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A High Priced Canadian Dollar Feels Good But Is It Really?

The rising Canadian dollar has caused many to sell foreign investments with the belief that such a move will spare them currency risk in their investments. "Why invest in foreign companies when Canadian investments are doing so well?". A simple examination of the Canadian companies that make up a typical Canadian portfolio reveals that this comfort may be misplaced. We must ask ourselves, if the Canadian dollar continues to rise how does that affect the companies I own?

45% of the market value of the largest companies in Canada (TSX index) is now comprised of energy and materials companies. Be it a metal such as nickel or an energy product like crude oil, each of these goods is priced in US dollars. These companies are earning creating revenue in US dollars which must then be converted into Canadian dollars. The problem with that is these companies expenses are primarily in Canadian dollars so they are earning less with each rise of the Canadian dollar yet there operating costs remain the same. The saving grace for these companies has been commodity prices which have risen sufficiently to offset the falling Canadian dollar, and thus falling revenues.

The majority of Canadian exports go straight to the US. This means many Canadian companies generate a significant portion of their sales in US dollars. In fact, aside from the banks, the 20 largest companies in the TSX earn approximately 68% of their revenue south of the border and / or in US dollars. Let's take that examination south of the 49th. The 20 largest companies in the S&P 500 index reveals that 64% of their sales are made in the US. The difference is, their costs and revenues alike are both in US dollars.

The bottom line is this. An equity portfolio may actually carry less US dollar risk by being invested in American companies. Also, Canada may have some profitable banks (albeit expensive compared to other banks around the world), our countries limited amount of important industries like world class pharmaceutical and consumer products companies like General Electric and Microsoft, gives us another reason why being invested in US domiciled companies may be a good thing.

The Disabled And Their Families Just Got A Big Break

There has been a new savings plan put together by the government. It's called a Registered Disability Savings Plan (RDSP) and it gives families with disabled family members up to $70,000 which comes directly from the federal government.

A parent or legal guardian will be able to set up an RDSP which will make them eligible for the new Canada Disability Savings Grant (CDSG) which works like the Canada Education Grant for RESPs. The maximum federal government matching grant for a RDSP equals 300% on the first $500 contributed by the family and 200% on the next $1,000 of annual contributions. This means the contribution into RDSP of $1,500 / year will have the government contribute an additional $3,500 / year. The family can't have an income over $74,357 / year to qualify for this funding.

With maximum contributions of $200,000 into a RDSP a family would get $70,000 in government grants paid into the plan (CDSG) and, if the family has a low or modest income another $20,000 in Canadian Disability Savings Bonds are available as well.

These matching grants and bonds are payable until the disabled person reaches age 49 however the earlier the plan is put in place, like all things, the better.

Disability Windfall (continued)

The application to receive these monies is broad as well. In fact, the RDSP could potentially benefit people who are in the work-force but who have never applied for the disability tax credit. Example would be a "disabled" person who is gainfully employed but has a moderate income and who has never applied the credit. With such serious money being given by the government it's worth the effort to apply and could potentially more lucrative than a RRSP.

More than 49% of people with registered disabilities are currently working (Statscan)

Try A Fake Retirement Before You Retire

I believe the big difficulty with retirement is the uncertainty. Many can't really know or envision, what their life in retirement will be like. Common descriptions that I come across like more golf, less work, no work, spending time with family and travelling are very general and quite common. That is a start however I have a couple of ideas that you may want to consider in deciding exactly how your own retirement will look and feel, before you actually do it for real.

Before you retire talk to as many retired people you can about their experiences and what they would have done differently. What did they expect to be doing in retirement? What did they actually do? Experience is a great teacher. We can learn a lot from those who have walked before us.

How about trying a trial run or faking retirement. For a couple of weeks, a month or maybe even a few months, try living as though you were retired. Do only the things that you expect to be doing in retirement. Pay special attention to how you feel about the experience. Write those thoughts down and keep track of your expenses. If you have always thought that retiring in a small town is nirvana for you, faking retirement would involve living in a small town for a month to get the flavour of how a small community functions in comparison to a large city. The theory behind faking retirement is that the only way any of us can really understand a new or different experience is to live it.

These ideas will either confirm what you already knew allowing you to make a more confident transition into retirement or they could completely change how you see your retirement years unfolding. If you are retiring with a life partner then I know it will stimulate all sorts of conversation.

Various calculations need to be made during your earning years and just prior to retirement however the foundational parts of retirement planning are more a matter of our own desires and how that feels than it is a mathematical equation.

The 7 Pillars Of Value Investing

1. A company must be cheap in relation to the value of its assets.
2. The business risk is much more important than market volatility.
3. Holding cash in a portfolio is not tactical, but rises and falls with the availability of value buying opportunities.
4. Investment in a company is held for 3 to 5 years and often much longer.
5. No attempt to time the market is made as the market value of a company in the short term is emotionally driven.
6. Hold a smaller number of high quality, profitable companies rather than several uncertain ones.
7. Dividends pay you while you wait for the price of the company to rise back to fair value.

Manulife Income Plus— It Looks Much Better Now

When the highly advertised, Manulife Income Plus program came out I wasn't particularly enamored with it. That has changed because of a significant improvement to the plan.

Income Plus, which was launched a little over a year ago, is really an add on feature to a segregated fund contract (the life insurance version of a mutual fund). Income Plus guaranteed a monthly retirement income from the fund for a period of 20 years regardless of how the underlying investment performed. Frankly, I wasn't that excited about it with that set up. However, that 20 year period has now been extended to the life time of the investor, starting after December 31st in the year that person turns 65. The extra plus is that this positive change has come at no additional internal expense to the investor.

Manulife Income Plus has become very attractive to those within 10—15 years of retirement because for every year you don't take an income from it you get a 5% bonus. This means that a person at 45 who wants to retire at 60 can get a 75% increase in their investment guarantee if they don't touch the money for that period of time.

There are a few financial companies that offer a very similar investment and income package that protects you from outliving your income.

Donation Schemes That Will Be Attacked

I've talked about making your donation dollars more effective by using what is written in the Canadian Income Tax Act to your benefit. That strategy uses a "Super" Flow Through share investment, getting that tax deductions and tax credits from making the investment (approx. 60 cents of tax savings on the dollar). Then, when the Flow Through share investment is converted to a mutual fund, donating part or all of the investment to the charity of your choice (approx. 40 cents of tax savings on the dollar). Again, all aspects of this set of transactions is written in the Income Tax Act. Getting tax benefits from flow through shares has been in existence since 1954. The gifting of publicly traded securities and not triggering tax on the capital gains tax was introduced in the Federal Budget in 2006. That is why this kind of gifting strategy works.

Donation schemes that don't work often seem to have these characteristics which are used to prove their legitimacy:

- Most often related to the gifting of Pharmaceuticals purchased at "market value" yet gifted or sold for substantially more.
- The value of the gift can be contested. You don't face this risk with publicly traded securities like a mutual fund.
- A legal opinion is provided however it usually only relates to a small part of the scheme
- Tax Shelter ID #. This is only given so the government can identify the scheme and their donors and thus find you easily.
- The promoter says they have a sizeable "war chest" to fight CRA.

So far CRA has reassessed more than 26,000 people who have participated in these schemes. They are starting on another 50,000 people and have stated that they plan to audit all of these kinds of arrangements. If you have heard about or been intrigued by a gifting arrangement or other "tax shelter" for that matter I'd be happy to supply you with some of my 20 plus years of experience.

Get Significant Tax Savings Before Buying Your First Home

Buying a home is the cornerstone of every person's financial plan. You need to live somewhere so why not own that asset, one that has appreciated on average by 8% / year (according to the Real Estate Board of Greater Vancouver).

A down payment is often gathered before the initial purchase is made. If that down payment goes down the wrong road you lose a significant tax saving opportunity, and frankly I've seen too many people lose it. The most beneficial road involves using the Home Buyers Plan where you can withdraw money out of your RRSP tax free for the purchase of a principal residence.

If you are contemplating a home purchase at anytime in the future OR are working on that down payment of yours now you should be putting that money into an RRSP first. With the Home Buyers Plan, an RRSP contribution up to $20,000 can be made per home owner. For a couple that equates to $40,000 between the two of you.

Why use the Home Buyers Plan instead of accumulating the down payment out side of your RRSP? The advantage - and it's significant— is that your tax savings will be as much as $17,480 if you make RRSP contributions before you buy your first home. In other words, you and your other half can turn $40,000 into $57,480 based on the highest tax bracket (kicks in at $121,000). These RRSP contributions must be done at least 90 days before you withdraw them for a home purchase. You also must pay back what you have withdrawn over the next 15 years. The best way to do that is monthly of course.

There are some financial planners that don't agree with this strategy. I believe however that if you are prudent with your tax savings by increasing your down payment and thus having less mortgage debt you will actually be better off.

Taking CPP Earlier Rather Than Later

As you may be well aware, it can make sense to take your CPP earlier rather than waiting until 65 or possibly later. You can take it as early as age 60 however your CPP payments will be reduced by 0.5% for each month you take it earlier. If you take it after 65 you will get 0.5% more for every month you delay your CPP after your 65th birthday. Statistically it makes more sense to take it earlier.

There are things that affect your decision on when to take your CPP benefits. The first is the rules that CPP has set out. This is, you can apply for early CPP (60—64 years of age) if you either, 1) Stop working the month before and the month your first CPP payment is to be paid or, 2) You earn less than the maximum monthly CPP payment ($863.75 for 2007) in the month before and the month when your CPP starts.

Once you start receiving your CPP you can work and earn as much as you want with no effect on the CPP that is being paid to you.

Provided you jump through those rules there are a few things that come into play when taking your CPP. The first is that your employer doesn't have to make CPP contributions for you anymore which means they won't be taking CPP contributions off of your paycheque either. That saves both you and your company 4.95% of your wages, each. If you are self employed this means that your costs go down by 9.9%. So although you will get less monthly CPP than you normally would, you have reduced your costs as well. That is the positive part. The negative

Taking CPP Early (continued)

is that CPP will increase your taxable income. The higher your income the higher your tax. If your net taxable income, that is, your income after all your deductions, is over $121,000, you will be losing 43.7% of your CPP benefits to income tax.

A less tangible and uncertain part of the equation is your family's record of living long. If it's a history of living well into the 90's then it may make sense to go with the odds and take your CPP later rather than sooner.

Hhhhhmmmmm......

When we earn income 21 – 44% is taken right off the top for income tax. When we put that income in our savings account, it's taxed again on the interest that is earned. Then, when we spend some of what is left, GST and PST is charged to us. Triple taxation.

Canadians have been selling billions of dollars of foreign investments over the past few months to buy Canadian investments. Non residents on the other hand have been big sellers of Canadian investments (The Canadian Press, Nov 2007)

Canada's most popular ETF (exchange traded fund), the iShares Cdn LargeCap 60 Index Fund, made a cumulative 22.2 per cent from the last market peak (2000) to Oct. 31 just passed. CI Harbour, a conservative Canadian focused equity fund, made a total return for investors of 99.1 per cent over the same period. (Globe & Mail, November 2007)

Through most of the 50's the Canadian dollar was worth more than the U.S. dollar.

The "Purchasing Power Parity" for the loonie is about 81 cents (U.S.). In other words, it's estimated that the U.S. dollar is 25 per cent undervalued against the loonie. (Organization for Economic Co-operation and Development)

In the past 20 years, the Federal Reserve has put through "emergency" interest rate cuts on four occasions, 1987 (Black Monday), 1998 (Long Term Capital Hedge Fund troubles), 2001 (September 11th) and last month (Sub Prime Mortgages). On each occasion the emergency rate cuts led to an equity mania (bubble) in a growth sector that didn't need any more stimulation.

China now has more billionaires than any country in the world except the United States. (Report On Business, Oct 2007)

Brazil has 20 per cent of the world's fresh water and accounts for over 20 per cent of the world's agricultural commodities. Many of its vehicles run on ethanol and it has enough oil to meet its' other power needs.

A 12 year old, very average 1,800 square foot rancher in Anchorage, Alaska sells for $330,000 (USA Today, Oct 2007)

Despite rising home values the actual level of home equity per Canadian home owner has fallen five per cent since 1997. This is due to people making home equity loans to finance other spending. (Financial Post, Oct 2007)

Between 1990 and 2005 the B.C. provincial government's health care spending had increased by 138% while inflation was up only 36% (BC Medical Association)

There are three kinds of stats: stats, lies and illusions.

Carey

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