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# mutual gains™

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## Guaranteed Losses With Perceived Safety

Below is a snippet of a recent commentary from the CEO (initials TB) of a boutique investment management firm which I hold in very high regard. I use this firm to manage a part of many of my clients portfolios.

There are 31 "partners" at this particular investment firm. These include the handful of people responsible for making investment decisions as well as many investment analysts and support staff. The 31 partners have $28 million of investment assets managed by the investment management team. This $28 million represents virtually all of the "partners" net worth aside from their own homes. Along with them, 50,525 people across Canada like you and me entrust them with part of our savings. One of Canada's best investors of our age has entrusted this investment management team with part of his significant wealth. Here is what their CEO, TB wrote in a relatively recent quarterly report that was sent to me.

*"We take seriously our job as guardians of your wealth and rule number one is to preserve it. Don't do stupid things; avoid the really dumb stuff.*

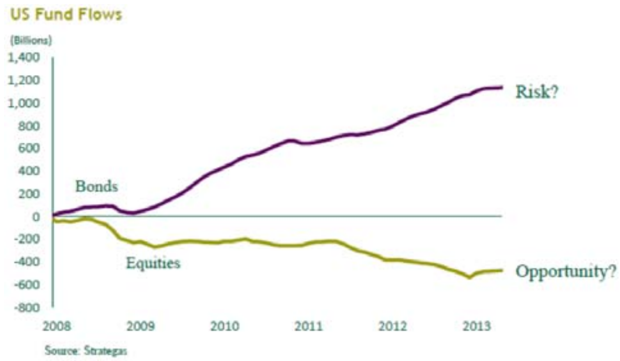
*Investing is about getting from Point A to Point B: retirement usually, or whatever your particular long-term savings objective happens to be. The goal is to have enough money to last a lifetime. Ironically, our hunter-gatherer and loss aversion instincts drive us to do exactly that which will result in us running out of money before we die. In other words, dumb things. Investors are tired of market volatility, which they view as risk. So what happens? Almost 200,000 years of loss aversion bias compels the masses to perceive as safe those investments that may prove anything but.*

*Take cash. Loss averters prefer cash even though it doesn't help them reach Point B. At 3% inflation and cash earning less than 0.5%, investors have the potential to be at least a fifth poorer in just a decade and a step closer to having less money than they need. Strangely, our minds are conditioned to think of cash as relatively safe today.*

*What about government bonds? A stable income stream and your principal back at the end sound promising. "What could possibly go wrong?" our inner hunter gatherer asks. To begin, bond yields are neither outpacing nor in step with inflation. Like cash, bonds can help you slowly go broke as everyday necessities like food and shelter get more expensive and your investments don't keep track.*

*We're conditioned to worry about tomorrow...tomorrow. Surviving today is singularly important. The problem with this as it relates to bonds is that the future won't look like the present. Between now and whatever long-term goal you're saving for, interest rates will probably rise. If the 30-year bond rate rises to 5.8%, (the average rate on a 30-year government bond, going back to 1790), the person investing in the bond suffers an approximate 50% price drop. This isn't a typo. 30-year bond prices will be cut in half should rates jump to 5.8% (before accounting for the coupon). We believe bonds are anything but risk free, especially at prevailing interest rates. Even if rates don't go up soon, all that really counts is whether they revert to their historical average before you reach your Point B.*

*Remember, risk isn't volatility. Risk is running out of money before you die."*




This is where I'd like to step in and give you some recent data about the level of uncertainty people are feeling. That uneasiness has made a lot of people sell their equity investments and in its place invest in the perceived safe havens of cash and bonds This is shown on the chart to the right.

Based on our natural, flee to safety wiring, would you say these people are making the right decision? I can say, with great confidence, absolutely not. Just as so many people were jumping into technology companies in 1999 only to see permanent loss of capital, so too are people doing exactly the same today, but this time it is into the perceived safety of government bonds and cash. It will only be a matter of time before those safety seekers face permanent loss.

Unfortunately, that desire for safety, no matter how elusive, is something so many people are wanting to invest in. So, if their advisor isn't giving them what they want, they'll turn to another advisor who will. As "TB" wrote to his kids in a letter intitled "Read Before Your 18th Birthday" he said this about working with a Financial Advisor: "*Are they always recommending something that makes you feel comfortable because everyone else is doing the same thing? If so, fire them and look for someone that seems to understand that investing isn't always supposed to make you feel all warm and fuzzy."*

It is easiest to sell what is text book "low risk". It's easier to attract assets under administration by filling orders to build portfolios of perceived safety than to do the right thing, especially when there are so many facts that show what is so obviously right. These include:

- Interest rates are at sea level so to speak and in some cases below that (yes, people in some countries are actually paying their governments to hold their money). They can't get much lower than where they are. That means, it is only a matter of time when government bonds in particular will fall in value for permanent loss.
- The level of dividends paid on high quality companies are almost 3 times as much as what you can get on interest bearing investments.
- The percentage of corporate profits that U.S. companies pay out in dividends is approximately 30%. This is at historic lows and dividends can only increase to their more normal level of 50—60% dividend payouts.
- Companies have been hoarding cash. They will eventually increase their dividends because of this.
- Increasing dividends mean increasing share prices.
- Companies are in the best financial shape they have been since the 2nd world war while government finances are in the worst shape they have been.

Owning shares of several excellent global businesses carries less risk today than ever before while owning government bonds carries the highest risk of loss. This is contrary to what so many believe to be true. Ironically, the conventional wisdom of a "balanced" portfolio is to have government bonds for security which, in today's low rate, highly indebted government environment is exactly the wrong thing to own. It appears to me that so many are running away from the very thing they should be running toward. Don't make the same mistake.

## What's Your Retirement Income Percentage?

For many people being able to "retire" early is the ultimate financial goal. The word "retire" has a very broad meaning and is very individual. However, in all cases it does mean, not having to wake up every day to earn an income. Being able to use the assets you have accumulated, to provide the income you need.

The common metric used in the the financial industry is to think in terms of percentage of income. As a percentage of the income you are used to earning, what percentage will you need when you retire? 75% is the benchmark income many financial planners start with. That again, is only a benchmark. The reality I come to find, is that most of the people I work with will need less than that, and in some cases, much less.

The most accurate way to determine how much you will personally need, is to calculate the expenses that will continue when you are not working. As well, there will probably be expenses that you will have to add, particularly since you will have more free time. Cheryl and I recently did a review for our own situation and came up with 63.1%.

With the clients I work with, I take their number and plug it into financial planning software. This brings together all the

*(Continued from page 2)*

other pieces of your financial life, as well as some assumptions such as inflation rate, retirement age, what you can expect to receive from CPP and OAS and what your RRSP will grow to. The goal is to ensure you achieve a financially viable retirement.

I've seen clients live on 20% of their working income happily and quite easily. The subtle signs of despair in someone's face have also been very evident when they realize that their current lifestyle has handcuffed them into having to work much longer than they would like. In the end, the current lifestyle you are living and the costs associated with it, will determine how much you will need when you decide to stop earning an income.

## Why Your Child Should File An Income Tax Return

Students who don't file an income tax return may be missing out on free money available to them. If you are doing your own tax return and you have a child who has even the most modest of earnings (yes even paper route or babysitting income), file a tax return for them as well. Here are some of the reasons why:

- It's easy and quick and they won't pay any taxes any way (assuming they earn less than approximately $11,000 of income in a year).
- A child over 19 years of age that files can apply for the GST / HST tax credit. That could mean a payment to them every three months. Free money that they could be passing up on.
- Any taxes paid on that casual or part time job could come back as a refund but, you have to file the income tax return to get it.
- Students may be entitled to deduct tuition, books, student loan interest, transit passes etc. from any income they earned which means higher potential for a tax refund.

Filing a tax return starts the accumulation of RRSP contribution room to be used for when income is higher. This can be a valuable tax deduction to be used in future years.

## A Mortgage Rate Hold Is Like Insurance On Your Payments

If your looking at selling your home and will need a new mortgage, you should seriously consider getting a mortgage rate hold. This allows you to find your new home over the next 3 to 4 months, knowing for sure what the interest rate on your mortgage rate will be. However, if interest rates fall, you will get the lower rate.

Let's say you get a 3% rate hold. Europe looks like it is on the mend faster than originally anticipated, the U.S. is getting their fiscal house in order which nobody anticipated and oil prices are heading higher. That 3% mortgage rate could easily jump to 3.5 or 4%. In this scenario, your rate hold will have saved you the pain of seeing your expected mortgage payments jump by 17 to 33%. How would that kind of increase change your house buying plans?

The rate hold by itself won't do you any good if you don't fit the banks financing qualifications. In other words, your income and employment history are important factors. So along with the rate hold, you should get a mortgage preapproval as well. This way, you will know how much you can spend before you fall head over heals in love with that perfect home.

Having said that, there is a big difference between being "preapproved" and "prequalified". To get a mortgage preapproval, the lender checks you out fully and commits to the financing whereas a prequalification they only do a precursory look and don't really guarantee anything.

This is where I put a plug in for dealing with a mortgage broker versus simply going to your bank. Many banks will only issue a prequalification. A mortgage broker on the other hand, along with putting your mortgage application out for banks to "bid" on your business so you get the best mortgage deal out there, A mortgage broker will ensure you're preapproved so there are no surprises. That is like having insurance on your mortgage rate, at no cost to you.

Note: I can refer you to one of the mortgage brokers I work with to fit your situation and personality.

## Web Gems

Letsgobiking.net My wife Cheryl and I love to cycle. Go for a few hours, a full day or a cycle tour over a few days. I found this site looking for leisurely trips around the Vancouver, Fraser Valley and other areas of BC. We've discovered some rides that have brought us to some completely new places. Many of these are perfect for a young family on a weekend and if you don't want hills, choose a route that follows one of the many rivers in our region.

## Hhhhhmmmmm......

The Dow Jones industrial average gained 5.8% in January, its best since 1994. USA Today, Jan 2013

"The outlook for equities remains positive as the worst appears to be over in Europe, and the United States is decidedly on the mend," Eric Bushell, CIO Signature Global Advisors (Toronto) who is responsible for anaylizing macroeconomic trends and developments in financial markets around the world, so as to shape investment strategy for over $35 billion of client portfolios.

$14.1 billion of equity mutual funds were cashed out in 2012, up more than 30% from 2011. By contrast, the money going into bond funds increased by 114% to $19 billion according to IFIC. These people are doing exactly the opposite of what they should be doing.

IBM is the king of patent, filing 6478 patents in 2012. This is the 20th year in a row they have filed more patents than any other company in the U.S. Report On Business, March 2013

Large companies like GE, 3M and Apple are bringing manufacturing back to the U.S. from China, rather than going to emerging markets. Advisor.ca and Report On Business, March 2013

“We went from a wooded land (through the Civil War, two World Wars and the Great Depression) to an incredible, absolute abundance of riches” because the U.S. has had a system that can “unleash human potential,” he said. “Never bet against what humans can accomplish if they’re operating in the right soil. And we have the right soil.” Warren Buffett, March 2013

China is outproducing Chile and Australia in wine making. G&M Report On Business, March 2013

In 2007, only 23% of all tax filers made charitable contributions, down from 29.5% in 1990. Statistics Canada

Household debt-to-income ratios in Canada are at 183.7. That makes the Spanish at 140.5 , Italians at 80.1 and Belgians at 91.7 look downright frugal. StatsCan, 3rd Quarter 2012

In a study conducted in cashed based rural India, it was found that simply earmarking funds for a single savings goal makes it happen. Indian farmers were give a paper envelope in which to save 1% or 2% of their biweekly incomes toward their children’s educations. Putting cash in a sealed envelope made them think twice about spending it. If they wanted to spend the funds, they actually had to rip through the children’s pictures. Not a single person broke into the envelope. Advisor.ca, March 2013

In 2007 there are was 2 million households who didn’t have cable. Today there are 5 million and the number is accelerating. They will likely be cutting their cable for good. USA Today, April 2013

Colorado and Washington State are more to the left regarding marijuana than the Scandanavian countries and Holland. National Review Online, March 2013

If you spend $150 per week on groceries today, in 20 years the cost of the exact same items will have almost doubled to approximately $270.92 (based on 3% inflation rate)

The 4 most intelligent animals on earth in terms of cognitive ability are chimps, dolphins, elephants and.... pigs. Report On Business, March 2013

Humility is the fairest and rarest flower that blooms. Put it on display and it instantly wilts and loses its fragrance. Dr. Chuck Swindoll