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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The Last 3 Years Is Not A Trend

Human nature tends to extrapolate shorter term trends well into the future. If that is done with how the Canadian equity market has performed over the past 3 years your money would be doubling every 3 years, based on 24.3% per year over the last 36 months (Morningstar to Jan 31st 2006).

Looking back to 1979 let's see what Canadian equities have done on a longer basis versus their U.S. and International counterparts. We'll use a starting investment of $10,000 invested to Dec. 2004 (Source: Frank Russell):

Canadian Equities (S&P/TSX Composite)	$103,200
International Equities (MSCI EAFE)	$138,700
U.S. Equities (S&P 500)	$242,000

Over the course of 25 years, a strictly Canadian portfolio would have limited an investors returns.

What we have seen over the past 3 years is an anomaly. It won't continue because it can't continue. Canadian equities are expensive when you compare them to the shares of companies in virtually any other developed country. Eventually, money will flow to where the best deals lie, and they are not in Canada.

Mortgage Rate Confusion

A very common question posed to me lately by someone with a mortgage is, "the variable rate isn't much different than a 5 year fixed rate. Is a floating rate mortgage still worth it?". Seeing that close to 60% of all existing Canadian mortgages were negotiated in the past 2 years, and many were converted to the variable rate variety, it's not a wonder this question / concern is being expressed so regularly today.

Short term interest rates have been increasing over the past several months while longer term interest rates have remained static. This is referred to as a flattening yield curve. The extension of that is an "inverted yield curve" where short term interest rates are higher than long term interest rates. This too, is not a trend. An inverted yield curve is an anomaly, a byproduct of the Bank of Canada trying to slow down the economy. The fact that longer term interest rates have remained static is a sign that inflation is expected to remain in check and short term interest rates will in fact fall again.

A similar situation occurred in 1998 – 99. This led to an exodus from variable rate mortgages. Was it a smart move? Those who switched from variable rate mortgages to 5 year fixed mortgages in January 1998 missed out on big savings, $8,300 over the next 5 years, based on a $200,000 mortgage.

So what do you do? If you find yourself worrying about increasing interest rates then a fixed rate mortgage is best for you. The potentially extra money spent will be well worth it. Think of it as an insurance cost. Also, if you have a large mortgage relative to your income a locked in rate would be simply be the prudent thing to do. You can always choose a variable rate when your income is higher and your debt is lower. If your mortgage is smaller and you have financial resources outside of your home equity, going the variable rate route is a reasonable road to take.

The History of Oil Prices

Prior to 1973, a barrel of crude cost less than $3. The oil embargo of 1973 – 74 helped drive prices above $12. Although prices surged to $40 in the early 80's a barrel of oil was in the $10 range in 1986 where it bounced around through 1998. Since then it has risen to almost $70. The swiftest price increases came over the past 3 years. This was from a low of $20 in January 2002.

There have been 2 factors that contributed to the recent oil price increase, and thus increased gas prices for you and me.

First, the demand for oil has increased by 150%. Second, there have been mergers within the oil industry. In other words, big oil companies have been buying up smaller oil companies. This has cut spending on exploration and development. Oil companies found that the low oil prices of the day didn't justify them spending money on trying to find more oil to sell.

The current high oil prices will and is, enticing more investment in oil exploration and production. Greater investment in oil production will increase the world's supply and eventually help curb rising prices. Recognize however that producing more oil and oil-based products like gasoline is not quick. This time-intensive process limits how quickly supplies can increase to meet demand. That is what we are facing today. (Source Brandes Investment Partners, San Diego)

Make Your Mortgage Tax Deductible

Still carrying a mortgage but also investing outside your RRSP? Under a strategy approved a number years ago by the Supreme Court of Canada, why not consider selling your non-registered investments (subject to any capital gain/loss considerations), paying off the mortgage (again, subject to any early-payment penalties) and then getting a secured line of credit against your home to repurchase the securities sold? This way, your otherwise non-deductible interest becomes tax deductible. For every $100,000 of debt that is a tax saving $2,294 / year…. For life (43.7% tax, 5.25% interest cost).

Using OPM To Build Your Wealth

I am sure you are familiar with the benefits of using a little of your own money and A LOT of "other people's money" (OPM), to make an investment. You, like most people, may have done that when you purchased your first home. You got a big mortgage from the bank and put it along side your small down payment. With today's low interest rates and the ingenuity of the financial services industry there are several ways you can do this, and tailor it to fit your own financial situation.

First, with any investment where money is borrowed, the risk for you is lessened when you have income coming from the investment to help pay your financing costs. This is particularly important if you are borrowing a large some of money.

Over the past few years a proliferation of "Principal Protected Notes" (PPN's) have been assembled which offer the protection of your principal over a set period of time. This maturity date can be anywhere from 3 – 12 years. The more recent additional feature with some of these PPN's is that an income is paid during the holding period.

Here is an example of 1 PPN based on a $50,000 investment using OPM:

Pays out $208 / month (issuer expects it to pay out $290 / month)

Interest on investment loan @ 5.25% (current prime rate) equals $219 / month.

Without factoring in the positive tax considerations, which definitely make these numbers look even more attractive, you have the "rent" (income) from the investment paying close to or more than the interest cost of the loan. This is referred to as positive leverage. Your potential benefit, on top of the income it generates is the gain your investment produces.

Note: Borrowing money always increases your risk. For an explanation of that see www.careyvandenberg.com/PIP_Leverage_Disclosure.pdf

When RRSP Deductions Are Not Enough

If you make a full RRSP contribution every year but want additional tax deductions a flow through share offering may be worth looking at.

Flow-through shares are tax assisted investments in the Canadian natural resource sector. Resource companies (oil, gas, mining etc.) that have more deductions within their business "flow through" to investors (you) the tax deductions they can't. They do this by issuing shares of the company to a limited partnership (LP) which you as an investor buy shares in. Most commonly, the LP will hold shares of several different companies creating a diversified portfolio of resource companies with up to a 100% tax deduction for you.

These tax deductions are written in the Federal and Provincial government budgets every year. The reason for this is governments very much want to continue encouraging the exploration and development of Canada's natural resources. In fact, flow through shares and the tax deductions related to them have been in existence longer than RRSP's have.

What happens to your shares in the LP? At maturity, in approximately 18 – 24 months, most LP's are exchanged for mutual fund units and are done so on a tax deferred basis. In other words, the conversion to the mutual fund doesn't trigger a capital gain.

Flow-though LP's can most effectively be used if 1) you have a particularly large income year, 2) have received an early retirement package, 3) are earning well over $118,000 / year or 4) if your income will drop in the near future.

The 2nd Marriage Family Feud

Sandy's father Tim passed away ten years ago. He and his 2nd wife Ellen had always intended for their home, which Tim owned long before their marriage, to pass to Sandy and her two sisters. Ellen's son from her previous marriage, was to receive his mother's investment assets. That was the intention.

During the course of time, and after hearing about probate fees and other issues, Tim changed the ownership of the house into joint name with Ellen.

After Tim's death, and being the honorable person Ellen was, she rewrote her will. In it she clearly instructed that the house would go to Sandy and her 2 sisters while her investments would go to Ellen's son. At the time, the house and the investment portfolio were worth approximately the same. When Ellen died however her investments had been depleted substantially to $98,000 and the house was worth $795,000. Ellen's son was in shock because of the discrepancy and with full force contested the will.

More than 2 years into the dispute, and after doing a lot of sleuthing, Sandy found a copy of a letter written by Sandy's stepmother Ellen, laying out very clearly the reasons for her bequest. In the letter she explained, with a history of events why she believed the house really belonged to Sandy and her 2 sisters. She stated she only lived in it and maintained it. A few months after this letter came into the light the courts ruled in Sandy and her sister's favor.

This situation ended correctly however thousand of dollars were lost to legal bills and close to 3 years of family peace. Not to mention the irreparable chasm that exists to this day between Tim's daughters and Ellen's son.

How could this have been avoided? Instead of transferring the ownership of the house in the will, it should have been transferred to a spousal trust. Ellen would have been able to continue to live in the home as she did until her death but the vicious family feud would have never happened.

I'm Leaving And I'm Taking My Pension With Me

When leaving a job many people leave their pension with their previous employer but there are most often better choices. Pension plans generally can't be cashed out but you can:

1) Transfer the funds to your new employer's pension plan

2) Transfer the commuted value to a "Locked In" RRSP account in your name

The 2nd option gives you the most amount of flexibility and control. Once you reach age 55 in most cases, you can convert the locked in RRSP to an account that will give you a regular monthly income, just like any other pension plan would. That is just the start of option 2's flexibility.

Upon death of the plan holder the entire amount could be transferred to your spouse. Leaving it in the pension plan will give your spouse a reduced income of 60% of what you were getting and when you are both gone so is the rest of the money. Not married? You could have it go to someone else (subject to paying tax however). This is not an option if you left the money in the pension plan. In that case as well the pension money expires when you do. Which could mean up to several hundred thousand dollars lost, money that could have gone to your heirs.

Note: there are other options with pension plans that allow the pension income to continue for a fixed number of years after you are gone.

HHHhhhhmmmm.........

The U.S. savings rate hit it’s lowest level at -0.5%. A negative savings rate means that Americans spent all their disposable income… and then some. There have only been 3 years that the savings rate has fallen into negative territory. Today and in 1932 and 1933, years when Americans exhausted their savings to try to meet expenses in the face of soaring unemployment as the country struggled with the worst economic crisis in its history. (Globe & Mail). Canada is in a similar situation.

A 65 yr old woman has a 29% chance of living to age 90. In 1980 she only had a 14% chance. (Investment Executive)

The S&P 500 Index is at the same level it was in 1998 (Morningstar)

The strong Chinese economy has produced 4 consecutive years of decline in the Shanghai Composite Index (it closed 2005 at it’s lowest level in 7 years). Strong economies do not always produce strong equity markets, nor do weakening economies mean poor investment returns (Harris Associates, Chicago)

A $100,000 investment in the S&P / TSX Index (large Canadian companies) in June 1975 was worth $925,370 on June 2005. That is EXCLUDING DIVIDENDS. (AGF)

A $10,000 investment in the oldest Canadian mutual fund in 1932 was worth $5.2 million at the end of Dec. 2005 (CI Investments).

In the late 80’s Toronto real estate prices shot up more than 100%. In 3 years they came crashing down. The bursting of this bubble was so severe that by the end of 2004, 14 years later, real estate prices were still 25% below their 1989 peak. (National Post, Nov 6th 2004)

The average equity mutual fund investor trying to time the market over the past 20 years only earned 3.5% / year when the S&P returned just under 13% / year. (Dalbar)

In 1995, 56 cents of the average $1.20 that motorists paid for a gallon of gasoline came from taxes, and 64 cents came from the cost of crude oil and the costs of transporting, refining, storing and marketing the fuel. (American Petroleum Institute)

Canada has the cheapest food in the world. In 1997, Canadians put 12.5 per cent of their spending money towards food; today, it's about 9.25 per cent.

Carey

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