Issue 148 March / April 2012

mutual gains™

published bi-monthly since 1987

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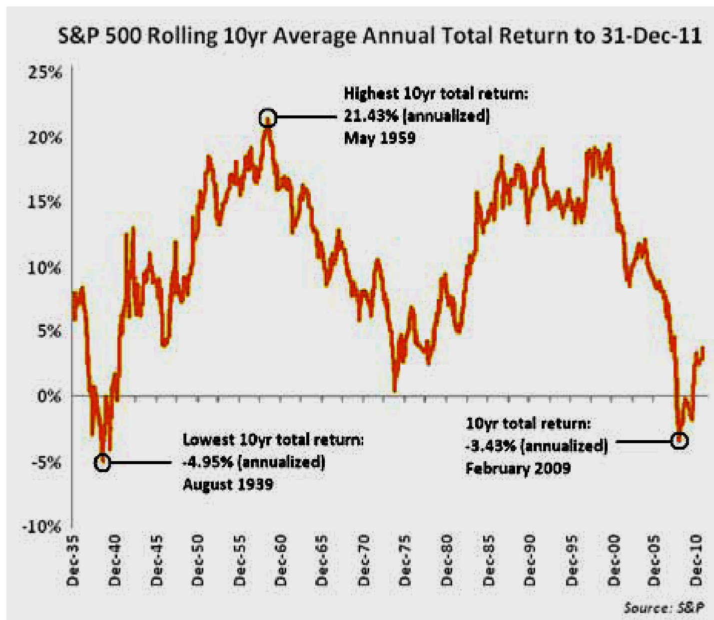
COULD THIS BE THE BEGINNING OF A MULTI DECADE RUN?

Poor economic news is difficult to ignore these days, particularly considering what we went through in late 2008, early 2009. It has been easy to become overly immersed in the negative current events that we ignore the new shoots of growth, all to the detriment of our long term investment portfolios. The collective angst of the investing public is best revealed by the pattern of mutual fund asset flows. Despite interest rates on bank deposits earning less than inflation, people have continued to pour money into investments that continue to lose money slowly. These loses are happening in a stealthy, cancerous way. That cancer is inflation, something you don't see and feel until it's too late to do anything about it and there is no way to make up long term inflation losses. They are permanent.



This flow of cash has gone in a direction which from all measures, is the opposite of what makes sense when you look at how long your money will be invested for. I'm 49, and God willing, I or my wife Cheryl will be needing our money to be making money for us for another 30, 40 or more years.

The graph above, shows the rolling 10-year return for the S&P 500 since 1935. It illustrates the opportunity that safety seekers may be foregoing. In 1939, near the beginning of World War II, the US market had suffered a punishing prior decade, posting an annual total return of -4.95% through the period. The same thing was experienced in the mid-1970's when annual returns for the trailing 10 years were barely above zero.

I'm quite sure people in the midst of the Great Depression had a general disdain for investing, particularly if they had a double whammy of seeing the start of the second World War. The same I'm sure was felt through the OPEC oil crisis, when we saw line ups to fill up for gas go around the block. Inflation was surging and New York city came within a hair of declaring bankruptcy. By the mid-1940's, however, the S&P index had delivered an annual return of nearly 10% for those who had invested a decade earlier and, in 1985, the 10-year investor had enjoyed compounded returns in the 15% per year range.

The market low of 2009 marks the third deep trough on the chart, with the opening years of the new millennium now commonly referred to as the "lost decade" by the financial press. It has been painful and frustrating.

Much as in the 1930s and 1970s, individuals today are simply apathetic toward the market. I see it every day and it was most evident during the first 2 months of 2012; "RRSP Season" as they call it. It was one of the lowest level of RRSP contributions in years. There has been very little interest or recognition just how cheap some investments can be purchased for. Corporate profits are very high, companies are financially stronger than they have been in over 50 years. This is very evident in the amount of cash sitting in corporate coffers. This is being slowly paid out in dividends which is at a rate much higher than the interest you can earn on a bank deposit or government bond. Your neighbours around you are probably too caught up in the gloomy macroeconomic news from halfway around the globe.

If history repeats, as the graph on the previous page gives compelling evidence for, then why let decisions based on past hurts hold you back from making your future economically brighter than today? The best thing we can do is take advantage of the opportunities that are right in front of us rather than make decisions based on what has happened in the past. The most successful "see where the puck is going". Take advantage now because we may not be back here for 20 years. I'm going to work my hardest to ensure that my clients are positioned (or repositioned if need be) to benefit as much as possible, based on their own unique situations.

ETF versus Active Management Debate Part Deux

As I said in the last issue of mutual gains, ETF's are looked at primarily as a lower cost alternative to a sea of poorly run, actively managed portfolios. The culprit is the breeding ground of the marketing and sales environment in trying to attract investment assets under a corporate umbrella. This is where financial institutions and investment management firms continue to come out with an investment story that is different; a story always created to push one of two emotional buttons, greed or fear. These portfolios have come in the name of "technology", "energy", "gold", "ethical", "environment", "China", "emerging markets", "Canadian banks" etc. All of these have attracted significant investment assets of which the timing has coincided with investors emotional wants rather than investment intelligence. This has created investment returns which investors have very often, not been happy with.

The natural reaction to combat that is to find an alternative investment "product" that can replace what is currently held. ETF's are always talked about for their lower imbedded cost advantage. If you look at that in isolation, you can very well go from one marketing driven investment product to another.

The most significant flaw though with index ETF's is that they magnify risk, because with them you are loading up on high or inflated priced companies. The most extreme example of this is when Nortel Networks soared in value and made up 42% of the TSX. Holding a TSX ETF would have given you a portfolio that, in early 2000, had 42% invested in Nortel. Back then, there were many who saw no problem with this. They had their greed glasses on and couldn't or wouldn't see the risk. A well run, actively managed portfolio, is continually reassessing and changing the holdings within the portfolio, selling the holdings that shoot above their true underlying worth and buying companies that they have on their radar, when they reach prices that are well under what the company is worth.

Index ETF's also don't get to buy into the gems of the investment world. Because they invest only in big companies they don't have exposure to the relatively small, high growth companies that are making a name for themselves. They don't have that instant coffee company that has over 80% of market share in the Far East to take advantage of the 12% per year growth in consumer demand for instant coffee. They don't own a discount U.S. retailer that continues to see strong sales in it's stores (I've been to one and it is crazy the line up at 9pm closing) with lots of room to open new stores to satisfy the demand by the budget minded consumer. If ETF's did own these companies, ETF's would continue to hold them even when they get significantly overpriced. A disciplined investment manager would have sold it and started buying other companies that the masses have yet to discover. In other words, ETF's can put you in a higher risk situation. Higher risk of permanent loss.

The primary reason active management is chosen for a portfolio is simply to get the best return with the least amount of risk. For 26 years I have witnessed the benefit of superior active management and the wealth that has been created and protected using it. It's all about uncovering superior investment management and having them do the work on our behalf so we can live life to the fullest because there is only so much time in the day to fulfil the picture of a life lived well.

Creating Income From The Proceeds Of A House Sale

Downsizing. It is one of the ways I have seen clients free up cash to create a retirement income stream and why not? The family becomes smaller with your kids leaving the "nest". You now sit in a house that has more rooms than you need, more yard than you know what to do with and definitely more upkeep than you want to pay for. So, the natural progression is to sell the house, move into something smaller, newer and maybe in a different neighbourhood. That leaves you with a lot of cash that could be used to help supplement your retirement income.   With interest rates expected to be ultra low for as far as the eye can see and probably very low after that you can't create the income you need from it sitting in a savings account or bank deposit paying 1.25 to 2% per year. For every $100,000 you'll only get $2,000 per year going this route. Here are a few areas to give you the additional retirement income you need or would love to have:

Corporate Bonds— Interest rates on a very diversified portfolio of corporate and government bonds of low debt countries can give you interest income close to 6% per year. Instead of sitting of collecting $167 / month of interest from a bank deposit (per $100,000 investment), you can collect $500 / month.

Preferred Shares of Canadian banks and oil companies— The banks charge their customers banking fees and interest on mortgages. Energy companies make money on the gas they sell. Bank profits continue to increase and gas for our cars seems to keep going up in price. Why not have a portion of those profits get paid to you through a steady, rising stream of dividends instead of being paid stagnant interest rates? You can get dividends paid to you in the 3.5% range equating to $300 / month. This should go up over time just like oil prices and banking fees do which should cover the rising costs of your groceries, phone bill, utilities etc., etc.

G.M.W.B. - The acronym for Guaranteed Minimum Withdrawal Benefit is a contract available by a handful of life insurance companies. As the name implies there is a guarantee attached to this plan. You are guaranteed a minimum monthly income of normally 5% for the rest of your life no matter how poorly your investment does. In other words you can be rest assured that for every $100,000 you invest you will never get less than $416 per month every month for as long as you live (and you will get more if your investment goes up).

Those are 3 of many ways in which to create income from cash that could be sitting or is soon to be parked, in a bank account.

Pension Plans—They Don't Have To Stay With Your employer

A pension plan has a significant value. If you have a "defined benefit" plan, you may not be aware exactly how much your piece of your company's pension plan is worth. This is very important to know because it is your money and it may make sense to transfer it out.

Most people I talk to aren't even aware that the pension plan they have at work can be transferred to a "Locked In RRSP" or other plan should they leave their job. More often than not, you can transfer the "commuted value" of your pension plan; that is the dollar value of what your portion of the pension plan is worth. Transferring the commuted value of a pension plan is an important option with analysis done to determine if it makes sense.

When you know the commuted value of your pension plan, calculations can be done to determine if you can get a higher retirement income if you transferred the money out of your pension plan and used one of many financial instruments available to you. Of course, you have to weigh out all the pros and cons but only after doing so will you know if you are truly getting the most out of your money.

Your life expectancy plays a key factor in this calculation. If you are suffering from a life threatening illness or have a history of health issues which could make your life expectancy shorter than the norm, the argument to transfer out the commuted value of your pension plan becomes stronger.

I have seen pension plan commuted values at close to a million dollars. Leaving it in a pension plan may mean the loss of hundreds of thousands of dollars which could have gone to your spouse and eventually your kids.

Web Gems

Www.Xmarks.com — I work on a desk top computer as well as a laptop. On those 2 computers I use 2 different browsers; Firefox and Internet Explorer (the latter because not all websites work within FireFox). This creates a problem. If I find a site I like or use regularly and "Add To "Favorites" in Explorer - I also want it also to be added to "Bookmarks" on Firefox. Install the Free Xmarks Bookmark Sync software and every time you make a change in your bookmarks in one browser it will sync it with the other browsers you use. Xmarks can sync your bookmarks across Internet Explorer, Firefox, Google Chrome and Safari.

Hhhhhmmmmm......

Americans spent 8.4% of their income on gasoline last year. That's double the percentage of a decade ago. They could pay even higher per gallon prices this year, even though demand is the lowest in 11 years as people drive fewer miles in more efficient cars. Tom Kloza, Chief Oil Analyst at Oil Price Information Service (OPIS)

The government has continued to warn consumers about debt. Debt to income ratio did fall to 151% from 152% in the past 3 months of 2011 however total debt was 6.1% higher than a year earlier. Globe & Mail, March 2012

HELOCs (Home Equity Lines Of Credit) have been used as a house ATMs as house prices have rose, making up almost 50% of all consumer debt last year compared with 11% in 1995. Globe & Mail, March 2012

"The problem is everybody already owns them (Cdn bank shares) and they're already very highly priced. We don't think that 's a recipe for success when you look at the next 5 years." Brent McLean, CEO McLean & Partners Wealth Management Ltd who manage $1 Billion for 430 households. Investment Executive, March 2012

U.S. companies pay out less than 28% of their operating cash flows in dividends. This is at a 140 year low giving them lots of room to increase their dividends (pushing up their share prices) or should the economy get really bad, simply hold their dividends at current levels. Globe & Mail, April 2012

Debt to GDP %

2000		2010	
Developed Markets	67%	Developed Markets	96%
Emerging Markets	50%	Emerging Markets	37%

In 2008, RIM and Nokia accounted for about 75% of the profits in the worldwide cell phone market. Today, Apple and Samsung make 95% of the sector's profits. Globe & Mail, April 2012

There were 2.85 million iPhones sold in Canada in 2011 versus 2.08 million BlackBerrys and thus the game between RIM and Apple is hardly over. With a change in leadership at the helm of Apple (Tim Cook) and RIM (Thorsten Heins), the long term script of these two companies remains to be written. Globe & Mail, March 2012

As of the end of 2011, Android had 68.4% of the smartphone market by the number of smartphones sold, up from 33.6% nine months earlier. Analysys International, April 2012

Of the 20 biggest US cities, Atlanta continues to suffer the largest price declines in home prices; down almost 20% over the last six months. Distressed home sales are probably driving those declines, economists say. Only 3 cities saw price increases: Denver, 0.2%; Detroit, 1.7%; and Phoenix, 1.3%. USA Today, March 2012

Unemployment in the U.S. came in at a 3 year low of 8.3% in February (down from the 10% cycle-peak in October 2009). However, unemployment is still well above the Fed's long-run "target" range of 5.2% to 6.0%.

An analysis of about 4 million U.S. consumers show that they are more likely to make payments on their car loans and credit card bills before their mortgage. Reason? The car gets them to work so they can continue to earn an income. USA Today, April 2012

"Once you have been bitten by a snake, you are very cautious of even a coiled rope" Dalia Lama

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