

Charting the right course

Successfully navigating challenging markets is the key to reaching your financial goals

In the markets as in life, it is when we experience adversity that we are given the extraordinary opportunity to discover what we are made of.

And with markets continuing to deliver prolonged turbulence, it can cause even the most level-headed investors among us to second-guess our financial strategies. But it is precisely during times like these, times that stretch our resolve and our resilience, that a long-term financial plan becomes more important than ever.



Murray Taylor,
President and Chief Executive Officer

As markets continue their volatile course, we hope you find this research report, *Charting the right course* from our investment management team at Investors Group, both informative and useful. I trust you will share my confidence in the men and women on our investment management team who represent one of the most tenured, experienced, and skilled group of professionals in Canada at a time when experience is of tremendous importance. Their wisdom, combined with the dedication of your Consultant, are working together to help you ultimately achieve your financial goals by staying on course in these turbulent times.

We look forward to continuing to help you achieve your financial goals.



Scott Penman, B.Comm (Hons.), CFA
Executive Vice-President and Chief Investment Officer

Scott has 28 years of experience in investment management and global capital markets.

“Throughout history, markets have gone through many challenges – only to gain new ground and reach new heights.”

years with Investors Group

This has been an incredible time in the financial markets, and a challenging one for all investors. When he wrote, “Tough times never last, but tough people do,” author Robert Schuller observed that to a large degree it is not so much a function of having problems – a universal condition – that is so difficult for people to overcome, but rather the attitude towards those problems that can have a tendency to exacerbate the situation.

How did we get here?

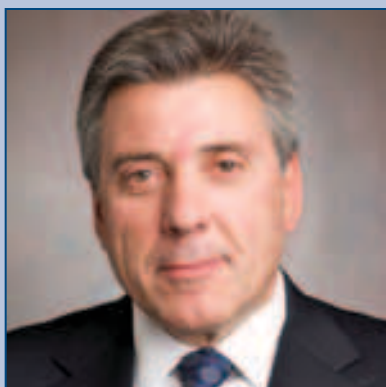
What is causing all the market turbulence? What began simply enough as a spike in access to easy money due to low interest rates over a number of years – has spiraled into a full-blown financial disruption. This disruption froze up credit markets due to a large unwinding of bad debt that lingered in complicated and layered investment vehicles in the U.S. largely built from the subprime mortgage market and other leveraged loans.

These loans were packaged up as investments products and sold off in other parts of the world. Hence the rippling and global effects of this turmoil.

The availability of cheap credit and loose lending standards, combined with misguided or absent policies all collided to create a situation that allowed the subprime mortgage market to occur in the first place. This market essentially sold loans to prospective homebuyers with poor credit ratings at high rates these homeowners could not hope to pay back. Enter mass foreclosures, bankruptcies, and a serious erosion of housing prices in America.

These events have created tremendous uncertainty in the marketplace and as access to capital has dried up, sentiment has shifted from one of confidence to one of fear. This has resulted in a general tightening in consumer spending which is having an impact on the broader economy – and translating into declining growth, employment, and sales.

Today, efforts to keep the flow of capital going are starting to take hold with programs and incentives that are expected to eventually change the direction of sentiment, the markets, and the broader economy.



“Fear is currently ruling the marketplace and it is only a matter of time before there’s a refocus on the facts and fundamentals.”

Dom Grestoni, CGA, CFP
Senior Vice-President, Head of North American Equities and Portfolio Manager

Dom is the Portfolio Manager for Investors Dividend Fund and has been with Investors Group for over 32 years.

32 years with Investors Group

Big problem or big opportunity?

Markets have not only corrected sharply, but with great speed. Some of the market’s exaggerated moves can be attributed to instantaneous access to information, heightened fear, and forced selling. Inflammatory headlines and negative newspaper reports with a bent towards sensationalism, means most of us are getting more than daily doses of skewed sound bites masquerading as reality.

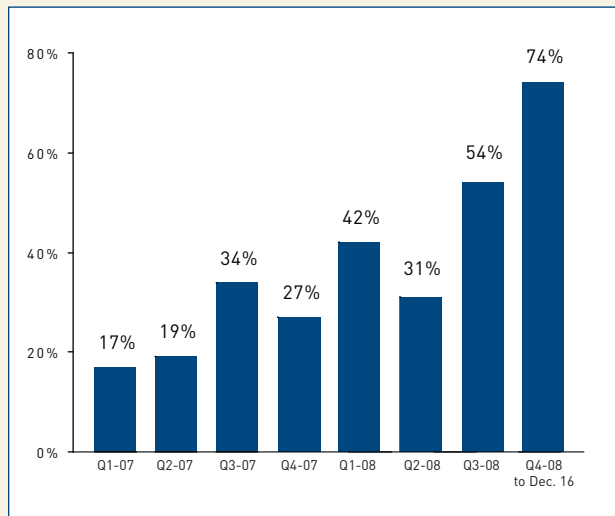
Heightened fear has resulted in a shift away from rational thought towards emotion and an irrational response to current market action. Finally, forced selling by hedge funds and large institutional investors due to increased liquidity pressures, has introduced a bias in the marketplace that has seen more sellers than buyers – creating in effect, a buyer’s market that’s devoid of buyers.

As is typical of this juncture in a financial cycle, markets have also been extremely volatile, with the volatility index or VIX level (often called the fear gauge or fear factor) reaching historic highs.

This volatility was even more pronounced as the year drew to a close, as shown in Figures 1 and 2. Market moves of greater than 1% had increased to 74% of trading sessions on the TSX and a full 85% of trading sessions on the S&P 500 by mid-December.

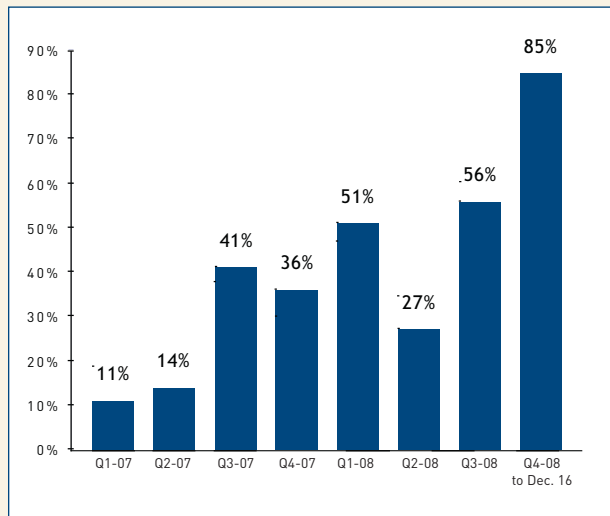
These levels are not sustainable and there will be a shift back. Valuations are incredibly cheap. Global efforts to stabilize markets are taking hold and will eventually bring significant capital back into play which is expected to create growth.

Figure 1:
S&P/TSX volatility + or – 1% daily price change



Source: Investors Group Portfolio Analytics

Figure 2:
S&P 500 volatility + or – 1% daily price change



Source: Investors Group Portfolio Analytics



Jeff Hall, B.Comm., CA, CFA
Vice-President, Head of Fixed Income Investments and Portfolio Manager

Jeff manages a number of our flagship fixed income products and has been with Investors Group for 15 years.

“Every crisis sows within it the seeds for its own recovery and the potential for tremendous opportunity.”

15 years with Investors Group

Is it different this time?

Comparisons to the 1930s abound – but are they apt?

There is a lot of information swirl out there, and it's tough to make sense of it all. At current price and volatility levels, there appear to be both similarities and differences to previous slowdowns.

When you look at the current situation and what has transpired over the past year with a period like the 1930s, though the decline in the stock markets has been precipitous, other indicators are not aligned.

The economic vulnerability during the 20s and 30s was significant. Bank and deposit failures were prevalent, housing prices declined 30%, mortgage delinquencies represented one-third of mortgages, consumer credit was off by 50%, money supply down almost 30%, and consumer prices were down by 18%.

Things were made worse by an absence of policy response by government, which was followed by serious errors in fiscal, monetary and trade policy. All this occurred against a backdrop of very high interest rates which in turn put pressure on profitability, investment and jobs. In fact, the unemployment rate during those years has been estimated at 25% and the economy retrenched by over 40%.

By comparison, current growth forecasts, while slowing, suggest Canada is still on solid footing, though we have been somewhat impacted by the effects of the financial excesses that have led to the recession in the U.S.

And although in Canada many of these same sectors and markets have experienced declines, it is not anywhere near the magnitude of what was experienced early in the 20th century.



“There will be no bell, no signal when the markets bottom. The markets will simply continue to do their job of eliminating excess, finding a floor, and resuming growth.”

Bill Chornous, CFA
Vice-President and Investment Strategist

Bill has over 20 years of experience in investment management at Investors Group.

20 years with Investors Group

It's time in the markets, not market timing that counts

Importantly, what has been consistent throughout history is the ability of the markets to face challenges, price them in, and move on to higher ground. Swift response and ongoing coordinated policy efforts by governments worldwide are taking hold, which will allow markets to find a bottom and move up. In fact, following particularly sharp corrections of equity and credit markets, or periods of financial stress, the rebound is typically quite steep.

Sitting on the sidelines can hurt your return experience, as during comparable periods of financial stress, equities gained an average 48% within six months of their bottom and 86% within a year as shown in Figure 3.

Figure 3: Six Major Periods of Global Financial Stress

	Peak to trough, %	Peak to trough, months	3m after trough, %	6m after trough, %	12m after trough, %
Finland 1990-92	-67.5	31.5	66.4	94.4	176.9
Japan 1990-98	-61.9	107.0	9.5	38.2	60.5
Norway 1990-92	-54.3	25.1	10.4	30.3	79.6
Sweden 1990-92	-56.4	27.2	48.0	70.0	131.6
U.K. 1990	-19.6	8.9	8.0	24.8	31.9
U.S. 1990	-19.8	2.9	7.7	29.7	34.1
Average	-46.6	33.8	25.0	47.9	85.8

Source: NBF Monthly Equity Monitor, November 2008



Murray Mitchell, CGA
 Vice-President, Portfolio Manager

Murray is Portfolio Manager of the flagship Investors Real Property Fund. He has been with Investors Group for 20 years and has close to 30 years of relevant experience.

“A pessimist sees difficulty in every opportunity. An optimist sees opportunity in every difficulty.”

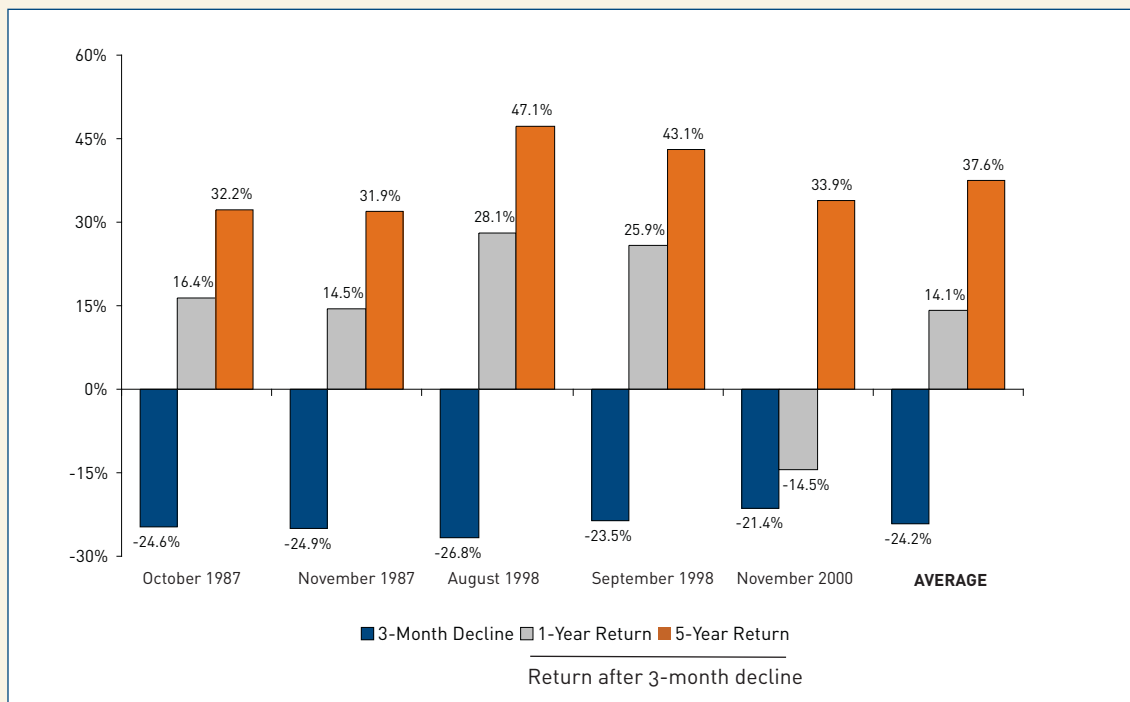
– Winston Churchill

20 years with Investors Group

Over time, markets have experienced tremendous turbulence and significant declines, similar to our current experience. Now is not the time to sit on the sidelines and wait for the markets to improve, or worse, convert paper losses into real losses. Look at what the TSX has typically done following a three-month period of decline greater than 20% (Figure 4). On average, it returned 14.1%. Five years later, the average total return was 37.6%.

So how important is that first year of returns? Without it, you missed out on 40% of the total five-year gain.

Figure 4: TSX returns following three-month declines of greater than 20%



Source: Computerized Portfolio Management Services Inc. (CPMS)



Peter O'Reilly, MA Economics, CFA
 Vice-President, Head of Global Investments, Portfolio Manager
 Peter has over 18 years of experience in investment management.

“Courage is resistance to fear, mastery of fear, not the absence of fear.”

– Mark Twain

18
 years of experience

Equities now on sale

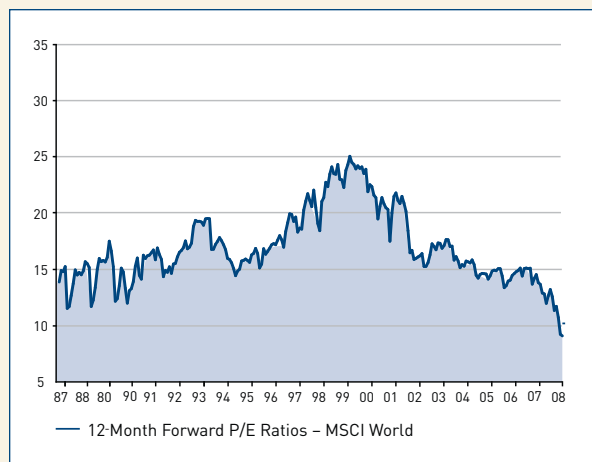
Current equity valuations are cheap. And though it's important to keep in mind that price-to-earnings multiples (p/e) are simply one measure and that fund managers look at a whole dashboard of gauges to assess and measure the health of any one company – current average p/e ratios of companies across many major global markets are reaching beyond 20-year lows.

This means, for example, if a price-to-earnings ratio is 15, a buyer is willing to value a company at 15 times its current earnings level. Low prices are attractive to buyers as they purchase securities in companies with an expectation for year-over-year growth in earnings. In essence, low p/e's can indicate companies are at attractive prices for buyers.

As shown in the chart (Figure 5), the world average p/e ratio is now trading at a more than 20-year low of less than nine times earnings.

In general, a high p/e ratio suggests a possible overvaluation while a low p/e scenario suggests a possible undervaluation.

Figure 5: World P/E



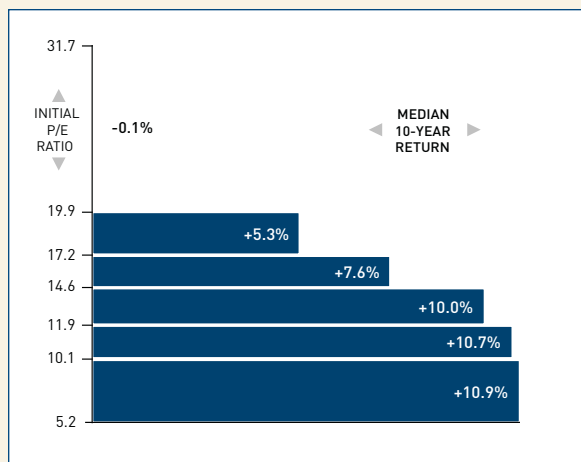
Although there is likely to continue to be earnings pressure on corporations in today's environment, the market has already largely factored this in to current low prices.

The following chart (Figure 6) shows some typical return scenarios based on an initial p/e ratio. As you can see, the higher the p/e multiple in the chart, the lower the median 10-year return scenario. The lower the p/e multiple, the higher the median 10-year return.

The p/e values that support this finding come from Yale economist Robert Shiller's own extensive work and index of price-earnings multiples. He calculates an adjusted p/e using a 10-year average of normalized earnings, which smooths out fluctuations.

While decent valuations alone are not enough, equities are cheap – and though they can stay cheap for some time, they currently represent among the best values seen in over 20 years.

Figure 6: The lower the P/E when you invest, the higher your return



Sources: Robert Shiller, Cliff Asness, AQR Capital Management – based on Shiller formula U.S. normalized P/E ratio's



Martin Fahey, B.Comm., MBS, CFA
 Vice-President, Head of European Equities and Portfolio Manager

Martin is the Portfolio Manager of the award-winning Investors European Mid-Cap Equity Fund* and Investors European Equity Fund and has been with Investors Group for over 15 years.

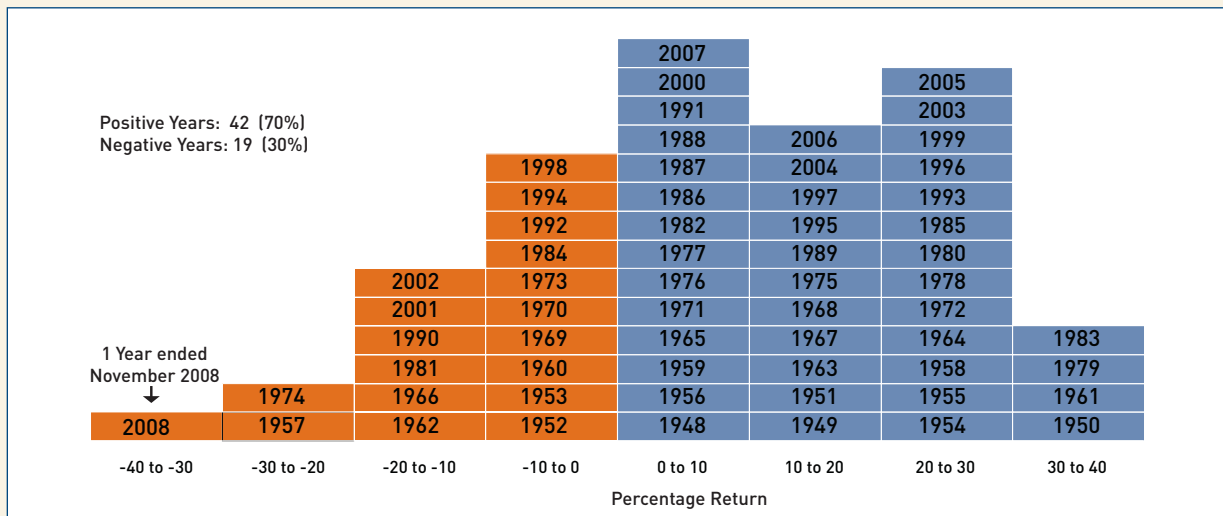
*“It is often times like these,
 when everyone throws up their hands, that
 can represent a key bottoming phase in the markets.”*

years with Investors Group

As shown in the chart below (Figure 7), if reversion to the mean holds true, that is, that markets deliver typically in the 7% range year over year, then the market is currently poised to return to a more range-bound environment.

The chart also shows that since 1948, the S&P/TSX has enjoyed positive annual returns 70% of the time and negative returns 30% of the time. So roughly, one of every three or four years can be expected to show a decline as valuations fluctuate depending on the business cycle and buying and selling pressures.

Figure 7: S&P/TSX composite price index 1948 to 2008



Source: Investors Group Portfolio Analytics

* 2008 Lipper Fund Award Winner



“Building long-term wealth takes patience and discipline. It means ignoring your feelings, and charting your course using your brain, not your emotions.”

Tim Leung, B.Soc. Sc., CFA
 Vice-President, Head of Asian Equities and Portfolio Manager

Tim leads our key Asian mandates and has over 18 years of investment management experience.

18 years of experience

Our bias for action

With markets and the values of our investments declining, it is human nature to want to “do something” about it. This is quite common. In many situations in everyday life, to solve problems or resolve issues – everyone’s first inclination is to take action.

This behavior served us well when we were hunter-gatherers seeking food, shelter and avoiding predators, but can be downright detrimental in investing.

As humans, we definitely have a preference for action over inaction – and this bias can play a significant role in all kinds of economic choices.

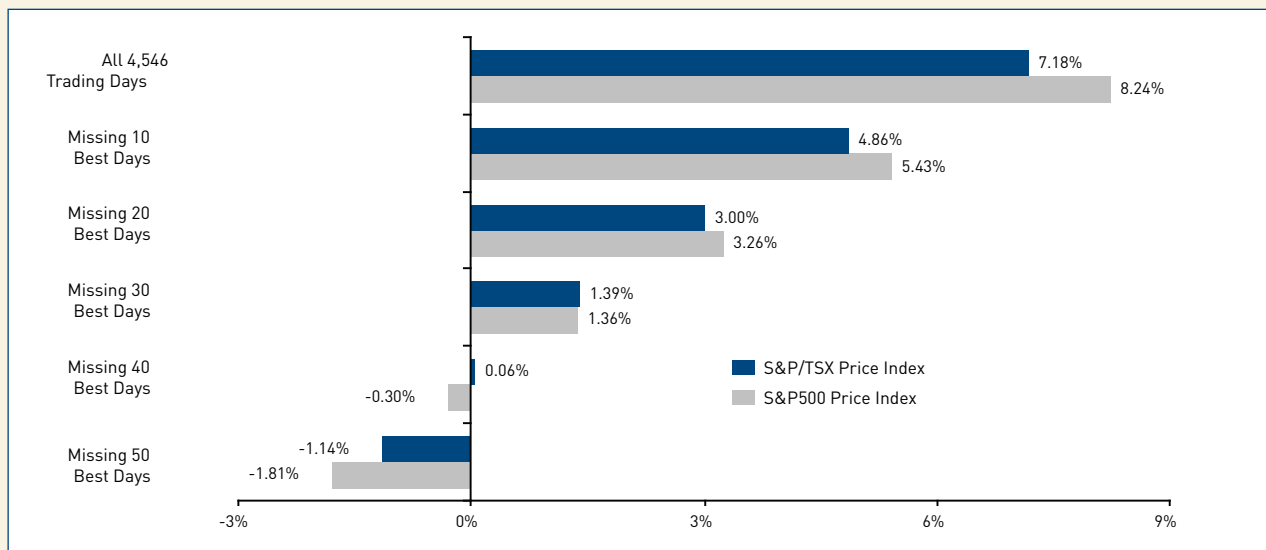
For example, when the economy is faring poorly, people are tempted to “do something” even if the risks outweigh

the possible gains. This is often ill-advised and can lead to efforts to try and time the markets, which is an ineffective and costly way to try and build wealth.

Because our nature is also to want to see patterns and connections between things, we also look to past results as being predictive for the present and future. We assume winners will always be winners, and weak performers will always be weak performers, and constantly try to move around after the fact.

Once upon a time, this bias for action served us well, but it can become a risky behavior in investing. See Figure 8 which shows what happens when an investor misses out on the best days.

Figure 8: Missing the best days a risky proposition
 S&P 500 and TSX Indices January 1, 1990 – December 31, 2007



Source: Investors Group Portfolio Analytics



Christine Décarie, B.Comm., CFA
Vice-President and Portfolio Manager

Christine manages Investors Mutual of Canada, one of the country's longest-running mutual funds, and has 22 years of investment management experience.

"The point of maximum pessimism is often the point of maximum opportunity."

years of experience

What's an investor to do?

Throughout history, markets have experienced periods of volatility – in this case brought about by a credit crunch and financial crisis which has created forced selling by some institutional market participants.

This search for liquidity and indiscriminate selling has resulted in a devaluation of everything to the same degree, regardless of the quality of the underlying securities or assets. Everything is being lumped together. It is only a matter of time before the markets readjust their focus from fear back to facts and fundamentals. Things will get better. Though no one can predict when volatility will subside, when the turnaround comes, it is likely to be sharp.

Unless your goals have changed substantially, then neither should your plan. It's never a good idea to let short-term thinking guide your long-term plan.

Figure 9 shows that where an investor allocates their investments can have a very significant impact on their

real return scenario. In this scenario, investors were clearly best served by ensuring they had some exposure to asset classes that provide inflation protection properties over time.

Figure 10 shows that short-term market events have very little impact on long-term trend lines. Looking back at \$1 invested in numerous asset classes over 200 years ago, the trend shows that though throughout history there have been many wars, pandemics, crises, and times of turmoil – despite these events, markets have continued to grow. So while there have been many challenges that at the time may have appeared to be insurmountable barriers to future growth, each time, the markets have carried on.

Markets do not build turnarounds on good news. They will continue to do the important work of digesting and absorbing economic and financial events, eventually find a base and begin to lay the foundation for new growth.

Figure 9: Example of the "real" return on an investment*

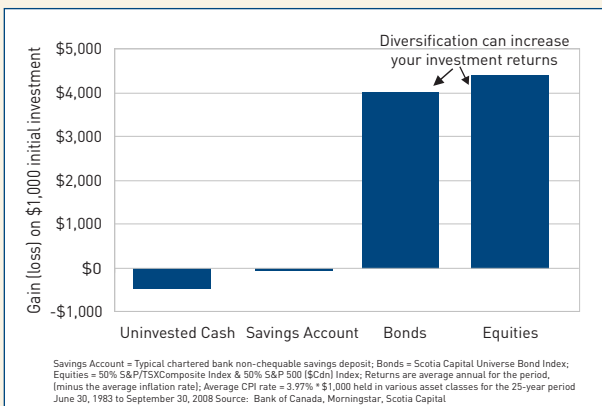
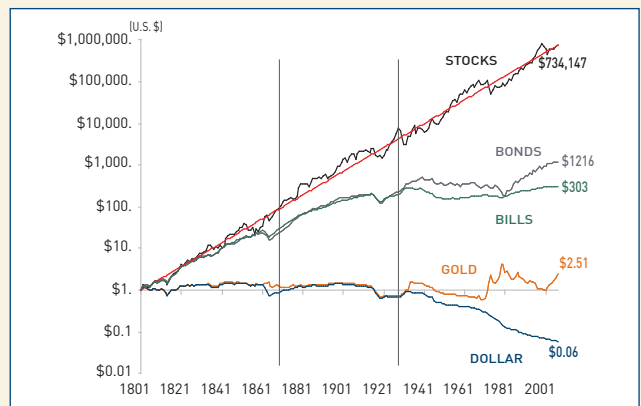


Figure 10: Market disruptions have minimal impact on long-term trends

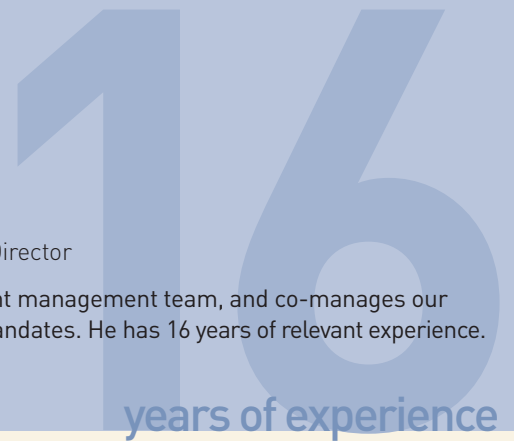


Source: "Stocks for the Long Run", by Jeremy J. Siegel



Daniel McClure, B.Sci., MBA
Vice-President, Portfolio Manager & Research Director

Dan is the director of research for our investment management team, and co-manages our technology and socially responsible investing mandates. He has 16 years of relevant experience.



5 good reasons to be positive

1. Swift, coordinated global response

Governments worldwide have responded to significant market volatility and economic weakness with unprecedented and decisive action. Coordinated global fiscal, monetary and trade policies and interventions have been swift and comprehensive. These actions will stabilize the economy and allow financial markets to gain a foothold, and build in a turnaround.

Further, by ensuring trade barriers stay low and protectionist policies are not employed, countries can continue to rely on established trade channels. This ensures that trading can continue to operate in a global and uninterrupted manner.

2. Significant levels of liquidity

Governments worldwide have ensured a significant level of liquidity has flowed to the markets, capital that will help stabilize the financial system.

Government efforts will go a long way to shore up financial markets and likely have the desired effect of stemming the selling and easing this prolonged bout of volatility.

3. Attractive valuations

Equities are at among the best values they've been in many years. World p/e ratios, just one of many and the most common valuation measure available, shows a decline in p/e levels that are now sitting at less than nine times earnings. These are levels that have not been seen in more than 20 years. Equities are at long last a bargain, and at levels where buying makes sense.

This is precisely when and where active investment management adds tremendous value. At Investors Group, fund managers employ key risk management strategies as part of their overall investment decision making process.

Further, a global presence complemented by tremendous depth and breadth of experience, create a prudent decision making process that is focused on quality in securities selection.

“The investor who permits himself to be stampeded or unduly worried by unjustified market declines in his holdings is perversely transforming his huge advantage into a basic disadvantage.”

– Benjamin Graham, Author, Intelligent Investor

4. Lower prices and rates

Prices and rates are coming down, and interest rates are at 50-year lows, which should help spur the economy. This is good news for consumers, despite fading confidence and spending levels. As an example, the drop in the price of oil has translated into hundreds of dollars of savings every month for individual consumers and billions in savings for businesses – particularly those in manufacturing.

Finally, as individuals save on many discretionary items that have been significantly reduced in price, combined with lower prices at the pump – there is an important pocketbook break to consumers that can help refuel spending.

5. A healthier market

It’s easy to lose sight of the fact that the process of creative destruction, though not a pretty one, is necessary for the resumption of growth.

Businesses that are poorly run or badly managed are regularly assessed by the market as part of a cycle of growth and retrenchment. The markets continuously do the important work of identifying the issues, digesting the news, and accounting for it.

History has shown there is a distinct pattern of market activity; cycles of both advancement and retrenchment, and periods of low and high volatility.

It’s also important to remember at times like this that stock markets are a leading indicator, which means they look out past current events and price in the news. It also means that disruptive financial events are often a precursor to long-term market growth, with markets typically recovering and turning up well in advance of the economy.

Although today’s situation may feel unique, what is consistent is that throughout history, markets have regularly gone through tests of confidence, only to gather strength and gain new ground.



Mark Kinzel,
Executive Vice-President

“Despite ongoing volatility and its impact on the current value of your investments, a long-term financial plan is the best possible way to steer through the uncertainty.”

25
years with Investors Group

In the meantime...

Try to mute the noise. Blaring headlines, negative and aggressive news reports, and instantaneous access to information can exaggerate your emotions and increase your fears. In fact, neuroscience has shown that the amygdala – the part of your brain that initiates feelings of fear – is an almost irresistible force. It’s important to set the daily news aside, and focus on your long-term plan. A long-term financial plan still remains the best way to steer through volatility.

Just when you think you’re in it, you’re probably through it. Experience has shown that typically half to three-quarters of a bear market is usually complete by the time the market acknowledges it’s in one.

Remember, rampant pessimism is actually a good sign. It is often precisely times like these, when everyone throws up their hands, that can represent a key bottoming phase in the markets and often some of the greatest investment opportunities.

Stick to your plan. Your financial plan has been developed with you in mind. It has taken into account your time horizon, risk profile, investment knowledge, and many other details specific to you – and these details ensure your plan is tailored and suited precisely to your needs.

If none of your major goals or objectives has changed, it is likely that neither should your financial strategy. Don’t allow short-term market action to derail your long-term plan.

trusted leader
for over

80
years

Investors Group has been trusted as an industry leader for over 80 years, with a focus on comprehensive planning, diversified investment solutions, and prudent management.



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