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Feeling Impatient Stuck In Traffic? Stay In your Car

When you hold high quality investments during a time like we have and may still be going through, a time when "Mr Market" is much more depressive than manic, you can't help but get frustrated. I completely understand if you are because I feel it too. I feel it with my own portfolio including our family's RESP. It's multiplied by the hundreds of clients whose portfolios I oversee and feel great responsibility and concern for.

Just because a particular kind of investment or portfolio manager hasn't been doing well does not mean to dump the investment or fire the investment management team. If it is simply a function of short term issues that are beyond our control, ones that will be resolved, then there is very good reason to stay on the same path. The path is fine and vehicle we're using has proven to get us to our destination time and time again, its just at the present time there is a great urge to find a different way.

Imagine that you had to drive from Vancouver, through Toronto and on to Halifax. Vancouver is today, Toronto is the day you expect to need to start drawing on your portfolio for income and Halifax is when you reach your twilight years. You're in downtown Vancouver hopelessly stuck in traffic. Cyclists are whizzing past you. Even pedestrians casually strolling past in conversation, are moving faster than you. Frustrated and impatient you jump out of your car, sell it on the spot for a ridiculously low price to someone who recognizes a good deal when he sees it. With the proceeds you buy a bike or a good pair of walking shoes and continue on your trip to Toronto with your final stop being to visit the Newfies.

As absurd as this scenario sounds people do it all the time when making short term decisions for a long term journey. Making a decision like this, one based solely on "I'm not moving right now", or haven't been for quite sometime, isn't as much a decision as it is an impulsive reaction.

Sometimes, there are times when a change is warranted because some of the fundamental reasons you chose a particular investment or investment management team have changed. It's not about making a change primarily for the reason you feel "stuck in traffic" but more so, a deterioration in confidence through several concrete things you can list down on paper. That is the only reason a change in a portfolio should be made (assuming your portfolio has the correct risk / reward profile to get you where you want to go). As soon as the traffic starts to dissipate (and it will) you'll be very glad you stayed in your car.

The ETF versus Active Management Debate

Occasionally I have someone ask me if we should be doing something different and the topic of ETF's (Exchange Traded Funds) comes up. The issue is always based on the touted low internal costs in relation to active management alternatives. As I'm sure you will agree, using the lowest cost choice for anything is generally not the best thing to do however, in this case, like any other, the lowest cost option should not be discounted simply because it is the lowest cost. It should be carefully looked at.

ETF's were originally designed to replicate a stock market index. The most common of ETF's mirror the S&P/TSX 60 (the largest publicly traded

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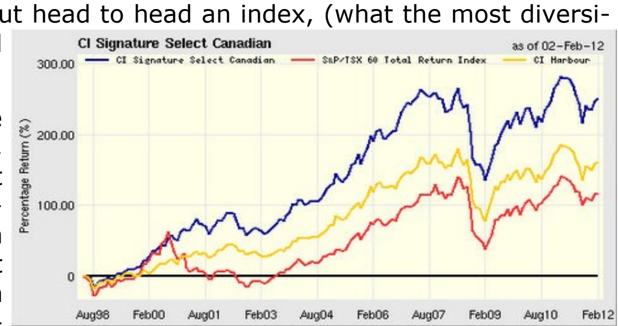
companies in Canada), the S&P 500 (U.S. companies) or the MSCI EAFE (a cross section of many companies from all around the world). There have been a proliferation of ETF's since the early days however, these replicate very narrow market sectors and are commonly used for "trading" (buying and selling often).

The biggest difference in most broadly diversified ETF's is that they are designed for "passive investing". There is no investment manager making changes within the ETF on a regular basis. However, a portfolio most people have is one of "active management", one where an investment manager and team of analysts is continually working on the portfolio. Most commonly this is done by investing in a mutual fund.

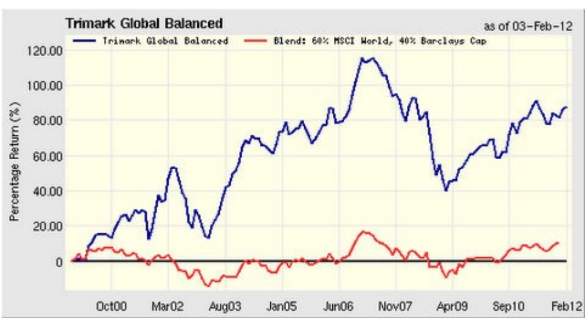
The debate is this: Is it better to buy a relatively fixed list of companies through a few ETF's or is it better to have a professional investment management team, one with a very disciplined investment process, make ongoing decisions on when to buy and sell particular pieces of the portfolio? Will the cost saving benefit of passive investing, which requires less work and thus less expense, win over a team of investment managers?

This question is primarily asked because there are so many subpar investment management teams out there trying to get us to hire them to manage our investment dollars. If you look at averages, most often an ETF can beat active management. One aspect of a financial planner's job is to sort through the chaff and partner with the most talented in the investment management business, ones who should outperform their benchmarks.

An example of this can best be shown in a few graphs which put head to head an index, (what the most diversified ETF's are made up of) with a comparable well managed mutual fund(s):

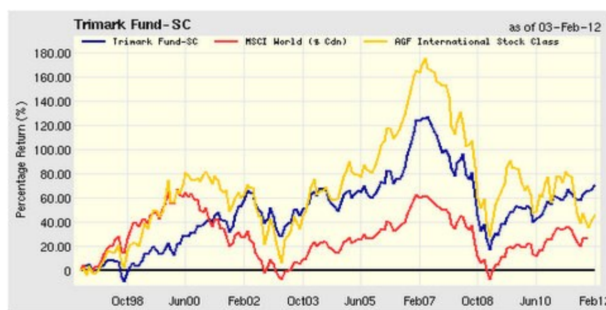


I believe active management is far superior to a comparable ETF. This is very evident in the graphs here. These historic, 3rd party graphs have no bias. Why? Despite the argument that markets are efficient, they aren't. Emotion creates volatility and price discrepancies like we have never seen before. An investment manager with a very disciplined system of calculating what a company is worth and buying those companies when they are below that price and selling them above that price will, over time create an ever increasing outperformance band.



I'll end this by using another travelling analogy:

You are going on a trip and you were offered the opportunity to fly on 1 of 2 jet planes. The first is piloted by an experienced pilot who is being paid to pilot. The second has no pilot but you are allowed to fly it yourself to save some money. If you choose the plane without the pilot, a computer will be installed in the cockpit that hooks you up to an Internet site that will tell you everything you need to know about flying. Which plane do you want for your journey?



Note: ETF's, particularly in specialty sectors can make sense within a portfolio however, these are managed in the context of an actively managed portfolio and used as one of the building blocks. The whole package can in fact serve to enhance a portfolio.

Last Minute Retirement Saving Through An RCA

I've used Individual Pension Plans (IPPs) for a select few corporate executives and business owners. They've often been referred to as an RRSP on steroids. A Retirement Compensation Arrangement (RCA) can be used in a similar fashion to an IPP however the 2 are quite different. Both can be very attractive alternatives or a step up from an RRSP for a well compensated business owner.

Like IPPs, RCAs offer a very effective way for a business owner to have the company fund his retirement savings. Half of all contributions are held in a trust account to grow in value. The other half goes to a Refundable Tax Account (RTA) held by CRA (Canada Revenue Agency).

The contributions are tax deductible to the business. So, if there is money in the corporation, you can get it out tax free through a contribution to an RCA. You pay no personal tax until you withdraw the funds. Half of the

(Continued from page 2)

withdrawal comes from the trust, half from the Refundable Tax Account set up with CRA.

While every entrepreneur loves double tax savings, RCAs have other very attractive traits. Unlike IPPs, RCAs allow your company to make contributions at any time and invest in an endless list of investments. Contributions can be of any size, provided the RCA doesn't grow so big that it pays an unreasonably high level of retirement income relative to your earnings history. This means your company could plug hundreds of thousands if not, millions into your RCA just before you retire. This makes the RCA perfect for business owners who have built their business but didn't do much retirement planning.

When I first started looking at IPP's and RCA's for my business owner clients, RCA's seemed very unappealing for one key point, that half of your contributions to the RCA and half of all earnings made to the tax account with CRA earn nothing. Because of that fact, the key to the using an RCA is to set it up shortly before you plan on exiting your business and using all the assets, including the RCA, to create an income for you.

If you want to make this really effective, leave Canada. Many do. Ottawa applies a withholding tax of up to 25% when a non-resident withdraws RCA funds, unless you live in a country covered by a tax treaty with Canada. Move to the States, for instance, and you'll pay just 15%. Move to Ireland, and the tax could be nil.

Get A Tax Refund With Every Paycheque

If you normally get a big tax refund and expect the same in the next month or two, you should really consider a "Tax Deduction At Source" for the 2012 tax year.

Let's assume you get a refund of $6,000 every year. You get this refund because of a variety of deductions including RRSP contributions, child care expenses, charitable donations, interest on investment loans, business expenses, etc.

Rather than wait for your 2012 refund to come to you in March or April of 2013 you can get a bit back every paycheque. By completing and sending it in to CRA they will give your employer permission to withhold less income tax on your paycheque. This means you will now be taking home $250 more on the 15th and $250 more on your paycheque at the end of the month.

So rather than giving the government an interest free loan for 12 months, you can use the money to pay down your mortgage (creating an interest saving snowball effect) or at the very least stick it into a savings account that will earn you a few shekels. Better in your hands early then getting it later with no interest paid to you.

You can print off a copy of the Tax Deduction At Source form (T1213) at www.careyvandenberg.com/paperwork

The Tax Refund Snow Ball Effect

A tax deduction is a great incentive to invest in an RRSP. It makes even greater sense to leverage those extra funds into something that will either reduce your debt or accumulate wealth. It's the concept of "pay it forward" but applied to yourself. Here's how your tax savings can snowball:

Say you contribute $10,000 to an RRSP for 2011 and you receive a $4,000 tax refund. The $4,000 tax refund becomes part of your 2012 RRSP contribution. This time next year, that $4,000 RRSP contribution generates a new tax refund of $1,600. The $1,600 becomes part of your 2013 RRSP contribution, triggering a $640 tax refund in 2014. That $640 becomes part of your 2014 RRSP contribution, generating a $256 tax refund in 2015.

Of course, as you can see, the refund gets smaller each year, but all the while, the original $10,000 is still growing tax free as well as each amount you've rolled back into it. Think how much better it gets if you put in a new $10,000 each and every year (or whatever the maximum amount you're allowed) - each additional contribution sets up a new snowball on top of the earlier contributions.

Web Gems

Www.StudioTax.com — there seems to be a free version of almost every kind of software and for tax preparation software in Canada this is no different. Unlike other software programs StudioTax has 1, full edition, not 3 or 4. Didn't file tax returns for previous years? You can download the tax year you need for your yet to be filed tax returns (back to 2004). The only real drawback to StudioTax is that if you used different tax preparation software last year you will have to input that information by hand. Once you do that however, you should be able to do your tax returns for free every year going forward, unless you want to "donate" for the support of the product but that is entirely up to you. Oh, and sorry Mac users. This version is available only for Windows.

Hhhhhmmmmm......

73% of S&P 500 companies were more profitable than analysts had forecast. Such news is always reflected in soaring equity markets but instead, today the good economic fundamentals of businesses is not being appreciated by investors because they are preoccupied with Europe and paralyzed by angst.

The average bull (up) market lasted for 46 months with a 121% average gain. The average bear (down) market lasted for 9 months and dropped by 28% (1956 through Oct 21st 2011). Mackenzie Investments, Dec 2011

Stocks tend to emerge stronger after steep corrections. Of the eight declines of 15% to 25% since 1945, the market was up an average 31.7% a year after the drops. USA Today, Jan 2012

Chrysler reported it's first annual net income since 1997. It has cut its debt by nearly half in 2011 down to $2.9 billion and had total cash of $9.6 billion. The company now employs 57,200 people, 9,400 more than it did when the company left bankruptcy protection in 2009. The Star, Jan 2012

In Europe, a record 1 in 5 under the age of 25 is out of work, though there are wide variations among countries. While youth unemployment is 9.1% in Germany and 8% in the Netherlands, it's 48% in Spain, 43.55 in Greece and more than 29% in Italy and Ireland. Globe & Mail, Jan 2012

In the U.S., consumers can get 30 year mortgages at about 4% and they deduct the interest payments against their taxes. Yet half of TD's U.S. customers are choosing 15 year home loans, a sign that the recession has had a significant effect on consumer behaviour. Globe & Mail, Jan 2012

Average student debt on graduation grew to $18,800 in 2005, up from $15,200 a decade earlier (a 2.2% per year increase which almost perfectly matched the rate of inflation). Morningstar, Jan 2012

Japan is in a region called the "Ring of Fire", an arc of earthquake and volcanic zones that stretches around the Pacific Rim, where 90% of the world's quakes occur. USA Today, Nov 2011

Evidence of how the Euro zone rescue plan is viewed inside China shows in a cartoon that ran in the China Daily. In it, an oversized European man is shown eating off 4 plates of food, and extending an empty 5th plate towards a smaller Chinese man eating rice from a bowl. "Can I have some more, please?" the European asks. Globe & Mail, Nov 2011

The typical U.S. household headed by a person age 65 or older has a net worth 47 times greater than a household headed by someone under 35. This wealth gap is now more than double what it was in 2005 and nearly five times the 10 to 1 disparity in the mid 80's, after adjusting for inflation. USA Today, Nov 2011

Household appliances use less power than ever. A new refrigerator consumes half the electricity as a similar one bought in 1990. But consumers have bigger houses, more air-conditioning and more electronics than before, outpacing gains in efficiency and conservation. USA Today, Dec 2011

At its very core, that's what government is for, to protect us from the behaviors of others that we can't protect ourselves from as individuals. USA Today, Dec 2011 (re: ban on cell phone use while driving)

Carey

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