stock exchanges, investors can closely analyze a company’s operations and have faith in the legitimacy of its business practices. Granted, we have recently witnessed some high-profile cases of corporate corruption and fraud, but such occurrences are, in fact, quite rare and serve to strengthen the measures in place to protect investors.²

Moreover, the capital markets in the United States are among the most liquid (i.e., heavily traded) in the world, meaning that stocks can be bought and sold with ease. As well, the transaction costs associated with buying and selling U.S. securities are minimal, generally speaking. These factors are particularly important for mutual fund investors, as fund managers require a highly liquid marketplace and low trading costs in order to effectively execute their investment strategies.

Diversification

The U.S. stock market is much better diversified than the markets of smaller economies such as Canada, where certain sectors or industries may be dominant. Consider the following: while the S&P/TSX Composite Index comprises 10 industry sectors, the three largest sectors account for over 70 per cent of the Index. In the United States, the three largest sectors make up less than 50 per cent of the S&P 500 Index. The broad diversification of the U.S. market provides investors with greater opportunities in sectors that may not be as well represented in Canada, and less potential downside risk if certain sectors succumb to a sell-off.



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CUMIS Market-Based Funds

Gross Annualized Rates of Return as at December 30, 2005

Fund	3 Month (%)	1 Year (%)	3 Year (%)	5 Year (%)	10 Year (%)
Money Market					
Canadian Money Market Fund (PH&N)	0.8	2.7	2.7	3.0	3.9
30 Day T-bills	0.7	2.6	2.6	2.9	3.6
Fixed Income					
Retirement Security Fund (CUMIS)	1.2	5.2	5.4	5.7	6.6
Universe Bond Index Fund (BGI)	0.7	6.5	6.7	7.4	7.7
Income Fund (Ethical)	0.8	6.6	7.0	7.4	–
Fixed Income Fund (McLean Budden)	0.9	6.4	6.8	7.4	8.0
Short-Term Bond & Mortgage Fund (PH&N)	-0.1	2.7	4.4	5.8	6.3
Bond Fund (PH&N)	1.0	7.0	7.2	7.8	8.0
ScotiaMcLeod Universe	0.7	6.5	6.8	7.4	7.7
Balanced					
Balanced Fund (Ethical)	1.2	12.5	11.5	4.8	–
Balanced Core Fund (McLean Budden)	2.5	10.9	11.0	6.4	–
Balanced Fund (PH&N)	1.2	10.0	11.6	4.7	8.6
Active Balanced Fund Benchmark	2.3	12.3	11.8	4.5	8.2
Canadian Equity					
S&P/TSX Composite Index Fund (BGI)	2.8	24.1	21.7	6.7	11.0
Canadian Equity Fund (Bissett)	3.0	22.3	19.2	10.6	–
Growth Fund (Ethical)	2.7	18.3	16.4	5.2	–
Special Equity Fund (Ethical)	6.7	27.1	–	–	–
Canadian Small Cap Fund (Franklin Templeton)	8.0	22.4	–	–	–
Large Cap Canadian Equity Fund (Mawer)	2.7	22.2	20.1	12.0	13.9
Small Cap Canadian Equity Fund (Mawer)	5.1	19.8	26.3	27.1	19.3
Canadian Equity Core Fund (McLean Budden)	3.2	21.2	19.5	10.7	15.2
Canadian Equity Value Fund (McLean Budden)	3.2	20.6	17.8	12.9	16.4
Canadian Equity Fund (PH&N)	0.9	15.7	17.5	5.8	11.5
S&P/TSX Composite Index	2.9	24.1	21.7	6.6	11.0
NB Small Cap Universe Index	4.4	13.8	23.3	13.7	8.1
Dividend					
Dividend Income Fund (PH&N)	2.9	14.9	18.9	11.3	18.9
S&P/TSX Composite Index	2.9	24.1	21.7	6.6	11.0
U.S. Equity					
U.S. Equity Index Fund (BGI)	2.7	2.0	3.0	-4.6	7.2
American Equity Fund (McLean Budden)	4.8	3.5	5.1	-0.1	10.9
U.S. Equity Fund (PH&N)	2.4	-1.4	0.8	-6.2	3.9
S&P 500 (\$Cdn)	2.8	2.3	3.4	-4.4	7.4
Foreign Equity					
EAFE Equity Index Fund (BGI)	4.8	10.3	11.6	-0.6	4.3
International Fund (Bissett)	3.8	8.4	14.2	2.1	–
International Equity Fund (Ethical)	6.6	13.3	–	–	–
Non North American Equity Fund (Mawer)	1.1	15.3	13.8	3.9	10.2
Global Equity Fund (McLean Budden)	3.8	5.7	6.6	-1.4	–
Overseas Equity Fund (PH&N)	2.1	5.5	8.2	-3.1	–
Growth Fund (Franklin Templeton)	1.8	7.1	11.5	2.9	–
MSCI EAFE (\$Cdn)	4.8	10.7	11.8	-0.5	4.2
Actively Managed Asset Allocation Funds					
LifePoints Balanced Income (Frank Russell)	1.7	9.6	9.2	6.0	9.0
LifePoints Balanced Growth (Frank Russell)	2.3	12.7	11.7	5.1	9.4
LifePoints Long-Term Growth (Frank Russell)	2.7	16.6	14.6	5.2	10.2
LifePoints All-Equity (Frank Russell)	3.3	14.5	–	–	–
Index Managed Asset Allocation Funds					
Conservative Balanced Index Fund (BGI)	1.8	7.7	8.0	4.1	7.3
Moderate Balanced Index Fund (BGI)	2.2	11.5	11.4	4.5	8.7
Aggressive Balanced Index Fund (BGI)	2.6	14.9	14.2	4.2	9.2

Note: All performance data is shown on a gross or “pre-fee” basis except for Retirement Security Fund

1 - Retirement Security Fund charges 1.2% in Investment Management Fees. The returns shown above for RSF are net of fees.

2 - Current benchmark composition: 35% S&P/TSX Capped Composite Index, 25% MSCI World ex Canada Index, 35% SC Universe Bond Index, 5% SC 30-Day T-Bill Index.

3 - Pooled funds are not guaranteed, their values change frequently and past performance may not be repeated.

4 - The Ethical Funds charge an expense management fee against the fund up to a maximum of 20 basis points.

5 - Mawer Investment Management charges expenses against the funds and are not included in the above fees.

Why Should I Invest in the U.S. Market? *(continued)*

Diversification *(continued)*

Given the “narrow” nature of the Canadian market (i.e., the lack of inter-sector diversification), it is prudent for investors to have at least some foreign exposure in the equity portion of their portfolio. And given the breadth of the American market, the U.S. is an excellent place to find that exposure. Canadian investors should be aware that if their own portfolio resembles the sector composition of the S&P/TSX Composite Index, they have significant exposure to Financials, Energy, and Materials stocks, and little exposure to Health Care, Industrials, and Information Technology stocks. While this has played in their favour over the past few years, it is important to maintain a long-term outlook, recognizing that certain sectors of the market tend to outperform and underperform at different times, and it is therefore prudent to avoid over-exposure to certain sectors of the economy.

Is now the right time?

Some investors acknowledge the merits of investing in the U.S. market, yet they are dissuaded by the current landscape and are “waiting for the right time to get back in.” Moreover, many investment professionals—ourselves included—have expressed concern that the U.S. dollar may have further room to fall against other major currencies, including the Canadian dollar. So, why not wait until things look a little more rosy to invest in the U.S.? Our response is twofold: first, trying to “time the market” (i.e., buy in at the trough and sell at the peak) is a losing game; and second, as previously mentioned, the near and long-term economic outlook for the U.S. is reasonably encouraging in our view. While the recent damage inflicted by Hurricanes Katrina and Rita adds an element of uncertainty to this outlook over the immediate short term, our longer-term outlook remains positive.

At PH&N, we have often emphasized the dangers of market timing, with respect to both equities and currencies. While tactical asset shifts (i.e., slightly reducing one’s exposure to a certain asset class in favour of another) can help add value to a portfolio, avoiding or exiting an asset class (or currency exposure) altogether with the intention of buying back in at a later date has proven to be a losing strategy. Few, if any, investment professionals have demonstrated an ability to successfully time the ups and downs of the market or currency movements on a consistent basis. Furthermore, while we believe that the U.S. dollar may depreciate further against the Canadian dollar, we acknowledge that the magnitude and timing of such a decline is

a large unknown. Thus, we do not recommend avoiding the U.S. equity market based on speculative views of currency movements.

Economic forecasting is a difficult game, as many variables and unknowns come into play. Nonetheless, we believe that a weak U.S. dollar will help the U.S. economy gradually work its way out of its structurally large current account deficit. As well, we feel that sustained strength in business and consumer spending will continue to support modestly strong economic growth over the medium term. Of course, there are risks to our outlook. In particular, a collapse in the housing market could lead to a consumer-led recession (we assign a low probability to this scenario), and high energy prices could weigh on consumer spending and economic growth. Yet, the U.S. economy has proven to be resilient in good times and bad—a fact that should not be discounted when considering its long-term prospects.

For those investors who cite currency concerns as the key reason for avoiding investment in U.S. equities, it is important to remember that the business strategy of many American corporations is global in nature. Indeed, a weak U.S. dollar will help contribute to greater corporate profitability for those companies that have a global presence (as revenues in stronger foreign currencies are converted back into a weaker U.S. dollar).

Concluding thoughts

The United States is home to many of the world’s most profitable, dynamic, and well-run corporations. Despite a rash of troubling headlines and legitimate reasons for concern, the U.S. market remains a highly compelling place to invest over the long term. A well-balanced equity portfolio should always maintain some exposure to foreign securities, especially U.S. equities, given the sheer size, sophistication and depth of the U.S. market.

¹ Source: The Centre for the Study of Living Standards. International Productivity Monitor. June 15, 2005.

² New York State Attorney General Eliot Spitzer has aggressively prosecuted corporate executives accused of fraud and has initiated industry-wide reforms, recovering billions of dollars for investors in the process.

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Correction

For our defined contribution (registered pension plans), RRSP and DPSP clients, please note a typo on page six of our Capital Accumulation Plan (CAP) Guidelines – Initial Plan Setup. On page six, under item 3.4.1, under “How CUMIS Supports Plan Sponsors,” CUMIS (CRS) does not provide investment advice, but can assist in identifying criteria to be used. The word “not” was missing. We apologize for the inconvenience.

News from the Government

Government Retirement Programs 2006

Old Age Security – First Quarter of 2006

Basic Benefits \$484.63	GIS max. Single \$593.97	GIS max. Married \$389.67	Spouse's Allowance \$874.30	Widow/Widower \$967.24
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	Canadian Pension Plan		Quebec Pension Plan	
	2006	2005	2006	2005
YMPE	\$ 42,100.00	\$ 41,100.00	\$ 42,100.00	\$ 39,900.00
Basic Exemption	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00	\$ 3,500.00
Contribution Rate				
• employee	4.95%	4.95%	4.95%	4.95%
• employer	4.95%	4.95%	4.95%	4.95%
• self-employed	9.9%	9.9%	9.9%	9.9%
Annual contribution (maximum)				
• employee	\$ 1,910.70	\$ 1,861.20	\$ 1,910.70	\$ 1,861.20
• employer	\$ 1,910.70	\$ 1,861.20	\$ 1,910.70	\$ 1,861.20
• self-employed	\$ 3,821.40	\$ 3,722.40	\$ 3,821.40	\$ 3,722.40
Retirement benefit (maximum, per month)	\$ 844.58	\$ 828.75	\$ 844.58	\$ 828.75
Death benefits				
• lump sum	\$ 2,500.00	\$ 2,500.00	\$ 2,500.00	\$ 2,500.00
• spouse maximum (per month)				
under 55	\$ 471.85	\$ 462.42	\$ 714.30	\$ 699.42
under 65	\$ 471.85	\$ 462.42	\$ 716.31	\$ 710.37
• spouse maximum over 65 (per month)	\$ 506.75	\$ 497.25	\$ 506.75	\$ 497.25
• orphan (per child, per month)	\$ 200.47	\$ 195.96	\$ 63.65	\$ 62.22
Disability benefits				
• contributor (maximum, per month)	\$ 1,031.05	\$ 1,010.23	\$ 1,031.02	\$ 1,010.20
• child (per child, per month)	\$ 200.47	\$ 195.96	\$ 63.65	\$ 62.22

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