

# MUTUAL GAINS™



published bi-monthly since 1987

Issue No. 100 March / April 2004

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



**C.E. Vandenberg & Associates Inc.**  
**-Life & Disability Insurance Services-**  
**-Financial Planning-**  
**13230 – 16<sup>th</sup> Avenue**  
**South Surrey, B.C. V4A 1P3**  
[www.careyvandenberg.com](http://www.careyvandenberg.com)

**Interested In Becoming A Client?**  
**Office 604-541-2690**  
**Fax 604-541-2650**  
**Toll Free 1-866-274-1222**  
[carey@careyvandenberg.com](mailto:carey@careyvandenberg.com)

**Do You Want To Be In our E-Loop and  
receive timely financial info. and  
mutual gains by e-mail? Send blank e-  
mail with "mail" in the subject line to  
[cheryl@careyvandenberg.com](mailto:cheryl@careyvandenberg.com)**

## The Reality Of A Company Pension Plan

With interest rates so low, pension managers have been struggling to generate the returns needed to ensure the money will be there to pay benefits as workers retire. The long bear market pushed some of the pension plans into a deep hole. All you have to do is look at the Air Canada situation to see how bad things can get. The airline's pension plan has a huge shortfall and failure to resolve the problem could sink the airline.

A company is required by law to top up a pension plan when it is actuarial calculated that their isn't enough money in the plan to pay it's workers as they retire. However, what happens when the company doesn't have the money to top up the plan? A negotiation of future pension payments. That is exactly the situation with Air Canada.

The requirement by the company to make up the shortfall is only there with a "defined benefit" pension plan. A DBPP is a pension that says it will pay you X amount per month when you are retired.

Currently Air Canada doesn't have the required funds to make up the funding shortfall for its pension. They will not be the last.

## With The Canada Pension Plan (CPP) It's A Different Story

There is a common perception out there that the Canada Pension Plan cannot be counted on to provide income during your retirement. That belief was warranted just a few years ago when, in 1996 CPP was paying out \$17 billion a year in benefits but only \$11 billion was coming in. Today, the picture is much different. Here are the facts now:

- Ø The chief actuary for Canada who reviews the health of the CPP every 3 years. He says that it is sound for the next 75 years at least. This 75 year projection period is required by CPP legislation.
- Ø CPP Pension reserves (\$64 billion today) are segregated from general government revenue.
- Ø It is projected that there will be enough revenue coming in from yours and my CPP contributions to cover all the benefits paid out until 2022 and therefore no need to deplete the money that is already in there.

"We are now in the fortunate position that, by maintaining the current contribution rate (9.9% split equally between employer and employee) and growing the reserve fund, the CPP is on track to be sustainable for generations" John MacNaughton, CPPIB President.

Government benefits like CPP and OAS (Old Age Security) are an essential part of your retirement plan. This shows that we can continue to use these as your foundation and on top of that build your other retirement assets (future retirement income sources).

So I say, especially to you Gen-Xer's (25 – 39 year olds), "don't worry, be happy". Your CPP will be there for you.

## So What Can You Expect?

At best, public pensions, OAS and CPP will provide around 40% of the national average wage which is currently \$41,000. That is the average. If you earn an income lower than \$41,000 you will get less, an income over \$41,000 a bit more..... a bit more.

So we've accounted for \$12,000 - \$15,000 of your annual retirement income. Your "Retirement Plan" projections will fill the gap. If you haven't seen a sample of what your "Retirement Plan" projections could look like go to [www.careyvandenberg.com/calculators.php](http://www.careyvandenberg.com/calculators.php). Click on "Retirement Plan Sample" on the right side of the page.

Note: CPP assumes a rate of return on their investments of 4% over the inflation rate. At today's inflation that is a projected 6.5 – 7.5% compounded annual return. By putting your RRSP assets to work effectively, and using the same assumptions, in time your plan becomes reality.

## Hoping and Knowing – A Comparison

Does this sound like your "financial plan"? Insurance from "my insurance guy", an RRSP from my "financial planner" in February, an RRSP from my bank last year, an investment I bought several years ago (one that Uncle Bob said was "really good"), a bit of cash to buy that "hot tip" I got from my friend plus that absolutely fantastic idea from the seminar advertised in the local paper last week.

That may sound a little silly however the truth is many of us run our financial life that way. No rhyme or reason, no foundation, no parameters, no real discipline, no concrete plan of getting from here to there, just a serendipitous collection of financial products thrown in your investment shopping bag.

Financial planning using an abstract and serendipitous approach more often than not doesn't work very well. Imagine your house being built this way? As I have said on many occasions you can buy a mix of everything all over the map hoping that it will all work out in the end or you can plan and know it will. I'd go with "Plan and Know" any day.

## Where Should I Invest This Year?

Foreign equities? Canadian bonds? U.S. Small Companies? How about the Emerging Markets? Where should I invest now?

It's a common question. Its commonality is as simplistic as its answer is perfect, "a bit in everything you are invested in currently". Here are some interesting numbers as provided by Franklin Templeton Investments:

If you had invested \$10,000 each year from December 1983 to December 2003 you would have had at the end of that 20 year period;

\$500,055 if you "Chased The Winners" (invested in the previous year's best performing asset class)

\$568,683 if you "Chased The Losers" (invested in the previous year's worst performing asset class)

\$644,452 if you "Diversified Across Several Asset Classes" ("invested in a bit of everything")

Any suggestions or advice contrary to that are only there to sell Investment Newsletters, Financial Books, Newspapers and Radio talk show space. Sometimes we try to be too smart for our own good. It's part of the human condition.

## University Study Shows Bank Deposits Lose Money Every Year

Researchers at York University's Schulich School of Business have concluded that short-term GIC returns are completely wiped out by taxes and inflation if held outside of an RRSP or RRIF.

The study was conducted by the Individual Finance and Insurance Decisions (IFID) Centre and used Ontario's highest marginal tax bracket in its calculations. Using the posted GIC rates from 1974 until 2003 and factoring in the diminished purchasing power caused by inflation, the study found real after-tax returns were in negative territory which simply shows that bank deposits lose money slowly over time. So.....

If you are holding money in bank deposits start looking for alternatives now and..... make a decision on a mix of the best of these. If not you will continue to lose money. That's proven to be the case over the past 30 years.

## Abria Protected Notes – A GIC Alternative

At the time of your reading this, the Abria Notes are probably already sold out. I make mention of it here because it is an investment that provides the strongest combination of, stability, security, guarantee, and tax efficiency I have seen in over 17 years. If you didn't hear about it before reading this it's because we either 1) don't have your e-mail address or 2) we have an old, outdated e-mail address for you.

## Making The Most Out Of "Labour Sponsored" Investments

Labour Sponsored Investment Funds (LSIF) are mutual funds that give you a tax credit when you invest in them. The most popular one in B.C. and one of the most successful in Canada is the Working Opportunity Fund (tax credits equal 30% of what you invest - \$5,000 equals \$1,500 in tax credits = \$1,500 in tax savings. This is on top of the tax deduction you get from putting them into your RRSP.) Here are a few ideas to increase their effectiveness:

- Ø Develop a "laddered portfolio strategy". If you invest in them for 8 consecutive years (\$5,000 per year) you get a tax credit of \$1,500 for each of those years. When the first investment comes up to its 8 year investment maturity date you can roll the investment over (re-invest) for another 8 year term and get another \$1,500 in tax credits. The next year you can do the same thing with your second investment. You now have ongoing tax savings of \$1,500 per year without having to invest more money. This only makes sense if your RRSP is in excess of \$300,000 to ensure you aren't loading up on these more aggressive "small business" investments.
- Ø Do you have a Locked In RRSP that is going to sit there for years? You can squeeze another \$1,500 of tax savings by taking re-allocating some of the cash in your locked in RRSP to invest in a LSIF (you can do this with your regular RRSP too).
- Ø Need to payback a Home Buyers Plan or Life Long Learning Plan? Pay it back into a LSIF. You don't get to use this as an RRSP deduction but you are going to get back 30% of what you put in because of the tax credits. It's like getting the government to subsidize 30% of the down payment on your home or post-secondary education costs.
- Ø When you are starting out you are trying to 1) save for retirement, 2) save for your kid's education and 3) pay down the mortgage. By investing in a LSIF you can do all three. A \$5,000 RRSP contribution @ 44% tax rate will give you a combined tax savings of \$3,700 (deduction and credit). Invest \$2,000 into the RESP (the government subsequently adds \$400 to the RESP from the CESG). The remaining \$1,700 can be used to pay down your mortgage. That \$5,000 investment has just increased your family balanced sheet to \$9,100.
- Ø Use LSIF tax credits as laid out in the "laddered portfolio strategy" to pay premiums on life or critical illness insurance. For a 40-year-old non-smoking male, \$1,500 of tax credits will buy a \$252,000 level premium term to 100 insurance policy. Enough to insure a \$500,000 RRSP / RRIF from tax at death.

## Catching Up On RESP Contributions

If you missed RESP contributions last year or the year before that etc. you can catch up your missed contributions and still capture the Canada Education Savings Grants (CESG). The maximum RESP contribution in any one-year is \$4,000 per child under the age of 18. However, you only get the CESG grant of 20% on the first \$2,000 up to a maximum of \$400 per child per year. The twist is this. If you missed your contribution last year and contribute \$4,000 this year, you will receive the grant for both prior and current years or \$800 in total per child.

## These Aren't 4 Letter Words But They Should Be

"Deemed Disposition" simply means that from CCRA's perspective you have sold the asset and are subject to taxes based on that. A deemed disposition normally occurs at death however it can also occur when you transfer an asset to someone else while you are living.

Example: Your mother has just passed away. The only asset she has is that nice little place "up country" she bought 35 years ago where you and your siblings shared countless summer memories. Today it's worth a lot more than what she paid for it, \$600,000 more.

Upon her death CCRA "deemed" that her up country place had been "disposed" of. This "deemed disposition" means a \$600,000 capital gain and a huge tax bill because she never filed the election to trigger the capital gain in 1994 to take advantage of the then \$100,000 capital gains exemption. Because of this, a tax bill in excess of \$100,000 is expected. The only way to pay this bill now is to either a) sell the property or b) pay the tax bill from other cash available.

"If only we had life insurance to cover that tax bill....."

## Passing On From You To Your Grand Children

With financial asset plans like RRSPs, RRIFs and Insurance Policies you have the ability to elect a beneficiary for the plan or policy. Beneficiary elections can be changed unless it's an "irrevocable beneficiary".

An "irrevocable beneficiary" designation can be very useful where, you as a grandparent wants to pass on the money inside your plan or policy to your grandchild but are concerned that your grandchild's parents might thru

divorce or financial hardship, change your intentions by pulling money out of the plan prematurely, for their own use.

By designating a grandchild as an irrevocable beneficiary, the grandchild has ownership rights and nothing can be changed in the plan without their written permission. But can a minor be an irrevocable beneficiary? Definitely, however the applicant (owner / grandparent in this example) would have to use a trustee until the child reached age 19. The irrevocable beneficiary designation would have to be made "in-trust" until the child reached the age of majority

Caveat: this doesn't necessarily mean that this transfer of money will go without a fight from someone within your family who feels entitled to this cash. Your letting everyone in the family know what your intentions are can alleviate that scenario. This way any concerns or potential "issues" can be dealt with.

HHHMMMMMMmmmmmmmm.....

The richest man in the world is now Ingvar Kamprad, the Swede who founded furniture retail chain IKEA. He has very frugal habits one of which is flying economy class.

"Korea is another place where we have a lot of investments. Samsung earned \$5.7 billion while IBM earned \$3.5 billion. It's the second highest earning tech company in the world after Microsoft."

Donald Reed, President Templeton Institutional Funds Inc. and Templeton Investment Counsel Inc.

\$10,000 invested in Templeton Growth Fund November 29, 1954 had grown to \$5.7 Million on Feb. 29 2004 (13.8% per year average). During that time there were 10 Presidents, 11 Prime Ministers and 153 wars.

The "Top 45 Movers" in the S&P 500 in 2003 collectively exhibited the following financial metrics. 1) Net Losses of \$8.5 billion, 2) Free Cash Flow burn rate of negative \$2.4 billion (in layman's terms, they are spending more than they are making). 27 of the Top 45 movers lost money, yet their stock prices increased an average 131%.  
\* Source: Bloomberg

The single biggest clump of baby boomers were born between 1959 and 1963 and are now 40 to 44 years old. That 40-44 age group accounted for a bigger share of the labour force in 2003 than any other five-year cluster of Canadians. The only others that came close were those aged 35 to 39 and those aged 45-49.

Household debt has increased 18% over the past 4 years.

The majority of tax filers will receive a refund this year because payroll deductions are calculated to ensure that people overpay. So if you are getting a refund this year then I would like to thank you on behalf of the Federal Government of Canada for your interest free loan.

The CPP Investment Board has announced the appointment of Connor, Clark & Lunn Investment Management as the first of two external portfolio managers to make investment decisions for the Canadian Pension Plan (I've used CC&L for almost 15 years to manage a part of some of my client's RRSPs).

90% of drivers think their driving skills are above average.



Chartered Financial Planner

### **DISCLOSURE / DISCLAIMER**

The information contained herein is based on certain assumptions and personal opinions. While care is taken in the preparation of "mutual gains", no warranty is made as to its accuracy of applicability in any particular case. The comments included herein are not to be construed as a public offering in any province in Canada. Any offering is made by prospectus or in certain cases an offering Memorandum. Carey Vandenberg is licenced with Partners In Planning Financial Services Ltd. for investment services in the provinces of B.C., Alberta, Saskatchewan and Ontario and through C.E. Vandenberg & Associates Inc. for life and disability insurance with Maritime Life acting as life and disability insurance licence sponsor. Commissions, trailing commissions, management fees and expenses may all be associated with mutual fund investments. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

