The QAM letter that highlights recent developments that we think either affect the markets or are important to understanding them.

"*People have always had this craving to have someone tell them the future. Long ago, kings would hire people to read sheep guts. There's always been a market for people who pretend to know the future. Listening to today's forecasters is just as crazy as when the king hired the guy to look at the sheep guts. It happens over and over and over"* – Charles Munger, Poor Charlie's Almanack

QE is for Quantitative Europe

Portfolio management is not a competitive sport. Despite all the marketing and ad campaigns comparing golf players, long-distance runners and high calibre athletes with investment managers or investment products, the comparison doesn't fit. Portfolio management is not a competitive sport because there is no real competitor - that is the trickiest part of all.

As Arthur Ziekel published in The Financial Analysts Journal in 1995, "portfolio management is instead, an important individualized effort to achieve some predetermined financial goal balancing one's risk-tolerance level with the desire to enhance capital wealth. Good investment management practices are complex and time consuming, requiring discipline, patience, and consistency of application. Too many investors fail to follow some simple, time-tested tenets that improve the odds of achieving success and, at the same time, reduce the anxiety naturally associated with an uncertain undertaking".

We are once again in one of those moments when most investors are tested in their discipline, patience, and consistency of application.

Europe is facing a severe debt crisis that also risks becoming a liquidity crisis. We are talking about the European Union that generates a GDP of over €12 trillion (US$16 trillion in 2010) according to the International Monetary Fund (IMF), making it the largest economy in the world. Although the average investor, and most people in the media, still have to make up their mind whether we are talking about a country, a group of countries, a continent or an economic bloc, they can clearly feel that the people in charge of trying to fix the problem are, to say the least, not communicating well.
The media reported that Luxembourg's Prime Minister (also Chairman of regular Eurozone meetings), in a combination of naïveté and blatancy, admitted: "When it becomes serious, you have to lie."

There are way too many interests, too many national sectors and too many politicians with large egos and short ideas at play for this to have a well planned solution. That is why more and more the inevitable is taking place and the printing presses are starting to warm up. Printing money in some shape or form will help to basically inflate the debt away. All other alternatives come with political costs which are just too painful and there is no Winston Churchill around. Nobody to offer blood, toil, tears and sweat. Or at least hard work and fiscal consistency.

In the middle of all this, The Economist published their October 15th edition with the cover proclaiming "Nowhere to hide", pointing out that in a very low yield world it is very difficult to find returns in any sector. Investors have been facing low yields across the board. Short-term interest rates are close to zero; ten-year government bonds in developed countries range between 1% and 2.5% and, in many cases, offer a negative return in real terms (after inflation).

Yet during the third quarter of 2011 lots of investors ran away from the volatility of equities and into the perceived safety of bonds.

It is in times like these that we have to return to the classics. In investing there is nothing more classic than the famous book "The Intelligent Investor" written by Benjamin Graham. One of the principles he wrote is: "Do not enter upon an operation— that is, manufacturing or trading in an item—unless a reliable calculation shows that it has a fair chance to yield a reasonable profit. In particular, keep away from ventures in which you have little to gain and much to lose."

Investors in bonds must demand convincing evidence that they are not risking a substantial part of their principal either to inflation or to an increase in interest rates.

Benjamin Graham wrote another rule which is more positive: "Have the courage of your knowledge and experience. If you have formed a conclusion from the facts and if you know your judgment is sound, act on it— even though others may hesitate or differ." (You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right.)

Investors in equities now must stay the course and focus on the fundamentals, not so much on volatility. Equities offer valuations not seen in a long time, particularly compared to the extreme low interest rates offered by bonds.

Market perspectives and portfolio positioning

Markets do not like uncertainty and uncertainty was the trademark this past quarter.

The S&P/TSX Composite Index returned a negative 12.0% for the third quarter and turned in a negative 11.9% for the year to date.
The S&P500 Index returned negative 6.4% for the third quarter and negative 4.0% for the year to date for Canadian investors. In US terms, the S&P 500 declined 13.8% for the quarter but an appreciation of the US dollar offset part of the market losses.
The MSCI EAFE Index returned negative 11.9% for the third quarter and negative 10.3% for the year to date. Both numbers are in CAD terms.

We continue to believe in good investment management and following simple, time-tested tenets that improve the odds of success in achieving the financial goal of our portfolios: capital growth in the long-run comes from holding high-quality stocks, while liquidity requirements and stability has to be provided by a cautiously selected Fixed Income position in the portfolio.