MUTUAL GAINS™

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Without money, possibilities are limited...... without personal relationships, life is barren....
without balance, happiness and fulfillment are just a dream.

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'Long Time Since It's Been This Good

This past April marked the 20 year anniversary of my becoming a Financial Planner. I've seen many things over the past 20 years including, shortly after beginning my Financial Planner's journey, the largest one day market decline since 1929. What I have never experienced over the past 20 years though are the globally robust economic days we are currently enjoying and it's these nirvanic times that has me a bit uneasy.

When things were uninspiring, particularly for a long time you only can assume the economic environment will slowly get better. However, in times like today, when jobs are plentiful and people are "buying what they want and borrowing for a little more", I can't help but wondering when the good times will become less sweet or heaven forbid, sour.

Increasing interest rates over the past several months hasn't helped but fuel my unrest. Interest rate increases are driven by increasing inflation and frankly, that is at the root of my solicitude. However, what I need to do is look at some hard facts and put my human nature in my back pocket if only for a moment.

The fact that interest rates are increasing with inflation at such a low level is encouraging. Some would suggest however that the government is increasing rates too much. Remember, interest rates are a tool used by a country's central bank like the Bank of Canada to curb economic growth and inflation. The governments in Canada and around the world are paying attention to inflation and it shows, even in a developing country like China. Historically however governments of developed countries tend to overshoot on raising interest rates.

Although inflation in Canada is above the government's target of 2%, Statscan says a chunk of the inflation gains are ironically attributed to higher mortgage interest costs and the replacement cost of homes. Hhhmmm.

The other affect of higher interest rates is that it pushes a currency's value upward and in the context of inflation this is good. The Canadian dollar's continuing ascent helps curb inflation and thus the pressure to raise interest rates. The Bank of Canada has determined that a 3% rise in the dollar has the same economic impact of a 1% hike in interest rates. With our Canadian dollar 10% higher than it was at the start of the year, the climbing impact of the dollar for inflation fighting purposes is like having interest rates raised to over 9%. If that is the case, and inflation isn't subsiding could in fact inflation be actually higher than what the official numbers say? The 6% and higher annual raises employees are getting in Alberta would suggest this is so.

> 20 years ago, prior to October 1987, the S&P 500 index had a 5 year appreciation of 230% and a 47% 1 year gain. Fast forward to today and the numbers are 100% and 26% respectively. Most of the investment managers I have had meetings with over the past few months say that equities are not cheap nor expensive but "fairly valued"

Interest rate and inflationary pressures are not isolated to Canada either. It's a world wide situation and clear evidence of a global economic boom. This boom is benefiting many people with higher wages, more job stability and increasing asset prices. It is also enhancing the financial health and profitability of companies that you and I have inside our company pension plans, personal pension plans (RRSPs & IPPs) and within our non registered investment portfolios.

The root of sustainable economic growth is the consumer. It's you and I and everyone like us. The health of the consumer determines the near term effects on company profits and thus whether share prices of those companies will rise or fall. It is the level of interest rates that determines how much money is sloshing around to buy homes, cars, furniture, vacations, dinners out and the drive to make additional investments. Much of that money wave is birthed south of the 49^{th} however consumer demand will, on a long term basis, continue to grow exponentially in the Far East and India along with Latin America and Eastern Europe.

So, how does all of that affect you and me and more directly the bottom line of our portfolio statements? Overall, and so far, it has been positive as I'm sure you can see by comparing your most financial statements to ones of years past. However, as inflation and thus interest rates continue to press higher the ride gets bumpier. This we have already been seeing more of after a few years of abnormally steady and consistent gains. We will see quick emotional market reactions when news comes out that can be either interpreted as bad or good. I want to ensure you are aware of the that.

Important Note on Bonds: The common alternative and often a compliment to equity or company ownership is bonds. However, today virtually all investment managers agree that in general, bonds are one of the least attractive places to be during this rising inflation, rising interest rate environment.

Driving By The Rearview Mirror

'Past performance is not necessarily indicative of future performance"

That disclaimer is the warning label that accompanies all mutual fund marketing material. Financial regulators and the financial industry as a whole knows that investors make decisions based on looking in the rear-view mirror and that we need to be constantly reminded of the fallacy of our investor psychology.

Warren Buffett, in the top 3 list of the wealthiest people in the world often reminds those who take heed that most people spend too much time looking in the rear-view mirror. When investments are soaring in price and true value is scarce, investors chase the proverbial big win. Today we are seeing that with Canadian energy and commodity stocks. Why? Because when you look into the rear-view mirror, this is what has shown the best results in the short term.

All too often, investors make decisions based on the recent past, believing, incorrectly, that the recent past represents the future. If you are making investment decisions on the basis of what you see in the rearview mirror, be aware that "objects are larger than they appear".

The "Income For Life" Mortgage

Many of us buy a home with a mortgage of some magnitude and over time pay the debt off. This leaves us with an asset we can sell for downsizing later in life, freeing up cash to invest for creating retirement income.

The same strategy of borrowing to create an income for life can be used in different investments and in a more customizable size to fit your own cash flow situation. The four big reasons why borrowing to make a long term investment like a home works so well are; 1) it is a forced saving, 2) we are paying interest at a lower rate than what the investment is expected or historically has returned 3) we are using the banks money to make money and 4) it's tax efficient.

Here is a strategy I refer to as an "RRSP Mortgage" which you can use today;

1. Apply for an RRSP loan with an amortization of up to 10 years with no payments required until May 2008.

2. Invest the money in your RRSP in equity based investments.

3. Use your tax refund to pay down the RRSP loan (or a nagging credit card balance?).

Your payments per $5,000 of RRSP "mortgage" is $68.40 per month for as little as 5 years if you use your tax refund to pay down the RRSP mortgage. Assuming an 8% average annual compounded rate of return on your RRSP, in 25 years a $20,000 RRSP "mortgage" could give you retirement income of $1,020 per month for the rest of your life. Can you afford to pay more per month to get a higher retirement income? Get a larger RRSP mortgage. If it's less, not to worry. Something is better than nothing.

If you are already contributing to your RRSP on a monthly basis a RRSP loan can put more money to work for you right away. It will also give you a much larger tax refund next spring dumping free cash into your lap to pay down debt. Or you can snowball the effect by taking the tax refund and using it to make an additional RRSP contribution, thus creating another tax refund. And so on, and so on.

It's a New Age For RRIF's

In the last federal budget, one of the high profile changes involved the RRSP rules. To allow an RRSP contribution to be made to the end of your 71st year, 2 years longer than the previous 69 year age limit. This proposal has triggered a series of consequential changes RRSPs and RRIFs (Registered Retirement Income Funds).

1) You can now make a contribution to an RRSP for the 2007 tax year if you are 71 and also in 2008 if you are 70. The rule is you can make an RRSP contribution until the end of the year in which you turn 71. You can get your RRSP deduction limit from your "Notice of Assessment" (NOA).

2) If you are 71 or younger you can transfer your RRIF back to a RRSP. This only makes sense if you are going to make an RRSP contribution. When you finally turn 71 you will however have to transfer back to a RRIF.

3) The minimum RRIF withdrawal requirement will be waived in 2007 for those turning 70 or 71 in 2007, and in 2008 for those turning 71 in 2008.

We're Living Longer But…

Maybe it's just my getting older but I've become more aware of health issues including the dreaded "C" word.

The positive spin is that more and more people recover from what are often referred to as "critical" illnesses. However, living with a critical illness can mean major changes to lifestyle and serious financial challenges if you are not prepared. Having a financial cushion at such an uncertain and stressful time not only enables you to enjoy a higher quality of life but also offers you the opportunity to live independently.

That is where "Critical Illness Insurance" becomes your financial cushion. It gives you the choices you might not otherwise have, including the ability to go to other jurisdictions to get specialized and quick medical attention should you so choose. Having critical illness insurance coverage is all about protecting your lifestyle during recovery. Critical illness insurance helps fill financial gaps not covered by traditional health coverage, disability, life and accident insurance. It's paid in a lump sum for the full amount you are insured for and it's tax free cash.

Other types of insurance simply aren't designed to meet the additional expenses of a serious illness or condition. They may help pay some hospital and doctor charges, or even replace part of your lost income, but they will not provide you with the lump sum cash needed to pay for things like experimental treatments, travel expenses to and from treatment, home remodeling / reconfiguring etc.

Again, the positive news is more and more people are surviving a critical illness. Critical illness insurance can ensure you don't fall severely behind financially.

More Ebay And Other Everyday Savings Outside Canada

I'm a big fan of Ebay and generally buying things right from my desk. A recent experience of this relates to the need to purchase a pond pump and filter for a recently constructed water feature in my yard.

A trip to the nearest location of a nursery chain had these items tallying up to $1,084 including all taxes. The exact same combination shipped to my door from south of the border was $497. The ironic thing is the items we bought are from a Canadian company.

More every day needs such as shaver parts, those specialty batteries for the remote control on the garage door opener, audio video cables and a 1 gig digital camera memory card were found much more quickly and painlessly than making a physical trek. (Those audio video cables arrived at my door for $15.01 a pair. They were $54.24 locally). And that isn't all. A new Honda Accord is 22% cheaper in the U.S., an Ipod 15%.

Be careful though. It's so easy to discover "a good deal" you can easily be tempted into purchasing that cool thing you "just gotta have" defeats the whole purpose of trying to spend less.

HHHhhhhmmmmm………

Canada could be become a creditor nation for the first time in its history by the end of the decade. Historically we have always depended more on foreign investment than we could afford to pay out to other countries. Being a net creditor will give Canada more control over its financial destiny.

When the last of the boomers hit the current retirement age 23 years from now, some 20 per cent of Canada's population will be 65 or older. As a result, there will be only two working-age Canadians per every senior, compared with five today. (Statscan)

More than half of Canadian employers are considering eliminating post-retirement benefits for most retirees to contain the soaring costs of health benefits including prescription drugs and dental plans. (AON Consulting Inc.)

190 good paying manufacturing jobs every day are disappearing in Canada. (Toronto Star, July 2007)

The Canadian dollar increased 8% during the 2^{nd} quarter of 2007, the second-largest quarterly appreciation in the loonie in the past 50 years (TD Securities Inc)

Canadian baby boomers are expected to work longer than previous generations. That's due to better health, less physically demanding jobs, impending labour shortages and financial necessity. (Informetrica Ltd)

Personal bankruptcies on a year-over-year basis increased in May, for the first time in 18 months, and the number of proposals for personal bankruptcies is the highest since the 2001 recession. (CIBC World Markets)

The consumer price index (CPI) has risen about 1.9% a year since 1820. (Global Financial Data)

The "real" or inflation-adjusted long-term average rate of return takes erosion of purchasing power into account. To get the real long-term average rate of return you subtract the rate of inflation from the annual return. The "real rate of return" on equities has averaged 7.2% - 8.1% annually. (USA Today, July 2007)

General Electric has nearly doubled its earnings in the last five years from $11 billion to $21 billion while its share price has gone nowhere. GE has grown its earnings by 11% per year for the past 20 years. Bill Miller, Legg Mason Capital Management

The average dividend payout ratio in 2006 for the companies that make up the S&P 500 index was 29%, it's lowest level in 12 years and much lower than the historical average of 45 to 50%. Bill Priest, Epoch Investment Partners

A particular Canadian Income Trust's 2006 distributions to shareholders was $61 million however it's actual cash flow for the business was only $30 million. Where did the shortfall come from? It borrowed $200,000 million. (Investment Executive, June 2007)

Between 1950 and 2007, the developed nations' share of the world's population shrank from 33 per cent to 20 per cent. Report On Business, July 2007

Latin American markets have been hot. So hot they are now trading on a trailing price/earnings multiple that is only a 5 – 10% discount to developed markets. In 2002 emerging markets were trading at a 60% discount. (Citigroup Global Markets Inc.)

Most economists feel we're in for one more interest rate hike, in September. (The Edmonton Journal, July 2007)

Nationwide, wages are running at a 3.5% pace, up from 2.4% in the first quarter, and well above the core rate of inflation at 2.2%. (Financial Post, Aug. 2007)

In a "dust to dust" or "lifecycle" analysis of cars where production pollution and disposal is taken into account when assessing true environmental impact, the Toyota Prius was among the worst polluters. Take the batteries, for example. Toyota buys 1,000 tonnes of nickel a year from Ontario (mined and smelted in Sudbury). This nickel gets shipped to Wales for refining, then to China, for further processing, and then to Toyota's battery plant in Tokyo - a 10,000-mile trip, mostly by petrol-gulping container ships and diesel-powered locomotives.

Carey

Chartered Financial Planner