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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Big Companies Hold Big $'s

Your portfolio, namely your RRSP, for the largest part is probably made up of a wide range of investments in some of the biggest companies in the world. So how financially strong are those companies? Let's take a look at the cash some big companies are holding to get a sense of this.

Microsoft Corp. and Exxon Mobil Corp. each have more than $30-billion (U.S.) in cash sitting in the bank. Apple Inc. and Google Inc. have more than $10-billion. These are only a few examples.

Record profits for the most part have left many companies around the world flush with cash. The bulging cash accounts of big corporations are a sign of how cautious big companies are about their future profitability. They are concerned about the debt squeezed consumer which could affect their bottom line. Once the horizon looks clearer we will probably see companies buying back their shares and / or larger dividends being paid out to shareholders (like you and me). These kind of actions have in the past propelled share prices higher.

3 Controversial RRSP Questions

During "RRSP season", more so than during the rest of the year, I'm asked 3 common and somewhat controversial questions. The questions are 1) Should I pay down debts or contribute to an RRSP, 2) Get a loan to catch up on RRSP contributions and 3) Isn't it better to invest outside an RRSP?

These 3 questions cannot be answered for you personally by a quick "you should (do this, this and this)" which is the quick and simple advice often dispensed in a newspaper article. These are very personal issues that can only be answered through a one on one conversation with a financial planner you have chosen to work with. I have all too often seen an action taken based on a casual conversation. Often the over the counter or newspaper advice subscribed to has made things worse not better.

I'm sure you realize that any analysis of financial issues needs to be carefully calculated. However, what is most critical yet often overlooked is the importance of behavioural factors. How you respond to situations will have a bigger financial impact on your life than the technical or mathematical ones. Because of that the advice for someone who is very disciplined and committed to building a secure retirement fund will be completely different from the advice for one who is undisciplined in their spending or who cannot save on a consistent basis.

1) Should I contribution to an RRSP or pay down debt?

When your mortgage or other debt is paid off, will you be disciplined enough to re-allocate a portion of what used to go to mortgage paydown to an investment program? If your habit is to spend most of your disposable cash flow to enjoy today instead of saving for tomorrow, the right advice here would be to start the savings habit and contribute to an RRSP monthly. Eventually, you want to be mortgage and debt free with a retirement fund, and if you never start "storing nuts", you won't have any to get you through the fall and winter of your life.

2) Does it make sense to get an RRSP loan to make a large RRSP contribution "catch-up"?

Again, the discipline factor of what happens to the RRSP refunds is key. If discipline is low, a long-term loan that causes no financial or emotional strain is a "behavioural solution" that locks in a higher level of commitment. This is because, once started, you don't have a choice but to continue the loan payments, and you might not consistently have the discipline to invest every year in RRSPs. This is "Forced Savings" at it's finest.

3) Is it better to invest inside or outside an RRSP?

There are 2 critical factors here. The first is what happens to the RRSP refund. If RRSP refunds are spent as is most commonly the case, you will end up with less at retirement. The second is the power of compounding money on a tax free basis. As your investment portfolio grows you have to pay more and more tax. The part of the investment portfolio inside an RRSP adds zero dollars to your annual tax bill. If your investments are outside your RRSP the taxes are paid from some of the growth of your portfolio thus slowing the rate of it's growth.

On the other hand, if you are in the lowest tax bracket you benefit the least from RRSPs and it is often better in your case investing outside an RRSP, especially if you are close to retirement.

NOTE: The RRSP contribution deadline for the 2006 tax year is March 1st 2007.

How To Erase Line 121 From Your Tax Return

Line 121 is a nasty line on your tax return. Line 121 is the reporting of your interest income for tax purposes and it is the main culprit for having to pay extra income tax. For every $100 of interest you earn you have to pay as much as $43.70 to the government. This leaves you with $56.30 after tax. Because you are taxed so heavily on your interest income your 3.5% interest rate is actually only 1.97%. With inflation in B.C. at 2.1% you are losing money and you are guaranteed to lose money each and every year unless you do something…. now.

Security of principal is a primary motivator for having money in a money losing bank deposit. There are alternatives for you, alternatives very worthy of your consideration. They will cut your tax bill from line 121 down to zero and you will have an investment with the security and flexibility you are looking for.

"Yield" Funds – there are only a handful of these available in Canada. They emulate the performance of a traditional money market fund however their returns are considered capital gains. This cuts your tax bill in half with $0 to report on Line 121.

Disclaimer: Mutual funds and other securities are not guaranteed; their values change and past performance may not be repeated.

Principal Protected Notes – this is a much broader category of investment than yield funds plus there are many more choices and more upside potential. You have principal protection for the life of the investment through a guarantee provided by one of Canada's big banks in most cases. In other words, you can't do much worse than what you are doing in your money losing bank deposit but you can do much better…….PLUS your tax bill is reduced substantially….. AND that little bit of tax you may have to pay won't be billed for 3 to 8 years down the road.

Don't Buy Into It Just Because It's On TV

Manulife has been spending a lot of money lately on it's new financial product, Income Plus. This multi million dollar advertising campaign has triggered a handful of calls and e-mails into my office which has prompted me to put a summary of my thoughts down on paper.

The timing of this advertising is quite clever on Manulife's part. They have recognized that a lot of financial advertising to date talks about the accumulation and building of a retirement nest egg however the other side of the equation has been largely neglected. That is, how to create an income in retirement on the money you have accumulated.

The biggest fear for retirees is running out of money. So the balance act is being able to take enough from your investments to live while at the same time having your money grow. The Manulife Income Plus "product" guarantees that you will receive income from your investment for no less than 20 years. That is the minimum. This money is spread out over a mix of their segregated funds.

You get upside from the investments through a reset of your plan's value every 3 years. So, if your portfolio does well your guaranteed income for life will be higher. If you don't want to take income from your portfolio you will get a 5% increase in your "Guaranteed Withdrawal Balance" (GWB) every year you let it grow. This automatically increases the value of your future income payments from the plan.

Just how well you do above the guarantee is based largely on the portfolio you put together using the segregated funds under the Manulife umbrella. And this guarantee isn't cheap. It's internally costing you 0.5 – 0.6% per year of your invested monies and this cost can be over 1% per year for more growth oriented portfolios.

It's a nice, neat package for someone wanting income from their portfolio but it's not magical. A guarantee of getting your money back over 20 years? yippee (with a small y). Certain ideas are good for a lot of people. This isn't one of them.

Good Performance or Just Outright Deceptive?

Deciding on an investment requires research and lots of it. Many people rely on a Financial Planner or Investment Advisor to perform this task. Let's take an example of the desire for an investment primarily holding U.S. assets with regular cash flow. Do a little digging around and you will find one that stands out as stellar performer in the North American equity category, one that also fluctuates less than most other alternatives in it's category relative to it's compounded annual returns.

I came across this scenario lately after uncovering what I thought to be a gem. After digging a little deeper I soon discovered that this particular fund had changed it's spots. It's historic track record was based on results that were achieved when it had a completely different mandate. I found out that up until July 2006 it was a purely Canadian "blue chip" equity fund and had only recently changed into the North American category to hold primarily U.S. investments.

Those very impressive long-term performance numbers now mean nothing. They should not even be remotely considered as this fund has changed from an orange to a cucumber. The numbers currently stated came about when the fund was an orange and benefited from the strong Canadian equity market and the rising loonie. The more worrisome thing is that an unsuspecting investor going into their bank branch may invest in this fund because of it's deceptively attractive performance numbers. I'm very surprised the bank involved hasn't deleted the pre-July 2006 numbers as they are very misleading to their banking customers. Investor beware.

Are We Canadians As Compassionate As We Like to Believe?

Although Canadians may like to think of themselves as more charitable than their U.S. neighbours a recent report by the Fraser Institute suggests that is not even close to being true. When it comes to reaching into our pockets and donating money to charity, Americans are far more generous than we are. The report shows that the average value of charitable donations in Canada from income tax returns, is $1,214. The U.S. average is $4,021.

You may recall that the Federal Government in Canada in May of last year made it even more attractive to donate to charitable causes. They did this by eliminating the capital gains when you give investments that have a capital gains attached to them. This may prove to be close the Canadian / American charitable donation gap.

How Your Charitable Donations Can Cost You Virtually $0 or…. (if you just want some EXTRA LARGE tax savings for 2007)

On a few occasions last year I wrote and talked about what I call the "Flow Through Share Donation Strategy". I am mentioning it here again as we are facing a deadline to receive extra tax credits that the Federal Government is making available for only a few more weeks.

If you make a "Super Flow Through Share" investment before by March 31st 2007 you will see **TAX SAVINGS up to $6,180** for 2007 (minimum $10,000 investment). If you chose to stop there that is entirely up to you. In that case you will have made a $10,000 investment for only $3,820. You are $6,180 richer with the simple writing of a cheque.

If you choose to take a second step and use your investment as a charitable donation **YOU WILL SAVE AN ADDITIONAL $4,370** in less than 24 months assuming the investment is worth the same at that time. Total potential tax savings is $10,370 on a $10,000 investment. In other words you have made $370 and the charity you choose gets $10,000.

If you are a regular giver to a charitable cause or church this is considerably better than simply donating cash which produces a total tax savings of only $4,370. I use the "Flow Through Share Donation Strategy" myself and will continue to do so until the government changes the tax rules.

HHHhhhhmmmmm………

Assets in online savings accounts in the U.S. more than doubled, to $112.5 billion, between the end of 2004 and the second quarter of 2006. On line savings accounts offer a 3% to 5.3% annual rate on account assets. By contrast, the average yield for all interest-bearing chequing accounts is only 0.3%. (USA Today)

More than a third of Canadians who aren't yet retired expect their home to be a source of retirement income. Of those, 40% see the sale of their home, or the use of their home's equity, as accounting for up to half of their retirement income. (RBC Financial Group 16th annual RRSP survey)

Seniors 65 and older represent the fastest-growing group seeking bankruptcy protection, though they made up only 5% of all bankruptcy filers in 2001. "We're at the tip of the iceberg. This generation will have no problem at all racking up debt and worrying about it later." (USA Today)

In 2005, eight Canadian companies were removed from the S&P/TSX Composite Index because they had been purchased by non- Canadian companies. (Globe & Mail)

Shares in Canadian banks trade at a significant premium to their US counterparts. Over the past decade, Canadian bank shares have typically sold for a slight discount to US bank shares. (CIBC World Markets)

Emerging Market companies are priced at a 10% discount to developed markets on a price-to-earnings (PE ratio) basis. That is down substantially from the 55% discount at the global markets' cyclical trough in the fall of 2002.

The affordability index for a detached bungalow in Canada's largest cities is, Vancouver 70.1%, Toronto 43.8% and Ottawa 30.8% A reading of 50% means that homeownership costs, including mortgage payments, utilities and property taxes, take up half of a typical household's monthly pre-tax income. (Globe & Mail)

Residential housing values in Canada have increased on average of 264% in the last 25 years. The highest appreciation was in Barrie, Ontario with a 372% increase. St. Catherines, Hamilton, Ottawa and Toronto (GTA) saw price appreciation of 290% and higher. Vancouver was on par with Halifax at 242%. Victoria rose 229%, Calgary was up 227% and Kelowna 211%. (Re/Max as reported to the Globe & Mail)

More than a third of borrowers in the U.S. who got mortgages in the first nine months of 2006 got non-traditional mortgages (interest only, partial interest only or "negative amortization"), up from about 2 percent in 2000. (First American Loan Performance, a real estate information firm)

People in the U.S. once again spent everything they made and then some last year, pushing the personal savings rate to the lowest level since the Great Depression more than seven decades ago.

In Canada the savings rate for all of 2006 was a negative 1%. This means that not only did people spend all the money they earned but they also dipped into savings or increased borrowing to finance purchases. This is the lowest rate of savings since the negative 1.5% savings rate in 1933 during the Great Depression. (Globe & Mail)

This year's production of Ethanol in the U.S. will surpass the mandate set for 2012, which was 7.5 billion gallons, in the Energy Policy Act of 2005. Ethanol is a clean-burning, high-octane fuel produced from crops such as corn. (Washington Post)

"When life looks like Easy Street, there is danger at your door." The Grateful Dead

Carey

Chartered Financial Planner

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