

Template for a Mid-Year Letter to Clients

By Dan Richards*

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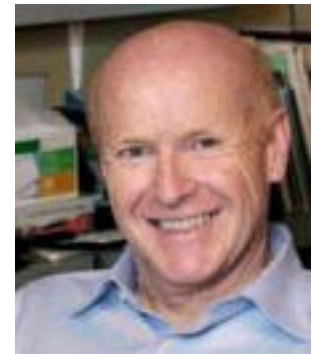
A list of Dan Richards' previous articles appears at the end of this article.

Below is a template for a mid-year note to clients. For background on how to use this template, see Dan Richards' companion article, [A Mid-Year Letter to Your Clients](#). Note to advisors: Please remember that this letter is intended as a template only; be sure to take the time to modify this to reflect your personal views.

For many of us, July 4 is the official beginning of summer.

It also marks the half-way point of the year. Looking forward, I am cautiously optimistic – and want to share some thoughts on where markets stand today and what I'm recommending right now.

If you asked forecasters in early March about the prospects for the economy, you would have heard some very dire predictions – this was when the conversation about the possibility of a depression or Japan-like lost decade was at its loudest.



Although we still face significant challenges and there's no shortage of negative forecasts, the consensus view is that that the worst is behind us:

- While we are still seeing some tough news on job losses and corporate earnings, it appears that global economies have generally stabilized and early March was the point of maximum fear and pessimism. Since the market bottom on March 9, we have seen markets rise by about 40%
- Consumer and business sentiment has shown modest improvement and some important economic indicators have gone from negative to neutral and in some cases positive. Much has been made of the so-called "green shoots" pointing to early signs of recovery.
- While businesses are still cautious, access to lending has improved and we are seeing some positive prospects for a resumption of economic growth. Even in the



face of worsening global growth projections from the World Bank, the current forecast is for the U.S. to exit its recession in the second half of this year and for modest growth in 2010, followed by a return to stronger growth in 2011.

As an example of the improving outlook, here's a June 16 report from Wall Street Journal on an upgraded estimate for U.S. growth prospects by the International Monetary Fund:

[WSJ.com - IMF Upgrades Its View of U.S. Economy](#)

Reasons for caution in the near term

In my conversations with clients over the past while, the number one question relates to the outlook for the period ahead and what we should be doing in our portfolios as a result.

Having said that the worst appears to be behind us doesn't mean we won't see continuing challenges in the economy and stock markets in the period ahead.

As I said at the outset of this note, I am in the category of "cautiously optimistic." Here are some of the things that make me cautious – note that some of these will be positive in the mid- and long-term, but are problematic in the short-term.

- Consumer spending, which fuels 70% of demand in our economy, is hurting as a result of increased savings rates in response to declines in stock markets and house prices. Reducing consumer debt is positive long-term but limits growth prospects in the near-term.
- Our housing market is still a mess, with 20% of mortgages in the "upside-down" category, where the mortgage exceeds the value of the house. House prices do show signs of bottoming, but it will take some time for the housing market and government policies to work through this.
- Many of you have read about "deleveraging" by businesses and financial institutions. This is a fancy word for reducing debt – and while decreasing debt levels will increase stability and reduce pain in downturns, it will also lead to lower earnings than we saw in the past few years.
- Reduced balance sheet debt will hit the profits of many banks, which are also eliminating high risk operations. While this will result in fewer crises and lower volatility in their earnings, it also means that some of the sources of windfall profits from trading and capital market activities over the past decade will disappear going forward.



- With the global economy still operating well below capacity, in the near term many companies will struggle for revenue growth and will also be facing pressure on margins; this will inevitably hurt profitability.
- The government is funding stimulus spending with record issuance of new debt and budget deficits. At some point, this will have to be repaid – and also runs the risks of fuelling inflation down the road.

Why I'm optimistic in the mid-term

While these challenges are real, I believe they are fundamentally manageable and that they are outweighed by the mid- and long-term positives. I don't believe anyone can predict market movements in the short-term and so avoid doing so myself – instead I try to focus on prospects for the economy and markets looking out eighteen months to three years.

When I do that, there are numerous reasons for optimism:

- The coordinated action by central banks and Governments around the world appears to have stabilized the economy and prevented the precipitous decline that many had feared. We've never seen the level of international cooperation on the economic front that exists today.
- Some of the most extreme fears about the banking system now appear exaggerated. The stress tests of bank balance sheets gave most banks a clean bill of health and some have started repaying the funds they received earlier this year (although these stress tests also highlighted continued problems with a few large financial institutions).
- We're going to come out of this with a more solid, better regulated financial system.
- The focus on energy self-sufficiency and clean fuels has unleashed a frenzy of entrepreneurial activity, with breakthrough technology being developed by many small and mid-size companies. In the past year, Fortune Magazine has devoted considerable space to profiling some of these companies. Here's a link to an article on green firms of the future:

[6 Green Tech Firms of the Future](#)

- Many of the building blocks that led to optimistic forecasts a year ago are still in place – the impact of technology on productivity and higher profits, record levels



of research and development around the world, the emerging middle class in China, India and other developing countries, continued growth of trade and the global move to open markets.

- Most important for investors, the bulk of the bad news appears to be fully priced into current stock valuations. Many veteran money managers with strong track records are identifying excellent values and a number have said recently that they are able to buy good quality assets at prices well below their intrinsic value.

What I'm recommending today

While the easiest profits may be behind us, I still see good opportunities in quality stocks with attractive dividends, with strong coverage should profits decline. The dividends on these stocks not only generate good income but also provide a buffer should markets move down.

As well, I like the value in investment grade corporate bonds and high yield bonds. While the greater volatility in these asset classes requires a stronger stomach than government bonds, the spread between the interest rates on these and government bonds is at historically high levels, even after narrowing over the last while.

Going forward, expect continued volatility and headlines that will cause alarm. As a result, we are continuing to focus on balanced, diversified portfolios – one of the important lessons from 2008 was the critical importance of diversification. I am also monitoring any signs of significantly higher inflation or a pattern of corporate earnings coming in below expectations, either of which would cause a rethinking our portfolio strategy.

In light of what's happened in the last year, all investors need to take a hard look at their risk tolerance and financial situation. I would be happy to sit down to update your financial plan and discuss any changes arising from this process.

In conclusion, I wanted to express my thanks for your patience through what has been an exceptionally difficult period. All of us have found ourselves challenged over the past nine months – and I expect to look back on this last while as a once in a lifetime test of our discipline and resolve.

Best wishes for a relaxing and restful summer – and remember, should you have any questions whatsoever, my team and I are here to take your calls.

Name of advisor
Phone number



** Dan Richards conducts programs to help advisors gain and retain clients and is an award winning faculty member in the MBA program at the University of Toronto. To see more of his written and video commentaries and to reach him, go to www.strategicimperatives.ca.*

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