THE Fred Langan e-REPORT

THIRD QUARTER 2011

DON'T PANIC

Stock markets don't panic, people do. Markets are made up of millions of people making decisions and they do tend to run in herds. And it isn't just stock markets. The Canadian dollar dropped 3.75 cents in two hours one day in late September. That hits the value of stocks for individuals and Canadian fund managers.

When there are huge drops in stocks like the ones we've seen in the past few months it is hardly surprising that smaller investors panic since there is so much information coming at them from so many different angles. To borrow a line from Jane Austen, it is a truth universally acknowledged, that a person in market panic mode must be in need of a good advisor.

Andrew McCreath is a money manager who sold his own firm to a large mutual fund company. While he waits to start another investment boutique company, he's taken a contract to appear as a commentator on BNN, the Business News Network. Along with investing other people's money, he also invests his own and he likes an outside voice.

So what does a money professional look for when he's shopping for financial advice?

"The first thing you have to ask yourself is what is your appetite for risk. If you can't sleep at night worrying about the ups and downs of the stock market, stick to something safer. And that includes mutual funds," explains McCreath over an afternoon coffee.

He says people also need to assess whether they need income from their savings or whether they want the entire lump to grow.

Then there is the question about the type of person you are looking for to take care of your money. McCreath had to ask himself these questions recently when he was looking for someone to manage his money. Even a pro has to step back and ask for help.

"Am I looking for a stock broker or a financial planner type? Is this is a person who only buys the TSX 60 (the top 60 blue-chip stocks listed on the Toronto Exchange) or someone more sophisticated. You might want someone who understands things such as high yield bonds. In my case I wanted someone quite sophisticated, but that isn't true for everyone," says McCreath.

There is also the decision of when to switch. McCreath says you shouldn't pull the trigger in a hurry, in particular when the market is hyperactive.

"Everyone makes mistakes, so you can't judge them on one bad quarter. You have to give people a chance to prove themselves," says McCreath, who realizes no one wants to hang in with a loser forever.

"The big question is are they sticking to their discipline? If the person is a value investor, have they moved away from that philosophy in a market panic situation? The time to switch is when you see a pattern of under-performance driven by reasons that make you uncomfortable."

That's the kind of advice Andrew McCreath gives his panic possessed friends and just what he's going to be telling TV viewers as he switches from money manager to TV commentator.

BANKERS' SALARIES AND SHAREHOLDER DIVIDENDS

Just about everyone reading this article owns shares in one Canadian bank or another, if not in all five of the top banks in this country. If you don't own the shares directly, they would be held in RRSPs, RRIFs or pension and other funds such as those managed by the Actra Fraternal Benefit Society. Certainly the Canada Pension Plan owns shares in all of the Canadian banks, and we all own the Canada Pension Plan.

That's why bankers' big pay cheques should get up our noses. Not out of envy – hockey players make more – but out of old-fashioned self-interest: Bankers are paying themselves with what should be our money.

For example, in the third quarter of this year the Bank of Nova Scotia paid out $1.4-billion in bonuses and salaries. In that $1.4-billion number, salaries remained pretty stable but performance bonuses rose, and those affect the higher paid employees in the bank and its investment-banking arm, Scotia Capital.

The higher risk side of the business, where the big bonuses go, in fact, made less money in the third quarter than it did for same period last year. As always in times of crisis, the domestic side of Canadian banks bails out the other riskier side. Scotia's profits from domestic banking were stronger.

The quarterly dividend paid on the Bank of Nova Scotia's common stock remained unchanged even though the bank's profits were up 18%. That means that the employees of the Bank of Nova Scotia, paid themselves well in the third quarter – including bonuses – while leaving nothing extra for us, the shareholders.

We all appreciate that Canadian banks rode out the recession much better than those in the United States, Britain and the rest of Europe. There was no sub prime loan crisis in Canada, as there was in the United States, because banks and other financial institutions are prohibited by law from making questionable loans and re-packaging them for sale as Triple A investments.

However, you could argue that one reason Canadian banks are so solid is that they have to play by the rules set by the federal government. The regulations for the size of down payments are tougher in Canada; and there are no such things as `teaser rates' that encourage people to borrow more than they can afford.

"Canadian bankers are overpaid. Let's face it – all they are doing is effectively running a regulated public utility," said a man intimately involved in the Canadian financial business. However, as senior bankers hold such immense economic power he wanted to remain anonymous.

The situation with compensation at banks, brokerages and insurance companies in the U.S. is out of control and is contributing to both the banking crisis and the political impasse. Canadian bankers' salaries don't get that much attention because they are paid a relative pittance compared to their counterparts in the United States. That still doesn't mean that shareholders should be ignored. If bankers want bigger pay packages they should buy more stock in their own banks and live on the dividends.

Fred Langan is a business writer and broadcaster.