



APPLYING A DISCIPLINED INVESTMENT PHILOSOPHY

### TO OUR CLIENTS

In February's federal budget proposal, the government called for the elimination of foreign content limits on RRSPs, RRIAs, and pension plans. At time of writing, this proposal was still not law. While we do expect removal of foreign limits at some point, be it this year or beyond, there's no time like the present to review the role foreign equities can play in your portfolio.

The ideal balance between domestic and international equities will depend on many factors and is something your ScotiaMcLeod advisor can help you define. This issue of *exchange* contains some key background information and investment principles for you to consider.

Sincerely,  
ScotiaMcLeod

## No Limit: How much foreign content is enough?

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Surveys of individual investors show that most Canadians have limited foreign investments within their retirement savings. The average allocation is about 5%. With an allowable limit of 30%, this data raises the question of why Canadians have kept their investments close to home.

### WHAT THE "SMART MONEY" HAS BEEN DOING

Statistics provided by the Pension Information Association of Canada (PIAC) paint a different story for the large pools of capital managed for pension funds. Approximately 51% of Canadian pension fund assets are allocated to equities. In the past 15 years, the portion dedicated to foreign equities has more than doubled – to about 25% of overall pension assets.

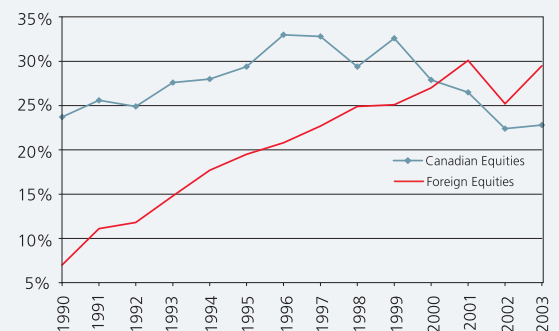
Within that foreign equity component, almost 45% is invested in U.S. equities, 40% is in major European markets, and the rest is scattered around the globe. With respect to fixed income, a much smaller 3% is invested in foreign bonds.

While individual investors have been content with their Canadian holdings, the so-called "smart money" has clearly embraced global investing.

### IT'S A BIG WORLD OUT THERE

Canada is a small piece of the international pie, representing less than 3% of the world's total equity market capital. While Canada has an attractive pool of companies that focus on commodities, energy, and financial services, we have limited exposure in consumer products, technology, health care, and broadly diversified industrial companies. What companies are available in these sectors tend to be smaller and consequently can carry more investment risk (financial, liquidity, and trading risks) than their larger international counterparts.

PENSION PLANS  
CANADIAN VS. FOREIGN EQUITY WEIGHTING



Since 1990, Canadian pension plans have steadily increased their foreign equity holdings.

Source: PIAC

There's also the history of the Canadian market to consider. Historically, our market corrections have been deeper and longer than in many other countries. In addition, global market performance comparisons show that Canada is rarely the world top-performer in any year or series of years.

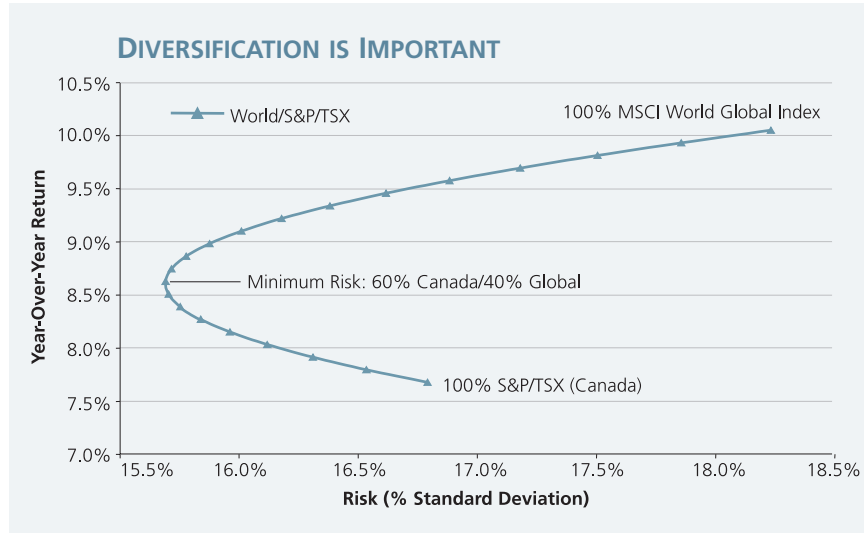
However, this does not mean you should leave Canada out of your RRSP. It simply means that there will be benefits in terms of risk and reward if you complement your Canadian investments with some exposure to the U.S., Europe, and other markets around the world.

### FIND YOUR PLACE

The correct balance between domestic and foreign investments in your RRSP ultimately comes down to your financial goals and the principles of asset allocation. Working with your advisor, you need to determine the amount of growth you require and the amount of volatility you can comfortably handle.

### WHERE TO START

The removal of RRSP foreign content limits can mean



**Why is diversification important?** By plotting risk and return characteristics along a curve, we can show that adding some foreign content to a Canadian portfolio (S&P/TSX index) reduces risk and increases returns. However, as the percentage of foreign content increases above 40%, risk will begin to rise.

\*Note: Data from Dec 31, 1984 to Dec 31, 2004

enhanced returns, less risk, access to companies and industries not available within our own borders, and even less cost and complexity than previous methods of foreign investing.

The key is to devise an RRSP asset allocation strategy that makes the most of this new world of opportunity. Broadly speaking, you could take a cue from Canadian pension funds and consider allocating roughly half of the equity component of your RRSP to markets outside Canada.

However, your actual asset mix strategy will need to reflect your individual needs. Your ScotiaMcLeod advisor can work with you to determine the right amount of foreign diversification to deliver the optimal levels of risk and reward to help you achieve your financial goals.



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