A Template for a Year-end Letter
By Dan Richards
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A list of Dan Richards’ previous articles appears at the end of this article.

Many advisors have told me they received a positive response from the quarterly review letters they’ve sent over the past year based on the templates I’ve provided.

Here’s a template that can be a starting point for a year-end review letter – just remember that to be effective, a letter such as this one needs to feel:

1. substantive
2. candid
3. backed up by facts
4. easy to read
5. reflective of the personality of the advisor writing it.

That means you need to take the time to personalize the letter, using your language and examples and to reflect your point of view.

Draft year-end review letter

December 15, 2009

Looking back – and looking forward

This was one of those years that reminded us what a roller coaster the stock market can be – and also of the dangers of conventional thinking.

After the collapse in global financial markets last fall and the resulting pummelling taken by stock markets around the world, the consensus in January was that the worst was behind us. That was a sharp reminder of the danger of conventional thinking – by early March, the market was down by 25%.
At that point, the consensus shifted and there was growing sentiment that we might be entering a long period of economic stagnation; that’s when we heard respected economic forecasters talk about a one-in-five chance of another Depression. It was precisely at this point that the coordinated stimulus spending by governments around the world finally had an impact and we began seeing signs of an economic recovery. From the market’s bottom on March 9 to the end of November, global markets were up by 50% to 65%.

Thus, 2009 was a sharp reminder that it’s impossible to predict short-term market movements.

Instead, we need to focus on two key questions:

1. First, what do the prospects for economic and profit growth look like in the mid term – 12 to 18 months and beyond?
2. Second, to what extent are these prospects for growth accurately reflected in today’s prices of stocks and bonds?

**Mid term prospects for growth** *(Customize this to your own point of view)*

In building portfolios, we start with some core assumptions about the environment going forward.

Noted British historian Paul Johnson has written that at every given point in time, you can always point to good news and bad news – the only difference is the balance between the two and what gets the media’s attention.

*This paragraph can be deleted if you feel the letter is too long for your clients to read:* In early 2000 (at the height of the tech bubble) and the beginning of 2008 (at the top of the real estate and finance bubble), all we read about was good news – almost no attention was paid to any offsetting concerns. By contrast, during market bottoms at the end of 2003 and early 2009, all we saw was the bad news – it’s as if there were no positives on the horizon.

Despite the recovery in the global economy and markets since the early part of this year, the general sentiment and confidence level among many people today is quite negative. Much of that is driven by concerns about our economy – still the engine of global growth.

And certainly there are lots of things to worry about in the U.S. – stubbornly high unemployment, a housing market that is still depressed (although no longer in decline) and government deficits.
Without dismissing the short-term challenges facing us, it’s important not to lose sight of some important underlying positives.

In an August cover story on “The case for optimism,” Business Week Magazine highlighted a number of reasons to be positive, among them the impact of technology and free markets in emerging economies.

Click here to read more about what Business Week had to say:

And recently two respected columnists at the New York Times, Thomas Friedman and David Brooks, weighed in on both the positives in the U.S. and some of the challenges that America faces.

The bottom line is: In the mid term, I believe the positives outweigh the negatives and that the dire predictions about America’s decline are overstated. We may not see the rapid growth we’ve seen in the past but we will see solid growth.

**Today’s valuation levels (Customize this to your own point of view)**

Being right on our mid term outlook for the economy only helps us if we buy stocks and bonds at attractive prices.

With regard to bonds, at current ten-year rates of about 3.6% it is hard to make a case for US Treasury bonds as anything except a safe harbor against more market disruption.

The returns on corporate bonds are more interesting – especially toward the bottom of the investment-grade category, which currently yield about 6%. We have to be very selective here, since companies with low investment-grade ratings are susceptible to shocks and downgrades should the economy run into difficulty.

On the issue of valuation levels of stocks, lots of academics have made a career of studying markets. Of these, I follow two in particular – Jeremy Siegel at the Wharton School of the University of Pennsylvania and Robert Shiller at Yale. Between them, they forecast both the technology and the U.S. real estate bubbles.

Shiller believes stocks should be valued based on their average earnings over the past ten years, using what he calls the Cyclically Adjusted Price Earnings ratio (CAPE for short). Employing that measure, at the end of November, Shiller calculated that the U.S. market’s multiple was 19.5 x times average earnings for the past ten years, within the normal historical range (although at the high end of that range.)

Prior to 2008, you have to go back to 1992 to find the last time we saw this multiple consistently below 20-times average ten-year earnings. Throughout the period from
1997 to 2001, this multiple was in the 30s and 40s. When the multiple was in the 40s, you were paying twice as much for a dollar of earnings as you are today.

Jeremy Siegel is the best known researcher of long-term returns in the stock market and author of *Stocks for the Long Run*, often cited as one of the all-time ten most influential books on investing. Among his claims to fame is an article in the Wall Street Journal at the peak of the tech mania in early 2000, predicting that sector’s collapse.

In September, Siegel did two interviews on long-term returns and current valuations, in which he talked about his research and his opinion that stocks offered good value at the time. You can see those interviews below:

Jeremy Siegel on today’s market outlook.
Jeremy Siegel on long-term stock returns.

The bottom line from these two experts: While stocks are not as cheap as they were in March, by historical standards they do offer reasonable value.

While we can expect continued volatility in 2010, we do believe that returns on stocks in the period ahead will be in line with historical levels.

**The right approach for your portfolio**

While my team and I spend a great deal of time focusing on the big picture, the most important issue is how we adapt that view to each client’s individual portfolio.

For older clients, we have always been believers in maintaining conservative, balanced portfolios – that stance protected our retired clients from the worst of the decline in 2008 and early this year. Today, we are focusing on higher quality stocks, as we believe that these will provide the best risk-return tradeoffs going forward.

In summary, we are cautiously optimistic about the economy’s ability to work through some of the current issues we face – and believe that valuations on stocks will make quality stocks an attractive investment in the mid-term.

We look forward to continuing to work with you in 2010 to ensure you have the portfolio that is right for you – and thank you again for the opportunity to work with you over the past while.

As always, my team and I area always available to talk about any questions that you might have.

In the meantime, best wishes for a relaxing holiday season – I look forward to talking in 2010.
* 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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