

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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A Subdued 2005 Expected

2004 wrapped up as a fairly decent year in terms of investment returns on a variety of asset classes. The fourth quarter, in particular, registered strong results. In fact, in early November it didn't look like it was going to be a stellar year. However, as has been shown in statistics many times before if you miss just a few of the best days or weeks you will have sub par investment performance. It may seem redundant, elementary and somewhat like a sales pitch by the investment industry but it really is "time not timing". This proved apropos in 2004.

Pace of profit growth is showing signs of slowing worldwide after a couple of years of significant strength and the consensus belief this year's gains are likely to be modest at best.

Having said that, the tsunami in south Asia forces us to remember that we must always expect the unexpected.

The Twin U.S. Deficits in Perspective

There has been a lot of talk and concern about the U.S. deficits, both in their budget and in their trade. The main concerns are, 1) interest rates are too low to create any incentive for Americans to save, and 2) the U.S. has become dangerously dependent on huge inflows of foreign money to finance both it's deficits. This can and is expected to be slowly reversing itself by going from a housing boom and consumer spending related growth to one of greater exports. It looks like a balanced combination of higher interest rates to dampen housing and consumer spending, and a weaker dollar to encourage exports will be the medicine.

"The U.S. budget deficit situation is improving, not deteriorating. The absolute dollars are certainly big - over \$400 billion for fiscal 2004, but at just 3.6% of GDP (and headed lower as the economy grows), we are a long way from the deficits of the 1980s when the figure was well above 5%. We remember David Stockman's shrill deficit warnings in 1985, and a similar panic in 1993 ironically preceded the budget surpluses of the late 1990s. The current improvement is coming from better-than-expected tax receipts" Ed Loeb, Harris Associates LLP, Chicago.

What Do Harvard and Yale Know About Investing That You May Not?

The most commonly held investments, namely Equities, bonds, and real estate have historically done well over time, but as most of us know from experience, they are subject to how well the economy is doing or not doing, if interest rates are rising or falling, personal incomes, and even things like terrorism and other unusually bad news. Unlike the traditional investments we have all become accustomed to, "Alternative Investments" or "Hedge funds" on average have more flexibility to swim upstream regardless of the current and in theory should have fewer ups and downs.

If you don't like the term "in theory" you are not alone. I feel the same way. Having said that however, if you look at actual returns there is strong evidence of achieving higher returns in your portfolio with less variability when alternative investments are used. According to the CFSB-Tremont Investable Hedge Index of 60 global

hedge funds, for the 10 years ending December 31st 2003, their index encompassing a wide variety of hedge fund strategies had an annualized return higher than the S&P index (11.11% versus 11.07%) with an annualized standard deviation 46% lower. Standard deviation is a widely used measurement of the volatility (ups and downs) of an investment. Less ups and downs with higher returns.... Hhhmmmm.

Here are some significant and very successful institutions that have used alternative investments quite extensively for many years. Harvard, Stanford and Yale Universities have in excess of \$30 billion in their endowment funds of which a meaningful amount (Yale 26%, Stanford 15%, Harvard 15%) is in hedge funds or more broadly called "alternative strategy" investments. They have done this to lower risk and to increase returns and that is in fact what they have achieved.

Canadian institutional investors also see the benefits in "alternative strategy" investments. In fact, the University of Toronto, Carleton University, OMERS, and the Ontario Pension board are amongst many institutions in Canada that have hedge fund allocations (I have used "hedge funds" and "alternative strategy" investments interchangeably).

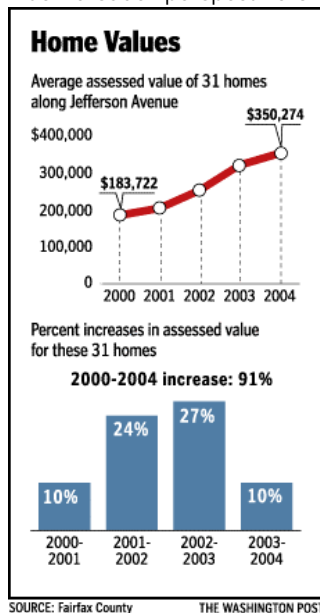
How much does the average Canadian have in these kind of investments? Virtually nil.

I've used hedge funds within client portfolios for several years and have seen the positive effect they have on a portfolio. It was going through 2000 through 2002 that their value was very evident. Usually, I find their validity has been questioned mostly after a time when the more traditional investments have done much better. A good example will be the past 2 years (2003 and 2004). A well managed Hedge Fund however produces a more consistent return. Yes, there are times when a Hedge Fund can be relatively flat but it should it should produce a long term return close to the more traditional investments but it will have gotten their with less bumps along the way. The Universities of Harvard and Yale have know this a long time.

B.C. Real Estate Has Only Been Warm I n Comparison



I get an e-mail from the Washington Post every day along with a few other e-mails to give me a much broader perspective on money, investment and on life in general. In January I received a link to an article that talked about how much real estate prices had increased in areas of Washington DC. Here are some snippets....



"...his Fairfax County colonial has nearly quintupled in value; a neighbor recently sold hers for \$460,000, a number whispered across front lawns and driveways up and down the block."

"...(tax) assessments have risen, too -- 78 percent since 2000. And the 2005 assessments, due out at the end of the month, are expected to jump again."

".....the average assessed value of a Northern Virginia house has roughly doubled since 2000. In Arlington County, for example, the increase is 125 percent; in Loudon County, it's 112 percent."

"....bought her colonial in 1998 for \$200,000. Then, expecting a child in 2002, she and her husband comforted themselves with the idea that they could always sell. Then, a few months ago, Treat's husband was transferred to Miami, and they sold for \$460,000. It was gratifying until they realized that Miami is hardly cheaper."

The value of a commodity like real estate has been driven by 2 primary factors over the past few years, very low interest rates and strengthening economies worldwide. In other words it is priced assuming everything will continue in this nirvanic economy. Should interest rates rise and the economy soften watch out. Consumers are in a debt straight jacket and have virtually no wiggle room.

Below is a link to an article on the CNN Money website about the "Irrational Exuberance" people have about real estate. www.money.cnn.com/2005/01/13/real_estate/realstate_shiller1_0502/

Note: At the time of finishing up this article, I read in the March 2nd issue of the Washington Post that that 36% of homes purchased in the U.S. last year were 2nd homes or for investment (my guess is with mostly borrowed money). I heard another stat on CKNW the same day that 20% of Canadians changed their address in 2004. Think those through for a few minutes...

Debt Levels Are "Alarming"

That's according to a recent report by CIBC World Markets. It did say that, although a possible collapse is an exaggeration, the dangerous sign is that we have developed a complacent attitude about borrowing.

Interest rates have been falling for several years now and our borrowing has been increased at the cheapest rates we've seen in 70 years. As the report says, we are sitting on a debt time bomb. A sudden rise in interest rates or continued strength in our dollar particularly against the U.S. dollar would produce a precarious situation.

Don't think it's an issues? How about this fact – our incomes grew 3% in 2004 while our debt increased by 7%. And that's not a new trend. Our debt has been going up 3% more than our income since 1989. As the song by the rock band RUSH says, "we buy what we want and borrow for a little more". At some point something has to give.

Getting The Most Money Back From Your Tax Deductions

When you do your tax return it's important that you allocate your deductions strategically among tax years where you can. One example of this is your RRSP contributions. RRSP contributions are one of those tax deductions that you don't have to use in the year you make the RRSP contribution.

RRSP limit equals 18% of earned income for the previous year			
Annual limits	2005	Maximum \$16,500	Max. when \$91,667 earned
	2006	Maximum \$18,000	Max. when \$100,000 earned

You can use that flexibility to your advantage and it's most likely you will have an advantage is when you are close to the threshold for the next tax bracket.

Let me illustrate. Let's assume you made \$38,000 in 2004 with no other deductions other than a \$15,000 RRSP contribution you made before the RRSP deadline. Normally you don't contribute the full amount but this year you had some extra cash and were able to catch up on previous years RRSP contribution room that you never used. You can choose to deduct the full RRSP deduction for the 2004 tax year however you will save 31.15% on the 1st \$7,000 but only 25.15% on the 2nd \$8,000. Again, since you don't normally make that large of an RRSP contribution it is best to only claim \$7,000 as a deduction on your 2004 tax return. Assuming you make a similar income (or more) in 2005 and 2006 it's best to claim the remaining RRSP deductions this way, \$7,000 in 2005 and the final \$1,000 in 2006. This way you will get the most bang for your RRSP contribution buck.

For lower income earners there are other benefits as well. You will have to do a bit of calculating as sometimes it may make sense to use more of your RRSP deductions as will get other benefits which may be more than the diminished tax savings you will get:

- Ø If you have dependants your Child Tax Benefit and GST Credits will increase as your taxable income goes down. You can calculate how much you will gain as you taxable income is reduced by going to the Calculators page at www.careyvandenberg.com. Click on "Canada Child Tax Benefit and GST Credit Calculator"
- Ø For various thresholds under taxable incomes of \$24,000 per year or less, MSP premiums are reduced in 20% subsidy increments.

2004 Taxable Income (BC)	Tax Rate
first \$32,476	22.05%
\$32,477 up to \$35,000	25.15%
\$35,001 up to \$64,954	31.15%
\$64,955 up to \$70,000	33.70%
\$70,001 up to \$74,575	37.70%
\$74,576 up to \$90,555	39.70%
\$90,556 up to \$113,804	40.70%
\$113,805 and over	43.70%

Mortgage Insurance Comparisons

If you are shopping for a mortgage and usually take the life insurance offered to you by the bank you may want to re-think that habit.

Bank mortgage insurance is very expensive. It is a form of group insurance where you are grouped in with smokers & other health risks. Also the bank owns the policy which means they can cancel it without your consent. They are the beneficiary (the proceeds are paid to them and not to you) and the insurance amount decreases the faster you payoff your mortgage however the premiums don't decrease.

The quotes in the box show you some eye opening comparisons for life insurance on a mortgage for a 37 year-old male, 35 year-old female - Joint First to Die – neither smokes.

<p><u>Life Insurance on \$200,000 Mortgage</u> Bank of Montreal - \$60 month Bank of Nova Scotia - \$ 56 month TD Bank - \$40 month Equitable Life (best on Lifeguide) - \$26 month</p>
<p><u>Life Insurance on 300,000 Mortgage</u> Bank of Montreal - \$90 month Bank of Nova Scotia - \$84 month TD Bank - \$60 month Equitable Life - \$32.75 month</p>

HHHhhhhmmmm.....

A family caring for a child from birth up to age 2, where the family income is less than \$40,700 a year spent an estimated \$6,820 per year for food, clothing, child care and miscellaneous expenses. Families with incomes from \$40,700 to \$68,400 spent \$9,510 per year, and those earning more than \$68,400 spent \$14,000 for the same period. Source: U.S. Department of Agriculture

In the book "Sink or Swim – Get Your Degree Without Drowning In Debt" the author Sarah Deveau talks about how to be virtuous enough not to fall into the trap of keeping up with the Jones on campus. "Some days, it seems like everyone else on campus is driving RAV4s, wearing Gore-Tex jackets and leather boots and drinking \$5 lattes. Do you really think all of them are rich or have no debt? In my experience, the students who spend the most can afford it the least."

In 2001, 10% of Canada's new fathers took parental leave, up 3% one year earlier. Canada ranks 4th in the world for parental leave taken by fathers. The top country is Norway at 80% of new fathers.

A survey of global real estate investors last year showed that the United States continues to rank as the No. 1 country for "stable and secure" property investments, with Washington as foreign investors' top city.

Canada's standard of living had slipped to 84 per cent of that in the U.S.

Stocks have produced an average of 10.4 percent a year for investors since 1926, according to Ibbotson Associates.

A down January preceded a down year for the S&P 500 14 of 18 times (78%) since 1950.

For finding value in equities, Europe represents the best value, followed by the U.S. and then Canada which is on the expensive side.

Thirty years ago newspaper headlines warned of global cooling and a coming ice age.



Chartered Financial Planner

PS. As much as there was an outpouring of donations in both money, provisions and personal time in reaction to the tsunami, remember the ongoing work by organizations in areas of never ending need. Needs that may not attract the same attention but are equally as devastating, namely cancer, homelessness and hunger within our own boundaries and in famine ravaged countries. Many of the organizations that deal with these silent epidemics count on your quiet ongoing, year after year generosity. As is the case with any kind of investment you make, whether for capital appreciation or humanitarian reasons, consistency, patience and discipline are the keys to success.

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