Issue No. 129

January / February 2009

mutual gains™

published bi-monthly since 1987

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184 Years Of History Is What We Must Look At

Seeing your 2008 year end investment statement was probably not your favourite thing. Mine neither (and I have to look at hundreds upon hundreds of statements just like mine). If you don’t normally look at your portfolio on the web you were probably significantly taken aback. Quite possibly, you still are.

What happened in 2008 and what is still happening today, though it is not normal, has happened before — quite a few times in fact.

Is it different than what we have seen before? Yes, but every significant event is.

When you are in the middle of a nerve- wracking event it is hard to put your feet back on the ground to a position of rational perspective. When we look back, several years later, removed by time, the events seem much less significant than when we were in the midst of them.

So, the only way you can gain this rational perspective is to look back at events similar to what is being experienced currently. I have been doing that for the past several months to maintain my own head and through it, gather what I have learned through countless hours of conference calls, presentations and research and pass that on to you in a very condensed form.

Originally, I was getting comparisons over the past 25 years, then 50, then 100. More recently I have gathered info looking back over the past 183 years, of which I lay out some of those facts, stats and commentary I have garnered.

- THE MARKET GOES UP LONGER AND MORE SIGNIFICANTLY THAN IT GOES DOWN -

Since 1825 the U.S. market has gone up and down in cyclical style and this is the 2nd worst decline in those 184 calendar years. With that length of history in mind, this is how many times it has gone up or down by specific bands of magnitude in any given calendar year (Source: Value Square Management, Yale University):

50 to 60%	Decline...	0 years	Rise...	5 years
40 to 50%	Decline...	1 year	Rise...	5 years
30 to 40%	Decline...	2 years	Rise...	15 years
20 to 30%	Decline…	6 years	Rise...	23 years
10 to 20%	Decline...	17 years	Rise...	36 years
0 to 10%	Decline...	29 years	Rise...	45 years

The market has gone up 70% of the time. It goes up for a longer period than it goes down and it goes up in much greater magnitude. Over time the market value of companies has gone up in line with their rising profits. This is simply due to a rising, and increasingly wealthier population.

- THE FEELINGS OF TODAY HAVE BEEN FELT MANY TIMES IN THE PAST—

Bear (declining) markets are all about sentiment. That is what creates things to go down so much and on the other side of the coin to go up so euphorically - sentiment. Today that sentiment is negative and it's negative to an extreme. I suspect because things happened so fast everyone just ran for cover. What needs to be done is to try to look back to similar crisis's and try to feel what it would have felt like back then.

The review of events leading into the 1974 market bottom and 1975 rally can do this, particularly for those older than I. Politics in the U.K. and the U.S. were in a shambles. Nixon resigned as President before he could be impeached because of Watergate. The Vietnam war was in the process of being lost. The Viet Cong was on it's way to capturing Saigon. The IRA bombing the Tower of London and House of Parliaments. The Arab oil embargo. Auto sales fell like a rock and the car makers announced massive lay-offs. Inflation reached 11.3% in the U.S. and 17.2% in the U.K. U.S. unemployment reached a high of 9%. Talk surfaced about a return of the Great Depression of the 30's.

On December 9, 1975 TIME Magazine had a great summary of the event and mood of that era. You can read it here:

www.time.com/time/magazine/article/0,9171,908956-1,00.html.

Try reading that as if it were happening today. Put your being into the period. Read it. Feel it. Now look at The S&P Total Returns Index chart near the bottom of this page. 3 weeks after that issue of TIME came out the market began it's recovery.

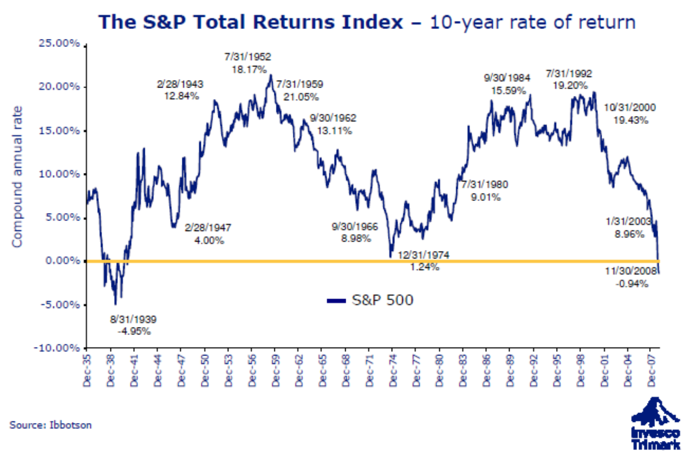
The market decline we have experienced, of any other in history, most resembles the one of 1907 (market chart on the left with red line being our most recent experience). It too was brought on by a significant banking crisis which led to a severe but short recession where many banks failed. The market hit bottom on day 285 of the decline. It was the intervention of then, J.P. Morgan that restored confidence in the market again. You can read about that time here:

http://www.bos.frb.org/about/pubs/panicof1.pdf

- THE FACTS OF TODAY -

The prices of commodities of almost every kind have fallen precipitously since last summer. This is a common event in past recessions. Over the past several months Copper, Oil, Zinc and Nickel have fallen in price by 60 to 80% in price. This is good for helping subdue inflation. The other inflation pusher is employment. When jobs become scarcer through layoffs, wage pressures for companies also subside.

Corporate bond defaults during the 30's peaked in 1933 at 17%. In other words, 17% of businesses couldn't pay back the money they were lent by investors. During 1990 and 2002 default rates hit a peak of 14 and 12% respectively. Today, the default rate is under 5% however prices have fallen so much that a default rate of close to 30% is priced into the market (more on taking advantage of this mispriced opportunity a little further down).



The markets have been bouncing around this bottom where we currently sit since November last year. Volatility has substantially been reduced since then.

The 10 year return ending November 20, 2008 (Nov 1998 to Nov 2008) was the worst on record, matching 1929 to 1939. In other words, over the past 10 year period, we have had the worst investment returns in recorded history. In the context of that knowledge and thinking back to how back it was in the 30's, how good a position would you say you are in today?

If you are and have been fully invested you have seen quite a drop in the market price of your portfolio. However, if you have been invested for several years, the price drop has been more about giving back part or all of what you had gained more so than losing the money you had originally invested, permanently. Although, I don't want to belittle how you may feel at this time, this is a key point. If you have high quality holdings, declines are always only temporary. Quality business that we deal with or buy products from on a day to day basis will survive and in time, again thrive. This frame of mind is often lost in the emotion of the moment.

- FEELING GOOD ABOUT YOUR SITUATION — THE ACTION STEPS -

What I have been doing for many clients, particularly more frequently over the past few months, is making long term projections on how current numbers affect long term plans. I have yet to find someone who has to alter their plans dramatically in the long term. If you would like to meet and do an analysis of your very own situation I welcome your call.

Sources: Bloomberg, Sentry Select Capital Inc., Invesco Trimark, Ibbotson

Be Intelligently Bold... Now

The basics of what I am writing about here has been sent out previously through the "E Loop". If you haven't heard about this already email Cheryl@careyvandenberg.com right now and we'll add you to the subscription list.

High Yield Bonds are a significant investment opportunity, one that is being widely brought to the attention of Financial Planners and Advisors but is not being talked about in the media. This excellent opportunity is about taking advantage of the fears of the masses, by buying bonds that many discarded indiscriminately, down to ludicrous discounts compared to their par values. These bonds were sold without really considering the financial strength of the company or government whose bonds they hold. Thus, the bonds are currently selling at substantially less than what you as an investor holding the bonds would get when they mature. This gives you, the "Intelligently Bold" investor, an opportunity for significant capital gains. While you wait for that, which should be in relatively short order, you get a very healthy interest yield on your investment.

The biggest difference between the common shares of a company and their high yield bonds is the bonds pay a higher income than the common shares of the company while giving you more safety than the common equity. The reason for this is that if a dividend paying company gets squeezed financially, they will cut or stop their dividend completely well before they will stop paying the interest on their bonds.

I have sorted through the 81 High Yield Bond Funds available in Canada and narrowed the field down to 11. The interest yields on these range from 7.4% to 12.7% per year (most being in the 8 – 9% range). These yields are simply the net interest paid on the bonds. In most cases the interest from the fund is paid on a monthly basis.

The names of the companies you would most recognize within these High Yield Bond funds include Shaw Communications, Rogers Cable, Rogers Wireless, Bombardier, Sprint Nextel, Allied Waste, Dollarama (the Walmart of Dollar Stores) and Aramark, along with some of Canada's major chartered banks. Many of these are financially sound, recession resistant companies. Also among the list I noticed a U.S. hospital operator with almost 300 hospitals and surgery centers, as well as Emerging Market government bonds.

What I find particularly compelling is that the interest income paid on these High Yield Bond Funds can be particularly attractive when used in the context of using borrowed money, or "leverage". The interest income paid to you as an investor more than covers what the interest costs are on an investment loan.

Example: $100,000 INVESTMENT IN A HIGH YIELD BOND PORTFOLIO USING BORROWED MONEY

Interest Expense @ 3.0% (Prime Rate) <$292 / month>

Interest Income @ 9.1% (Average Income) $758 / month

With the interest expense being tax deductible and the interest income fully taxable your after tax net income is $262 per month. In other words, after all is said and done, you are putting $262 / month into your pocket. Ironically, if your marginal tax rate is lower that net / after tax income is higher. This can be used to pay down the investment loan, or better still (from a tax perspective), pay down debt that is not tax deductible (a principal residence mortgage or other debt).

This anomaly won't last long. The last time this happened was in 2002, after the tech bubble had burst. However, the most significant in the past 25 years was in 1990, when the JP Morgan Global High Yield Index declined by 6.4% only to be followed by a 43.8% increase in 1991. With the same index down by 26.8% in 2008 I will leave it to you to guess on what the upside could be.

Want a diversifier? Real Estate Investment Trusts (REITs) are also trading at very low levels and because of it paying a very healthy rental income. The only REIT mutual fund available in Canada, which has 14 REITs in its portfolio is currently paying a combined net rental income yield of 11.8% per year.

Partners In Planning's "Leveraging Disclosure" can be viewed here: http://careyvandenberg.com/paperwork/PIP_Leverage_Disclosure.pdf

Refinance Or Not To Refinance—A Case Study

If you have a mortgage and are wondering if it makes sense to refinance, here is an example of a couple who did exactly that. Today the best thing to do is take advantage of opportunities to better your position. This is just another example of that (normally the section "Web Gems" is normally in this space but I thought this info. To be more timely).

Dan and Leslie took out a $300,000 mortgage 2 years ago. It was amortized over 35 years with an interest rate at 5.35% fixed for 5 year. The monthly payment was $1,570.25. Leslie checked with the bank their mortgage was with and discovered the penalty to payout early would be 3 months interest. That equaled $3,928.91 on a remaining mortgage balance of $293,750.87.

The reason the couple was doing this digging was that they wanted to update their kitchen for an quoted cost of $20,000. Along with the $3,928.91 penalty to refinance they would have to pay legal and appraisal of $1000 as well. When all is said and done their new mortgage balance would be $318,679.78 with a new rate of 4.29% for 5 years. Dan and Kim can leave the amortization the same (33 years remaining) and their new payment will be $1,498.48 per month.

This example was supplied by George Colegrave, one of the handful of mortgage brokers I work with. Go to www.careyvandenberg.com/other.php for more information

Hhhmmmmmmm......

The Bank of England cut interest rates to 1.5% on January 9th 2009, the lowest level in its 315-year history.

U.S. households paid down their debts for the first time since at least 1952. Households paid off more mortgage debt than they took on for the first time on record. Federal Reserve

If banks follow and cut their prime lending rate to 2.5 per cent, there are some homeowners who negotiated variable-rate mortgages more than a year ago who could be paying as little as 1.5 per cent interest per year, Toronto Star, Feb 2009

During the 80’s and 90’s government debt was 50% of GDP. Today it is in the 35% range. Quance

We are already one year into the recession. In the postwar period, recessions have lasted 10 months on average, so this one is long by comparison. Since 1854 the average is about 17 months. Historically, equities tend to turn up a little more than halfway through a recession, and have posted 40% returns, on average, 12 months after the turn. USA Today, Dec 2008

"I'm in the camp that believes it's too late to be defensive. You want to be on the offensive and be ready for the rebound," Bradley Radin, Templeton Global Smaller Companies

The greatest stock-market rally of the past century occurred in the depths of the Great Depression, when the Standard & Poor’s 500 index more than doubled during the three months from July to September of 1932. Globe Investor, Feb. 2009

There were more than 9,000 bank failures globally in the Depression; today that tally stands at 23. (Advisor.ca, Jan 2009)

If the predictions of a late 2009 economic recovery are correct then the stock market should be on the verge of starting its recovery. Avery Shenfeld, senior economist, CIBC World Markets, Jan 2009

“An acquaintance who has been annually contributing to his RRSP for more than two decades, mainly buying ETF’s, is shockingly under water in his plan, with the present value below what he bought his investments for over all those years.” William Hanley, Financial Post

A period of 19 years of births in Canada, those now aged 43—61, is a bulge which now makes up almost 1/3rd of the population.

GM's Pontiac Vibe and Toyota's Corolla are built in the same factory in Fremont, Calif. About 65% of the parts for Japan's Honda Accord come from the U.S. or Canada vs. 50% of the parts in a Chevrolet HHR. Accords are made in Marysville, Ohio. The Chevy HHR, a small SUV, is assembled in Mexico.

In early 2009, the Seymour-Capilano water shed will have a new $600 million Water Filtration Plant which will be the largest plant of such a kind to use ultraviolet light to purify water.

“They should go back to wood sticks. The new sticks are crap.” Wayne Gretzky

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