

# MUTUAL GAINS™



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*Without money, possibilities are limited..... without personal relationships, life is barren...  
without balance, happiness and fulfillment are just a dream.*



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## A Quick On Inflation and Deflation

You may remember conversations with your parents starting with the words, "When I was your age.....". This was often a loving attempt to convey how life was so much different in the good old days.

At the time I didn't dwell much on those conversations because, I like most kids thought them as simply old people ramblings. I'm sure, as I find these same ramblings spilling forth from my own mouth, that my sons discount my words in much the same way I did... "ramblings... old person".

Those recollections, as they relate to how much a dollar buys now compared to days gone by, were in varying degrees correct – one dollar does buy much less than it did, 20, 30, 50 or 60 years ago. That my friends is inflation.

There's more to inflation than memories, it's a measurable economic force. Stats Canada determines the rate of inflation through the Consumer Price Index (CPI). This is a basket of about 600 different goods and services that represent typical household expenses such as food, housing, transportation, furniture, clothing, and recreation. The index is also weighted. In other words, it takes into account that we spend more on food than on clothing so an increase in the price of meat,

fruits and vegetables affects us more than the cost of shoes.

One-way inflation occurs is when there is a significant increase in the cost of an imported good or service for which there is no substitute. Take oil for example. In the 1970s, oil prices soared, setting off a chain reaction because oil prices affected the cost of delivering goods as well as the direct cost of making products, especially those derived from oil (i.e. plastics). These price increases made employees ask for higher wages to compensate.

Another inflation cause is if there is an oversupply of money in the economy, in other words, "too much money chasing too few goods". The most radical example of this sort of inflation was in Germany after the First World War, when consumers had to take wheelbarrows of cash to buy groceries and the government kept printing new money.

Deflation, on the other hand, is a decrease in the price of goods and services. It's caused by a weakening demand for goods and services. Companies are forced to reduce their prices and, faced with shrinking profits, they may be required to lay off workers or reduce wages. This in turn can further lessen consumer spending. While inflation eats away at the consumer's purchasing power, deflation will reduce the value of his or her real assets – this is a particularly precarious situation for debtors. Those who lived through the Great Depression of the 1930s, for example, saw both their incomes and the value of their homes plummet while their mortgages remained the same.

The reason for the quick inflation / deflation primer is that there has been a lot of talk over the past couple of years on whether we will see continued inflation or a period of deflation. With interest rates so low the deflation concern was warranted, since deflation is a problem that governments have much less control over once we are in that kind of environment. In a deflationary environment, those with much of their wealth in real estate (a home) with a big mortgage tied to it are hurt big time. Inflation is not necessarily perpetual. Right now we are straddling the inflation / deflation fence and could be for many years to come.

## Cars Are No More Expensive Now Than In 1964

In 1964 a new Ford Falcon or Fairlane was approximately \$2,700. You'd pay almost \$5,000 for a T-bird. In that year the bottom rung wage was approximately \$2,700 per year (those are all U.S. dollar figures). Today locally, a basic car can be purchased for \$15 - \$16,000. The minimum wage pays \$16,640 per year (B.C.).

There seems have been a astronomical increase in the amount of car leasing that has been undertaken over the past several years. I've heard some people suggest that it's because cars are more expensive now than they have ever been. The above numbers however contradict that presumption. Sure, our income taxes are higher however a very basic car can be had now for a cheaper real price than 40 years ago and well built cars today have a longer life span than in ones built in years past.

I do believe this. We individuals in a society of consumerism want more today than those who preceded us by 40 years. We don't need more we want more. We seem to "buy what we want and borrow for a little more".

## Income Trusts 101

There seems to be a misconception out there that owning an Income Trust units are very different than owning Common Shares of a company that pays dividends. I'd say the misconception seems to go as far as believing that Income Trusts carry less risk than a traditional form of business ownership, common shares. Here are 2 very basic characteristics these 2 entities share that show exactly how similar they really are.

Income Trusts and Common Shares represent ownership in a business – if you have invested or "own" either, Income Trust Units or Common Shares and the underlying business runs into problems or the general economy falls into recession, both income trust units and common share prices will be negatively effected.

Income Trusts payout virtually all of their net income to share holders. Common shares of large companies on the other hand payout only a part of their net income to it's shareholders. They do this with dividends. The remaining income is retained within the company and used to make the business more valuable (open more stores, buy more machinery, buyout competitors etc.)

The bottom line is this. If the profitability of the underlying business suffers for some reason the distributions of the Income Trust or the dividends of the Common Shares, however the company is structured, will be reduced. A reduction or adverse change like this will have a direct impact on the price of your investment.

## Income Trusts Overvalued or Common Shares Undervalued?

Over the past few years' businesses of all kinds have raised money through the public markets by structuring themselves as Income Trusts. Well, how about if a consistently profitable business (like a bank) converted to an Income Trust? What would happen? Let's take a simple, paper napkin look.

The company would pay out more of its net income to its owners (you the shareholder). Because of that the price would go up. What sense does that make? The business is unchanged. What you own remains the same. The only thing that has changed is the price you are paying as an investor and the fact that because virtually all of the income is being paid out the company will grow more slowly. You are now paying 30 – 100% more just because it's an Income Trust. How about the flip side? Convert an Income Trust back to Common Shares. What would happen? You could probably now own the business for a much cheaper price - exactly the same business paid for with less of your money.

## RESP Grants Going Up

In the New Year your RESP contributions will be getting more CESG added (CESG, not MSG) but only if your family income falls within certain bands. Currently, the government contributes a matching 20% Canada Education Savings Grant (CESG) up to a maximum of \$400 to your child's RESP plan.

Effective January 1, 2005, the CESG will be increased by: 40% on the first \$500 of your contributions if your family income is less than \$35,000 and 30% on the first \$500 of contributions if your family income is between \$35,000 and \$70,000. The remainder of your contributions will continue to qualify for the 20% matching rate. An extra \$50 - \$100 per year courtesy of your friendly neighbourhood federal government, but only if you contribute to an RESP of course.

## RRSP Beneficiary Designations – Beware Of This Flaw...

Most often those of us who are married name our spouse as beneficiary on our RRSP plan(s). This works very well since, when you "pass on", your money will automatically roll over tax free to your spouse. A problem will

present itself however when your beneficiary is someone other than your spouse, traditional or common law, dependent child or dependent grandchild.

The flaw lies in who will end up paying the tax bill at the end of the day. Example: if you named your brother, aunt or other “non spouse like person” as a beneficiary that person, upon your death will get all the money in the RRSP. Your estate, and everyone else who you wanted to give money to will be stuck paying the full tax bill.

The Income Tax Act has dealt with this problem by making the person who received your RRSP money equally responsible for paying the tax. There is a catch however. If your estate has other assets that can be sold to pay the full tax bill then all those other people you intended to leave money to will end up with a much smaller piece of your estate pie. The person who got your RRSP money on the other hand will be way ahead of the game. You will have left money in unfair allotments along with a potential family feud. I’m sure you want to be remembered for much better things.

## Reverse Mortgages – Tapping Your Home Equity

The heading above may lead you to believe that I’m going to talk about how a reverse mortgage can be used to create an income for you and that Reverse Mortgages are the most innovative thing since velcro. About how they create an income, yes - about Reverse Mortgages being a great thing.... I don’t think so.

A reverse mortgage is exactly that, a mortgage in reverse. It’s most commonly used, or recommended (and in my opinion more than they should) for those who, a) own a home, b) are retired, c) need additional income or a lump sum of cash. Because you have a home with lots of equity just sitting there many institutions will lend against it.

That is the biggest point. A reverse mortgage isn’t your only option. In fact, I think it should be one of your last options, particularly because reverse mortgages have interest rates that are well above what you would pay through other means, and higher interest means a quicker depletion of the equity in your home.

## Hidden Extras – You’ll Be Glad You Have Them

Hidden extras are something you don’t see but may be paying for. We often buy the cheaper of 2 alternatives based on it’s face value, what it looks like on the outside. In other words, a cheap product may look, feel, smell and taste the same as it’s more expensive alternative however the real difference will only be felt over time. This is as true with a printer for your computer as it is with a less tangible item you may buy, like an insurance policy.

Suppose you are awakened from your sleep by a smoke alarm triggered by flames consuming your house. After the dust settles you are left with a 25% burned house with the other 75% ruined by smoke and water. 95% of your possessions are no longer. It’s in this instance that the “hidden extras” or lack thereof reveal themselves.

Hidden Extra #1 – With most insurers you have to pay for all the replacements out of your pocket first. Only after that are you reimbursed. If you don’t replace your contents you will get the depreciated value, usually only 10 – 25% of the replacement cost. Since you have Hidden Extra #1 you will receive the full replacement cost once everything is calculated.

Hidden Extra #2 – If you need to live somewhere else for a while you may end up paying for it from your own pocket after a basic threshold is reached of course. With Hidden Extra #2 your “Additional Living Expenses” amount is substantially higher than the basic amount on your typical policy.

Hidden Extra #3 – Assuming you have this one, once the value of the house is calculated to rebuild you are handed a cheque for the full amount. You are free to renovate, rebuild or sell the property and buy something else. That is not the case with the cheap policy. The insurance company would make systematic payments to the construction company as your house is rebuilt.

Hidden Extras can be found in various forms with all kinds of insurance policies, be they car, house, income replacement (disability) or life insurance. So when you see 2 different policies and 1 is cheaper than the other compare the Hidden Extras. You get what you pay for.

## 1 Call To Telus Will Save You \$47.40

That \$47.40 saving isn’t just a one time saving either it’s an annual saving.

If you look at your residential Telus bill you will probably see a monthly charge of \$3.95. This \$3.95 is a long distance administration fee, which is applied to your residential line if you have a Telus residential long distance plan. You say you don’t make long distance calls from your home phone? Call Telus and ask them to cancel your long distance service with them. You have just been paid hundreds of dollars over the next few years....just by making 1 phone call. If you do need long distance service in the future you can always call them back or set up a plan with Sprint.

## Separating Your Majors From Your Minors

Jack Welch, the legendary CEO of General Electric, had a great analogy when it came to ensuring that G.E. employees only focussed on their core competence (Front Room), what they were particularly good at. Everything else (Back Room) was either delegated, or farmed out to a third party that specialized in that area.

For example, instead of G.E. trying to run a staff cafeteria, they would hire a company that specialized in that area. To G.E., a cafeteria fell under the category of Back Room, yet to a catering company, that is of course their Front Room. Make sense?

Trying to become an expert in many different areas that are, in fact, your 'Back Room' takes a cumulative toll that may be rather invisible while it is happening yet can add up to months of wasted time and productivity. From that you get 'opportunity leakage.'

Learn how to separate the majors and the minors. A lot of people don't do well because they major in minor things. Jim Rohn

It is human nature to try and reinvent the wheel when it comes to anything in your life, particularly financial areas; however, the dos and don'ts of money related things have already been played out incalculable times.

The most successful people in life, success not simply reflecting financial wealth, spend the majority of their time doing what they do best and delegating everything else. Identify what those "Front Room" things are for you and then eliminate those distractions, delegate them, or farm them out.

HHHhhhhmmmm.....

Each pack of cigarettes smoked costs society US\$7.18 in health care and lost productivity. Source: U.S. Center for Disease Control & Prevention

Rising oil prices are good for both Canada and Britain as they are the only G7 countries that are net exporters of oil and therefore experience gains in net income when oil prices rise.

Why aren't gas prices at the pump going up like the price of oil? Simple really. The price of crude oil is quoted and sold in U.S. Dollars and the Canadian Dollar has been rising against the U.S. dollar, faster than oil prices.

Oil prices are, in real terms still 25% cheaper than they were at the peak around 1980. Oil consumption per unit of world GDP is now lower than in 1960 as the global economy gets increasingly efficient.

Source: Bill Miller, CEO Legg Mason Funds Management, Inc.

Mortgage rates are more closely tied to the 30-year bond yield than the Bank of Canada rate, which is why mortgage rates have fluctuated throughout the past year, even though the bank rate has remained static.

Old age security (OAS) pension rates will rise to \$471.76 per month, a 1.1% increase, effective October 1. The guaranteed income supplement (GIS), intended for lower income seniors, will also climb 1.1%. Ottawa adjusts OAS and GIS rates quarterly, based on inflation.

The median income of seniors 75 or older is 25% less than that of seniors in the 65 to 74 age group.

When everyone is buying something it's expensive. When no one is it's cheap.



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