

November 1, 2012

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## Introduction

Greetings everyone,

The third quarter of 2012 was particularly interesting as the Canadian and U.S. stock markets grew by 7%. The bond market, meanwhile, remained slightly positive with a gain of 1.24%. It remains our view that the stock market is always the most likely to generate long-term positive returns on the savings of our customers.

The Canadian resource sector seems to have slowly come back to life and we are once again looking for opportunities in this sector. We added Rio Alto Mining, a mining company that specializes in the exploration and extraction of precious metals, to the portfolio. We bought these shares on August 23 at \$4.92 and they were trading at \$5.67 on 19 October 2012, a gain of 15% already. Other securities that performed particularly well this past quarter include Newalta, with a gain of 11.1% and Rogers Sugar at 13.2%.

I will begin this newsletter by talking about what is, in my opinion, the most important risk faced by investors today: the bond market. Indeed, this asset class that has historically been designated as "defensive" could cause many headaches for investors and pension funds. Retaining the services of a private management firm can help a great deal to mitigate the financial risks. The second section of the newsletter is devoted to a topic that I find very interesting: the myth of average yields. I will explain why it is impossible to obtain attractive returns above inflation without the inherent risks of investing. Finally, I present Rivemont Investments' perspectives on the markets and favorite securities.

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*« New opportunities in the resource sector. »*

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- 1 Introduction
- 2 The Bond Risk
- 3 The Myth of Average Returns
- 4 Market Perspectives
- 5 Favorite Securities
- 6 Conclusion

On a separate note, I am pleased to announce that I have accepted to take on the role of Ambassador of the Francophonie for the Ottawa chapter of the CFA Institute. I will be the main link between the Francophone community in the National Capital Region and the CFA Institute. My first responsibilities will include organizing events in French related to the field of finance. As President of the only private management firm in the Outaouais, this new volunteer activity aligns perfectly with my current professional objectives.

## The Bond Risk

Stocks and bonds make up the vast majority of assets invested in by the largest financial firms in the world including Rivemont Investments. The benefits of these assets are numerous, and include historically interesting returns and high liquidity. Liquidity is the ability to sell an asset quickly without influencing the price. Thus, unlike other assets, such as real estate or private equity, the market value of a portfolio of stocks and bonds is usually identical to its net asset value. In Canada, the bond market is estimated at \$1,000 billion, or half of the Canadian market capitalization, which is about \$2,000 billion.

A bond is a debt and the loan term is called "maturity". A bond held in a portfolio is simply a loan. The investor purchases the bond in exchange for loan repayment and interest payments. Bond issuers are generally governments and private companies.

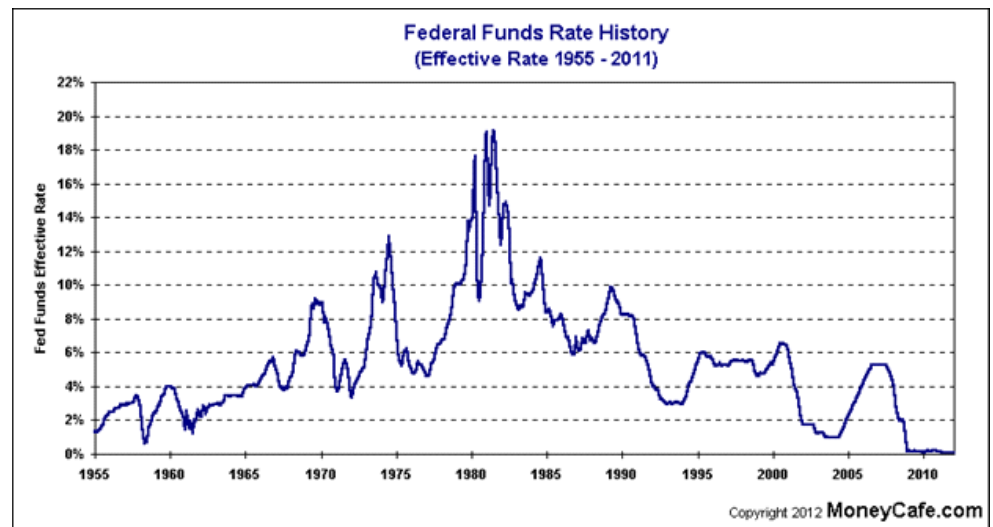
The two main risks related to bonds are credit risk and interest rate risk. Credit risk relates to the ability of the issuer to repay the debt. In practice, very few issuers fail to fulfill their commitments. The most publicized bond defaults in recent years have been those of Iceland and Greece.

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*« Interest rates have never been this low over the past 60 years. »*

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But the greatest risk for bond holders, especially for those who hold government bonds (long-term bonds in particular) is the risk associated with interest rates. The value of a bond moves in the opposite direction of interest rates. A decline in interest rates leads to an increase in the value of bonds, while a rise in interest rates causes a decline in the value of bonds. As a result, bonds have performed extremely well over the last 20 years due to the steady decline in interest rates in North America. Here is an illustration of this trend:




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*« An increase in interest rates causes a decline in the value of bonds. »*

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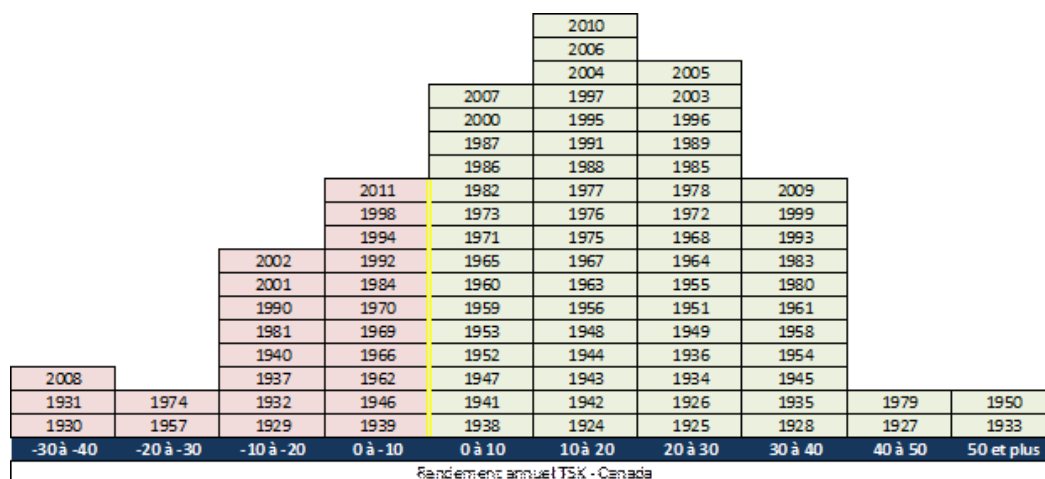
One of the first things to stand out is the fact that the short-term rates have never been this low in the past 60 years. Since 1980, bonds have been the most effective asset class precisely because of the impressive and steady decline of interest rates. However, if interest rates rise, the value of bonds should fall, possibly very quickly. Should this happen, not only would there be a loss of capital, but what is usually considered the conservative ("defensive") part of a portfolio is what would be most affected. So it is essential that bonds be selected judiciously for portfolios in order to minimize the impact, which is what Rivemont Investments has been doing and continues to do.

The risk described above also applies to all investments whose performance is mainly composed of cash flow, such as preferred shares or rental property. It goes without saying that it will be important to underweight these assets in our portfolios. It is also important to be wary of financial advisors who nonchalantly offer "income" or "balanced" investments based primarily on past performance of funds that often have a high proportion of government bonds. The current level of interest rates means that this type of investment carries a risk of major losses due to the loss of capital.

## The Myth of Average Returns

In order to carry out the largest financial fraud of all time, Bernard Madoff did not promise astronomical returns to his customers. Rather, he promised a moderately high performance that was stable over a long period. Unfortunately, too many people believe that a 10% return is possible year after year. And why shouldn't it be? The average return of the stock market is 10%, right?

The truth is that there is nothing less stable than stock market returns. Generally a "normal" year is an extreme year as opposed to an average year. Here is a graph of the historical performance of the Canadian market:



« Canadian markets up  
73% of the time. »

You will notice that the graph has a shape that resembles a normal curve, but with higher ends, indicating that the risk is higher than what one might expect. There are two aspects of this picture that I found particularly interesting. First, in 88 years, there are only 24 years in which the return was negative, a ratio of 27%. Historically, it has been nearly three times more likely to have a positive year than a negative year on the Canadian equity market. This is not bad, especially since there is little or no alternative to the stock market that offers similar potential for the substantial growth of your savings. The other important aspect of this table is the fact that only 50% of the annual returns are between -10% and +20%. For a third of all other years, the yield reached more than 20%! It is therefore important to remember that the stock market volatility is quite normal and it is certainly the main reason why yields are also attractive to investors. The risk/return relationship has never been as easily verifiable.

## Market Perspectives

Rivemont Investments			
Subject	Question	Recommendation	Comments
Allocation between equities and fixed income securities	Is it better to invest in stocks or bonds?	Our preference is for stocks rather than bonds.	As long as interest rates on commercial and government loans remain low, stocks are most likely to outperform bonds.
Distribution between Canadian, U.S. and international holdings	Is it better to invest in Canadian, U.S. or international securities?	Neutral approach to international diversification.	We still avoid European markets due to sovereign debt risks.
Distribution between corporate and government bonds	Is it better to invest in corporate bonds or government bonds?	We recommend corporate bonds rather than government bonds.	We recommend short- and medium-term corporate bonds as well as high-yield bonds.
Investments in Canadian dollars or in foreign currency	Will investments in other currencies increase or decrease the total yield?	The rise in value of the Canadian dollar should be modest and insufficient to discourage diversification abroad.	We avoid investments in Euros, because of the high risk of devaluation.

## Favorite Securities

You will find below a list of the eight individual securities with the largest weight in our "growth" portfolio. These stocks were selected based on their respective potential to outperform the stock market. You will find a short description of their activities, the annual dividend, if any, and the total return since their first inclusion in our portfolio.

Dated October 19, 2012

1) Symbol: GIB.A

Name: **CGI Group**

Description: Consulting services, IT.

Dividend Yield: N/A

Total Return: 21.0 %

2) Symbol: RSI

Name: **Rogers Sugar**

Description: Refiner, processor, distributor and marketer of sugar

Dividend Yield: 5.6 %

Total Return: 42.5 %

3) Symbol: PJC.A

Name: **Jean Coutu Group**

Description: Retail Pharmacy

Dividend Yield: 1.9 %

Total Return: 40.2 %

4) Symbol: CTC.A

Name: **Canadian Tire**

Description: Retail

Dividend Yield: 1.7 %

Total Return: 3.0 %

5) Symbol: RIO

Name: **Rio Alto Mining**

Description: Exploration and production, gold and copper

Dividend Yield: N/A

Total Return: 15.2 %

6) Symbol: CHE.UN

Name: **Chemtrade Logistics**

Description: Chemicals

Dividend Yield: 7.2%

Total Return: 0.8 %

7) Symbol: BDT

Name: **Bird Construction**

Description: Residential and commercial construction

Dividend Yield: 5.0%

Total Return: 9.4 %

8) Symbol: DSG

Name: **Descartes Systems**

Description: Technological solutions related to the transportation of goods

Dividend Yield: N/A

Total Return: 3.7 %

## Conclusion

As many of you already know, I contribute regularly to *La Presse* in articles where I name certain stocks that look promising over the coming months. For more than a year now, the stocks that I have recommended have always collectively beaten the performance of the Canadian market. I am convinced that intense and targeted research can offer superior performance year-over-year when compared to benchmarks. Sector rotation and trend monitoring is a method that, when properly applied, can ensure that the portfolio's holdings are concentrated in the highest performing sectors in the market. Combined with the fact that our management fees are often 50% lower than those of mutual funds, there is no doubt that the private asset management services offered by Rivemont Investments is the best option for individuals and families with significant assets to invest.

Sincerely,

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President

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*Les investissements*  
**Rivemont**  
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