Issue No. 133

September / October 2009

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published bi-monthly since 1987

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Here We Are 1 Year After The Eye Of The Storm...

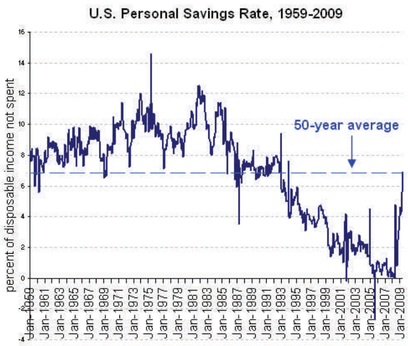
If there is one thing that we have learned and are witnessing after the most financially tumultuous time in modern history, it's that the deeper the downdraft the zippier the bounce back.

"Never before has the S&P 500 rallied 60% from a low in such a short time" David Rosenberg, Gluskin Sheff

Despite being up well over 50% from the lows we saw in March of this year, you shouldn't feel like you missed the boat on making an investment at an opportune time. The lows we experienced in March should never have gotten that low. They were artificially low, "end of the world" lows. Things fell to such extreme levels because the calls of "Depression" were rampant. Today, it is looking more like just another recession.

Also, just before this decline started in October 2007, equities were fairly valued. Every other bear market occurred when equities traded at huge premiums or were overly expensive at high PE (price-to-earnings) ratios. In this situation, we've had the second-worst bear market since the Depression, but we came from a period where equities were not overly priced.

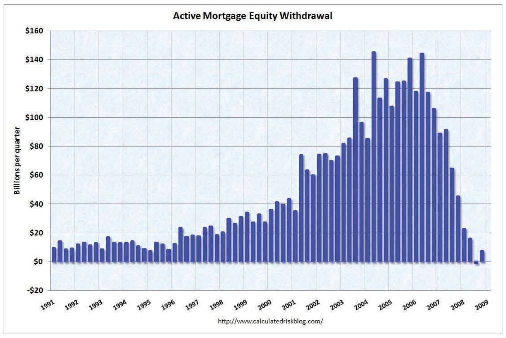
Don't however let this quick bounce back suggest to you that it will continue with the same fervour. Recessions associated with credit crises have tended to last longer and give rise to a more subdued recovery because credit remains tight. As the signs show evidence of that, a more subdued uptrend should continue to match the unfolding economic reality.



The biggest headwind the economy and in turn all kinds of investments will face in the longer term is the consumer, particularly those in North America and more specifically the world's biggest and most powerful force, the U.S. consumer.

You will see 2 charts here which I hope will give you some indication on the next few years.

The first chart has to do with the amount people save. The 50 year average is a 7% savings rate. Historically, for every $1 earned people would save 7 cents. You can see that for the past 20 years people have been saving less and less and for a time were spending more than they earned. It has only recently broken that trend. Savings rates could quite conceivably remain closer to their historic norms over the next several years. This means in general, companies that survive and thrive on selling us our "discretionary" products and services may not see the same kind of profits they experienced over the past several years.



The second chart shows just how much people have used their home as an ATM machine and been depleting their home equity. This accelerated over the past 10 years and has now come to an abrupt halt.

This kind of "de-leveraging", a term you may already have heard in financial news, usually is a very long process. What in fact will most likely happen over the next several years is that people will continue to reduce their debt and rebuild the equity in their homes. This will be friction on future real estate price appreciation as real estate needs the grease of borrowing to make it work best. Additional friction to any real price appreciation will be an eventual climbing of interest rates as the economy starts to pick up steam.

Having said that, despite inflation being talked about as a future given, currently there is still a lot of slack in the economy. Deflation is being experienced in Japan, Germany and other parts of Europe and could easily become imbedded in the U.S. economy. Deflation comes when businesses and consumers stop spending which stops economic growth. With 10% unemployment in the U.S., Germany, France, Italy, China, India etc. the best thing would be a low inflation environment for the next couple of years which would give government the ability to move methodically with their monetary policy (raising interest rates).

A subdued recovery is particularly favourable for quality businesses that generate free cash. This is money over and above what is needed to keep the business growing. Most of the holdings in my client's portfolios are companies such as these.

On a personal note, I must say that I have been thoroughly impressed by the level headedness of the clients who I am so blessed to serve. Their outward calm was very evident to me despite the torment some may have been feeling internally as negative financial news poured from newspapers, TV, the web and was magnified by nervous conversations with their friends and family. The ability to deal with emotional financial push and pulls is the most significant character in determining ones long term financial success.

Corporate High Yield Bonds Will Continue To Perform

"It's not too late and it's still a good investment. Over the next couple of years, high yield (bonds) should provide an added total return of 25%." Wall Street Journal, September 2009

Anyone who has deployed some or all of the cash they had sitting in virtually zero interest bank accounts to corporate and high yield bonds have seen their investments do very well since then. Of the 15 High Yield funds I follow, investors in high yield bonds have enjoyed a combined return (interest PLUS capital gains) of 16.4% to 54.6% from Jan 1st—September 30th (Morningstar). It's really not surprising when financially sound companies had their bonds selling in the market for well below their maturity or "par" value.

An overall idea of where we have come from and where we are now can be very clear when looking at an index of corporate bond prices. Anything below $100 means that corporate bonds are selling for a discount to their par / maturity value.

The Credit Suisse Average Loan Price Index is such a barometer. It climbed to 81.87 at August 31, 2009 from 80.27 at the end of July (1.99% gain). At the end of December 2008 it was 62.25. In other words, corporate bonds have come up in price significantly since the beginning of the year yet they are still selling for almost 20% less than their par / maturity value. Along with that they pay you the investor interest every month.

If the economy plods along rather than moving forward quickly, people invested in corporate and high yield bonds will keep enjoying the benefits.

Corporate and High Yield Bond prices will continue to rise and over the next 24 months should do so until they reach close to 100 (their maturity value). Add to that the interest being paid (mid to high single digits) and you have a very healthy, tax effective and relatively low risk return on your investment over the next few years. Invesco Trimark, Sept 2009

This is the proverbial "buy and get paid while you wait". At some point it will make sense to sell but at this point that looks like that's a few years off.

Dancing In The U.S. Real Estate Graveyard

Yes, it's a mess down there but it's not like we haven't seen this before. In the early 90's many of my clients, with my assistance, bought an interest in one or more apartment buildings and some commercial properties in hard hit areas of the U.S. namely, Dallas, Denver, Las Vegas and Phoenix. Over the past few years Partners In Planning's sister company Walton International, has been assembling packages of land for investment in the U.S.

Recently however a few clients have expressed to me interest in taking advantage of today's depressed U.S. real estate market so I thought it apropos to address some issues that can come about with that kind of transaction.

First thing is financing. If you want to get a mortgage from a U.S. bank you are going to run up against brick wall after brick wall. The U.S. lending market is still in disarray for U.S. residents and the availability of credit to foreigners has virtually dried up. The only real way to simply do this is by borrowing against real estate you own in Canada. If you want to buy a $300,000 property in the U.S. you'll have to borrow $320,000 Canadian. You'll also need money for closing costs. These can be 3 times more than Canadian real estate closing costs.

Although interest on a mortgage in the U.S. is tax deductible, if you use the property for personal use you won't be able to deduct the interest costs on your Canadian tax return. If you are renting the property out you will also need to remit 30% of the gross rent you collect to the IRS. If you want to reclaim some or all of that you will need to obtain a U.S. taxpayer id number and file a U.S. tax return every year along with your Canadian tax return, that however is only if you are renting the property out.

There are a few other slippery spots on the dance floor you want to watch out for. The first is liability insurance. In the litigious world of the U.S. you need to protect yourself with liability insurance and that you will need to buy in the U.S. Another cost that can add up is annual property taxes. They are approximately twice as much as Canadian property taxes (ironic, isn't it?).

On ongoing property management and maintenance and repairs you'll need to hire someone for that. Even though it's your property you can't do any work on it yourself in the U.S. if you are not an American. The legal ramifications are severe if you ignore this.

When you do sell your U.S. property sometime in the future there is a 10% withholding tax on the full price. That is unless it's under $300,000 and the buyer intends on making it their primary residence.

One last thing. You are buying a U.S. dollar investment so as the U.S. dollar goes vis a vis the Canadian dollar so does your investment price. Also, if you are relying on U.S. rent cheques to pay your Canadian mortgage a precipitous fall in the U.S. dollar will reduce the actual money you have to pay your that Canadian dollar mortgage you financed the purchase with. Increasing interest rates, which will materialize at some time, will squeeze your cash flow even more.

Make Gifting A Part Of your Financial Plan

It's an interesting dichotomy being a Canadian. On the one hand we want our underprivileged, housing deprived and less financially successful citizens to be taken care of adequately but we are only willing to do that significantly if the government, through legislation, takes the money from us. In other words, we aren't willing to give or redistribute our wealth unless it's forced upon us and I think, the real issue is, if everybody is doing it I'm not falling behind financially by giving.

Here is a way you can give voluntarily, to the causes you care most about, in any amount. You can give yet have the cost to do it be potentially much less than what you are putting out. It has to do with investing in a flow through share offering and getting tax savings on that which can total $6,114 on $10,000. The second part has you gifting all or part of your investment. This gives you an additional $4,500 in tax savings.** In this case you are actually cash flow positive.

I haven't talked about this in a while however there are a few reasons why I bring this up again now. 1) We are getting into the last couple of months of the year. This means the deadline for many tax saving ideas for your 2009 tax return is fast approaching. 2) Investments in flow through shares are at the lowest level we have seen in years and 3) I know of one flow through investment than can save you over 60 cents in tax for every dollar you put in AND the investment is currently valued over 20% higher than what you will pay for it.

**For illustration purposes we have assumed the $10,000 investment value doesn't change and the highest tax rate in B.C. of 43.7% which applies to any income earned over $126,000.

What To Do With That Mortgage Or Line Of Credit Of Yours

The Bank Of Canada rate is at 0.25% and can't go much lower. Because of that borrowing rates are at all time lows. Many people with variable rate mortgages are currently paying less than 2% interest. This is very attractive, particularly if you are making mortgage payments based on interest rates higher than that. This simply means that most of your payment is going to paying down your mortgage. This can only last so long and nobody really knows how long. Today you can get a mortgage with a fixed rate at 3.85% for 5 years and 5.25% for 10 years. Rates can stay low for a long time. Also, the variable rate can stay the same but the fixed rates banks are offering can stealthily increase. Unless you are paying attention you may not notice. In any event, there is only one direction that they can go. That direction is up.

Web Gems

XOBNI— I found this "app" or more accurately "plugin" when I downloaded another program. There is a lot of software junk that you can add to your computer however this one is a pure gem and the features I'm going to tell you about are only scratching the surface.

If you a) Use Outlook b) have a lot of "Contacts" in your database and c) use either Facebook or LinkedIn then XOBNI is a must have. After installing, it indexes your Outlook folders. Whenever you click on an email from someone XOBNI quickly searches these 2 social networking sites, using the person's email address as the common denominator. Presto! In 1 or 2 seconds, if the person who emailed you, now or previously, is on either Facebook or LinkedIn you now have some of the contact details you may not have had before. It also searches Hoovers, a listing of businesses and displays the details of that business including revenues, head office location, number of employees etc etc. That will only show when you get an email from someone who is using their business email address however. If you haven't guessed already, xobni is simply "inbox" spelled backwards. You can download the free version as described above at www.xobni.com or you can get the paid version (well worth the $30) and have Skype, Yahoo Mail and Twitter added to the list of sites it will search along with a bunch of other features. They are also working on a Blackberry version of this….

Hhhmmmmmmm……

The value of Canadian imports exceeded that of exports for the first time since 1976 because of our dependence on U.S. consumers. Globe & Mail Report On Business, August 2009

The average home price in the Toronto area is virtually unchanged since the end of 2008 at around $379,000. If things hold prices will have increased every year since 1996, a total of 13 straight years. This is despite consumers being repeatedly told that this is the biggest economic downturn in North America since the Great Depression. Toronto Star, August 2009

The unemployment rate continues to climb, and is soon expected to reach 10%. It was under 5% before the recession started making this the biggest jump since the Great Depression. Yet, housing sales have rebounded strongly. Globe Investor, Sept 2009

Toyota recalled 700,000 Camry, Corolla, Yaris and Vios models, because of faulty electronic window switches that could overheat and short circuit. It was their largest recall in history. The cars were made in China. Globe & Mail, Sept 2009

Asset managers focused on investing in very large companies posted their best returns in 22 years in the second quarter as Canadian equity markets roared back to life. Advisor.ca, August 2009

Most of the top 9 safest banks in the world for 2009 are based in Europe. BNP Paribas based in France is one of those (a common holding amongst my client's portfolios). Royal Bank of Canada is 10th Global Finance Magazine.

BYD which makes electric cars and batteries and is Hong Kong's largest car company, is slated to sell its e6 electric car in the United States in 2010. They say it is capable of driving 400 kilometres (249 miles) on a single charge. Globe & Mail, August 2009

About 50% of traders in the U.S. oil futures market today are speculators, up from around 20% before 2002. (Rice University study, August 2009)

McDonalds profitability is enhanced be a weaker U.S. dollar. Other large multinationals such as Procter & Gamble, Johnson & Johnson and Coca-Cola have been moving higher as the dollar has weakened and have also been upgraded by analysts. CNN Money, May 2009

$134 billion in "Option ARMs" (Adjustable Rate Mortgages) will reset in the next 2 years. On average, monthly payments are expected to jump 63%, or $1,053, a month. Option ARMs, allow owners to choose how much to pay each month. Nearly all the borrowers who took out this type of loan from 2004 to 2007 chose to pay less than the interest that was accruing. 75% of these mortgages are on California, Florida, Nevada and Arizona homes, where prices have already plunged on average 48%. Washington Post, Sept 2009

In Calgary the downtown office vacancy rate was less than 1 per cent in 2006 and 2007. Today 13.1% of office space is empty. It has almost tripled from the 4.7% a year ago. Globe & Mail Sept 2009

A spousal RRSP must remain a spousal plan even after divorce. It will remain so until the death of the contributing spouse.

Canada's 6 largest banks securitize (selloff their balance sheets), more than 25% of their mortgages (Globe & Mail, Sept 2009)

In the post World War II era, the government has attacked recessions with an average total stimulus of 2.9% of GDP. This time the total stimulus is likely to measure 19.5% of GDP. Wall Street Journal, Sept 2009

71% of 2nd quarter profit estimates for companies in the S&P 500 index were higher than analysts had predicted. Gerry Coleman, CI Portfolio Manager

Risk-averse Canadian households are sitting on up to $1-trillion of cash and "near-cash" holdings, earning close to 0%. (Scotia Capital Inc.)

The H1N1 vaccine will contain thimerosol a mercury-containing preservative. USA Today

Carey

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