

# MUTUAL GAINS™



published bi-monthly since 1987

Issue No. 107 May / June 2005

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



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## Don't Buy At The Brick - Buy BRIC

The potential for super-charged growth in the financial markets of Brazil, Russia, India and China has attracted the attention of investment managers in the past few years.

The BRIC countries, as the 4 are known, were first identified in 2003 by New York-based investment house Goldman Sachs. These 4 countries as a group offers great growth potential, much better than that of the areas with greying populations (North America, Western Europe, UK and Japan).

All 4 countries are very different and synergistic. India has a highly educated, technical workforce and is growing provider of specialized services. Phone Dell tech support's 1 800 number and you will probably be talking with someone in India. China is a manufacturing powerhouse with cheap labour. Both India and China are growing very strongly. Brazil is a recovery story loaded with various commodities and agriculture. In fact, China buys a lot of Brazil's steel and other resources. Russia on the other hand is heavy involved energy. Shares in Russian companies can be purchased at the deepest discounts in the world.

There are other countries worth mentioning, outside of BRIC, that offer growth potential also, namely Mexico and Eastern Europe. They are strategically tied to big trading blocks such as the U.S. and Western Europe. Other economies, such as those of Poland, Turkey and Thailand, have the potential to grow at a good clip, but they are quite small.

As with any potentially high growth investments, BRIC and the Emerging Markets will put you on a roller coaster ride. If patience is 1 of your strong points however the potential rewards could prove to be very great.

The underlying message of the title "Don't Buy At The Brick - Buy BRIC" is that you can choose to spend on depreciating assets (Brick) or you can choose to benefit financially from the tidal wave of economic activity building in BRIC and other Emerging Markets.

## Buying Investments Below Their Real Worth

The equity markets are not some mystical place but simply a wealth redistribution system, which is often a manifestation of crowd psychology where the crowd usually loses.

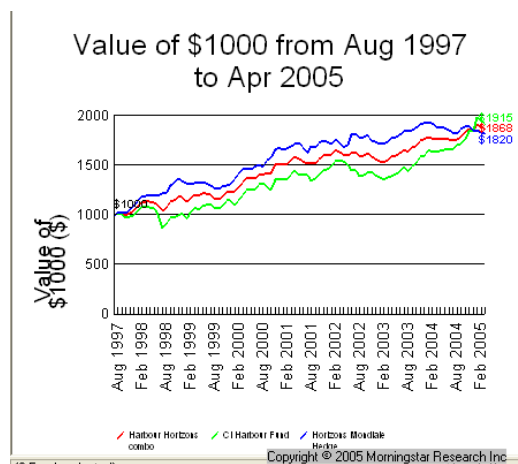
It is because of the crowd psychology that a value investor or investment manager can exploit the difference between the intrinsic value of a company and its quoted price in the marketplace. In other words, he buys when the price he can buy the shares for are way below what the company is truly worth. That is the simple explanation of being a value investor, and in time, a successful investor at the crowd's expense.

How and why share prices fall below actual company worth has all to do with the manifestation of crowd psychology. It has absolutely nothing to do with the change in the companies actual worth. The crowd is what the marketplace is, participants, who in Warren Buffet's opinion (the 2<sup>nd</sup> richest man in the world), often do not know what they are doing. These are the people who do not know the intrinsic value of the companies whose shares they are buying or selling.

The mathematic method in determining the true worth of a company was written by Benjamin Graham in 1934 and is thoroughly explained in the bible of value investing, Security Analysis. Adhering to these mathematical principles stringently has created much wealth over the years. It is the most reliable way to achieve repeatable, long-term investment performance. As I have heard someone say before, value investing requires too much patience, too much thinking and too much discipline for the average investor. Many investors focus on outlook and trends, not value, because such a focus is assumed to deliver good results in less time than value investing.

I've had many a call from people telling of a company whose shares they just had to buy. However, in 18 years of being a Financial Planner nobody has every told me that their investment decisions were based on mathematical or accounting criteria.

## 1 Investment Zigs The Other Zags



To the left you will see a chart which I thought was quite interesting but to me, really not surprising as it re-affirms the approach I have taken in assembling client portfolios, particularly since 1999.

The chart shows 3 lines. 1 is a Canadian equity fund (CI Harbour, Green Line) whose manager I've recommended to clients since 1987. On the other end of the spectrum is a "Hedge Fund" (Blue Line) which I have used for the past 8 years. The middle line (Red Line) is a 50/50 combination of the 2.

Over the past 8 years, through good times and bad, these funds have traveled different paths but come to virtually the same place. Held solely, either of the 2 holdings (CI or Horizons), would have produced attractive returns (mid 8% per year) with low variability. Combining them however has produced a smoother performing portfolio. Less fluctuation with virtually the same, good result.

## Your "Defined Benefit" Pension Does Not Mean "Guaranteed"

"Defined Benefit" (DB) pension plans are plans that promise members a pension for life after retirement, based on income and years of service. For many people, their company pensions mean the difference between a comfortable retirement and one of a scraping by existence.

The reality is that many private DB plans in Canada are currently under-funded. In other words, they technically don't have enough money to pay out to all of their members. Which lead us to a very simple question. Will these pension plans be able to make good on their promises to retired workers? Or will some of these plans be forced to reduce benefits or, in a worst-case scenario, default on them entirely?

Of course, not all pension plans are in trouble. Some are in good financial shape. There are those however which are seriously crippled. A number have already gone under, leaving their pension plan members angry and helpless. Here is 1 example of a pension plan gone bad:

Former employees of the St. Anne Nackawic Pulp Company in New Brunswick got a shock in late 2004. The mill they had worked for, some for all their working lives, went into bankruptcy in September of that year, throwing half the town's population out of work. But that was just the first hit. Later came the news that the company's pension plan had run up a deficit the Canadian Auto Workers union said could be as much as \$25 million. As a result, all employees under 55 years of age were expected to lose all of their pension benefits while older workers would experience cuts. The desperate faces of ex-employees told their stories on the CTV National News.

The Certified General Accountants Association of Canada has warned of a "looming social and economic crisis" in a 2004 report they did on Canada's defined benefit pension plans. In the report they surveyed 847 plans. With the help of Mercer Human Resource Consulting, they concluded that 59% of defined benefit plans were in a deficit position.

## Housing and Consumer Debt Determines Future Health of the Economy

I got these Canadian real estate and mortgage figures from the Globe & Mail, June 14<sup>th</sup>. Underlying trends are important to know when assessing risks, risks that can filter down to you:

60% of mortgages have been renegotiated over the past 24 months.

50% existing Canadian mortgages were done with a down payment of less than 10 per cent.

2.2%: Canadian household debt has risen 2.2% in the last 3 months of 2004. Personal income rose a mere 0.3%

There was \$21 billion of EXTRA consumer spending over the past 36 months.

Personal lines of credit increased 25.9% in April, compared with the same month in 2004.

\$55-billion was withdrawn from existing home equity.

There was a 19.1% rise in debt-to-asset ratio for Canadian households at the end of 2004.

## The Sky's Are Clearing For Private Equity aka Venture Capital

Venture Capital or Private Equity is money invested by people like you and me that has made small companies morph into big companies and in the process made a lot of people very wealthy. Bill Gates and Microsoft have to be the most famous modern day example of Venture Capital successes. However, all you have to do is look at Christopher Columbus to see that Venture Capital isn't a new concept. Isabel of Castille, after some due diligence, financed Christopher Columbus in a private deal, expecting low liquidity but possible extremely high returns — if only he had found India.

Over the past few years, Venture Capital has had a tough time sledding. As opposed to the insane pace of the mid to late 1990s, during which two guys in a garage would plug two machines together and raise \$10 billion, the early 21st-century VC market has had the closed sign in the door window for quite a while. In the last 18 months though, the tide has turned and investors are quietly trying to buy that next home run. This has started to put upward pressure on the prices of small, feasible businesses with commercial potential.

The most common way most people dip their toe into Venture Capital investing is through a Labour Sponsored Fund. LSIF offer tax credits in the neighbourhood of 30%. That tax credit, combined with what I believe is a strategically good time to invest in this asset class make a professionally managed Venture Capital investment pool something that should be part of most long term investment portfolios, namely an RRSP.

Note: I haven't mentioned the issue of "stale pricing", a common issue in a Labour Sponsored Fund, one which could potentially work in your favour today. Call me if you would like me to explain this further.

## Hot Tubs & Hardwood – They Aren't Tax Deductible

Under the Income Tax Act, medical expenses qualify for a 16% federal credit as well as a provincial credit. In addition to the most common medical expenses like prescription drugs and dental bills, other qualifying expenses can include certain home renovation costs. The problem that CCRA has had to deal with is they didn't mean the cost of hot tubs and hardwood floors. These have been the most popular home renovation expenses claimed for medical reasons.

The most recent hot tub tax case, which was decided last fall, involved a taxpayer who was on long-term disability and suffered from several serious medical conditions including clinical depression and bi-polar disorder. He purchased a hot tub on the recommendation of his psychiatrist, who recommended hydrotherapy to provide "deep relaxation for depression and anxiety." While the judge did not allow the cost of the hot tub as medical expense, he did allow the cost of the installation of the hot tub.

As for hardwood floors, a June 2003, case involved a taxpayer suffering from severe allergies who had his carpeting removed and installed hardwood floors "to remove sources of mould in the house." In this case, the judge concluded that the \$11,000 cost indeed qualified as an eligible renovation expense for purposes of the medical expense tax credit.

The government is now cracking down on the installation of both hot tubs and hardwood flooring. As the budget documents state, "such an expansion goes far beyond the policy intent of the credit because it subsidizes renovation expenses that increase the value of the home, and extends tax recognition to expenses with a substantial element of personal consumption and personal choice."

There is now a 2-part test which determines the legitimacy of a tax deduction. One, the expense must not typically be expected to increase the value of the home. Two, the expense must be something that would not typically be undertaken by someone without a mobility impairment.

## HHHhhhmmmm.....

A CPP audit released by the Retirement Planning Institute (RPI) found errors in 1 of every 6 people receiving CPP benefits resulting in retroactive payments to date of \$1.3 million.

Ottawa spends 20% more on a per-square-foot basis than the private sector average to operate its real estate.

Corporate balance sheets in the U.S. are loaded with cash, and earnings quality is the best it has been in 15 years, according to Empirical Research Partners.

Pension funds have always maximized foreign content. In contrast however, according to a 2004 RBC/Ipsos Reid RRSP poll only 5% of RRSP holders used up their 30% maximum.

Between 1985 and 2004, moving from a 100% Canadian portfolio to 40% Canadian one, with the balance invested internationally, reduced risk from 15.3% to 13.3%, while increasing returns from 11% to 13%. (AIM)

"To me they (business income trusts) are just small cap stocks where the owner wanted out of the business and no one else would pay him the price anywhere near what he could get in the Income Trust market. So the retail investor, if you will, is the high bidder." Stephen Gerring, portfolio manager of the CIBC Monthly Income Fund

"Business trusts look like U.S. junk bonds." (Financial Post April 22 2005)

Henry Ford failed and went broke five times before he achieved success. Dr. Seuss's first children's book was rejected by 23 publishers. The University of Bern rejected Albert Einstein's Ph.D. dissertation on the grounds that it was irrelevant and fanciful.

At the end of Dec. 2004, Microsoft had a market capitalization of \$290.7 Billion with sales of \$38.5 Billion. A Global Equity Portfolio I use for my clients held a portfolio of companies with a combined market capitalization of \$176.0 Billion and sales of \$142.7 Billion. (Source: Factset and AIM Trimark). What do you think is better value?

Tim Hortons accounted for more than 25% of Wendy's \$3.6-billion (U.S.) in sales last year and nearly 50% of its profit.

The #1 exporter to China is Japan.

TD expects home prices to grow at an average annual rate of about 3% over the next decade.

Land and structures account for approximately one third of the average households' total assets.

The bonds issued by Ford and GM's were downgraded on May 5<sup>th</sup> to "Junk" status.

Since 1973, average international stock gains plus dividends have produced a 24 fold return on investment. In other words, \$100,000 would have been worth \$2.4 million today. (Datastream)

The average Japanese has 55% of personal financial assets in cash. (Henderson Global Investors)

Vancouver is the only city in Canada that has speculative excesses in its real estate market. (David Rosenberg, chief North American economist Merrill Lynch)

In 1998 and 1999 oil had fallen to \$10 / barrel and the prediction was that it would fall to \$5. The headline on the front cover of the March 1999 issue of the Economist read "Drowning In Oil" and talked about the problem of too much oil. At that time many "value" investment managers had oil companies listed in 50% of their top portfolio holdings. Today that number is close to 0.

"The law of supply and demand isn't the main factor driving up (oil) prices...market fundamentals clearly indicate without any doubt that supply in the world markets is more than demand"

Mohammed bin Dhaen al-Hamili, United Arab Emirates' oil minister



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