Issue No. 142

March / April 2011

mutual gains™

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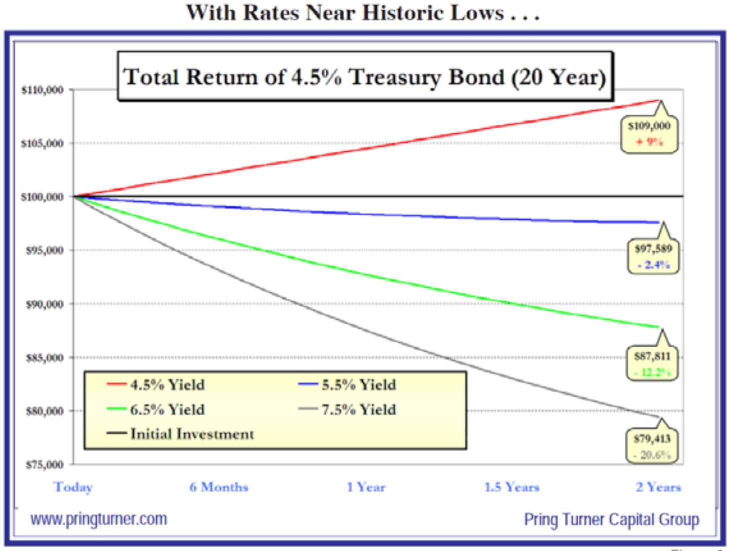
Time To Get Out Of Bondage

It's been 2 years since we hit the bottom of the economic barrel. At that time many people rushed into anything safe. The biggest destination for scared money was the government bonds. That was understandable since it was an unprecedented event and uncertainty and fear were rampant.

Today, many are sitting in these perceived to be safe government bonds and the debate has been going on about the possible development and eventual bursting of the government bond bubble. Wharton School finance professor Jeremy Siegel has been one of the most vocal. The suggestion is that investors were rushing into government bonds seeking security after 2008's stock market crash in a mania resembling the drive to tech stocks a decade ago.

There is a distinct difference. Government bonds promise to repay the initial investment with interest. Governments are considered to be the most stable borrowers. In other words, you are more likely to be paid on a government bond than any other debt investment. That may be true but the next few or even several years could be a difficult time for bond holders. The unprecedented monetary and fiscal stimulus policies taken to stave off a financial disaster have increased the money supply, which could lead to inflation. Interest rates, which are about as low as they can go, will rise to keep inflation in check. As interest rates rise, government bond prices fall. If you are holding a bond paying 3.5%, who in their right mind wants to buy that if new bonds are paying 5 or 6%? The end result is that your bond price will fall. The more interest rates go up, the lower the price.

With Rates Near Historic Lows . . .



. . . A Small Rise In Rates Can Lead To Big Losses!

Figure 1

A modestly increasing interest rate environment is actually good for some investments and that is where you should look for a viable alternative. The closest alternative to government bonds are corporate bonds in their various forms, including floating rate

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bonds. I have used these a lot for clients in the last few years. They don't react to increasing interest rates like government bonds and currently corporate bonds are still paying interest rates that are higher and in some cases, much higher than government bonds. Also, along with the enhanced interest rate you have capital gains potential. "Real Return" or "Inflation Indexed" bonds can also work but they need inflation to really make them sing. Currently however we don't have much of that happening.

If you want a more tax effective option, preferred shares are very attractive. You get paid regular dividends from the profits of the company even though the value of the investment may fluctuate. The dividend on preferred shares is in the 4% to 5% range with much less tax to pay than on bonds. With dividends your income tax can be as much as 80% less than with interest income.

TFSA "Need To Know"s

Here are some key points to know about TFSA's:

A TFSA can be made up of a wide variety of investments. Most people think of the TFSA as a savings account kind of thing but you can put virtually any investment under the sun into a TFSA. Also, if you plan on not using the money for a long time, a higher growth, yet sound investment, can create an investment mountain.

TFSA contribution room accumulates every year. The maximum in 2009 was $5,000. In 2010 and 2011 you have another $10,000. That's $15,000 in total than can be put in a TFSA if you haven't already contributed.

If you have already maximized your TFSA contributions, a TFSA withdrawal can not be put back into the plan in the same year. You would have to wait until the following year to put the money back.

Do you want to move a TFSA from one institution to another? A TFSA transfer is the best way to do this otherwise, if you withdraw the money from our old TFSA and put it into a new TFSA you will be hit with an over contribution penalty of 1% per month.

If your TFSA grows from, as an example, $15,000 to $22,000, you can take out $22,000 and then replace the full $22,000. $22,000 is your new contribution room. You would have to wait until the following year however.

You can open more than 1 TFSA just like you can open more than 1 RRSP but like an RRSP, there is a contribution limit. Unlike an RRSP the TFSA limit starts out the same for everyone.

Over-contributions to your TFSA are subject to a 1% per month penalty. This goes to the federal government.

The TFSA limit on your NOA (Notice of Assessment) from CRA <u>cannot</u> be relied on to be correct. If you rely on that number and it is incorrect you will still be charged a 1% per month penalty. Yes, even if though CRA overstated the TFSA contribution amount. CRA has said they intend to send out corrected TFSA limits to individuals where the number they previously gave was wrong. This isn't actually all the government's fault. The banks lobbied CRA to be able to delay reporting their customer's TFSA activities until the end of February of the following year. This timing of reporting between the government and the banks led to the error.

Getting RRSP Or RRIF Dollars Into Your Offsprings Hands

Tax free growth within an RRSP along with year after year of tax deductions is a very powerful combination. The idea is to get tax deductions when your income is higher and pay the tax back when your income is lower. All the while you have essentially borrowed money from the government (the taxes you will eventually owe), interest free, and pay back the government years down the road. To top it off, all the while you pay no tax on the earnings of your investments.

Most people take their RRSP and convert it to a RRIF when they retire (or by age 72 at the latest) and then start taking income out to maintain a lifestyle that one has become accustomed to. I've discovered this income however, isn't always needed. You may have contributed to your RRSP diligently for years but, now getting close to or near retirement, you find that you don't need the income from your RRSP to maintain your lifestyle.

Let's take this case, Dan and Gloria Harper. After 35 years in the workforce, they've just retired. The Harpers

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are both 65 and in good health with active lifestyles. They have 4 adult children who are financially very self sufficient. Although Dan and Gloria have $500,000 each in their RRSP's, they live quite comfortably off of their CPP, OAS and defined benefit pension plans from their working years.

Like many clients who come to me, they hadn't given much thought to exactly how or when they would use the RRSP savings. It was simple for them. They just saved and invested as much as they could during their working years. Since they now have come to realize that their income is sufficient without using their RRSP, they would like to leave the money in their RRSP's (soon to be RRIF's) as an inheritance to their children when they die.

They initially thought, "why not just designate our 4 children as beneficiaries of our RRSP's?". Their financial planner however pointed out that, with the compounding of their money, they would create a potentially huge tax liability at death. This would drastically reduce the value of the inheritance.

The solution they eventually put in place was this. Dan and Gloria Harper confirmed they already had each other as beneficiary on their RRSPs. With this, RRSP assets transfer tax free to the surviving spouse's RRSP. It is the death of the last spouse where the big tax hit comes. A joint last-to-die life insurance works perfectly here. The insurance proceeds are paid out upon the death of the surviving spouse, exactly when the final tax bill comes due, and exactly when they would like to pass their inheritance along to their children.

Here's how the numbers work out. Purchasing a $3 million dollar life insurance policy would cost them $4,026 per month. Their RRSP / RRIF withdrawal is $6,194 and then, after paying tax (approximately 35%), the net amount paid out of the RRSP or RRIF is $4,026. Assuming they both pass on in 25 years (age 90) and taking into account their minimum RRIF withdrawals, they would still have some money in their RRIF however they have secured a guaranteed, tax free $3 million estate for their 4 adult children. Alternatively, they could bypass their adult children and pass it all on to their grandchildren.

At the end of the day Dan and Gloria haven't escaped paying income tax on their RRSP / RRIF withdrawals. They've just put in place a strategy to control their taxes, gradually drawing money out of their RRSP / RRIF over time and maximized the value of their inheritance to their children and / or grandchildren.

Why To Avoid Those Group Scholarship Trust RESP's

Have you or someone you know recently added a new born child to the family? Well then, if a call hasn't come in already it will shortly from a person trying to sell a "group scholarship trust" RESP.

Just like any financial program (RRSP, RRIF, TFSA etc) RESP's can be set up by almost any financial institution, financial planner, investment advisor or insurance agent. An RESP done through any of these channels will almost always be an individual RESP which offers much more flexibility and potential growth than their group scholarship trust competition.

The first downfall with a scholarship trust plan is the "enrolment fee". Participants must pay an enrolment fee and make contributions according to a pre-set schedule. With one of the scholarship trust companies, a $95 a month plan would cost you $1,070 in enrolment fees during the first year. That's 94% of the money you invest. Yes, even these "not for profit" plans as they so proudly tout, want their salespeople and executives to be paid.

The next issue is when you want to change your monthly contributions, miss a monthly contribution or simply transfer your RESP dollars somewhere else. As was written in a 2008 a study for Human Resources and Social Development Canada, "..there is a significant risk that participants in group plans end up in a worse financial situation as a result of their participation."

Even if you are with the plan for several years, you will be hit. Someone who closes a plan before maturity will forfeit the enrolment fee plus any investment gains and government grant money. Some of the forfeited money is then distributed to people who stay in their plans until they mature. This is not the case with an individual RESP. The OSC warned several years ago, if you miss a payment with a group scholarship trust plan "your account goes into default and you may lose your membership or you will pay interest on the missed payment."

There is an out if you have set up one of these RESP's up recently. You have 60 days to cancel your enrolment and get all your money back. This way you can put ALL your educations dollars into a less restrictive, less internally costly RESP for your children or grandchildren's post secondary education.

WEB GEMS

www.getnoodles.com— The average teenager spends practically every waking minute outside of school using a smartphone, computer, tv or other electronic device. It has been found that 8 - 18 year olds use these devices more than 7 1/2 hrs a day. That's where www.getnoodles.com comes in. This free educational software program interrupts kids' web surfing, texting, blogging, etc. with pop ups that ask grade appropriate questions in various school subjects. Kids have to answer correctly to get back to their computer activities.

HHHMMMmmmm......

There's been a corporate cash build up of almost $2-trillion, the largest in U.S. history. Globe & Mail, Feb. 2011

Microsoft is generating $25 billion of free cash flow per year. They pay out $5.5B in dividends and capital expenditures is $2.5B. That leaves the company with $17B of discretionary annual free cash flow. Manulife, March 2011

5 years after entering China, Best Buy is shutting down all of it's stories in China, 1 month after Home Depot shut down its last Beijing store. USA Today, Feb. 2011

The price of cotton doubled last year and it is up 25% this year due mainly to demand in China. Farmers worldwide could very well start to switch from growing food to growing cotton. Globe & Mail, Feb. 2011

With one lawyer for every 265 citizens, the United States is the global litigation leader. Malpractice suits are a primary reason U.S. health care is the most expensive in the world. Outrageous "runaway jury" awards have driven malpractice insurance rates through the roof and forced physicians to spend countless hours in courtrooms rather than attending patients. Globe & Mail, Feb. 2011

Canada has also become an oil trading nation. Crude accounts for 20% of Canadian exports, double what it was in 2000. Report On Business, Feb. 2011

Total debt levels rose for the past 25 years. The deleveraging process could last a decade. Barry Allan, Marrett Asset Management Inc., Feb. 2011

Canadian household ratio of debt to disposable income rose just above that of Americans at the end of September 2010. Stefane Marion, Chief Economist and Strategist, National Bank

Apple is below-average for its "ethical policies and performance." The lowest ranking is Research in Motion (Blackberry) earning a 3.3 rating largely because of the company's environmental record. USA Today, Feb. 2011

Honda and Subaru are the overall best car manufacturers. Volvo is the only European brand with above average reliability. Mercedes and BMW are near the bottom for reliability. Consumer Reports 2011 Car Guide

The median annual return for people using a financial advisor or planner was almost 2% higher net of costs than those who did not. A 45 year old working with an advisor would have saved 47% more by age 65 than someone who does everything on their own. Investment Executive, Jan. 2011

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