Issue No. 127

September / October 2008

mutual gains™

published bi-monthly since 1987

C.E. VANDENBERG & ASSOCIATES INC.

Financial Planning— Insurance— Wealth Management

For more information

& contact details go to
www.careyvandenberg.com

Questions?

carey@careyvandenberg.com

604 541 2690

1 866 274 1222

In this issue....

S Surrey / White Rock Office
13230—16th Avenue
South Surrey, B.C. V4A 1P3

Burnaby / Vancouver Office
4400 Dominion Street
Suite 410
Burnaby, B.C. V5G 4G3

Know Yourself First Before Taking In "The News"

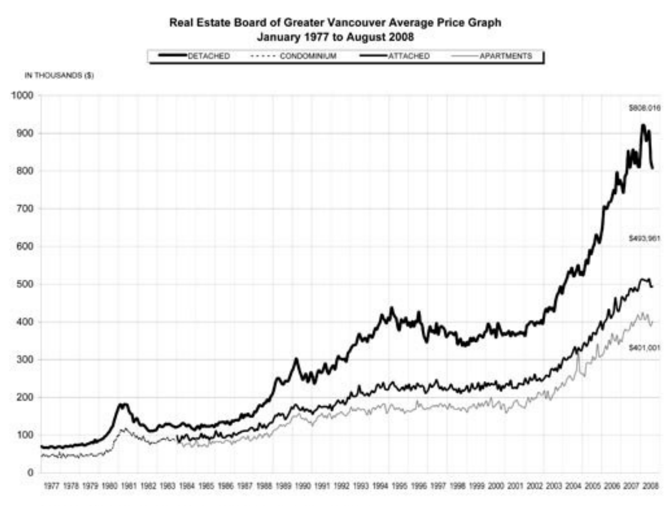
The human mind is an incredible thing, except it appears to be hardwired to doom us in our investing. One of the things our brains do, which is deadly when it comes to investing, is place the highest importance on the most recent events. We see what's flashing before eyes on the screen and react based on those things alone. When things have been going down for a while we assume that the trend will continue, indefinitely. When we are in the midst of good times or bad times it feels like things will always be that way. How did you feel 12 – 18 months ago? Quite different than today I'm sure. Did it feel like financial nirvana would never end? Did it? Of course it did. Why should today be any different?

Certainly, recent events in the market haven't been pleasant. The corrections since the late summer 2007 have not treated our portfolios well. And it's an easy conclusion to make, albeit an emotional one, that since global equity markets have gone down over the past several months it will continue to do so. Let's look at a time many of you in your 50's and older will most likely remember…..

The Last Biggest Financial Contagion Was Inflation

The financial phenomenon most governments are dreadfully and widely fearful of has always been inflation. The last significant bout we faced was in the late 70's. The bubble finally burst in 1980. Borrowing rates went to almost 20% and because of it housing prices fell by approximately 35%.. In Vancouver. In the middle of this turmoil everyone was running for cover. Banks were requiring payment in full on construction loans. Mortgage payments for many people doubled while job layoffs rippled. No one was immune to the carnage. The end could not be seen.

During this period, the equity market dropped and reached its lowest point in April 1980. One year after the first market bottom, the S&P index was up 34%. The economy experienced a growth period from July 1980 to July 1981. The recession resumed in July 1981 and lasted until November 1982. The new market low occurred in August 1982. One year later, in August 1983, the market was up 56% however it took 7 years for residential home prices to reach their current highs.



(Note: you will notice in the graph above that Vancouver real estate prices peaked again in 1994 and slid after that. They didn't come back to the same price level until 8 years later, 2002). Funny how we tend to forget the history and only see recent events.

A Financial Mess Is Created Every Several Years

Today, the U.S. and global financial system is under significant strain as the U.S. embarks upon a deleveraging cycle following a 20-year binge of increased borrowing. The deleveraging process has created uneasiness and uncertainty. However, it is neither the end of the world or the U.S. economy, nor is it unprecedented as the world has to clean up a financial mess every several years (the last one was due to the technology bubble).

The International Monetary Fund recently released a paper on 124 distinct banking crises in the past 27 years. There are lessons from Japan in the 1990s and the rest of Asia in 1997-98 (the Far East has cleaned to become a financial power house since then). The most basic of these is that excessive lending results in bad loans that mess up the balance sheets of good financial institutions. As the weaker ones fail, the stability of the financial system comes into question which freezes everyone in fear. The economy grinds to a halt thus further aggravating the situation. Ultimately, government must step in and recapitalize the banking system by removing the bad loans and providing the money to restart the flow of money. That is where we are today.

Despite the gloomy sounding news many investment managers (including Warren Buffett) are beginning to be more optimistic on the investment outlook. With global stocks trading at around 11 times estimated earnings over the next 12 months, markets appear to have already priced in at least a mild to moderately severe global recession. At these prices, investors will be well rewarded in the coming years.

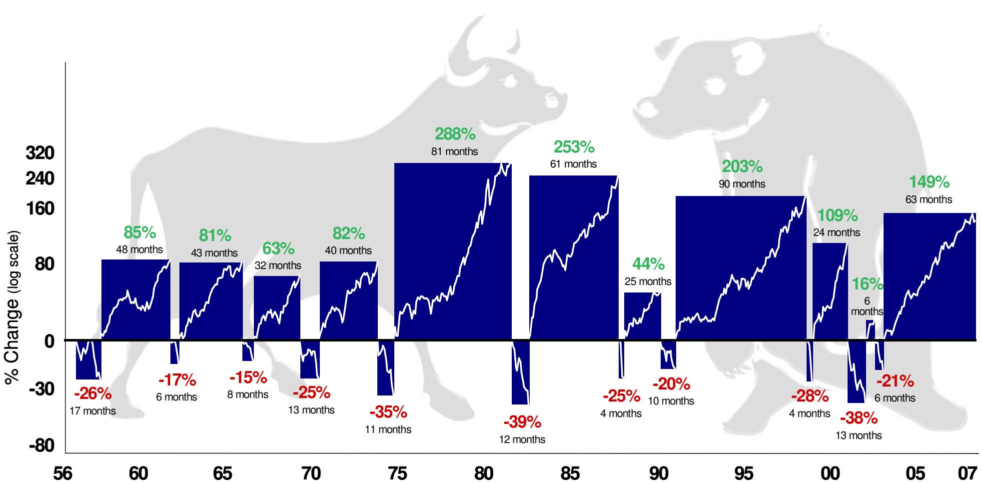
We do think that one lesson from financial history is that credit crises tend to be followed by long periods of financial deleveraging. That was certainly true in the early 1980s and early 1990s following other periods of inflationary booms. Financial deleveraging tends to put downward pressure on inflation rates and commodity prices even after economic growth stabilizes and recovers. This is welcome relief to many today and is slowly being reflected in the gas prices at the pumps.

This would suggest that the sectors which have led the stock market in recent years, primarily companies that extract and deliver commodities to the market, who have benefited from booming global growth and rising inflation pressures, will not take the performance lead going forward.

From a historic view, here are some stats to put today, the here and now, into perspective:

- Since the reopening of the stock market in 1914, the average "bull" or up market showed a total return increase of 189% and it took only 3 years and 7 months to do it.
- The shortest bull market occurred between June 1932 and September 1932 and in those 3 months the market more than doubled in price. The 1920s bull market was the strongest, increasing by 657%, while the 1947-1957 bull market increased by 517%.
- For the past 50 years, the average "bear" or down market has lasted 9 months with a total 29% drop. The 1973-74 bear market lasted 20 months, and on average it has taken 17 months for the markets to regain their value following a bear market.
- 6 of the last 8 bear markets have ended in October.

These historic facts should remind us that bear markets do end, that bull markets are stronger and last longer than bear markets, and that in the long run, the overall rise in equity prices far offsets the declines (see chart below for the last 50 years). That if you invest and hold for a long period of time, and take a bold step by adding to your investments when it feels the most emotionally uncomfortable time to do so, you will do very well. Personally, although I don't feel good emotionally when I read the news of the day (and I'm sure you feel the same way) the more I look at historical versus today's financial metric the more excited I am that we are very near the end. Ironically, the masses won't recognize it until times feel good, or at least palatable.



It's hard to see a nice tidy room when there are boxes of junk and clutter in front of your face and under your feet and your bed has a wet dog sleeping in it however, when all that stuff gets moved and either thrown out, put in its proper place or kicked out and washed, stress dissipates with every small improvement and calm returns once again.

Remember the inflation issue we talked about under "The Last Biggest Financial Contagion Was Inflation"? 6 months ago it was being talked about as a significant issue that could become a problem. Today that problem is dissolving with every passing day, a very good thing.

Cash Out Of RRSP To Pay Credit Card Debt—Good or Bad Idea?

On rare occasion I have someone tell me they have debt that needs to be paid off and they want to take the money out of their RRSP to do it. Before making that decision, here are a few scenarios:

Withdrawals from a RRSP are added as income for the year which is then taxed at your marginal tax rate. To help pay for this year end tax, the RRSP withdrawals face an initial withholding tax. Note that the withholding tax applies to EACH withdrawal and not the total annual withdrawal. (10% for the first $5,000, 20% from $5,001to $15,000, 30% for $15,000)

For Example, 40% marginal tax rate and $5,000 withdrawn would result in an initial withholding tax of $500, in addition to $5,000 added to reported income for the year. Providing that the extra income doesn't result in a tax bracket jump ($5,000 withdrawal x 40% withholding tax - $500 of tax already paid = $1,500 still owed at tax time).

With the tax basics illustrated, we can look at some scenarios:

Scenario #1 : $7,000 credit card debt with 12% interest with minimum monthly payment of 3%, 40% tax rate and long term portfolio growth averaging 8% / year.

In order to pay off the $7,000 credit card debt, approximately **$11,667** needs to be withdrawn from the RRSP to get $7,000 after taxes. That is providing that the withdrawal doesn't put you into the next tax bracket.

Doing a few calculations, here are the results for the RRSP vs Credit card debate providing the assumptions made above and only the *required* minimum monthly payment is made:

Years:	**5**	**10**	**15**	**20**
RRSP Gain on $11,667:	$5,475.49	$13,520.79	$25,341.97	$42,711.17
Credit Card Interest:	$2,458.56	$3,190.12	$3,407.79	$3,472.56
Conclusion:	**Do Not Withdraw**	**Do Not Withdraw**	**Do Not Withdraw**	**Do Not Withdraw**

Interpreting the table above, it seems that for this particular situation, keeping the money in an RRSP is the obvious choice. Even if the minimum payment was made on the credit card for 20 years, the total interest would only be $3,472, whereas the potential portfolio gain would be $42,711.

Scenario #2: Let's use lower income tax (25%), higher credit card interest rates (18.5%) and lower portfolio growth (5%).

Years:	**5**	**10**	**15**	**20**
RRSP Gain on $9,333:	$2,578.63	$5,869.68	$10,070.00	$15,430.78
Credit Card Interest:	$4,335.03	$6,130.54	$6,874.21	$7,182.22
Conclusion:	**Withdraw**	**Withdraw**	**Do Not Withdraw**	**Do Not Withdraw**

In this scenario, the table shows that the credit card interest would outgrow any RRSP growth for the first 10 years. After that however, the RRSP growth takes over with a big lead at the 20 year mark.

The general rule is that, keeping your money within your RRSP for the long term is much better than using it to pay off the credit card debt. The human nature part of the equation is that normally when a credit card debt is retired using RRSP withdrawals there is a strong propensity to get oneself right back into debt again.

Since there are so many variations, you will find a RRSP versus Credit Card Spreadsheet in the "Calculators" Section of www.careyvandenberg.com so you can run numbers based on your situation.

Web Gems

SCREEN IT— Ever find yourself watching a DVD with your kids (or grandkids) and cringing at some of the scenes? www.screenit.com gives a very detailed breakdown of scenes you can expect to see in the movie. This is particularly useful if you are going to the theatre because you can't fast forward like you can with a DVD. When my kids were younger we (Cheryl & I) used this for virtually every movie we were planning to watch. ScreenIt is a "must have" resource for parents with young to mid teen kids.

YOU TUBE— Not just a website people talk about where kids put up their silly antics. www.youtube.com is a fantastic place to find a video recording of a song done by a musical artist or band in a live or studio setting. As a hobbyist drummer, I found a fantastic clip that shows a very young Steve Gadd, show someone how he played the rhythm part on Paul Simon's "Fifty Ways To Leave Your Lover". Or use it to search for visual instructions on one of the programs you use on your computer. I'm now hooked on this site.

HOAX SLAYER— Every so often you may get an email from a caring friend or family member about an email they received that you need to act on. The next time you do, go to www.hoax-slayer.com , before you forward that email on to others. You can either click on one of the categories or do a search using the contents of the subject line.

HHHHHMMMMM......

For every $1 of assets written down (off) in the global financial sector there was a corresponding decline of approximately $5 of market value as of July 31st 2008 (Bloomberg & Datastream)

The US government has very deep pockets. Privately held US government debt was under $4,400bn at the end of 2007, representing less than 32 per cent of gross domestic product. This is roughly half the debt burden carried by most European countries, and an even smaller fraction of Japan's debt levels. Kenneth Rogoff, *professor of economics at Harvard University and former chief economist of the International Monetary Fund*

It was discovered by the Commodity Futures Trading Commission (CFTC) that after examining Swiss energy conglomerate Vitol's books, that at one point in July Vitol held 11% of all the oil contracts on the New York Mercantile Exchange (NYMEX) and that it was for speculation rather than for their business. Financial firms speculating for their clients or for themselves account for about 81 percent of the oil contracts on NYMEX (Washington Post, Aug 2008)

Canadian employers shed more jobs in July than in any month since the 1991 recession. (Globe & Mail, Sept 2008)

The Bank of Canada, erroneously holds that deflation "has negative consequences for economic growth." In fact, the deflations of 1879, 1895, 1922, 1928, 1939 and 1955 were all accompanied by strong economic growth. (Globe & Mail, Sept 2008)

Bull & Bear Facts

Average length of **bear** market:	10 months
Average loss in **bear** market:	-26%
Average length of **bull** market:	47 months
Average gain in **bull** market:	+125%

It takes 7% of the average worker's disposable income to run a car for 15,000 miles a year at today's gasoline prices. That compares to nearly 14% of disposable income in 1980 when gas prices were US$1.26 / gallon. (Trilogy Global Advisors, LLC June 2008)

Europeans are generally less indebted than Americans. Britain aside, mortgages were not handed out to Europeans like newspaper flyers. In Italy, for example, it's hard to get a mortgage for more than 50 per cent of the value of a property. (Globe & Mail, Sept 2008)

"It is now (nationally) 20% more affordable to carry a house than it was in 1990" (Benjamin Tal, CIBC World Markets, Sept 2008)

"If you look back to the mid—1990's, interest rates went up and the banks dropped about 40% in 1 year". Kate Warne, Cdn Market Strategist, Edward Jones

A permanent loss only happens when you a) buy a shaky investment that isn't financially sound or b) sell a perfectly good investment for emotional reasons.

"We have to fight back those emotions of fear, and deal with simple principles - good companies, good balance sheets and an environment that may not be good today, but in a year, two or three years, will be better than what it is today." Frank Mersch, Front Street Capital

Chartered Financial Planner

PS. Questions on what you've read? Concerns about your own financial situation? Would you like to set up a meeting? Call or email me directly

604 541 2690 carey@careyvandenberg.com