Issue 177– Jan / Feb 2017

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Expensive Defensiveness

As I have pointed out many times before, in late 2008 through early 2009, we went through the most extreme financial and economic pain that the world and its people have experienced since 1929. These deep and wide events are few and far between.

Despite their rareness, financial uneasiness for many people continues to linger. Trying to avoid any future emotional pain, while still being able to invest with a reasonable rate of return, is what so many people seem to be seeking today and the financial industry is happy to cash in on that desire. This trend has continued to build.

Like any building pressure tied with investment popularity, it leads to a continual elevation on prices, no matter what the investment is. Eventually, the price gets to a point that implosion or a long-term slide in prices is inevitable. The end result is substantial financial damage. History has shown this kind of thing to repeat itself. It just happens to be a different investment theme each time we go through the cycle.

To give you some perspective on this, let's look at the criteria many people look at today:

- Investment with the highest possible, ongoing, income payouts. People aren't looking at the whole investment picture, but rather this 1 characteristic; wanting to see cash paid out on a monthly or quarterly distribution, or what is referred to as "yield". The thought is, "If it doesn't pay out something to me monthly or at least quarterly, I'm not looking at it."
- The kind of investment that doesn't fluctuate in value as much as most market investments do. By "market investments" I mean, investments that can readily be bought and sold on any given day. "Give me an investment that fluctuates as little as possible".

If you have more and more people pursuing these kinds of investment, what happens to the prices of these investments, which are in limited supply? They become increasingly more expensive.

Since the finance industry is paid a percentage of "assets under management" (AUM), what do you think the finance industry does? They create vehicles (financial product) they can sell, to fit the investment public's growing demand.

As more people (and their money) chase these now darlings of the investment markets, you get ever building, price and supply pressure. This causes more and more people to pay less attention to what the underlying investments are actually worth. If someone will pay more, it must be worth more.

As there become fewer investments that fit have these 2 criteria of "yield" and "low / no volatility", investment parameters are loosened, paying prices that in a more normal market environment would never have been paid. This puts anyone who continues to let the boundaries be pushed, at risk of permanent loss of capital.

When all falls apart, it is only then that people realize the mistakes they made. Shouldn't however, it be more prudent, to put paraments in place that don't move? Rather than buy investments that you want to behave a certain way, why not….

Choose a business because it is a good business? Buy a business like a business person would. Analyze the value of the business. Know exactly what it is worth, when it comes on your radar, should you choose to buy it and if so, re-evaluating the numbers, the whole time you own it, at various intervals. Buy it for a price that takes into account the worst that could happen for the business as well as the rosiest of forecasts. This way you know in what price band, it is actually fairly valued. You will know exactly when it becomes overvalued and take the appropriate action, by selling it. This is how you take risk out of a portfolio. You don't second guess your value analysis because everyone is willing to pay more. Let those who don't know the actual value of what they are buying, pay too much for it and put their money at risk.

A perfect example of this herd mentality is the optimism that the effect Trump induced initiatives will have on particular business sectors. Few are asking or taking into account, "what if these initiates don't happen?".

There has been an over-focus on buying companies that are domiciled in the US versus those headquartered in Europe (that was even before Trump was elected). Over the past several months the investing public has been selling out of European based companies in favor of US ones. This is despite the fact that the US has been growing slower over the past 2 years than Europe, as a whole has.

As well, the Price:Earnings (PE) ratio of European companies is 14.5 (PE being one way to measure the value of a business). US companies as a whole are more expensive at a PE of 17 yet. This simply means, European business are cheaper. US businesses are seeing their earnings grow in the high single digits yet European businesses are seeing their earnings grow in the low teens / year. People are chasing US businesses despite European businesses growing faster. Hhmm…. Paying a higher price for lower growth. This doesn't make sense and will play out in favor of the independent thinking investor, the one willing to not follow others.

As has been said by many successful investors before, "the problem with most people is they have no idea how much the companies (investments) they are buying are actually worth". They just assume if someone is paying $X / share for it, it must be worth that. That is simply paying a price without knowing the intrinsic or built in value of what is being bought. No wonder so many people get frustrated with investing however, it's not the investing that is at fault, it's how it is being done.

Why Do Bonds Lose When Interest Rates Rise?

It sounds counterintuitive, doesn't it? It may, though the inverse relationship between bond prices and interest rates, is just simple math.

I'm going to use an example of a "zero coupon" bond as it is easiest to illustrate. Zero coupon bonds are simply bonds you buy for e.g. $90,000 that will give you an even $100,000 at a fixed date. If the going rate of interest over 5 years is 3% / year, a 5 year bond would cost you $86,300 and would give you $100,000 at maturity. That $86,300 becoming $100,000 in 5 years equals a 3% / year return. See what I mean by simple?

Let's jump forward, 12 months into the future. Interest rates are now at 6%. If someone wants to invest for 3 years, they could buy a new bond that is being issued at 4%. You have a bond that is paying 3%. To make the selling of your bond, attractive to the market, the price would have to be dropped to $79,200. The $79,200 becoming $100,000 in 5 years equals a 6% / year return.

I know what you are thinking. "Why would anyone by a bond with those kind of possible results when you can simply get a bank deposit that doesn't change in value"? There are a few reasons:

1) With a bank deposit, you can't cash it in. A bond however can be sold at anytime. A bond doesn't have liquidity risk which your GIC has. With a bond, you at least have a choice to cash it in on any given day.

2) You generally can get a better interest rate with a bond. Government bonds pay less than say a bond issued by a company.

3) Interest rates generally go up as the economy picks up steam which means, you have higher inflation. Locking up your money and it paying you only 3% when inflation is running at 5% means you are losing 2% / year. That might not be so bad for 1 year but if you have money locked in for 5 years, you are losing 3% per year or 15% over 5 years.

This last point, relates to not willing to see something on paper that says your investment is worth less than what it was previously. That is simply an emotional need and in the long term, a financially damaging one at that. It has no reality in economics. It is akin to not going to the doctor for fear of what you think they may tell you. Reality is that you are sick but as long as you aren't told you are, you aren't.

In a falling interest rate environment, bond prices can give you very healthy returns. Everyone wants the higher interest rate, so your bond price goes up. I haven't illustrated the effect of how far off the maturity date is in the future (short term, medium term or long term bonds). Suffice it to say, the longer term a bond you buy, the more it will go up and down in value. Now you know why bonds go up and down in value with interest rates (if you didn't already).

How To Multiply Your Estate, Tax Free

An Estate Bond can be a very lucrative, profitable, tax efficient and guaranteed way for you to pass money on to the next generation. If you have money that probably won't be needed to sustain your retirement lifestyle, then this idea is something worth considering. Here's how it works.

You decide an amount that you can tuck away; money that you won't need access to. For this example, we'll use $100,000. With it, you invest in a "joint last to die" life annuity. For a couple, both 65 years of age, this annuity would pay out an income of ~$5,700 per year. This money gets re-directed to pay for a "permanent" life insurance policy in the amount of $375,000 (based on 65 year old, non-smokers in average health). "Permanent" meaning, the insurance cost never goes up and the insurance is in place until you both are gone. Result is $100,000 invested in annuity that produces $375,000 tax free to your beneficiaries.

You will be hard pressed to find anything that even comes close to producing these kind of results on a guaranteed investment. Running the numbers on something that would produce 3% / year, shows you would have $166,000 by age 90. Income taxes however would have to be subtracted. Assuming that is interest (not dividends or capital gains), the tax bill would be approximately $30,000. Net to the estate is $136,000. The only way to beat the Estate Bond, using the same 25 years, is to have an investment that produces capital gains returns well in excess of 6% / year.

This is not a new idea on how to pass assets to the next generation. As you can see, investing through a life insurance company using the Estate Bond idea can have significant advantages. Money pays out a 1) guaranteed amount, 2) it's tax free and 3) it goes directly to who you want it to go to without probate fees and nobody else knowning. Nothing else does all of that. Nothing.

Vertical Decisions & Horizonal Ramifications

The biggest part of "estate planning" is working out how your money is going to be distributed after you are gone. You, as a parent, passing down money to your children is a vertical decision. These can affect how you will be viewed by your children after you are gone.

After that comes the horizontal ramifications of those vertical decisions. Those are how your children will react between each other, after you are gone. In other words, the vertical decisions you make in regard to who the Executor of your Will is, who takes over the family business and who you favor over another in the division of your assets and possessions, will have a direct impact on your children's relationship to each other. You have to be keenly away of how your vertical decisions can have horizontal effects. Here are some of the common tilts, that would cause favoring one child over another:

- One does most of the work when you are less capable of taking care of yourself and because of it, you only think it fair to give that one a larger part of your estate.
- One of your children seems to struggle financially much more than your other(s). You feel an obligation to help them, at the expense of the others. Or the flip side to that…
- There was always 1 child you thought was irresponsible and therefore, giving them money was simply rewarding them for that.

If you follow through with these vertical decisions, the horizontal relationships, those between your children and grandchildren will have ramifications that can go on for the rest of their lives, tainting or evening destroying what could currently be, good sibling relationships. So, the question remains, do you give unequally to your children using your vertical relationship or maintain harmony in the horizontal relationships among your children and your grandchildren?

Get $1,200 When Your Child Turns 6 (or if they will be 7— 11 in 2017)

In 2015 the BC Government announced the BC Training and Education Savings Grant. The BCTESG is $1,200 the BC government is wanting to put into your kid's RESPs. They will send it your way if:

⇒ Your child is born in 2006 or later

⇒ Is a BC resident

⇒ Has a RESP set up in which they are listed as a beneficiary

The earliest you can request the BCTESG for your child (or grandchild) is when they turn 6. After that you may apply any day before their 9th birthday.

Because this is a new program, the BC government is giving you some time to line up your ducks (and some slow financial institutions to line up theirs). If your child was born in 2006, you have until August 14th 2019 to apply and get $1,200 added to your RESP.

If your child was born in 2007—2009, you have until August 14th 2018. Children born in 2010 or later have until the day before their 9th birthday.

Governments are really throwing money in the direction of your kids and all you need to do is set up an RESP to get this new money the BC Government money is offering. Our clients who qualify, will automatically be getting applications sent to them for the BCTESG.

Note: Not all institutions are set up to accept the new BCTESG (If you bank and get your financial direction through CIBC, you probably won't be able to apply for this until late in 2017)

Let BC Provide Downpayment, Not You

The BC government is giving a 5 year, interest free loan to first time home buyers through the BC Home Owner Mortgage & Equity Partnership program. This program is set to run from January 16th 2017—March 31st 2020.

If you are someone who has a downpayment, or you are a parent, willing to help your kids with that, you will probably be much better off using the goverments, cost free loan instead of your own money. Looking over that 5 year time horizon, you could place money you would normally use for a downpayment and invest the proceeds instead. Even in a relatively conservative portfolio, that will pay more than 0% / year, you would come out ahead. On the maximum $37,500 @ a relatively conservative 4% / year, you could sell the investment, pay back the government and have an extra $8,000.

Having said all that, be forewarned that some banks are not recognizing the BC government's portion as a down payment because they see it as financing that is too aggressive. However, finding a lender that will, through a mortgage broker, could put you well on your way on to taking advantage of the BC government's interest free loan.

Tech Gems— PragerU

PragerU.com is a website of "Short Videos, Big Ideas" named after very popular, radio talk show host, Dennis Prager. These short (3—5 minutue) presentation videos deal with anything in the area of economics, environmental science, history, religion, philosophy and foreign affairs. These are things that you may hear talked about on social media. The problem is with social media is you get a lot of "group think" because it sounds logical. However, what sounds true may not be logical at all, after you watch a PragerU video on the topic.

Like any point of view, there are usually holes that can be found. What you will leave with on PragerU is an exercise in thinking through a subject because frankly, there are too many views that don't get challenged (even YouTube bans good videos based on group think). You may come to the conclusion that there is more to an issue that is often decided on as right, from an emotional sway. #thoughtfulreasoning

Hmmm…

- Delta Airlines, the most profitable airline based in the USA, has its own oil refinery which it bought in 2012. In 2016, this refinery reportedly accounts for nearly 30% of New York's jet fuel supply as it sells jet fuel to other airlines. Simply Wall Street, Jan. 2017 #AirlineSupplyingCompetitors
- Enerjet is a new Canadian airline that plans to partner with the company that backed Spirit Airlines in the US 10 years ago. The average airfare at Spirit Airlines was US$66.96 in the third quarter of 2015, while the average domestic economy airfare in Canada was $282.80 in the same period. Financial Post Nov. 2016 #CompetitionMakesBetter
- I read about an ETF that has "razor-thin" MER giving it a sizable cost advantage against its peers and got a "Gold" rating by a financial rating agency yet, it has underperformed against the category average by 0.25% / year since inception. #pennywisepoundfoolish
- J.C. Penney, Walt Disney and the Pampered Chef all borrowed from the cash value of their life insurance policies. J.C. Penny to meet payroll following the 1929 stock market crash, Walt Disney to build Disneyland in 1953 because no bank would lend him money and Doris Christopher in 1995, to Pampered Chef and subsequently sold it in 2002 to Warren Buffett for $900 million. Advisor.ca #BeYourOwnBank
- Ireland has the fastest growing economy in Europe, driven by the exports of about 1,000 multination (companies) that emply 5% of the workfors and generate nearly a quarter of the economic output. Apple today is the biggest private employer with over 5,500. CTV News, Dec. 2016 #LittleCountryThatCould
- 2% is judged to be just enough inflation to keep the economy from falling into deflation while not being so much that changes in prices become de-stabilizing and harmful. #GoldilocksInflation
- Total household credit market debt -- which includes consumer credit, and mortgage and non-mortgage loans -- was $1.973 trillion at the end of the June 2016, including $585.8 billion in consumer credit and $1.293 trillion in mortgage debt. (2/3rds mortgage debt 1/3rd other debt). BNN.ca #CdnHouseOfCards
- $100,000 condo I bought in 1995 close to the centre of Richmond BC, 21 years later, was worth just under $300,000. That is <u>gross</u> capital appreciation of 5.4%/year (before subtracting ownership costs). Does that sound like a stellar return to you? All in an environment that gave real estate a tailwind to push prices because financing costs fell precipitously, from 11% for a 5 year mortgage down to 2.5% today. (Monthly cost on $100,000 mortgage @ 11% is $963, $300,000 @ 2.5% is $1,344 / month. 39.6% higher costs when minimum wage went up 61% in BC (from $6.50 to $10.45) #PropertyBlinders #RiskWhenInterestRatesRise
- Interest rates are at historic lows yet a recent survey of Gen Y and Millenials said that they think interest rates are too high (despite being at the lowest levels in almost 100 years). Manulife Bank Homeowner 2016 Debt Survey #NoConceptOfReality
- *The question:* "What are your thoughts regarding multiple financial advisers?" *My reply:* "I can't see the benefit… You could end up with conflicting advice, or ineffectual and even harmful advice that results from an adviser not knowing what other financial input you're receiving and acting on. When someone asks about having two advisers, it tells me he or she hasn't found the right person yet." Rob Carrick, Globe & Mail Finance Columnist, Nov. 2016 #1Doctor1Dentist1FinancialAdvisor
- Pension money is not guaranteed to be there. It can be seized by creditors, which is what happened with Nortel. So, anyone left in the pension is only going to get his pension after all other creditors in a company bankruptcy, are paid. Advisor.ca, Jan. 2017 #BeliefDoesntMakeTruth
- If the underlying reason for keeping accounts separate is that you're worried about your spouse stealing assets (or overspending) , why are you going into the relationship?" Estate Lawyer Corina Weigl, a partner at Fasken Martineau in Toronto #LoveYouButDon'tTrustYou
- Any business partnerships, unless they have a rock solid agreement, expose each partner to debts they may not even know exist, even those owed personally by your business partner. Globe & Mail, Feb. 2017 #EnterAtYourOwnRisk
- Emma Morano, from Verbania in North Italy, is the oldest person in the world at age 117 (this past November). At age 20 her doctor told her to eat 2 raw eggs and 1 cooked, for her Anemia. She has eaten 2 raw eggs a day since then. The previous oldest person in the world ate bacon every day. TheDailyMeal.com, Nov. 2016 #LiveLongEatBacon&Eggs
- "The Obama administration turned a deaf ear to us and frankly, we feel things are going to move in the right direction (with Trump re promoting US made goods)" Matthew LeBretton, New Balance's vice president of public affairs, told the Wall Street Journal. Many on the Left started burning their New Balance shoes despite New Balance being the only shoe manufacturer to make their shoes in the US. Financial Post, Nov. 2017 #BlindProtest
- Canada is the only country in the world that has universal health care but no universal drug coverage. Fifth Estate email, Dec. 2016 #NoDrugsNoDental
- "As I hurtled through space, one thought kept crossing my mind—every part of this rocket was supplied by the lowest bidder" John Glenn, American Austronoat and State Senator, Ohio #CapitalismCreatesInnovation