Issue No. 125

May / June 2008

mutual gains™

published bi-monthly since 1987

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Serious Loss Of Capital — A Risk Assessment

When I talk to clients about risk, the most common definition communicated to me is that risk is all about "not losing all my money"…. permanently.

The aversion to this definition of risk is so very common, yet there is a definite dichotomy among the investing public today. There is an innate fear of "not losing all my money", yet there is a pervasive feeling that one is missing out on the TSX index's rise. The evidence of these feelings is very real in the occasional question I get when reviewing a client's portfolio.

Yes, we have seen the TSX index rise almost uninterrupted for the past 5 years. After the bumps from the subprime rumblings, the TSX has continued it's ascent to new highs. However, one fact has to be brought to light. Very few of the companies that make up the TSX have actually gone up in price over the past year. Shares of most of the banks are down significantly. The reality is that half of the recent gains in the TSX index has come from no more than 5 companies, of which the biggest part has ballooned from Potash Corp., EnCana and Research in Motion (aka RIM, Blackberry maker).

We have seen this narrow rise before. It comes around like arms on a clock. That last time the boom was technology based and it was Nortel that lead the way. At that time, resource companies were shunned. Today, it's a complete reversal with technology companies (except for RIM) being completely ignored despite some strong financial metrics. To that I say Hhhhmmmm…..

The risk assessment of not losing all your capital has everything to do with, 1) The quality of your holdings, 2) The price paid for an investment AND 3) Diversification. If we ignore any one of those parts because we are convinced "this time it's different" then the risk rises exponentially and sets us up for a potentially fatal fall.

Yes, maybe we are missing out on the rise, but at what risk are you willing to be a part of it?

Increasing Productivity Is Built Into The American DNA

This is what the U.S. economy in particular is very good at, and it's much better at it than Canada.

The primary economic push that Canada is enjoying is the boom in energy prices. With it we've got some nice new condos, shiny cars and monstrous plasma TV's all of which has been spin off from our selling of oil and gas to the world. This economic push has actually made Canada lax in increasing our productivity and increasing our countries brain power.

Assume we sold water instead of energy. We produce and bottle a million gallons of water but all of a sudden people are willing to buy it for $5.00 a gallon rather than $1. We don't try to produce any more we just hire a few more people so the owners of the business can kick back a bit more and take more vacations. Despite that lax business attitude the profits of the business can go up without having to actually produce any

American DNA (continued)

more. The only difference is that the price of the commodity has gone up. That is what has happened in Canada, although it's not water but oil, gas, potash etc. Employment and spending is up but not productivity which is the real driver of long term prosperity and any one company's health.

The United States economy is and always has operated much differently than Canada's, and much of the world. U.S. businesses are known for increasing productivity, even in good times when it's easy to sit back. They do this because they know they have to. They can't ride the coattails of commodity prices like we can do on occasion. And when it comes to tough economic times they adjust ruthlessly to make sure they will survive. It's that difference which makes the U.S. economy so resilient, something it is famous for. It was written in the American DNA when the country was formed and is as strong today as it was then.

RESP Update

The last federal budget has made Registered Education Savings Plans, or RESPs, better than ever. So they remain a fine way to save up to cover the costs of post-secondary education.

Under the old rules a student had to collapse the RESP by age 25. Now the budget plans to extend the age limit to 35 years. That's a good thing, because today many students doing post-graduate work are over 25. Many travel or find out who they are before taking up post-secondary studies. This new rule also gives students the flexibility to change directions if they're unhappy with their initial field of study.

On up to the first $2,500 that you put into a RESP each year, the federal government puts in 20 per cent. That works out to an extra $500 a year. Although there is no "tax deduction" for contributing to an RESP the money in the plan grows tax free. And when it's withdrawn, the money is taxable in the hands of the student. Since most students earn little and get certain tax credits, they're likely to pay little, if any, tax at all.

6 Kinds of Insurance You Don't Need

If you are like me, you pay thousands of dollars a year in insurance. However, do we really need all this insurance we're paying for? Here's a look at some types of insurance we could probably do without.

1. Children. Life insurance is designed to protect your surviving family members if one of the income earners dies. Although losing a child is every parent's nightmare and could wreak havoc on the unity of the family unit, kids don't have debts, dependents or earn income that a family unit relies on. Sure, life insurance on a child is cheap but so is much of that stuff you find at a dollar store that you can do without.

2. Accidents. Unless you like driving really fast and weaving in and out of traffic the odds of you dying in an accident are very low. Insuring against this eventuality often costs more than the premiums on a regular term life insurance policy, which would pay you out no matter how you die.

3. Identity Theft. I'm sure you are just as careful as I am (or more so) about ensuring that someone doesn't steal your personal information. Identity theft insurance is usually an add-on to house or condo insurance but frankly, it isn't likely to help much. Most coverage like this is free. Virtually all credit card companies and banks reimburse the losses due to identity theft. Your cost in the event of identity theft will normally be more of time and frustration than actual dollars lost.

4. Warranties. Sure, an extended warranty can give you some protection in case your purchase breaks down after the manufacturer's warranty runs out however the cost / benefit ratio is highly skewed in the insurance company / retailer's favor. The cost of this coverage can boost the price of your purchase by 30%. Considering the stats (ie Consumer Reports) show, today's products are multiple times better quality than a 30% repair ratio. Besides, many credit cards give extended warranty coverage to customers who purchase a product using their credit card so you could be paying for something you are already covered for.

5. Cars. If you own an older vehicle, collision and/or comprehensive coverage is unnecessary.   That depends however on how much of a financial strain a loss of your vehicle could put you in. I'd suggest it wouldn't be financially devastating for you, just painful. But pain you will survive from. Many of us who own a car or 2 (or 3 or 4?) have managed to pay the 3 – 4 fold increase in gas prices without much effect on the rest of our life, right? It's amazing what we can overcome when faced with a situation.

6. Flights. What I am referring to is flight / trip cancellation insurance. Unless you have serious health problems that could prevent you from taking your anticipated trip, you are throwing money away. If you can't fly the loss is the cost of the flight. That may not feel good but most of us, if we can afford to fly, can afford, somehow and at some point, to replace the cost of that flight.

Don't misunderstand me. Most everyone needs various forms of insurance but it all depends on the coverage you have, your financial situation, and your family circumstances. The things you should definitely insure for are what I call the "big risks", the things that could put significant financial strain on your family. These include (listed from highest risk to lowest risk) losing your income earning potential, your life, your health, your home, and to a much lesser extent, your car. That is usually as far as it goes. Many insure against any sort of financial bruise.

"Prime Bank" Scams Are Often Promoted By The Nicest Of People

Ever been presented by someone you know and get along well with that you can make an investment with no risk and get a return of 6% a month? Something that will pay returns to you monthly? And, although you want to tell other people about it you are told to participate secretly? That is the sign of a "Prime Bank" scheme and B.C. seems to be a common breeding ground for these fraudulent enterprises.

I have myself been approached on more than one occasion about getting involved, often by a client who I have a very good relationship with. There was a case in B.C. about 2 years ago where 2 Abbotsford men, in conjunction with someone from the U.S. collected over $40 million for trusting investors, $23 million of which was from 89 people from B.C. Most of these were recruited through church connections.

It was discovered that, several of these investors say they started small but when their so called "interest" payments came consistently they followed up with much larger investments. The "opportunity" was made to appear even more legitimate by having the investors make their cheques payable to an unsuspecting lawyer who would in turn make the payment to a bank based in the U.S.

So if you are approached by a really nice person and what they are telling you sounds vaguely similar just politely say, "no thanks".

My First U.S. Car Buying Experience

I must confess. I have never bought a new car before. Frankly, I can't bring myself to pay such a high price for that new car smell, whether it be through a lease or otherwise. I'd rather have someone else take the big depreciation hit so I can use the thousands of dollars in savings for other, appreciating asset, or non-deductible debt pay down purposes. My last car purchase (a used Infiniti) has cost me approximately $1,200 / year in depreciation. And during the almost 6 years I have driven it, it has been very reliable, low maintenance and a joy to drive. But, it was time for another car so, after a lot of tire kicking, the end of my search was a major car dealer in Bellingham.

Without going into a lot of detail on the whole process, which I will say was actually much easier than I thought, I have my first new car. At the end of the day, it was just under $11,000 cheaper than what the exact same new car in Canada would have cost. Also, the cost was what the same car, 2 to 3 years older in Canada, could be purchased for. Had I bought a car made in North America rather than one made off shore, the savings would have been almost $13,000. And yes, with this brand of car I have a full warranty and with it my first enjoyment of the new car smell.

If you are looking at buying a car, whether new or used, I encourage you to look across the line. I will be putting a summary of steps on www.careyvandenberg.com so you will have the keys to keep several thousand dollars in your pocket (which you can of course put into an RESP or RRSP where you will multiply your savings by an extra 20—43% through government grants or tax savings). In the interim, if you have any questions, please do feel free to ask. I'll be of any help that I can to you.

Web Gems

CANADIAN PENSION PLAN— Look at your pay cheque and you will see that you have money being taken off for CPP contributions each and every month. If you want to know where your money is going check out www.cppib.ca. You will see exactly where the currently $122.7 billion in assets is invested, which firms are making the investment decisions, the historic returns since CPP started building a "fund" or pool of assets in 1999 etc. I find it quite interesting, but maybe that's just me.

STAPLES— It may seem a little strange that I put a retailer's website on this pages. The reason though is that I have found it to be a great time as well as, gas saver. This isn't restricted to www.staples.com. It also applies to many other consumer items. The nice little feature on this site in particular is that you can save items you use regularly, on your personal "Shopping List". In other words, if you continually use a particular 8 1/2 x 11 paper and a specific cartridge of ink for your printer, you can save these exact items on your "Shopping List". These stay on your list until you delete them. Whenever you need these items you can simply logon to the website, click on your "Shopping List", click on the items you need, type in your credit card numbers to pay online and, and if your order is over $50 you will have it delivered free to your door the next day. This is much more efficient than driving to the store, wander around searching for the items (that is only what guys do), stand in line and drive back to your office or home.

WEATHER NETWORK— This is something I refer to at least once a day. It is a little program you can download which shows the temperature in your area (mine is set for White Rock B.C.) displayed in a yellow icon in the bottom corner of your computer screen. If I ever want to see what the weather is expected to be at particular periods of the day or how the week is shaping up, simply click on the yellow icon and a small window opens up to display the next 2 to 9 days. Travelling to a different city in the next few days or week? You can add that particular city so you can see what the weather could be like when you are there. I've found it to be as relied upon as a cell phone, where by the way the info can be sent as well to. Go to www.theweathernetwork.com for it all.

Hhhhhmmmmm......

There has much talk lately about the probability of a U.S. led global recession. Over the past 30 years, commodity prices (oil included) have lost 30 per cent of their value during such slowdowns. (International Monetary Fund)

There was a 20-per-cent surge in the amount of cash held by investors in late 1987 and a 30% jump after the tech meltdown in 2000. In both cases, investors sat on their cash for almost a year and a half while the equity markets surged by more than 20%. Benjamin Tal, CIBC World Markets, May 2008

Nortel 's share price is worth less about 7% of what it was 8 years ago (used to be $125 now approx. $9) yet the company is actually more profitable today than when everyone was chasing it.

This is probably one of the best times in the past 5 to 6 years to be buying this stuff" (high yield or "junk" bonds). Gavin Graham, CIO Guardian Group of Funds (April 2008)

Saskatoon had the steepest gains in housing prices over the past year (up 58%) followed by Regina at almost 29%, Edmonton 14.8%, Winnipeg rose 14.5%, Halifax 11.4%, Vancouver 6.6%, Montreal 4.7% and Toronto 4.4%. (Globe & Mail, April 2008)

The last residential real estate downturns in the US and the UK lasted 6 years yet the bubble before that time was shorter and did not climb as steeply as the one we just went through. If history is any indication the housing downturn will last until 2012 in the US and a couple of years longer in the UK. Financial Times, April 2008

Nevada has the highest home foreclosure rate (1 in every 139 households). California is 2^{nd} highest. (USA Today, June 2008)

At the end of 2007, 15% of U.S. homeowners had a mortgage to value ratio on their home greater than 100%, meaning their mortgage were worth more than their homes, and it's not getting better. Advisor.ca April 2008

The average public transit bus in the U.S. uses 4,365 British thermal units (a measure of energy) per passenger mile and emits 0.71 pounds of carbon dioxide. The average car on the other hand uses much less per passenger mile (3,445 BTUs per passenger mile and 0.54 pounds of CO2). In 1970, the average bus used 2,500 BTUs per passenger mile; by 2005, it used almost twice as much (4,300 BTUs). In 1970, by way of contrast, light trucks used 9,000 BTUs per passenger mile; in 2005, they used less than half that (4,300). The average pickup truck is as energy efficient now, <u>per passenger mile</u>, as the average bus is. Randal O'Toole, Senior economist, Thoreau Institute and lecturer in environmental economics at Yale and at the University of California at Berkeley

At today's gas prices, the Toyota Highlander hybrid takes 12.7 years to break even; the Saturn Aura, 24.3 years, Edmunds says. And the $106,000 Lexus LS600h hybrid, compared with the gasoline LS460L takes 102.6 years. USA Today, May 2008

The IMF's (Intl Monetary Fund's) leaders which represent 185 countries agreed that soaring food prices are the biggest problem currently not global banking problems from the subprime / asset backed commercial paper (ABCP). (Globe & Mail, April 2008)

Air Canada can buy that aircraft 60% cheaper from Boeing than they could five years ago (Globe & Mail, April 2008)

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PS. Questions? Comments? Would you like to set up a meeting? Let me know by phone email (carey@careyvandenberg.com) or phone (604 541 2690).

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