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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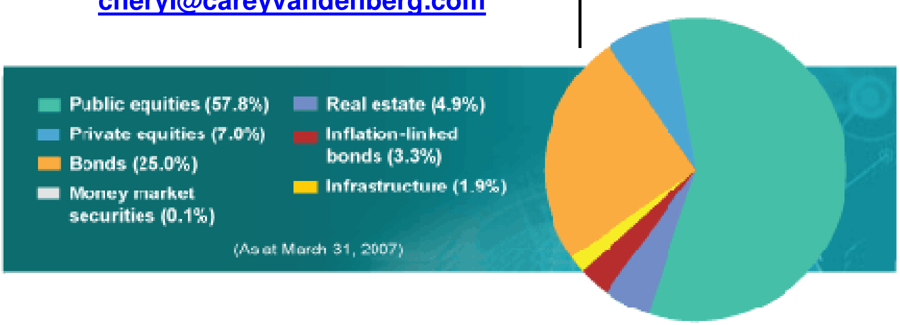
The CPP Is Like A Big Mutual Fund

I've always looked to various pension plans that are responsible for in aggregate, millions of employee's retirement assets as a benchmark for how an RRSP portfolio should be allocated. So I thought, why not provide a snap shot into what your and my Canada Pension Plan "portfolio" looks like. However, before I do that I want to dispel a myth that started several years ago. It's been continually evident in this statement of doubt that I still hear today; "If CPP is there when I retire."

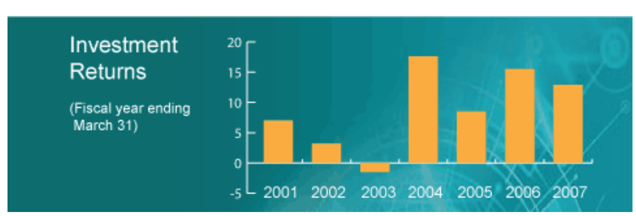
The premiums that come off of each and every paycheque used to go to pay the retired people who were collecting CPP. Money came from your and my cheques and went immediately to the Federal Government so they could pay a retired person their CPP (almost like a Ponzi scheme).

In 1999 that all changed. The CPP payments coming off of our paycheques got much larger and the surplus went to what I call the "CPP mutual fund". It was in 1999 that the "CPP mutual fund" made its first investment. It now has $117 billion in assets and is growing daily.



So where is that $117 billion dollars invested? The pie chart on the left gives a quick snap shot.

Why do they invest our pension plan money this way? It's simple really. A portfolio made up primarily of publicly traded equities and balanced with various other assets is expected to produce the highest returns with the least amount of ups and downs.



Is your RRSP invested in a similar fashion? Do you have someone reviewing it on a regular basis? Is it re-allocated or "tweaked" periodically? If you answered "no" or are unsure, I'd suggest your RRSP may not produce the most income for you when you decide to retire. And that is the ultimate goal, to make a transition from YOU working for your income to having the money you accumulate set up so it will work for you.

How Upward Are These Interest Rate Pressures?

Over the past several months interest rates have been stealthily pressing higher. If you have recently refinanced or renewed a mortgage you are probably well aware of that fact. However, the question you may be asking is, "should I be worried"?

First, interest rate increases are of concern not just for anyone with mortgage or other debts outstanding. Interest rate increases are a sign that inflation is potentially on the rise and our economy could be speeding up too much for its own good. That isn't good for anyone. The dichotomy is that in Western Canada the economic good times are rolling however they just aren't feeling the same pleasure east of Manitoba. That very fact is the dichotomy that could be the interest rate rise limiter.

Raising interest rates is a tool used to cool an economy and thus slow the rise of inflation. The bi-product of that on a financial healthy country like Canada is that the currency generally rises as well, and a rising Canadian dollar is hard on Canadian manufacturers, tourism, resource companies and ultimately to their employees should it continue to rise. It's this bi-product, the Canadian dollar's meteoric rise over the past couple of years and a more recent 10% rise against the U.S. dollar in the past couple of months is the thing the eastern half of Canada definitely doesn't want.

The rising Canadian dollar will potentially limit the rise of interest rates hear in Canada. So, if you are concerned about rising interest rates pay some attention to what the Canadian dollar is doing. Use that as your barometer.

It Pays To Be A Canadian Tourist

When our own currency increases in value against other currencies around the world, we who live and work in our country have a tendency to travel more frequently to other jurisdictions. We can buy so much more outside our borders than we ever could before. "Look how much our dollar buys!" Hotel rooms, meals, car rentals and a Latte are all cheaper.

Compare our habits as tourists, and our propensity to travel abroad when our currency is up to our actions as investors. Our tendency as investors with a stronger currency is to buy more Canadian assets because they seem to have done so much better than our foreign holdings. The reality is it's the currency that has created the majority of the gains.

I'd suggest that our investing would be much more successful if we viewed and acted on the stronger Canadian currency in the same light as the tourist. Tourists are happy because they get more foreign currency (in this case, U.S. dollars) for each Canadian dollar they spend. As long as we are making investments outside of Canada, the same applies to us as investors: we are getting more investment purchasing power for our Canadian dollar.

None of this is to deny that while the Canadian dollar is rising it adversely affects the dollar value on our foreign investments - again, while the Canadian dollar is rising. But it is important to remember that the key to investing outside of Canada is to think about the whole picture — the potential returns and diversification within your portfolio. Cycles end, and nobody really knows when the Canadian dollar's cycle of rising will end (it's now at it's highest level in 30 years). When the tide changes which it will, you could be on a long road of making money on your investment tourist dollars.

Mental Accounting – When A $100 Isn't Really $100

You are headed to a concert. You are walking up to the door of the venue and at the same time reaching into your pocket to pull out your tickets. No tickets. "*!#@%? I forgot them at home". Do you still want to see the show? You will have to pay another $100 for new ones. If you are like most people, you would probably think twice but you would most likely bite the bullet and lay out some more cash.

Here's a slightly different scenario. You are going to a concert. As you stand in line at the box office to buy your ticket, you discover that you have lost the $100 you were going to use to buy the tickets. You're not feeling very happy about this of course, but would it affect your decision to buy the tickets? Again, if you are like most people, you feel pain in losing the $100, but it probably won't affect your decision to buy the ticket.

A psychological experiment found that only 46% of those who lost a ticket were willing to buy replacement tickets, whereas a surprising 88% of those who lost an equal amount of cash were willing to buy tickets. Since the lost tickets and the lost cash had the same value, their loss should have been experienced in the same way. Why then are nearly twice as many people willing to ignore the lost cash but not the lost tickets?

It's called mental accounting, and the household version of true accounting, the accounting that financial professionals use. It affects how we spend money and how we save. When we feel a little richer our spending tends to increase as well. This phenomenon is particularly noticeable in the U.S. where people are using the equity in their homes to buy a new car and the boat or Harley they always wanted.

Mental accounting alters the way we manipulate our deficit and surpluses by robbing Peter to pay Paul. At the end of the year it may not feel comfortable spending money on a cool new Blackberry because the "new toys" budget is blown but since the monthly RRSP contributions or life insurance (which is still technically needed) was cancelled, there seems to be some wiggle room.

A very common mental accounting situation, one you may have faced recently is if you got a tax refund. We love looking forward to our tax refund. It's like free money. Not really because it simply our own money being returned to us with no interest.

The way we handle tax refunds is often like how we deal with "free" money we may have been given to gamble on. If we are given $100 we may gamble or spend it frivolously however when the $100 is close to gone we stop. Mental accounting has us believe that the $100 isn't ours and never was. In reality though it is in our hands for us to decide what is done with it. That money is yours just like any other money that comes into your hands.

For B.C. Home Owners Over 55 Years of Age Only

The following idea relates to the power of deferring taxes, the most widely used tax concept suggested by Financial Planners and Accountants alike. The most common form of this is building up an RRSP portfolio and not paying tax on it until you start withdrawing several years down the road. Another is sheltering investment income growth within an exempt life insurance policy (most commonly, Universal Life). There are several others but these are the largest and most powerful.

Another tax deferral idea, one that I would classify as a "small advantage" is one that any home owner in B.C. who is at least 55 years old can use. If that is you, you can, if you so choose, defer paying the property taxes on your principal residence until you sell your home. This can make a lot of sense provided you are disciplined enough to take that money and put it in an investment specifically for paying all of the property tax owing when you sell your home. Discipline is the key on this one. If you don't think you have that attribute I'd suggest not reading any further. Continue to do things as you always have. All others 55 and over read on.

Let's assume you pay $3,000 in property tax per year. Instead of sending your city your property tax cheque, apply for the "Deferment of Property Taxes" and put that money in a capital gains oriented investment. If you did that every year for 10 years your investment account (assuming an 8% / year return) would be worth $53,413.

Jump ahead 10 years, the day you decide to sell your home. You've deferred your property taxes for 10 years so now you have to pay up. The government is going to charge you an interest rate of 2% per year below prime. Assuming that prime hasn't changed you would be paying 4% per year. Your bill based on that is $41,900.

Sell your investment account (or just have the money come off the house sale proceeds) and you are ahead by well over $11,000. That's over $1,000 / year and the longer you plan to stay in your current house the better it gets.

Yes, the government charges interest on your tax deferral balance. They will also charge you a one time fee of $60 to set this up along with an annual fee of $10. Despite all of that, if you can earn slightly more than 4% per year after income taxes, you are making money to defer your property taxes. That is ultimately what deferring taxes is all about, using the government's money to make money.

This is just another example of a "small advantage". Using "several small advantages can add up to making a big difference". As usual, if you have any questions about this idea and want the application form e-mailed to you and / or want info. on how you should invest this money for your particular situation please call or send me an e-mail (604 541 2690 or carey@careyvandenberg.com). If you want to implement this idea for this year's property taxes YOU MUST ACT NOW.

The preceding idea was brought to my attention by a client, so you can thank "Gail" for that one.

Should you hear about **a financial planning idea or a "small advantage" that seems new to you** I WANT TO HEAR ABOUT IT. I don't care how insignificant the idea is. It just needs to be a "small advantage". In a combined effort you could be helping hundreds of people. "Small Advantages Make a Big Difference".

HHHhhhhmmmmm.........

A 67 year old Mexican Engineer turned telecom mogul has unseated Warren Buffett as the 2nd richest man in the world and is nipping at the heals of Bill Gates for the World's Richest Man title. (Forbes, April 2007)

Corporations in North America have more cash, and less debt, than they've had in over 20 years. (Globe & Mail, May 2007)

The 2007 Civic has the same basic headroom and legroom as a 1990, traditionally larger, Honda Accord. (AutoObserver.com)

More than 30 per cent of Canada's workers are unionized, a much higher percentage than in the United States and many European countries. (Globe & Mail, June 2007)

Britain's largest bank, HSBC, is changing its services. Its branch in the affluent area of Canford Cliffs near London will only be offering teller services to richer clients from June 11. Everyone else will have to make do with ATMs. They are splitting their customers into 2 classes, "first class" and "cattle class". (Globe & Mail, April 2007)

Between 1999 and 2005 the median value of homes in Canada was up 25%. Household debt increased by more than 47% during that same period. (Statistics Canada)

Royal LePage defines high-net-worth Canadians as individuals with a primary residence valued at $500,000 or more, and other assets with a value of at least $250,000.

The star of "Flip This House", Sam Leccima, has been accused of several elaborate hoaxes in the show. Many people have invested with his company due to the perception of his acumen for real estate investing. They have yet to see any money back. (USA Today, June 2007)

The age group of 25 - 44 accounts for almost 70% of all home purchases at any given time in Canada (CIBC World Markets, April 2007). That same age group's numbers are declining.

Choosing a five-year mortgage a few years ago was almost like buying expensive insurance against interest rate increases where the premiums were in the form of much higher interest costs. Today, you can get that insurance at a much lower cost.

With the loonie currently running nearly 8 cents higher than it was at the start of this year, the impact would be comparable to the Bank of Canada having raised interest rates by almost 3%. (Report on Business, June 2007)

Tata Consultancy, a giant Indian computer services firm, is hiring 5,000 workers in Mexico because wages in India have increased. (Financial Post, June 2007)

The highest average rent in Canada for a two-bedroom apartment is $1,681 per month, and it's in a northern Alberta municipality called Wood Buffalo. That same apartment rents for $1,073 in Toronto, $1,051 in Vancouver, $1,037 in Calgary and $630 in Montreal. (Globe & Mail, June 2007)

More than 50% of investors in one of the best performing mutual funds of all time lost money because they bought when everything was rosy and sold when times were tough.

That tax refund you got is simply a return of your own money from the interest free loan you gave the government over the past 12 months.

Carey

Chartered Financial Planner

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