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 Subprime Troubles Snippet

The subprime market troubles and the ensuing contraction of money supply caused a quite a bit of concern since mid August. It looks however that although the worst is not over on subprime mortgage defaults, pricing of a worst case scenario expectation had been fully factored into equity and money markets. In fact, some suggested that the effect on the global economy had been overblown and thus equities and most corporate bonds had been oversold. It looks like everything is bouncing back in support of that thesis.

Seeing as we could, or should is I say we will, be going through emotionally charged times I thought a couple of pieces on how emotionally triggered financial decision making can do more harm than good.

Survival Instinct & Money Mistakes

Selling triggered by fear is a very simple survival mechanism however; it is this reaction to fear that causes continual financial mistakes.

Anyone who has sold an investment in a panic, a few years later would have been much better off staying put. It is also this fear of making yet another mistake that hinders us from making another move until we are comfortable again. This is when our fear has changed to optimism. These feelings generally come way too late to be aligned with reality.

It can be hard to resist the temptation to sell when the world seems like it is crumbling around you. It's your brain that is to blame. The study of this behavioural science is called "Neuroeconomics". Understanding it can help you improve your financial decision making track record and thus will improve your life.

As investors, we are slaves to the ancient parts of our brains that were designed to maximize survival. In the beginning pages of human history, if we were threatened by a predator, our brains told us to run, run like you've never run before. What has this primal trigger have to do with how we make investment decisions? I'd suggest, more than we often care to admit.

When we watch our portfolio plunge in value, the losses we see stimulate the same part of the brain - the amygdala - which responds to mortal danger. As the amygdala pumps us full of stress hormones, our pulse and blood pressure rise, muscles tense and breathing quickens. Even though we're not in any physical danger, our body acts as if we are. Have you ever watched a suspenseful movie? Same brain activity. They are feelings not reality.

So what does an emotionally charged investor do? He sells, which is the investing equivalent of running for the safety of the nearest cave. It may make him feel better temporarily, but from an investing standpoint, it's the worst thing to do, because losses are locked in for good and future gains are missed.

Our brains also trick us into making mistakes when investments are rising. "The neural activity of someone whose investments are making money is indistinguishable from that of someone who is high on cocaine or morphine," (Jason Zweig, author of "Your Money and Your Brain"). Moreover, when a particular stimulus is repeated, your investments continue on their accent, the human brain automatically, unconsciously and uncontrollably expects continuation. Result: people buy investments *after* they've already climbed in price dramatically instead of buying when they're selling at bargain levels.

The trick is not to turn off your emotions but to turn them inside out. To do that you need to see the correlation of your feelings to what is happening around you. The best tool is by writing down what you are feeling and keeping it all in a journal. One or two sentences a day is all that's required. If you had done that through this past spring your entries would have been more positive than what you wrote in September.

In time, you will be able to directly correlate your feelings about your financial situation to a financial index like the Dow or the S&P/TSX. It turns out that the time to be skeptical was when the ancient parts of your brain were telling you to be optimistic, and the time to be optimistic was when your brain was telling you to be scared. Learning to bet against your own emotions is one of the secrets to making intelligent financial decisions. The financially successful generally have more self awareness than those less so.

Free and greed are two emotions that can hijack intelligent decision making and cloud judgment in what should be a financial planning and investment process rather than an event. This August and September were just events in the process.

"We view short term market volatility as a reflection of the emotional changes of the investors who participate in the market and not representative of the real value of the businesses it includes." Brandes Investment Partners

Beat The Need To Not Look Stupid And You Will Do Well

People who avoid letting greed or fear dictate their investment decisions almost always outperform their emotionally charged market timing friends. That is what a recent Quantitative Investment Behaviour Study by Dalbar found although frankly, I knew that.

Dalbar found that the average mutual fund investor grew a $10,000 investment to only $21,422 between 1987 and 2005, while a buy-and-hold investor using the S&P 500 index grew that same $10,000 into $94,555.

"Investing should be dull. Investing should be more like watching point dry or grass grow." Paul Samuelson, Nobel Prize winning

Behavioural factors play a pivotal role in investment sell-offs. Fear heightens the herd mentality which prompts us to make decisions that are often against our better judgment. We tend to react impulsively when barraged with bad news from the media, and we often copy the behaviour of others even in the face of unfavourable outcomes.

Pride can play a big role in making the wrong decisions. We are driven by a need to feel good about our decisions, and so often we make financial choices that confirm we're smart. This is also obvious in how much more we acknowledge our positive outcomes than our negative ones which fills a primal ego boosting need. However, the lessons we learn from what we did wrong are much more valuable than from what we did right.

So, when things seem like they are going crazy and you have the urge to make a knee jerk decision in your financial life, it likely makes sense to hold your breath, tie your hands behind your back and adopt a true buy and hold strategy, rather than succumbing to primal emotions.

Why Canada Savings Bonds Don't Make Any Sense

Every fall the government has a campaign, to borrow money at low rates from the Canadian people. They do this through the annual Canada Savings Bond blitz and their target market is conservative Canadian savers.

Over the past few years the people have been waking up and instead of CSB's have been putting their cash into "high interest savings accounts" offered by banks like ING. This is very different than a tiered savings accounts offered by TD, RBC and CIBC which pays you a miniscule amount of interest below a certain threshold ($1,000 - $5,000) and at least some interest on anything over that. A high interest savings account on the other hand pays the highest interest rate you will find on ALL of your savings.

So why are high interest accounts far superior to CSB's? Along with a) paying interest to you at a rate often higher than CSB's, b) the ability to contribute to them monthly (CSB's are often used for in conjunction with an employee payroll deduction), c) offering a guarantee on your savings, and d) no fees, you can transfer money between your regular chequing account and your high interest savings account over the phone or on the web.

Don't have a high interest savings account? Call or e-mail my office. We can set one up for you.

Buy A Car On Payments? Why Not Buy An Income For Life on Payments

Car manufacturers make large financial hurdles seem easy by offering financing with "low, easy payments". This approach is so popular among consumers that we are now a monthly payment society. Borrowing and paying off a car loan over a few years and then keeping it used to be the norm. Now leasing a car has reduced the pain of acquiring transportation even further by allowing us to finance just a part of the life of a vehicle.

I'm going to take a bit of this slick consumer marketing, but instead of trying to separate you from your money and impeding your financial freedom, this I hope will encourage and spur you on to the financial freedom of having your money work for you rather than you working for it.

How would you like to have an extra $20,000 of income paid to you every year for life? Yes, you will have to wait 25 years before this income will start but it should last for 25 years. How much do you think your "payments" would be to buy that? How does $3 a day sound? That's $90 a month to start. Can you afford that? Or should I ask, can you afford not to do that?

$90 per month for 25 years will give you $1,600 of extra income for 25 years. I wonder what that leased car will look like then….

Time For Some Tax Deductions For 2007… Before It's Too Late

The following applies particularly if you; a) Maximize your RRSP contributions b) Don't have much RRSP room because you belong to a pension plan or c) You gift money regularly to a church or other charity.

This first part applies if you are in any of the above (a, b or c). It involves making a "Super Flow Through Share" investment in 2007. This will save you up to $6,180 on a minimum $10,000 investment. This is a substantial tax savings. RRSP contributions provide maximum tax savings of $4,370 per $10,000.

Flow through shares are nothing new. They have been a huge part of the Canadian economy for over 50 years, much longer than RRSPs. However, unlike RRSP contributions you must make a Flow Through Share investment before December 31st. As Flow Through Shares are based on a limited supply the best time to do one is now.

If you simply want the tax savings and hold the investment for yourself then we'll stop there. You will have made a $10,000 investment for a net cost of only $3,820.

If you choose to take a second step and use your investment as a charitable donation you will save an additional $4,370. The $6,180 tax savings for investing and then $4,370 tax savings for donating. In other words you have made $370 and the charity you choose gets $10,000.

For 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 "Super Flow Through Share Donation Strategy" myself and will continue to do so for years to follow or until the government changes the tax rules. Multiply the tax savings by the number of years you will have breath and we are talking potentially hundreds of thousands of dollars in extra dollars for your (or your kids).

Think Twice Before Doing A "Pooled" RESP

Pooled "Scholarship Trust" plans have been promoted for over 40 years. When you have a child you can expect a call from an agent promoting one of these pooled education savings plans. Today however, there are much better options.

High cost and lack of flexibility are the big issues. When you start contributing to a pooled RESP the first two years worth of contributions you make to the plan go virtually all to fees, much of which goes to the agent that sold you the plan. If you decide to withdraw from the plan that money is gone. When your child finishes high school but only attends one or two years of schooling or technical training after that, you give up a portion of the earnings your investment has made. The "sand on the hardwood" is that you can't choose the investments you make within the RESP. Pooled RESPs invest only in bonds and your hands are tied. With such a long investment horizon - it's usually 22 years by the time someone finishes 4 years of post secondary education - coupled with your making investments monthly, it makes much more sense to choose something other than just bonds for an RESP.

If you have a pooled RESP going already the best thing to do is reduce your monthly contributions to the minimum or better still, if possible, stop the payments altogether. Set up a new RESP and reallocate the monthly contributions there. Questions? Call or e-mail me directly.

HHHhhhhmmmmm………

During the market's decline from August 2000 to September 2002, the fund cumulatively gained 5.3% while the index and median fund shed 43.2% and 22%, respectively. (Morningstar, July 9th 2007 re: Gerry Coleman's investment management track record)

Equity market recoveries often begin when investors are extremely pessimistic and equity valuations are reasonable. That's the case on both counts right now. Many see similarities to the stormy years of 1987 and 1998.

September is traditionally the worst month for equities, but this year's was the best since 1998 (Financial Post Oct 1st 2007)

If you had invested in the MSCI World Index (which can be purchased using an ETF) 25 years ago you would have increased your initial investment 17 times. If you had invested in a good quality mutual fund over that same period you would have increased your investment 33 times.

Manulife Financial Corp, a Canadian company that is the 5th largest life insurance company in the world, derives nearly 57% of its revenues from the United States. (Financial Post, Sept 2007)

Over 40% of the combined revenues for companies in the DOW index come from outside the United States. Proctor & Gamble's and Coca Cola's total revenues are 61 and 71% global (respectively). (Financial Post, Sept 2007)

The British Columbia Investment Management Corp. has 44% of its pension plan assets invested outside of North America. Another 29% is invested in the U.S. (Financial Post, Sept 2007)

More than two-thirds, 68.4%, of all Canadian households owned their principal residence. This is the highest home ownership since this information was first collected in 1961. (Statscan)

Canadians can now borrow 103% to buy a home and pay for it over 40 years.

Over the past 30 years, detached housing in the Vancouver market has increased in value, on average, by 7.91% per year. The TSX has returned 12.25% per year including dividends. (Advisor's Edge Report, August 2007)

Ireland's population has reached its highest level in 135 years with 4.23 million people. The last time Ireland's population reached over 4 million was in 1871, when the census recorded 4.1 million. 10% of today's population have come from Eastern Europe. Half of them have come from Poland. (AGF Intl Advisors)

A couple both living at age 65 have a 50% chance that at least one of them will live to 90 years of age.

If you pay your car insurance premiums to ICBC on a monthly basis rather paying for a full year up front, you are paying an extra amount equivalent to paying interest of 14.5% per year to do so.

The card you use to open your hotel room has your personal info. on it including your credit card number.

Carey

Chartered Financial Planner