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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Some Say "It's Different This Time"

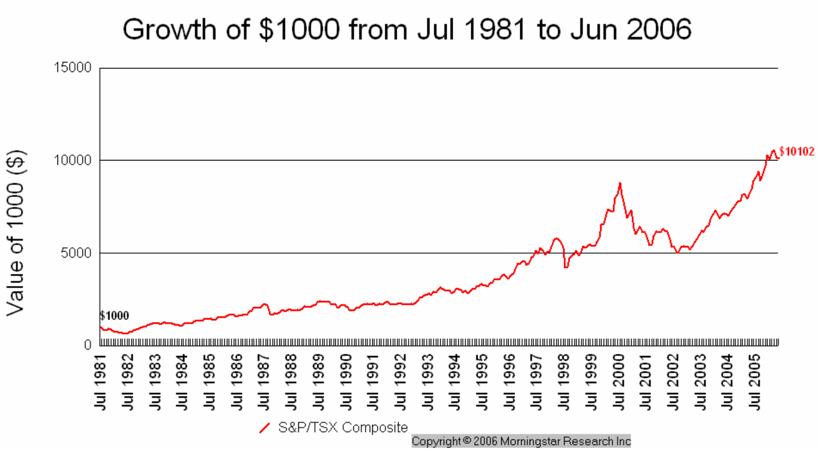
Starting in September of 2002, the Canadian equity market has been on a strong upward trend and since then has been one of the best performing markets in the world. The reasons for this are 1) a declining US dollar and 2) a surge in natural resource prices.

A heavily weighted Canadian equity portfolio has been the beneficiary of this strength. Some of these gains can be locked in and portfolio risk can be reduced by increasing global exposure. That however is not what the average Canadian is doing. The majority continue to chase returns. The last time this occurred with the same fervor and mass participation was in 1999.

Today is not any different than in 1999 except that the popular investments have changed. Natural resources and real estate are the fashionable commodities now, and like all other times in history, the rise of a particularly hot investment can come to a abrupt end where a swing from double-digit gains to double-digit losses can happen in the blink of an eye.

Here is some 500 year old wisdom from Jacob Fugger (1459-1525), one of the wealthiest individuals of all time:

"Divide your fortune into four equal parts: stocks, real estate, bonds, and gold coins. Be prepared to lose on one of them most of the time. During inflation, you will lose on bonds and win on gold and real estate : during deflation, you lose on real estate and win on bonds, while your stocks will see you through both periods, though in a mixed fashion. Whenever performance differences cause a major imbalance, rebalance your fortunes back to the four equal parts."



Although the theory is over simplified the basics are as true today as they were 500 years ago. The first part of the quote points out that you should expect part of your portfolio to lose money during economic weather that the other 3 benefit from. The last part really is the key, to re-balance your portfolio regularly which means selling the parts that have performed the best and allocate those monies to the areas that have lagged.

We are enjoying growth in natural resources and real estate today yet like everything those leaders of today will be the laggards of tomorrow. When it does how will your portfolio be positioned? Will you be holding yesterday's winners?

Just Because It's Where You Live Doesn't Mean It's The Best

Would you consider investing 60% or more of your portfolio in Iceland? Probably not, yet Icelanders do exactly that by investing 60% of their investment portfolios in their native Icelandic companies, the ones they are most familiar with.

You may think it ridiculous to invest heavily in Iceland. That however is exactly what someone living in Iceland, Germany, Japan, the U.S., the U.K. or Brazil may think about you investing most of your money in Canada.

Like Icelanders, Canadians have most of their investments in the country they live. Sure, Canada has more people, more companies and overall more investment opportunities than Iceland, but on a global basis the Canadian market still only makes up 3% of the total value of all of the world's investments. The world is our oyster. Comb its beaches.

We've Seen This Interest Rate Movie Before

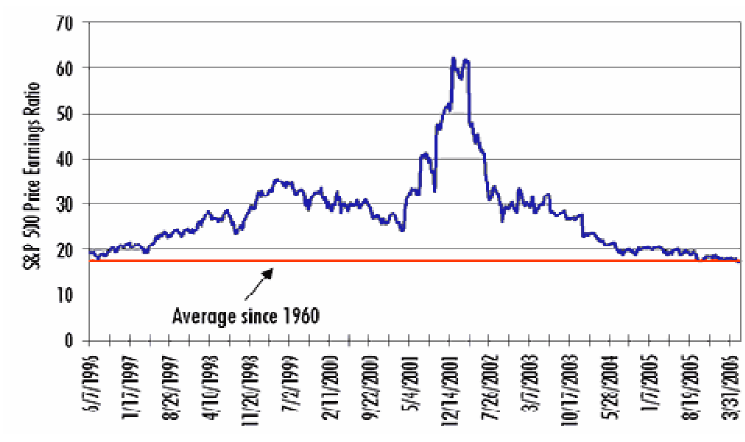
Like in times past, a surge of inflation gets economists and governments alike concerned which sets up a scenario like this:

Economic growth presses onward and upward. More and more people become employed until you see 'help wanted' signs in abundance. The economy goes into overdrive and the inflation balloon continues to be pumped with air.

The Canadian government raises interest rates to cool the blazing economy. At the same time, the U.S. economy falls off a cliff because of the rising interest rates in the U.S. U.S. demand for Canadian products plummets because Canadian stuff is getting to darned expensive. Canadian manufacturing, already on the brink of recession hits bottom. Ontario's economy stumbles and the rest of the country is dragged down with it.

That scenario is only theoretical, and may be an exaggeration of what could transpire. It is the assembling of a few very basic economic principals that has created this picture in the past. If the Bank of Canada and, or the U.S. overreacts to higher inflation by raising interest rates too much interest rates will fall again.

U.S. Equity Market – A Quick Snapshot



Volatility aside, the most attractive feature of the U.S. equity market is its valuation. The P/E ratio is currently at historic lows. The P/E ratio of the S&P 500 is under 16 and is at a ten-year low. As the graph shows, the current P/E level is below the 17.5 average since 1960.

According to an investment manager based in Dublin, one I use to manage a part of many of my client's portfolios, "This is an anomaly as corporate earnings are at record levels and corporate balance sheets are not over leveraged. This is the most opportune time to be invested in equities."
Chart Source: Bloomberg and wsj.com

Canada Savings Bonds – There Are Much Better Alternatives

Canada Savings Bonds continue to be a popular savings vehicle and often utilized through company payroll deductions schemes. They have however been losing their lustre as other financial institutions have come out with much more attractive alternatives, namely higher interest rates and quicker access to the cash when you need it.

One of the attractions of CSB's is they used to have a rate guarantee. This proved to be great for you but not so great for the government. As interest rates declined to historic lows the government found themselves paying out higher interest than it need to. Therefore, CSB's no longer carry a rate guarantee. This means when interest rates fall you get paid less. The government does pay higher interest to you when interest rates are going up however there are several financial institutions that are paying over 1% per year more on their respective "high interest" or "investment savings" accounts with some very attractive features that CSB's just don't have. These are:

- Full transferability of your cash between your chequing account to your high interest or "investment" savings either by phone or on the bank's website.

- Interest paid for each day you have your money deposited. This isn't the case with CSB's where if you take your money out as late as the very last day of the month you don't earn any interest for that whole month.

I have set up "high interest / investment savings accounts" for many of the clients I work with. I have one as do both of my sons. I often recommend money be deposited to a high interest savings account automatically for "deferred expenses". These include things that only happen once a year (a trip, holiday or time off work) or a major expense that is contemplated (i.e. a new / newer car) or a major house repair (i.e. New roof).

If you are interested in this idea for your situation you can e-mail or call me directly. If you currently have money just sitting in a chequing account earning virtually zero this idea is a must. I'd be happy to discuss your options.

A Gift For You From Stephen Harper - Use It And Pay It Forward

The government's gift to you was in the last budget. If you regularly make charitable donations this gift from Stephen Harper can mean your donations can cost you almost nothing, and could quite possibly put money in your pocket as well. In some cases, more money than you actually donated.

The change in the budget is this. You can now give to a charity of your choice, publicly traded investments and not have to pay tax on the capital gain. The key to maximize your benefit is to find an investment where you can write off the entire investment, saving yourself $3,100 to $4,400 in tax (on $10,000). You then donate the investment and get a donation credit. This combination of deduction and credit saves you just over $10,000 in tax. $10,000 invested and then donated means $10,000 back to you in tax.

The investment that has stood the test of time for 100% tax deductibility is a flow through share investment. They have been offered in Canada year after year since the fifty's. With flow through shares you can write off your full investment which means a $10,000 investment can save you up to $4,400 in tax. There are a handful of B.C. only flow through share offerings that have an extra tax credit, saving you an additional $1,600. This can bring your total tax savings to $6,000 on a $10,000 investment.

You can stop there if you prefer or you can go one step further and use your investment as a charitable donation. This is where Stephen Harper's gift to you comes in, the one he gave us in the last Federal Budget. I did mention it in the last issue of Mutual Gains but it definitely needs repeating. If you donate your investment to a charity you pay no tax on the capital gain. Here is how the numbers look:

Invest $10,000. Get $6,000 back in tax savings for making the investment (that is including the B.C. only flow through share offerings I mentioned earlier). Donate your investment to a charity in 18 months or more (assuming your investment is worth the same amount) and you save an additional $4,400 in tax.

The short and sweet is you invest $10,000 and get $10,400 in tax. If the investment is only worth $8,000 when you donate it your total tax savings would be $9,500. No matter how you slice it, we've been given a gift. All you need to do is use it today and "pay it forward".

This strategy should be considered seriously for anyone who makes charitable donations every year. If you give cash you only save $400 per $1,000. If you give a flow through share investment <u>you can save an extra $600 per $1,000</u>.

Call or e-mail me and I'd be happy to work out some numbers for you.

Note: If you don't intend to donate your investment, flow through shares are an excellent way to get a tax deduction in a high income year and sell them when your income is lower.

An OAS Clawback Elimination Strategy

If your retirement income is over $62,000 and you are 65 or older then the government is reducing or "clawing back" your Old Age Security (OAS). For every $1 of taxable income you get over $62,000 your OAS is reduced by 15 cents.

To eliminate, or reduce your OAS clawback, and assuming you don't need all of your retirement income to live on, you may want to consider investing in flow through shares. Example: A $10,000 investment in flow through shares will offset $10,000 of taxable income thus increasing your OAS. You will need to do this every year however.

The other alternative is to withdraw a lump sum out of your RRIF and invest an equal amount in flow through shares. The tax deductions from the flow through share investment will offset the extra taxable income from the RRIF. The key here is that your RRIF balance will be lower which reduces your minimum RRIF withdrawals in the future. Again, the end result is you have more money coming to you from OAS.

RRSP To A RRIF And Back Again (RRIF's Are For Any Age)

A RRIF can be used at any age and contrary to public understanding you don't have to wait until your 69.

An RRSP can be transferred to a RRIF at anytime you want to create an income for yourself. Say for example you are retiring early but most of your pension income will start at 65. You can transfer your RRSP to a RRIF, use your RRIF as your primary income source until 65 when your pension incomes kick in. You can then transfer your RRIF back to an RRSP and let it grow for another few years at which time you change it back to a RRIF.

HHHhhhhmmmm……….

Over the past 50 years, the longest rally in the Canadian equity market without a 10% correction was 43 months. At the beginning of June 2006, we entered month 45 of the most recent rally. Sionna Investment Managers, June 14th 2006

After a 30-year campaign, Brazil has replaced 40 percent of its gasoline with alcohol produced from sugar cane. (Washington Post)

RBC forecasts the loonie dropping to 81 cents (U.S.) by the last half of 2007 from its current level. National Bank on the other hand believes the Canadian dollar will be worth one U.S. dollar by the end of next year. Both link their views to commodity prices. RBC expects commodity prices to fall, National Bank sees them rising.

"When your kids have all the advantages anyway, in terms of how they grow up and the opportunities they have for education, including what they learn at home, I would say it's neither right nor rational to be flooding them with money." Warren Buffett

Moscow has dethroned Tokyo as the world's most expensive city for rental housing. Toronto is the 47th most expensive world wide. Vancouver rose to 56th.

A guaranteed 44% tax saving, one written into the Income Tax Act is always much better than a "potential" 100% gain on any investment.

"If you invest (in equities) with the specific aim of making money, you will be lucky to keep your shirt at the end of the day. If you invest (in equities) with the specific aim of not losing money, you will wind up doing very well in the long run."
C. Ross Healy - Chairman & CEO,
Strategic Analysis Corporation

Carey

Chartered Financial Planner

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