

The old rules still apply

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-  Comments (6)
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OTTAWA — Back in the early 1980s when I trained to be a stockbroker, the very first thing the instructor said was that people should not invest money in the stock market that they could not afford to lose.

Somehow that notion has been lost in the last couple of decades and we are now paying the price, both as investors and as taxpayers. The current crisis is a reminder that the old rules still apply.

In the last couple of weeks, companies have asked the government for extra time to make up pension plan shortfalls caused by the stock market drop, groups representing seniors want looser rules on when pensions must be cashed in because share values have declined, and the Canada Pension Plan Investment Board, which invests pension savings on behalf of all Canadians, reported a \$10.3-billion loss in the value of its holdings.

Individuals who own stocks, either directly or indirectly through mutual funds, have witnessed heart-stopping declines in the value of their portfolios and their Registered Retirement Savings Plans. Just about everyone, with the exception of the CPPIB, wants the government to help.

It is easier to see how we got into this predicament than how we will get out. There has been a sustained and sophisticated campaign encouraging share ownership by those who benefit most from expanding public participation in the stock market: the businesses selling the shares and the financial intermediaries who market them.

It is not just a Canadian phenomenon. Way back in 1954, the New York Stock Exchange launched a marketing program called, "Own your own share of American business." There have been countless similar efforts since.

In Canada, the marketing clamour reaches a crescendo at the end of each year with the approach of the deadline for last-minute investments in RRSPs. It will be interesting to see the approach taken this year.

Promoters play up potential rewards and play down the risks. Greed, or the fear of a poverty stricken retirement, do the rest. The hook has always been that, over the long term, stocks provide a better return than most other investments. And that is what fearful investors are being told now.

But as every company selling shares has to declare these days (albeit in fine print that not everyone reads): past performance is no guarantee of future results. It's worth asking if that does not also apply to the future of the stock market.

BusinessWeek, the U.S. magazine, did just that in an article in its Nov. 10 edition headlined, So much for buy-and-hold advice. The article is well worth reading, especially the bit where it goes through how long it took some stock markets to recover from a blow.

(Italy holds a record here, taking from 1906 to 1978 before the increase in stock prices exceeded the rate of inflation.)

The article doesn't really come to a conclusion, which is interesting in and of itself. What it says is that whether stocks turn out to be a good investment depends on how long you are willing to wait.

Here in Canada, the economics team at Toronto-Dominion Bank asks a similar question in its Nov. 13 special report titled, Can equities recover? Just posing this question may seem like heresy for a bank, which after all makes money from underwriting share offerings, repackaging stocks and selling them to the public in the form of mutual funds, and even selling shares of its own.

The TD report, however, is much more sanguine than the BusinessWeek article. As long as governments and central banks get their responses right, equities should recover, it says, adding that this may take some time. That reassuring message is slightly undermined by a warning in a black box at the top of the report, which says: "This report is based on economic perspectives and does not provide financial, legal, tax or investment advice."

Those involved in the selling and marketing of shares would no doubt like everything to return to business as usual. Even if that were possible – and it may not be, given the loss of trust in the stock market and the state of the global economy – it would be a mistake.

There will be little point to all the pain the financial crisis has caused unless we learn some lessons from it. Putting pension savings in the stock market is, and always has been, a risky business. It may pay off handsomely, or it could be a disaster. Only those affluent enough to take that chance should buy shares. The rest should content themselves with lower returns on safer investments.

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