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# mutual gains™

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## In this issue....



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## Reallocating Should Be Done When You Least Want To

We've recently seen a bounce back from the bottoms we saw earlier this year. That isn't to say those bottoms are gone. We could revisit them again. However, we may not.

You may not have felt the urge to reallocate investments assets over the past few months. However, if you are feeling the urge to move to more conservative investments at this juncture, please do read on.

It's the emotional part of our DNA that makes us drive more cautiously right after an accident or to change our diet and lifestyle after a heart attack or other health scare. This is no different than an urge to reallocate a well balanced portfolio to more conservative or "safe" investments. Bank deposits, bond investments and all of their cousins are not sound investment decisions in times of feeling nervous because they're not investment decisions but rather psychological decisions. Just like the car accident or heart attack, if you didn't "feel" so uncertain would you still be so cautious?

I must admit these aren't fair comparisons because changing our poor driving habits or dangerous lifestyle are smart decisions for anybody. Changing our investments from a purely psychological perspective is not. Any reallocations to a portfolio should be made without fundamentally altering the long term potential of it. Taking money out of growth oriented investments which have historically excelled in the long term, and reinvesting the money in bank deposits and bond investments will lessen your long term returns.

Let's face it. When times get better, as it always does, the natural tendency is to almost always reallocate back to growth oriented investments. And it's most often done <u>well after</u> they have had a good run. Over the past 22 years I've seen this mistake made over and over again.

## Playing "Deal or No Deal" With Your Finances

I'm not one to watch much TV however I recently found myself glued to an exchange between Howie Mandel and a contestant on a very popular TV game show called "Deal or No Deal. Without explaining the inner workings of this game, the basic decision this contestant faced was, "do I walk away with close to $200,000 or do I keep going by choosing 1 more suitcase for a 1 in 7 chance of getting closer to winning $1 million?".

A couple facts about this person, he had admitted to making several poor financial decisions in the past and because of it had significant debts. Ironically, he was an accountant by profession.

After choosing 1 or more cases unsuccessfully, including the elimination of his chances on winning anything more than $250,000 he settled on approximately $90,000. In other words, he gambled $110,000 for a chance at getting closer to winning $1 million. The big mistake he made was a psychological accounting error. He didn't see the $200,000 as his money. That $200,000 was his if he simply pushed a button and said "Deal". I'm sure he was no different than virtually all of the contestants on this show by doing the same "emotional accounting" rather than look at the reality of the decision they are making.

Every financial decision you make is a deal or no deal question. Many purchases and decisions may seem like a "deal" but are just a compromises that will take you off your road to financial peace. I'm sure, if you are like me, you have made a bad deal by mak-

### Deal or No Deal (continued)

ing an emotional accounting decision over your own financial security. The nice thing about life is that we don't only have one chance. If we make a "bad deal" we're not stuck with it forever. Changing your own financial life has a lot to do with changing a propensity to make "bad deals". It will take some work, but you can eventually get out of it. So next time you are making a financial decision, no matter how small, ask yourself, is it a "deal" or "no deal".

## Use Your Tax Refund to Make Your Day to Day Financial Life Sing

Did you get or are you getting a tax refund? Here is a suggestion to improve your cash flow, but first a comment on tax refunds.

Generally, getting a tax refund, is not necessarily a good thing. Some people actually have their employer take extra tax off so they get a tax refund. The argument is that it's a forced savings plan. Getting a tax refund simply says that the government has had that money, YOUR MONEY, in their hands when it should have been in yours. That said, here is my suggestion.

I am an advocate of having and using a "Deferred Expenses Account" for expenses that come up annually (life, car and home insurance, property taxes, vacations etc) or every few or several years (saving for your next car instead of leasing or borrowing, new furniture, future home expenses like a new roof, hot water tank, furnace etc.) It is always something I recommend when preparing a Financial Planning Recommendations summary for new clients. The DEA is a high interest savings account where you contribute monthly and from it pay all your annual and non-regularly scheduled expenses . You calculate when and how much these "deferred expenses" will be and break it down into monthly bite sized pieces. Let's face it. We all have to pay those expenses when they come up. If you don't have a "deferred expenses account" how are those annual and large, one time money outlays going to come from? Many people either face a tough several months trying to pay for it or just end up borrowing the money. But if you will be forced to pay for it at that time why not be proactive and work it into your cash flow today?

That is where the tax refund comes in. I strongly recommend you use your tax refund to start your own "Deferred Expenses Account". But you must not stop there. It is imperative you set up a monthly deposit into your DEA at the same time so when expenses come up you will enjoy a liberating feeling of being able to pay for that Mexico family vacation or new Mazda in cash.

If you want to set up a DEA for you or your family, send an email to cheryl@careyvandenberg.com and we'll have one set one up for you. Not sure if this makes sense in your situation, particularly if you have mortgage, credit card debt or other obligations that seem more pressing? Feel free to call or email me directly (604 541 2690 or carey@careyvandenberg.com)

## Hurdle Rates Determine Viability of Borrowing To Invest

Using borrowed money to invest, "Leveraging", can be a profitable financial strategy to implement if done prudently. However, to determine it's viability some calculations must be done. These calculations will determine your "hurdle rate". This is the minimum acceptable rate of return you need to get on your investment on a long term basis. If your actual return exceeds the minimum, then leveraging makes sense. If it doesn't clear the hurdle rate then the buck stops there.

Starting the hurdle rate calculation begins with 1) your tax bracket and 2) your expected loan costs. Because interest costs for investment purposes are tax deductible, the higher your income and thus your tax rate, the better off you are. Higher tax rate means more money back in taxes. The stated interest costs on the loan can and will fluctuate. Factoring in a higher number than you expect to pay to day should be used to leave room for increased borrowing costs.

Example: If you are earning $80,000 your marginal tax rate is 36.5%. Assuming 6.5% annual borrowing costs (4.65% is achievable at today's rates) you subtract 36.5% from that interest rate. That is your net cost of borrowing which, in this example, is 4.13%. This is your hurdle rate. In other words, if your investment earns over 4.13% on a long term basis, you are making money on the banks money.

Note: Borrowing or "Leveraging" for investment purposes has its risks. These are outlined in the PIP Leverage Disclosure.

## Leaving Canada—Make Sure You Cut Virtually All Your Ties

Whether for retirement or just to live for a while outside of Canada for a job opportunity, if you want to leave Canada and not be subjected to Canadian tax rates on your income, you need to make sure you are making a clean break.

Everybody must live somewhere, or in other words, you have to be a resident of a country, some country. You can't simply jump on a boat or travel around the world by foot and train and not have a residential home for tax purposes. All countries rely on their citizens to provide tax revenue to build and maintain the infrastructure required to sustain the country.

If the Canada Revenue Agency (CRA) is to deem you a non-resident of Canada you must accomplish 2 things. First is to become a resident of another country. Again, you have to live somewhere. If you don't satisfy this requirement everything else you do will be absolutely useless. The other thing is to satisfy enough conditions to convince CRA that you no longer have residential ties to Canada.

The CRA uses the NR73 form (Determination of Residency Status—Leaving Canada) to determine your residency status. Some of the factors they consider are:

- Will you keep a Canadian driver's licence?

- How often will you return to Canada to visit?
- Will you keep Canadian bank accounts, credit cards or investments?
- Will you stay eligible for medical coverage in Canada after you leave?
- Will you still be a member of any Canadian organization (social, professional, religious, union)?
- Do you still have a cottage or other recreational property in Canada?
- Will you keep a car in Canada or any other personal items?

You aren't required to submit this form but it will ease your mind as CRA will give you an "opinion" on your residency status. Not all conditions have to be met. Having a Canadian drivers licence and a small bank balance isn't probably going to keep considered a Canadian resident. However, if you also kept a car in Canada and came to visit occasionally you could be jeopardizing your non-Canadian residency status and thus your tax position.

## Losing A Spouse - A Few "To Do's"

A few things to make sure you do if you have recently lost a spouse:

- Apply for the CPP death benefit and any CPP survivor benefits that you may be entitled to. You can call 1 800 277 9914 to get an application or go to www.servicecanada.gc.ca
- If your home is mortgage free and in joint names you need to apply to the province for a new land title certificate.
- Cancel your spouse's social insurance number after getting the clearance certificate upon settling the estate. This will ensure no one else can assume the identity of your spouse.

## The "Aging Agenda" For The Boomer

If you have parents who are into their retirement years, here are some facts you should know:

- Adult children are legally responsible for supporting their parents in the event the parents are unable to.
- We assume that if something happens to someone, a spouse or child automatically has the right to manage the affairs. Not so. In fact, in some jurisdictions, the spouse is the one person who cannot sell or mortgage the marital home. The signatures of both spouses are required.
- An adult child who has Power Of Attorney over their parent's affairs and adds themselves as joint owner of their parents property or direct themselves as direct beneficiaries of their parent's assets are generally conflicts of interest and could expose them to litigation.
- If you as an adult child is in a high tax bracket and has no mortgage on your principal residence having your parent(s) leave you an inheritance by way of a Testamentary Trust could be you're the way to go. It could save your several thousand dollars in tax over your life time.
- Trying to avoid probate costs by changing aging parent's assets into joint ownership with you or naming specific beneficiaries on particular assets could prove to divide the estate up inequitably amongst the beneficiaries, creating turmoil for all.

## Web Gems

**RADIO STATIONS** – Do you love 70's music like I do? Maybe you're more into 30's, 40's, 50's, 60's, 80's or 90's tunes? There are 411 stations that are considered "Oldies" on www.live365.com. Do you want to sing Christmas songs all year? No? Maybe Jazz or Country is more your thing. There are thousands of stations spanning 260 genres and broadcasting in 150 nations. Enjoy some nostalgia or stimulating talk while you work at your desk or surf the web.

**HOME FOR SALE**— Have you ever driven by a house for sale and wonder about it's details. Things like how much the owner is asking, what size is the lot or just want to see some pictures of the inside? You will be able to find it on www.mls.com. Or maybe you just want to view randomly what is for sale in your area. This is a great site but I do have a caveat. Homes are emotional. A random walk down internet Main Street can trigger you to make a purchase you had no premeditated notion of entering into.

**HOME EXCHANGES**—I've talked about the idea of home exchanging before and www.homeexchange.com is the best site on the net for this purpose. Home exchanging is a great way to experience the places and people of the world that you wouldn't normally go to. Because you live in someone's house you get an authentic feel of the area. All it costs you is a bit of time emailing potential home exchange partners and the cost of a plane ticket. Worried about your house? The people you are exchanging with are exactly in the same position.

## Hhhhhmmmmm......

The 50 biggest publicly traded companies in 2006 had average foreign sales of 43%. In 1987 it was only 24%. (Investment Executive, Jan. 2008)

4 of the top 10 richest people in the world are from India.

A year ago, with the markets coming off a strong four-year winning streak, investors were pouring money into equity funds. Now, with some real bargains emerging, the average investor is withdrawing. Globe & Mail, Feb 2008

Over the past 45 years equities have had 13 down years but averaged 10.5% annually. One of the worst years was in 1982 with a decline of 39.2%. The following year however prices surged 86.9%. (Investment Executive, June 2006)

From 1890 until present day, we have never seen such a big move in Greater Vancouver real estate prices in such a short time as we have seen over the past few years. Michael Levy on CKNW (paraphrased)

Canada's current housing boom is the strongest and longest of the post-war era. Between 1998 and 2007, average inflation-adjusted home prices have soared some 65%.

"The current housing upswing is going on 10 years, whereas the prior three cycles ranged from five to six years. It has also outlasted the housing booms experienced in many other advanced economies this decade." Adrienne Warren, Senior Economist Scotia Bank

Home prices are falling the fastest in California, Florida and Nevada. The largest surges in new foreclosures were in California, Arizona, Florida and Nevada. Many people would agree that these are viewed as some of the most attractive places to live in all of North America.

The price of oil has now passed the inflation-adjusted high of US$102.53 reached in 1980, a year after the Iranian revolution.

Food inflation last year rose 4.7% in the U.S., the fastest pace since 1990

New York is the safest big city in the United States. USA Today, Feb 2008

There are approximately 75 million TV sets and 5 million personal computers in India. That is expected to reach 225 million and 30 million respectively in 2008. (Property Frontiers)

China is the world's largest cell phone market with more than 501 million subscribers and is growing at 6 million new subscribers per month. (Morgan Stanley; World Bank)

"Capitalism without failure is like religion without sin, it doesn't work." The Fleet Street Letter

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*PS. If you are making charitable donations by cheque on a regular and substantial basis ($5,000 or more per year) you are only saving a maximum of $440 of tax per $1,000 donated when you could be saving $1,000 in tax for that same $1,000 donation. Let me know if you want more information on this by calling or emailing me directly (604 541 2690 or carey@careyvandenberg.com)*