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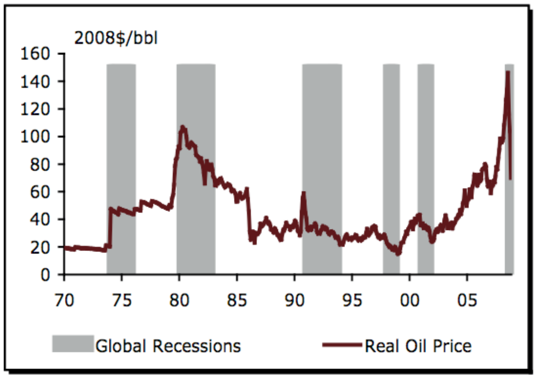
A Quick Economic U Turn

The price of oil had reached an all time high of over $147 per barrel this past summer. The price is more than 70% lower today. How's that for a welcome price cut. This single factor has taken inflation concerns right out of the economic equation. Recently, it was announced that the U.S. saw it's inflation rate drop the most in one month since they have been keeping records back to 1947.

Past Recessions and Oil Spikes



Only a few months ago interest rates were trending upwards because of inflation worries and to cool a heating economy. Interest rates are now dropping precipitously because governments around the world are concerned that the global economy will cool down too much and slide into a deep recession.

Equity prices were also considerably higher yet considered fairly valued by historical measures at those levels. Now they are ridiculously cheap in many cases.

We had enjoyed unprecedented price increases in residential real estate over the previous several years. This was not isolated to us alone. It has been a worldwide phenomenon. Today, there are substantially more "For Sale" signs than there are buyers. If real estate could be bought and sold daily much like it is with equities, prices would be down significantly.

Huge construction projects protrude the global landscape. Some have halted construction due to lack of, or restrictions on financing.

We haven't seen a quick economic U turn like this in a very long time so automatically the word "depression" gets tossed around. However significant this economic shakedown may be, the 30's it isn't. Not even close.

In the early 30's the central bank (the government) did nothing. They just let things disintegrate by letting things run their course. The exact opposite is happening today. Governments around the world are assisting in a coordinated effort in every way they can. They are helping in spades. This should guide the world economy into a period more similar to the financial quake of 1907 where commodity prices dropped by 21%, unemployment went from a very low 2.8% to a modest 8% and bankruptcies increased by 47%. This was when the U.S. did not have a central bank like the Federal Reserve or Bank of Canada to steer money to where it was so direly needed. Back then, this role was taken on by a group of financial institutions.

As I said, today interest rates are being lowered significantly and governments around the world are lending money or taking an ownership stake in financially strapped businesses. The positive effects of these actions will take some time. However, this will prove to be the difference between an extremely long and painful situation versus just an uncomfortable, and some even say, a short one.

Want more detailed information on how this crisis started and where we are today? I'd strongly suggest going to www.careyvandenberg.com/links.php. Under the subheading "Investment Topics" you will find an audio and slides of a November 7th conference call presented by Larry Lunn, CEO & CIO of Connor Clark & Lunn for its Institutional Pension Fund clients. It's well worth taking in. (Note: CC&L is one of only a handful of independent investment managers who are responsible for managing a part of the Canada Pension Plan's investment portfolio).

BEHAVIOURAL FINANCE — DOES TIMING REALLY WORK?

"Behavioural Finance" is the area in investing and financial planning that has the most significant impact on a person's long term financial success. Key findings in this area are:

- Investors are over confident and think they are better at making choices than they really are.
- Investors believe in winning streaks and are impressed and easily influenced by short term success.
- Investors confuse familiarity with real knowledge and over react to both good and bad news.
- Many investors are trapped in a cycle of fear and greed. When the market goes up they believe it will continue to go up and when it falls, they become convinced it will never recover.

Market-Timing Approaches Fall Short (US Example)

Strategy:* 1926-2007	Annualized Return	Growth of $100,000
Exit when market declines; Stay out until market has a decent year	8.4%	$72.6 Mil.
Exit when market is "too high" Stay out until after correction (a down year)	8.3	70.7
Remain Invested Through Ups And Downs	**10.4**	**323.9**

This is a hypothetical example. Past performance does not guarantee future results.

*The first approach involved switching from stocks to T-bills following any year in which the stock market declined and returning to stocks after the market earned at least 10% for a year. The second approach involved switching from stocks to T-bills following a combined two-year stock market rise of 40% or more and returning to stocks after the market declined for a year-or after two years, in any event.

Source: Compustat: Roger G. Ibboston and Rex A. Sinquefiled, "Stocks, Bonds Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Pres Journal of Business (January 1976); Lehman Brothers and Standard & Poor's

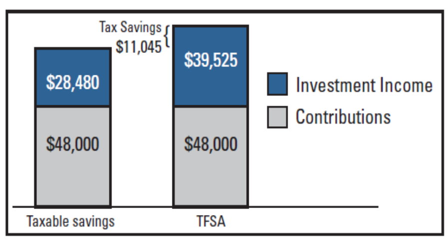
The chart on the right is very compelling. I have often thought it could be much better to move into more conservative investments before a major correction and re-enter at lower levels and I continually revisit this thinking. The chart above shows that even with specific systems in place (taking out human behaviour or "emotion"), the answer is clearly "stay invested".

COMING JANUARY 1ST—TAX FREE SAVINGS ACCOUNTS (TFSA OR "TIFSA)

As of January 1st all adult Canadians will be able to save / invest up to $5,000 every year without being taxed on the earnings (interest, dividends or capital gains). The TFSA or "TiFSA" is the most significant savings vehicle since the RRSP.

What this means is that money you generally hold in a savings account or have invested in some other vehicle, can be held in a TFSA. Everything else remains the same except that, any interest, dividends or capital gains you earn within your TFSA is completely TAX FREE. You will be able to compound the money tax free and when you take it out there is no tax to pay. Simply put, it is exactly the same as any other Non RRSP account or investment you may have except the earnings on it are completely TAX FREE.

To help you understand how Tax-Free Savings Accounts will work and what they will do for you, I've put together a Top 10 list of things you may want to know. Since the TFSA is not officially available until January 2009, we may not have all the answers yet, but I'll tell you what I know so far.



Assumes a $200 monthly contribution for 20 years, a 5.5% rate of return and an average tax rate of 21%.
Source: Government of Canada, 2008 budget.

1. All Canadian residents can open a TFSA if they're 18 years of age or older and have filed a tax return.
2. The TFSA will let you invest while not being taxed on the interest, dividends or capital gains earned in the TFSA.
3. You'll be able to open Savings accounts, GIC's, Mutual Funds etc with no tax.
4. Unlike an RSP, your contribution to a TFSA will not be deducted from your income on your tax return, but the interest, dividends, capital gains etc. you earn will not be taxed - so you get to keep what you earn.
5. You can contribute a maximum of $5,000 a year.
6. If you take money out of your TFSA, you don't lose the contribution room - you get it back the following year. If you take money out of your TFSA you will have to wait until the next year before you can put the money back in.
7. If you don't make the maximum contribution you don't lose the contribution room. The unused contribution room gets carried over to the following year. There is no limit to how much contribution room can be carried forward.
8. You can hold more than one TFSA with a number of financial institutions but the total of the contributions must be within your total contribution limit in that year.
9. Money you take out of your TFSA will not affect federal income-tested benefits and credits (i.e. Guaranteed Income Supplement for low income seniors), so you're not penalized for saving.
10. Each year, the government will determine your remaining available TFSA contribution limit, much like your RRSP.

Even though the Tax-Free Savings Account is not available until January, you can set up it up today. Then in early January you can transfer existing savings OR existing investments you currently hold into your TFSA.

Cost Saving and Estate Preservation For The Mature Person

If you have a single, widow or widower parent or if this describes you personally then you should keep reading. The information that follows could save you several thousand dollars when estate assets pass on to the next generation or whomever that may be.

Estate planning is a commonly used term in financial advertising however many don't know what it really means other than a properly prepared will.

Passing on your estate to whom you want it to go is the basic premise of estate planning. Bricked on top of that foundation is the consideration given regarding the costs of doing that. Also, there is the potential market risk the assets or investments face between now and the time the mature person passes on. Therein lies a significantly cost saving and risk reducing idea.

Fact: Money in a bank deposit, mutual funds, stocks, bonds or any many other "investment" account or portfolio is subject to various costs. These include the often talked about and much hated probate fees. However, there are also legal, accounting and possible redemption charges which can be much larger than probate fees. For much of the investments mentioned some of these costs cannot be avoided and the total costs can range from 3 to over 20% depending on the complexity of the estate (3—6% is closer to average). These costs can however be cut entirely if things are arranged properly.

Unlike most investments, ones done with a life insurance company are not subject to these costs. Upon the death of the holder of the investments, the monies would be disbursed directly to the beneficiaries. No legal, accounting or probate to deal with.

There are a few ancillary benefits that apply. One is privacy. Probated estates are of public record. Anyone can see all the details of your estate, of how much, to whom etc. This isn't the case when an estate bypasses probate as is the case with an insurance company deposit or investment. The other significant benefit is the market value of the investment. Normally, the value of the investment disbursed is what the market value is at the time of death. Not so with a segregated fund (the life insurance equivalent of a mutual fund). In that case, should the market value be below what was actually invested, the beneficiaries get paid out the amount that was originally invested or the value of the investment, whichever is greater.

So again, if have a single, widowed or a widower parent or you are one yourself, it may be time to look at your existing investments to see how much your estate is going to be charged when you pass on. We can cut that cost to $0.

Year End Tax Savings PLUS Reducing The Cost Of Your Giving To Potentially…. $0

On occasion I have talked about what I call the "Flow Through Share Donation Strategy". I am mentioning it here again as we are nearing year end which is a deadline for virtually every tax saving opportunity (other than RRSP related tax deductions / savings).

One of the most popular year end tax saving vehicles are Flow Through Shares. The steroid version is called a "Super Flow Through". With the "Super" version you will see <u>TAX SAVINGS up to $6,180</u> for 2008 (assuming a $10,000 investment). If you choose to stop there that is entirely up to you. In that case you will have made a $10,000 investment for only $3,820. You are $6,180 richer with the simple writing of a cheque. Another way to look at it is that your "at risk capital" is only $3,820. This means your investment can fall in value to that level before you are underwater. Seeing as virtually all investments have fallen, some dramatically, investing at these levels is much more attractive.

If you choose to take a second step and use your investment as a charitable donation <u>YOU WILL SAVE AN ADDITIONAL $4,370</u> in less than 24 months assuming the investment is worth the same at that time. Total potential tax savings is $10,370 on a $10,000 investment. In other words you have made $370 and the charity you choose gets $10,000.

If you are a regular giver to a charitable organization of any kind (churches included) this can work out to be considerably better than simply donating cash which produces a total tax savings of only $4,370. I use the "Flow Through Share Donation Strategy" myself on an annual basis and will continue to do so until the government changes the tax rules which is highly unlikely for the foreseeable future.

Web Gems

NATIONAL DO NOT CALL LIST— The URL for this site, https://www.lnnte-dncl.gc.ca/index-eng , is a bit convoluted as are all Government of Canada sites but the working of it is really quite simple. You enter the phone number in which you don't want unsolicited calls on, type in the "confirmation code" shown on the screen and you're done. If the number has already been registered it will show the date that was done. You will have to register your number(s) every 3 years and you won't get any notices when that time is up. In the interim though you will notice less calls coming in. I sure have.

I OPT OUT— This is on the same theme as the National Do Not Call List however it works from another angle. You register on www.iOptOut.ca (a free website initiated by a law professor at the University of Ottawa) and they will send out notifications to companies you don't want calling you. Companies are by law required to keep their own Do Not Call List. The system will send emails to all the companies you earmark, requesting that they not call you. Companies, like those you have a credit card with, don't have to comply because there is an exemption for a wide range of organizations including registered charities, business with prior relationships, political parties, survey companies, and newspapers.

EPICURIOUS— Need room in your cupboards? You can start by giving away all your recipe books and go to www.epicurious.com. There are over 20,000 recipes, all from Gourmet and Bon Appétit magazine. You can do a search by an ingredient (i.e. rice, chicken etc), and then narrow it down by a cooking method (i.e. bake, sauté etc) or dietary consideration (i.e. low sodium, low fat etc), a season or virtually any other breakdown you can think of. You can focus it down so you have exactly what you are looking for. When you the dish at the table you can say "Eet Smakelijk" (pronounced Ate Smakkelick, it is the Dutch version of Bon Appé-

Hhhhhmmmmm......

6 times between the Civil War and WWII the U.S. made the same mistakes by mortgage securitizing schemes. This led to a mortgage meltdown similar to what we are seeing today. (Robert Wright, Stern School of Business at New York University)

The credit contraction that resulted from the Savings and Loan debacle in the late 80's saw 1,838 banks fail between 1988 and 1992 with total assets of $696 billion. These failures included 7 of the top 10 U.S. bank failures. (Source: FDIC)

In the Great Depression Detroit closed their city's zoo and killed all the animals to feed the people (Vancouver Sun, Oct 2008)

Oil has declined in price by almost 2/3rds from its July peak of US$147.27. It's now down in the low $40 range.

The drop in gas prices in the U.S. is equivalent to a tax cut of approximately $250 billion for U.S. consumers. Every penny drop in average gas prices increases cash flow to U.S. consumers by $1.3 billion. (Martin Hubbes, CIO & Portfolio Manager AGF Funds Inc)

U.S. consumer prices fell by 1% in October, the biggest 1 month decline on record that go back to February 1947.

Generally, when an official announcement has been made that we are in a recession the recession has actually ended. On average, the announcement that the recession is over happens 15 months after the recession and if not invested, the largest, most risk reduced gains have been missed. (Sandy McIntyre Portfolio Manager, Sentry Select)

"When it's easy to invest, you don't usually do well and when you invest with enormous confidence in your decision , it's usually a bad one." James Morton, Portfolio Manager for Mackenzie Cundil

Investors sat in cash for 3 to 4 years after the October 19th 1987 crash although markets were at pre that date levels by 1989.

Emerging market equity valuations are now back where they were in 1998 and 2003. Those were the two best times to be buying over the last 10 years. (BCA Research)

"I have been in the investment business some 32 years and the valuations are the cheapest they have been during this time." Steven Clements, Senior VP Beutel, Goodman & Co

"Dividend yields are high because prices are low, not because dividends are high"….."We think the dividend yield will go down because equity prices will rebound." Vincent Delisle, portfolio strategist at Scotia Capital.

The percentage of earnings for companies paid out as dividends, is traditionally around 50% (Howard Silverblatt, Senior Index Analyst, Standard & Poor's). The rest is used to build the business and increase the value of it.

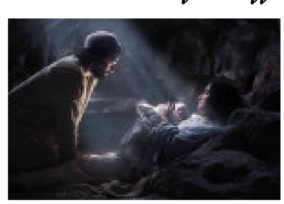
Wal-Mart is the only company on the Dow Jones industrial average to post a gain in the past 12 months, up 12 per cent. McDonald's restaurants was the next best performer on the Dow, with a 5.4-per-cent loss. (Financial Post, Oct 2008)

U.S. debt today, as a percentage of GDP (size of the economy), is at a level similar to what it was in the mid 50's and in 1995. It was twice as high in the mid 40's. (NBF Economic Research)

Warren Buffett, in the world's top 3 in terms of wealth, lives in his 1958 home which he bought when he was married. Ingvar Kamprad, IKEA founder, worth $31 billion drives a 1993 Volvo. Azim Premji, one of the wealthiest people in India (worth $12 billion) drove a Ford Escort for 8 years. He traded it in for his current transportation…. A Toyota Corolla.

When hazardous amounts of snow are expected within a 12 – 24 hour period a warning is issued. The definition of "hazardous" in the Vancouver is 5cm of snow while in Toronto it's almost 5 times that amount.

And with that…. *I wish you and those closest to you, a season of ineffable Joy on the firm foundation of the Breath of Peace.*



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