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FINANCIAL PLANNING— INSURANCE— WEALTH MANAGEMENT*

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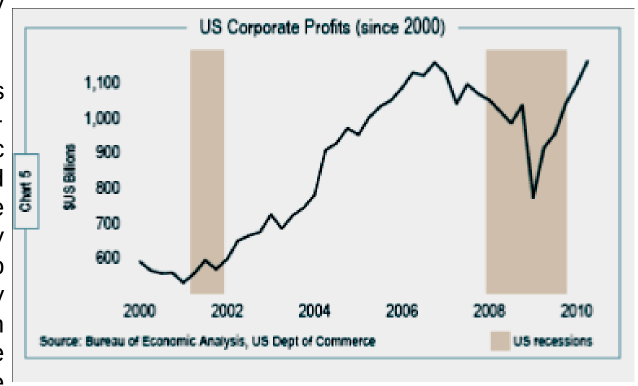
GET COMFORTABLE BEFORE EVERYONE ELSE DOES

"We have a severe crisis of confidence, not a crisis of fundamental strength"
Waddell Reed Investment Management, November 2010

There is a continued feeling of uncertainty and uneasiness among the investing public. You may be feeling it too. I'm sure you'll agree, that the uneasiness and caution you feel has come down dramatically over the past several months. It is I suspect, very prevalent and very much still there however.



Sentiment by the public is generally the fuel that either hinders economic growth or stokes it beyond sustainability. When there is pessimism the primary fuel source isn't there to move a country's economy significantly forward. With economic optimism, the reverse is true. The more optimism, the more fuel, which creates an economy that can get too hot.

It is amazing how the cautious sentiment of today is subduing the economic growth despite the reality that there is fundamental strength, particularly amongst corporations globally.

Yes, there is significant economic healing still to come. That healing encircles the globe. You need not look any further than unemployment rates which in both the U.S. and Europe as a whole are well above 9%. That is high but it was once much lower. Over the next several years, it will come down again. That is inevitable. Time is an amazing healer.

We continue to hear the inflation versus deflation debate volleyed back and forth. The largest source of consumer spending in the world, Americans, having significantly increased their saving rates over the past couple of years, don't seem to have a big appetite for spending. Not surprising with what has happened to home values and the job market. Companies won't have the ability to raise prices on their goods and services very much because of these factors. Result? Inflation should remain constrained.

Yes, commodity prices like oil could continue to move upwards. However, with 2/3rds of the cost of producing the products we buy being labour costs, that shouldn't have a significant effect on prices.

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"As long as wages are muted, overall inflation will be muted" Jennifer Lee, Economist BMO Nesbitt Burns

Interest rates? They are generally a function of the speed at which the economy is going down the highway. Currently that isn't very fast however, that too will only increase with time.

The primary message here is that our feelings are most often disconnected from reality. Those feelings can't be trusted. What you need to do now is get comfortable well before the vast majority of the investing public does. The only way to do that is get that cash, the cash that you may have been accumulating in savings accounts, GIC's government bonds etc put to work in a diversified portfolio of investments that will only get more attractive to people who will eventually want to get comfortable. If you wait until everyone else does, the cost of a seat will be significantly more expensive than it is today. It always is.

The Coming Mortgage And Line Of Credit Squeeze

The government changed the mortgage rules in April last year. They will be tightening the screws even more:

- The maximum amortization period is being reduced to 30 years from 35 years for new government insured mortgages with loan to value ratios greater than 80%.
- The maximum amount that people can borrow against their home will be lowered from 90% down to 85%.
- Insurance backing by the government for Lines of Credit is being withdrawn completely.

Just a few years ago you could borrow over a 40 year period and really have no skin (downpayment) in the game. The government has and continues to make things more difficult to borrow because, unlike Americans, Canadians have continued adding to their personal debt.

The government is clearly concerned. Canadians have continued to use their homes as ATM machines, for consolidating existing debt or, for those in a better financial position, using equity in a property to make more investments. It may be time to look at ways to secure funding for yourself should there be a need to do that.

"Pensionizing" Your RRSP With Longevity Insurance

We in the developed world are enamoured with trying to take the pain out of everything by using various kinds of insurance. We insure consumer products with extended warranties, flights in case we get sick and can't take the trip we had scheduled, pet insurance for vet bills and rental skis or snowboards in case they are damaged. Should something go wrong and we didn't carry any of these insurances we would feel a bit of financial pain but the downside would be relatively minor. The purpose of insurance isn't about eliminating the pain against any kind of financial loss. It's about insuring against events that could have financially catastrophic ramifications.

The next step up the risk ladder is where insurance starts to make sense. The most common form of insurance is on our cars. This includes collision, theft, fire and liability. Some of these (ie liability) are potentially more catastrophic than others. An example of the latter would be getting in a crash which is entirely your fault and you don't have collision insurance. I'm not going to argue about whether or not collision insurance is useful or not. What I am going to suggest is that, if you totalled your car, having to buy or lease another one would I'm sure be financially painful but it wouldn't be significantly life altering. In a relatively short period of time, I'm sure you would recover financially. Getting sued on the other hand could cost a whole lot more.

We also insure our house and for very good reason. It is a very valuable asset. Disability insurance is used in case we can't work. We can earn millions of dollars in a lifetime so the ability to earn an income is definitely worth insuring. Life insurance is purchased on the life of a family's income earner(s). Again, it's the insurance against someone's earning power and the risk of losing that because of premature death. These insurances cover the risk of suffering a significant strain on one's financial well being.

(Continued from page 2)

Another form of risk coverage is the protection you can get on your portfolio which will insure against you outliving the income it will pay out. In other words, insuring that your income will last just as long as you do.

Think about how a pension plan works. Once you retire you get a monthly income that lasts for the rest of your natural life. If you retire at 65 and get $2,000 per month until your 95th birthday, you would have received $720,000 in income (taking out the factors of inflation and growth of your portfolio over time). This could be much more than you and / or your employer contributed into the pension plan. Traditional pension plans have longevity insurance built in. It's part of a pension plan's DNA.

Many of us however don't have traditional pension plans other than our Canada Pension Plan. It's with CPP that many of us enjoy the benefits of longevity insurance. So where do you get longevity insurance? The answer is simple this, by buying your own pension plan. It won't be called a pension plan per se but it will have many of the characteristics of one.

There are a couple ways to do this. One is through an "Annuity". You give an insurance company money, either from your RRSP or with cash outside of your RRSP and they will give you a guaranteed income for life. To have that income go up with inflation during your lifetime the insurance company is going to need a larger amount of money from your RRSP or portfolio. You can also get a guaranteed income period (ie 10 years) so that if you die shortly after buying the annuity, your spouse or heirs will get income for at least guaranteed period of time. This is exactly how most pension plans work. It is longevity insurance in it's purist form. You give up cash and for that you get all kinds of guarantees so you don't have to think or worry about anything.

The Guaranteed Minimum Withdrawal Benefit (GMWB) Plan is similar in many respects. Although the income is guaranteed for the rest of your life, the income will go up only as your investment goes up. If the investment does very well your income will go up proportionately, usually every 3 years. Also, when you pass on the balance of your GMWB Plan will go to your heirs. This is much better than an annuity (and a pension plan) where your money disappears when you do (however there are ways around that).

Your CPP and company pension plan are pure pensions. They have longevity insurance built in. You can "pensionize" other assets and get the same kind of guarantees with an annuity or GMWB plan. Yes, longevity insurance will cost you however insurance is used to cover significant risks and is well worth the cost. Longevity insurance guarantees against you outliving your money and income. That can be priceless.

Socially Responsible Investing (SRI) Is Relatively Ethical

I occasionally get requests for a portfolio that is ethical. I completely recognize and understand the desire someone may have for not wanting to invest or "promote" unethical businesses. That I think most people agree on. However, what may be unethical for one person, may be seen as perfectly fine by another. Knowing that everyone has different definitions for what is ethical makes this very difficult in an all encompassing portfolio such as a mutual fund. The lines can get quite blurry in the investment world of Socially Responsible Investing (SRI).

Environment, Human Rights, Weapons and Tobacco are probably the most commonly agreed upon ethical categories although even those have their degrees of latitude. Alcohol, gambling and pornography are usually further down the SRI hot list. These are significant ethical issues for many however.

Here is where it gets messier. Every SRI mutual fund uses "screens" to weed out companies or investments that fail to meet it's criteria. Where one investment management firm may screen out as examples, alcohol companies or gambling, others will not.

Another issue, one that takes into account the ethics of being environmentally responsible is with oil and mining companies. I am not aware of any SRI firm in Canada that screens these out. That would be too restrictive, particularly as the health of Canada's economy relies heavily in these sectors. Because of that they use a "best of sector" approach in these areas. A controversial example of this would be Suncor Energy. It is included in some SRI portfolios despite its heavy involvement in the Alberta oil sands, an industry noted for its high greenhouse gas emissions and significant environmental damage. On the plus side of the ledger Suncor also runs wind farms which is seen to offset its carbon footprint. Despite that many individual investors would not want Suncor in their portfolio but as you can see, SRI or "ethical" investing isn't perfect, it's relative.

Web Gems

<u>Internet Movie Database</u>— With all the Oscar talk lately I thought this insertion was apropos. Movie and entertainment buffs know all about www.IMBD.com and for good reason. It's packed with all sorts of current and historical entertainment information. You can find an amazing library of movie trailers, both old and new, bios etc. Search on anything to do with the entertainment business from within this site including a search by Plot.

Hhhmmmmmmm……

Like many large, well known companies MacDonald's is classified as a U.S. company yet 64% of it's sales in 2009 sales were from outside the U.S.… And growing. (MacDonald's 2009 Annual Report)

Gold isn't used. It sits there in bars and its value is in the eye of the beholder. Globe & Mail, Jan. 2011.

The price of silver is up as much as 60% since the end of the summer, even though fabrication demand for the metal sits at a 17 year low. Dixon Mitchell Investment Counsel, Jan 2011

Unlike Canada and the U.S. which have been increasing their debt, last year Germany cut its debt by 7.3% and Switzerland cut its debt by 8.9%. Globe & Mail, Oct. 2010

Canada recorded 3.4 bankruptcies per 1,000 businesses in 2010, "by far" the lowest bankruptcy rate on record. Globe & Mail, Feb 2011

"There is nothing so disturbing to one's well-being and judgment as to see a friend get rich." Panics, Manias, and Crashes: A History of Financial Crises, Charles Kindleberger

The 2012 VW Passat will be $8,000 cheaper thanks to it being built in the U.S. at it's new factory in Chattanooga, Tennessee. USA Today, Jan 2011

November marked the 53rd consecutive month of declining home values in the U.S. National home prices are down 5.1% in November (2010) from November 2009, resetting to levels last seen in October 2003. USA Today, Jan. 2011

Last year, U.S. carriers flew more than 10 million flights and hauled more than 700 million passengers in 2010. Despite that U.S. airlines did not have a single fatality. It was the third time in the past four years there were no deaths, continuing a dramatic trend toward safer skies. USA Today, Jan. 2011

Developed economies expect to see an average increase in life expectancy at age 65 of approximately one year for each decade in the future. At the current level this implies that an individual turning 65 now will have to accumulate sufficient capital to fund retirement for 18 years on average. Canadian Investment Review, Jan. 2011

The 1976 Olympics in Montreal were followed a year later by the Montreal Canadians winning the Stanley Cup. 1988 Olympics in Calgary were followed a year later by the Calgary Flames winning the Stanley Cup. The Olympics in Vancouver were in 2010. We're well into the 2011 NHL season and the Vancouver Canucks are on fire….

Carey

Chartered Financial Planner