

## My Annual Report Card for 2005

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*The best investors are like professional socialites. They always know where the next party is going to be held. They arrive early and make sure that they depart well before the end, leaving the mob to swill the last tasteless dregs. Good money managers understand that. Investment is all about change and anticipating it.*



**17<sup>th</sup> Century School**

**Johannes Vermeer's "Girl with the pearl ear ring".**

Johannes Vermeer of Delft, also known as Jan Vermeer or Johannes van der Meer, is considered to be one of the great Dutch master painters. However, his work was forgotten after his death in 1675. It was not rediscovered until the late 19<sup>th</sup> century. Little is known about his life and only a small number of his paintings have been preserved. I have visited the Rijksmuseum in Amsterdam many times during the past 40 years and I continue to stand in awe when viewing Johannes Vermeer's paintings.

Like paintings excellent investments of the paper kind are far and few between. Some are terrible investments as many investors have found out during the collapse of the markets in 2000 and 2001 and remain mediocre, many an investor relying on hope that they will recover if only held a little longer. Having an eye for and understanding the underlying fundamentals which move the financial markets is similar to have an appreciation and understanding of what goes into a "objet d'art."

The key is to be able to identify the investment in its early stages of a long-term bull market, preferably much before the start of a long-term bull market. That's not all because then the investor and advisor must have the discipline to just sit and let it ride until it is time to take money off the table or when such an investment has come to its end of the long-term bull market cycle. One would think that this is an easy task to accomplish. Not so. Financial markets and sectors can humble many an investor and advisor and one has to be forever vigilant. Throwing darts at a board and hoping that several of the darts will stick is not good enough. Therefore the often-perpetuated mantra of "asset allocation" and "diversification" is a panacea and a simpleton method of investing.

## HOPE

It's human nature to be optimistic. It's human nature to hope. Furthermore, hope is a component of a healthy state of mind. Hope is the opposite of negativity. Negativity in life can lead to anger, disappointment and depression. After all, if the world is a negative place, what's the point of living in it? To be negative is to be anti-life. Ironically, it doesn't work that way in the stock market. In the stock market hope is a hindrance, not a help. Once you take a position in a stock, you obviously want that stock to advance. But if the stock that you bought is a real value, and you bought it right -- you should be content to sit with that stock in the knowledge that over time its value will work out without your help, without your hoping. So in the case of this stock, you have value on your side -- and all you need is patience. In the end, your patience will pay off with a higher price for your stock. Hope shouldn't play any part in this process. You don't need hope, because you bought the stock when it was a great value, and you bought it at the right time.

**Any time you find yourself hoping in this business, the odds are that you are on the wrong path -- or that you did something stupid that should be corrected.**

Unfortunately hope is a money-loser in the investment business. This is counter-intuitive but true. Hope will keep you riding a stock that is headed down. Hope will keep you from taking a small loss and instead, allowing that small loss to develop into a large loss. In the stock market hope gets in the way of reality, hope gets in the way of common sense. One of the first rules in investing is "Don't take the big loss." In order to do that, you've got to be willing to take a small loss. If the stock market turns bearish, and you're staying put with your whole position and you're HOPING that what you see is not really happening -- then welcome to poverty city. In this situation, all your hoping isn't going to save you or make you a penny. In fact, in this situation hoping is the devil that bids you to sit -- while your portfolio of stocks or mutual fund goes down the drain. In the investing business my suggestion is that you avoid hope. Forget the siren, hope -- instead embrace cold, clear reality. **Courtesy Richard Russell, DOW THEORY LETTERS**

## My philosophy and strategy past, present and future....

In the often-misleading vocabulary of the fund business, my strategy is not based on allocation in specialty funds defined as a 'growth fund' or a 'value fund' or an 'index fund'. Therefore my strategy does not have a fancy description. In reality, I have merely been aiming at the preservation of your capital that you entrusted to me in a manner not dissimilar to that of a wise man looking after his fortune - entirely uninterested in what anyone else is doing. Alas, capital preservation of your capital is far more difficult in practice than the words seem to suggest. In order to understand the quality of investment results, it is important to look beyond the unqualified presentation of its numerical performance. When someone tells you proudly of his returns, you must question him closely as to the risks he ran in achieving them. It is one thing to earn \$1 and quite another to earn \$100 by betting \$100 at the game of roulette. In each case, the outcome might be the same, but both the chances of success and the consequences of failure - i.e. the risks - could not have been more different.

In yet another way, compare the case of a gold jeweller working on a commission from a familiar and creditworthy customer, with that of a lone prospector, pick-axe in hand, leading his mule up a rocky trail into the bandit-ridden high country. Now ask yourself: who took more risk to make a profit from the possession of a few ounces of gold? Despite the obvious satisfaction, which would accrue to all in comparing our results to the general markets, I will not do so. Competition with others is not my game. Wall Street and Bay Street choose to measure returns (whether positive or negative) relative to one's peers rather than in absolute terms. In my view, the practice could not be any more dishonest than that of relying on luck. Where I stand: it would be inappropriate and disingenuous to make any forecasts. In short, I view the economic environment at best as anaemic and view risks to capital missing out in some 'imminent' stock market rally.

Although I do practice 'sector allocation' it is only put into practice when one or more sectors are in harmony with the underlying fundamentals. You will not hear me proudly talking of 'beating the index', while losing my clients' money, or intoning that I should 'dollar cost average', or 'buy and hold'. Regardless of trends or the noise that surrounds me, the only thing I seek is under-esteemed value and the only thing I will hold fast to are my principles, eschewing all fads and talk of new 'metrics' or 'paradigms'. My methodology, though difficult in execution, is simple to enunciate. It is as follows: Firstly I prefer to hold what is least risky - or, conversely, what seems to be the most safe - whatever form that holding takes and wherever in the world it may be found. Simple as it may sound, it isn't. It requires that I have a sound understanding of the macroeconomic forces that are shaping our world and the courage to do what is right rather than what sells or what the herd is following. Doing this I will best be able to preserve the sacred capital which I manage - the most important of all duties - while using it to support the needs of its owners where possible, and, perhaps, of returning more talents than those with which I was first entrusted. My aim is stewardship - not speculation.

## 2005 IN REVIEW

Now that 2005 is behind us and the performance of all mutual funds is public knowledge let's have a look at the sectors, which have generated excellent returns for mutual fund investors. Although these returns are exemplary in a secular bear market the 2005 – One Year Returns are impressive but when spread over 5 years the majority of asset classes post either lack-luster or minus returns. On average I must assume that mutual fund investors have not or barely recovered their losses, which were first inflicted upon their portfolios in March 2000. Average mutual fund sector returns were as follows;

### Average Annual Returns

<b>Asset Class</b>	<b>1 year (2005)</b>	<b>3 years</b>	<b>5 years</b>
TSX Composite	22.00%		
Asia ex-Japan	9.3%	12.9%	3.2%
Canadian Balanced	9.3%	9.6%	4.4%
Canadian Bond	4.9%	5.3%	5.7%
Canadian Dividend	15.4%	15.3%	9.2%
Canadian Equity	16.7%	16.2%	6.4%
<b>Canadian Income Trusts</b>	<b>17.6%</b>	<b>22.5%</b>	<b>16.8%</b>
Canadian Small Cap	18.7%	22.5%	13.8%
Emerging Markets	31.9%	27.5%	12.0%
European Equity	7.0%	10.5%	-2.4%
Financial Services	14.5%	13.3%	2.9%
Global Equity	7.1%	9.0%	-1.7%
International Equity	9.0%	10.5%	-1.9%
Real Estate	13.4%	14.4%	10.5%
<b>Natural Resources</b>	<b>41.8%</b>	<b>31.0%</b>	<b>21.5%</b>
Japanese Equity	23.9%	17.3%	-0.1%
<b>Precious Metals</b>	<b>23.8%</b>	<b>12.9%</b>	<b>27.4%</b>
Science & Technology	2.5%	9.5%	-12.2%
U.S. Equity	2.6%	-4.9%	4.5%

Because of our over-weighting in Canadian Natural Resources Funds, Energy Funds, Precious Metals Funds, Real Return Bond Funds and Canadian Income Trusts my clients' accounts on average increased last year by:

**2005 Average Client Account Increased + 34%**

**January 1, 1999 to December 31, 2005 (6 years) Total Return: +163%**

**Average Annual Return: 27% per year**

**Mutual Fund Assets under Management: \$ 63 million**

**NOTE: Individual client returns may differ slightly according to age and risk-tolerance levels.**

## **Comparative Index Performance**

Relevant indices posted the following returns for 2005:

### **As at December 31st/2004**

**S&P/TSX Composite Index + 21.97%**  
**S&P/TSX Capped Gold Index + 21.47%**  
**S&P/TSX Capped Energy Index + 59.93%**

**S&P 500 Index + 3%**  
**DJIA -0.6%**

**Nasdaq + 1.37%**

**PLEASE always remember that past performance is not a guarantee of future performance results.**

**DISCLOSURE:** The rate of return or mathematical table shown is used only to illustrate the effects of the compound growth rate and is not intended to reflect future values of the mutual fund.

## 2005 One Year, Three Year and Five Year Returns on Mutual Funds held by my Clients

Acuity Income Trust	33.1%			Guardian Income Trust	22.8%	26.6%	32.4%
AGF Canadian Large Cap Fund	20.8%	18.9%	6.7%	Mackenzie Growth Fund	10.5%	17.0%	18.2%
AGF Canadian Resources Fund	44.1%	35.1%	24.5%	Mackenzie Sentinel Real Return Bond	9.7%		
AGF Precious Metals Fund	19.4%	21.8%	35.6%	Mackenzie Universal Canadian Resources	35.5%	33.1%	29.8%
Aim Trimark Canadian Resources	25.7%	26.4%	25.0%	Mackenzie Universal Precious Metals	26.8%	9.7%	29.3%
CI Global Energy	61.6%	40.7%	21.7%	Renaissance Cdn Income Trust	23.5%	23.8%	
CI Signature Canadian Resources	49.8%	34.1%	24.7%	Sentry Select Cdn Income Fund	22.6%	29.2%	
CI Signature High Income	16.6%	19.7%	16.4%	Sprott Energy Fund	42.4%		
Dynamic Precious Metals	26.3%	13.3%	30.3%	Sprott Canadian Equity Fund	13.2%	26.6%	20.6%
Dynamic Focus + Div. Inc. Trust	18.2%	24.6%		Sprott Gold & Precious Minerals	16.3%	17.7%	
Dynamic Focus+ Resources	34.9%	31.9%	26.4%	TD Real Return Bond Fund	11.0%	11.8%	9.3%
Dynamic Real Return Bond Fund	14.7%						

**Summary:** I do not make bold predictions and neither do I compete with my peers. My track record speaks for itself. For 2006 I will continue on our disciplined path by being over-weighted in those sectors, which offer the greatest amount of defensive safety and best possible return prospects. And, I promise to continue to adhere to Warren Buffett's Two Cardinal Rules of Investing:

**Rule No. 1 – Never lose money and Rule No.2 Never forget Rule No.1**

My most sincere thanks go to Ed Bugos of Vancouver for his excellent analytical work and brilliant essays. <http://www.goldenbar.com> His brilliant work has been pivotal to the strategies I have followed. There are several others who with their independent articles and essays have helped me in formulating a "safety first" investment strategy. Thank you: Alan Newman of SAMEX Advisors in New York, Doug Noland of PrudentBear.com, Bill Fleckenstein of Fleckenstein Capital in Seattle, David Chapman of Union Securities in Toronto and Robert D. McHugh Jr. of Mainline Investors Inc. The biggest "thank you" goes to you, my clients for your continued confidence, trust and the privilege that you have extended to me to be your financial well-being advisor.

**Hans Merkelbach**

E-mail Address(es):

[hansmerkelbach@shaw.ca](mailto:hansmerkelbach@shaw.ca)

[hmerkelbach@dundeewealth.com](mailto:hmerkelbach@dundeewealth.com)

Personal Information:

Home Office Address:

520 Smugglers Cove Road

RR # 1-L-43

Bowen Island, B.C. V0N 1G0

CANADA

Phone: 604-947-9623

Fax: 604-947-9624

Toll Free in British Columbia: 1-866-241-6068

Title: Financial Advisor

Company: Dundee Private Investors Inc.

Web Page: <http://www.strategicsector.com>

