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mutual gains™

C.E. VANDENBERG & ASSOCIATES INC.

Financial Planning— Insurance— Wealth Management*

For more information

& contact details go to
www.careyvandenberg.com

Questions?

carey@careyvandenberg.com

604 541 2690

1 866 274 1222

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*Mutual Fund and Other Investment Products Are Supplied Through...

PARTNERS IN PLANNING
FINANCIAL SERVICES LTD.

S Surrey / White Rock Office
13230—16th Avenue
South Surrey, B.C. V4A 1P3

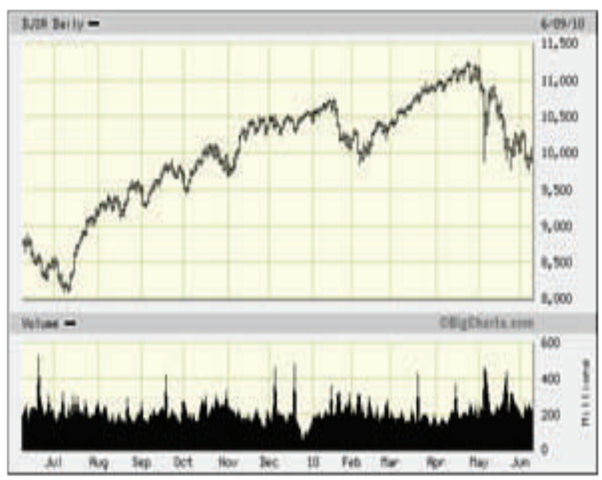
Burnaby / Vancouver Office
4400 Dominion Street
Suite 410
Burnaby, B.C. V5G 4G3

Greek (and other PIIGS) Belt Tightening Is A Good Thing

Since early last year we've seen an unprecedented, swift yet relatively steady increase in investment values from the lows of March 2009. Now, with European PIIGS (Portugal, Ireland, Italy, Greece and Spain). we are dealing with one of the repercussions and problems to fix of the deleveraging cycle. This is nothing new, unexpected or abnormal. It's part of the healing process of a global economy that generally got used to living way beyond its means. These bouts of influenza will continue on for more years than just this one. We are only more emotionally sensitive to this now as it is happening so soon after the significant economic car wreck we experienced in late 2008.

The current potholes in the road this May followed a smaller bump in February related to the same problem. It had and still has to do with Greece and their population of 11 million people, with the worry that a couple (or more?) other larger European countries will have to go through the same fiscal belt squeezing, namely Portugal and Spain. If that happens, our healing global economy could fall back into recession. Although, not terrible, that is the concern.

Yes, the bumps are many and the ride is feeling quite uncomfortable again as of late however the risks now are much less than they were early last year. After all the money that was pumped into the system, in a global government effort to steer clear of a meltdown and in it's place, orchestrate a successful landing, those same governments are now switching gears. This is clearly evident in the latest meetings of world leaders. Governments are calling for a change in direction, to one of reining in government spending and cutting deficits. This is the next step, the next correct step, in healing the global economy.



If you look at various stats it is quite evident that we are currently in the early stages of a global recovery. The U.S. inflation rate is unusually low but likely to pick up as workers are rehired. Growth in China and emerging Asia is generally quite strong. Canada seems to be leading the developed world economies. Even in the Eurozone there is much life despite the Greek news. Industrial orders rose in March at their fastest annual pace in a decade.

Overall, economic data is looking stronger than anyone would have expected so I'm not surprised that the various investment managers whose comments I have read, talked to personally or conference called with are very upbeat on the next several months. With the recent pullback in prices, they are picking up some very good buys. In fact, 1 investment management team I have used since 1987, and has one of the most successful investment track records since then, has recently reduced cash holdings from around 25% to 11%. The last time they did this was in the first few months of 2009.

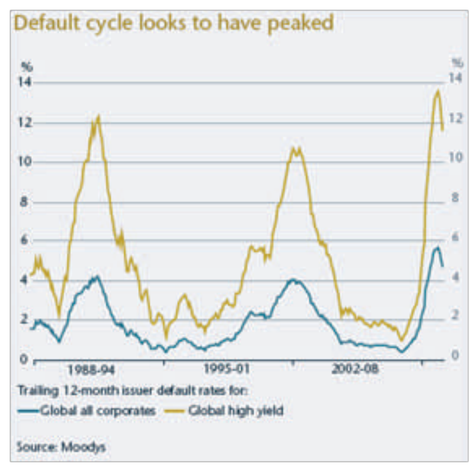
It's ironic how the selling by Joe Public and frantic buying of successful portfolio managers mirrors a recent experience I've had with trying to buy copies of Windows 7 Ultimate Upgrade online for our office computers. Although you can get a copy with free delivery off Amazon.com for $165, people often pay 30% more than that on eBay despite copies having been sold for as little as $91. Compare that undisciplined bidding up of a price for a consumer item to the current market environment where people are selling shares of excellent, financially strong, dividend paying, world class companies for a lower and lower price. Neither makes any real sense.

Holding and buying more of "best of breed" global companies at today's prices due to the nervousness Joe & Jane Public and "Mr. Market" feel at the beginning of an global economic expansion will only look savvy 1, 3, 5 and 10 years from now. (Sources: CI Investments 06/08/10, BigCharts 06/09/10, Financial Post 06/06/10)

High Yield Bonds—There Is Still Lots Of Track Ahead For This Train

Clients of mine who invested significant amounts of cash from March 2009 in high yield bonds (trusting my urging to do so despite their nervousness) through the end of the 2009 have enjoyed significant returns in an investment area that few people took advantage of. The returns enjoyed have been 10% over the past 6 months to over 30% in the past 12 months. That has been a combination of interest and capital gains on the bonds. And the astounding thing is that these returns have been in BONDS, not stock / equity.

People were panicking in late 2008 early 2009 so equity AND corporate bonds were selling at significant discounts. The key difference on the bond side is that bond prices were selling on the assumption that over 30% of corporations would go bankrupt and thus people holding their bonds would lose a significant amount of their money. In other words, people were fearing that the economic climate would be WORSE THAN THE GREAT DEPRESSION and because of it bonds were selling for as little as 35 cents on the dollar. A repeat of the "Dirty 30's" was highly unlikely, particularly with governments around the world lowering interest rates so dramatically. Therefore the wise and courageous investor made a timely investment based on their head over their heart (and a grain of faith in the prodding by yours truly).



As you can see from the graph on the right, default rates came no where near 30%. It looks like they peaked at under 14%, a bit above the levels they reached in the last 2 recessions (2000 and 1990). Default rates have been falling quite dramatically, as is the case following all recessions. Corporate bonds prices continue to be pushed up.

Not convinced yet? Well, according to credit ratings agency Moody's, they expect the decline to continue, predicting that defaults in the US and Europe will fall to only 3.3% and 1.7% respectively by December of this year. Meanwhile, companies are committed to cost-cutting and rebuilding their balance sheets, activities that further insulate bond holders from the risk of further defaults.

In summary, here is why High Yield Bonds still remain a very attractive, low risk investment:

- Default rates are falling and are expected to fall dramatically over the next several months
- High Yield Bonds are still priced below their par / maturity values
- The economy hit bottom several months ago and should continue to recovery steadily
- With government debt concerns, inflation continues to not be a concern, therefore interest rates should stay low for longer
- Cash on the sidelines (GIC's, savings and chequing accounts etc) remains at record levels. As the past few years pains and worries fade, this money will in time move, seeking out a better return. Corporate and high yield bonds will be the first choice for many cautious investors.

People who hold this kind of investment (or make new investments now) will continue to see their money rise in value and collect the interest gravy along the way. According to a few recent reports I've had from investment management teams who specialize in this investment class, the returns should be in the high single digits to low double digits (capital gains PLUS interest).

I invite you to review the articles I wrote though out last year why High Yield Bonds were (AND STILL ARE) expected to produce such excellent, low risk returns. You will find them in previous MUTUAL GAINS issues, namely #129, #130, #131, #132, #133 and #134 (or go to www.careyvandenberg.com/mutualgains.php)

Sources: Manulife 06/10/10, Invesco Trimark (various in 09), Aviva Investors (05/26/10), Moody's (1/11/10),

Turn Your $1,500 Into $5,000 (and maybe more) With An RDSP

That title may have gotten your heart to skip a beat or two however, before you get all excited about getting a bunch of free money from the government, let's reign your curiosity in right here. An RDSP is the acronym for "Registered Disability Savings Plan". The RDSP was set up by the Canadian government to provide long term financial security for people with disabilities. You don't belong to a family with person with disabilities? Well maybe you know a family with a disabled person. If so, your passing on this letter could prove to be highly advantageous for them. The qualifications are:

- Eligible to claim the Disability Tax Credit (DTC).
- A valid Social Insurance Number (SIN)
- A Canadian resident
- Under the age of 60

There is a life time contribution limit of $200,000 per RDSP however, there is no annual limit. In other words, up to $200,000 can be contributed to an RDSP all at once. There are no tax deductions for this investment however there are significant government monies available to be collected by the account AND all of the money grows tax free (just like a TFSA). Here are some figures to give you an idea on what kind of money is available from the government:

Canada Disability Savings Grant (CDSG) - On the first $500 you get $1,500 contributed by the government ($3 for every $1 you put in). On the next $1,000 it's $2 for every $1 you put in (that's another $2,000 of government money on your $500 investment). That $1,500 investment of yours is now worth $5,000. You can do that every year until you reach the maximum of $70,000 in CDSG's (these maximum amounts come to a family whose net income is $78,130 or less). However, it doesn't necessarily end there...

Canada Disability Savings Bond (CDSB) — Even if the "Account Holder" (legal parent, guardian or even the disabled person themselves) doesn't have the money to contribute to an RDSP, they may be eligible to receive cash from the Canada Disability Savings Bond. Family income of $21,816 or less will get another $1,000 each year to a lifetime maximum of $20,000. This amount is prorated for family incomes between $21,817 and 37,832.

Vancouver Foundation Grant— This part is available for residents of B.C. only. The Vancouver Foundation received a $5 million grant from the B.C. government to assist people with disabilities. This provides people with disabilities $150 towards their RDSP. In September 2009, the BC Ministry of Housing and Social Development mailed a letter to all persons with disabilities who are eligible to receive monies from "Endowment 150". Recipients can take this letter to their financial planner, advisor or wherever they set up their RDSP account and have the $150 paid directly to their RDSP.

And last but definitely not least. The RDSP will not reduce other federal and provincial government programs (OAS, GIS, CPP, GST Benefit etc.). Sources: www.hrsdc.gc.ca ; Vancouver Foundation

If You Own Assets Outside Of Canada This Is a Must Read

All Canadian residents are required to report their worldwide income on their tax returns. This means, any income (rental income, dividends, capital gains etc) that you earn on investments you hold outside of Canada must be tallied with the income you earn within Canada. So, what happens if you don't report it?

Where an individual knowingly fails to file a form T1135 (reporting foreign investment assets), the penalty starts at $500 per month for 24 months. After 24 months an additional 5% of the cost of foreign property / investment is charged.

If you fail to report foreign income in a return, the penalty can be 50% of the unpaid tax. Also, criminal fines may apply in the case of tax evasion ranging from 50—200% of tax evaded and may even include a prison term of up to 2 years.

You do have options if you haven't been compliant whether unknowingly or even intentionally. Under the CRA voluntary disclosure program (VDP) if a taxpayer fesses up before the CRA comes knocking on their door, you may be spared the financial penalties and prosecution that you could otherwise face.

Should CRA accept your written submission to the local CRA tax office, fines and penalties and future prosecution will be eliminated. You will however have to pay interest on the amount owing but that too may be reduced. So, if you haven't properly claimed foreign property income on your Canadian tax return, it may be a good time to file a disclosure. You may not get another chance so take it.

Where Will Your Money Really Go In The End?

The "text book course of events" with regards to estates has the husband passing away first with all the assets transferring to the surviving spouse. When she in turn passes on the remaining assets are, in textbook fashion, given to the surviving children through the Will. Fact is, life doesn't often work like a text book. There are divorces, remarriages after divorce, remarriages after the death of a spouse, the natural kids, the adopted kids through marriage and the blended families that may have happened in the generation following. Life is messy.

Commonly, when a surviving spouse remarries, the new couple often make up a will based on the "text book course of events". Let's again assume the husband passes on before the wife. The surviving spouse will have all the assets passed on to her. This creates a lottery win for her children (his stepchildren) as quite often the surviving spouse's Will has their own children and no others as the beneficiaries of the estate. The deceased spouse's children in the end up with nothing, or at best very little.

Often the couple, sometime during their life together, recognizes this inequity and tries to balance the scale in their Wills. This isn't often quite as clean as they may want because assets are often held jointly by couples, most often the matrimonial home. By default, this cuts the kids of the person who passes on first, out of the beneficiary string. The end result, despite their best efforts, is most or at best a larger portion of the wealth again will go to the children of the last surviving spouse.

This is the direct result of holding assets as "Joint Tenants With Rights of Survivorship" (JTWROS). Joint Tenancy is most often done for simplicity and smoothness as well as reducing potential probate costs of an estate. A potentially more equitable way to hold joint assets is as "Tenants In Common". When one of the owners passes on, the deceased owner's share of the asset is passed on to whomever is named in their Will. This isn't necessarily a perfect way to pass on assets in and of itself however, it is an alternative to JTWROS. Of course, the best way to layout any kind of estate plan is in working with a Lawyer and a Financial Planner… jointly.

Insure Your Income Earning Power And Get An Added Benefit

Many people know that securing life insurance is important. Look at life however and you will see that the more important thing to insure is your ability to earn an income. It's called Disability Insurance and it can be a significant risk reducer. Also, there is a neat little feature a few companies offer as an addition to their policies.

My own disability insurance just came up to it's 8 year aniversary date. The policy I have in place has a "Return Of Premium" rider. If I don't make a claim on my policy I get 50% of my premiums refunded back to me. Because I've been claim free for 8 years now I am waiting for my $12,000 cheque to come in the mail.

Web Gems

BBC— It's the British version of the CBC. Although I can watch a live stream of a Stanley Cup game on the CBC website (very cool), www.bbc.co.uk has a much broader information base. It is the most global news site I have ever seen. You can find almost anything there. One part of the site is very much like an encyclopedia where you can get a snap shot of any country around the globe with all sorts of facts very nicely laid out. Looking at travelling somewhere or hear about a country in the news? Skim through this section of the BBC website by searching "country profile" in the top right search are. How did we ever survive without the web...

Hhhmmmmmmm......

CIBC anticipates the Bank of Canada will take its benchmark interest rate up from the current 0.25% (now 0.50%) up to 2.50 per cent by the end of 2011. At the other end of the spectrum, Toronto-Dominion bank expects 3.25 % and Royal Bank of Canada forecasts a 3.5% Bank of Canada rate. Globe & Mail, April 2010

The average cost of owning and operating a sedan in the USA rose 4.8% this year to 56.6 cents per mile, or $8,487 per year (that's over $700 per month which includes depreciation, fuel, tires, insurance and maintenance) USA Today, April 2010

The median after-tax income for all census families in Vancouver was $52,357. The average price of a detached home in Vancouver.... $921,000. Stats Canada, 2005

Medical marijuana dispensaries are springing up in coffee shops, nail parlours, tanning salons and even taco shops in Colorado's major cities. Denver has some 250 dispensary storefronts and Boulder has more than 100. Since 1996, the state has issued more than 66,000 cards that allow holders to purchase medical pot. USA Today, April 2010

Federal, state and local taxes in the U.S. including income, property, sales and other taxes consumed 9.2% of all personal income in 2009. This is the lowest amount of total tax paid since 1950 and well below the average of the first half of the century which was 12%. USA Today, May 2010

Debt in the Group of Seven countries - the United States, Japan, Germany, Britain, France, Italy and Canada – is in excess of 100% of gross domestic product (GDP) for the first time since the early 1950's. European countries outside the G7 are similarly strained. G&M Report On Business, April 2010

Despite the high deficit levels of the 50's....The best decade of returns since 1830 was during the 1950's with 18.2% per year average annual return (Yale International Center for Finance)

Over the past 12 months the Dow is up 40%. Since 1918, the Dow Jones Industrial Average has seen 20 periods where the index has risen 40% from the previous year. On average, from the beginning of each of these periods the market is higher 68% of the time 1 month, 3 months and 6 months later. One year later, it is up 89% of the time. Financial Post, April 2010

Canadian new home prices saw a 0% increase for 12 years, from 1988 to 2000. Prices were actually down during the period from 1990 through to 2001 (Statistics Canada New House Price Index)

Investors held just 50.9% of their portfolios in stocks and stock mutual funds in May, down 9.5% from April. That's the smallest percentage in stocks since May 2009, shortly after the market bottomed. CNN Money.com

In 1998, oil provided 38.69 per cent of the world's energy; coal, 25.45 per cent. In 2008, oil provided 34.78 per cent, a decline of 3.91 percentage points; coal provided 29.25, an increase of 3.80 percentage points. Globe & Mail, June 2010

Carey

Chartered Financial Planner