

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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Stopping the Income Trust Tide

On September 19th the federal government stopped giving advanced tax rulings to companies attempting to convert to trusts. It looks this announcement has discouraged some companies from converting to trusts and it has also created uncertainty and volatility in a lot of income trusts.

CCRA loses approximately \$600 million in tax revenue because of income trusts, 2 times as much as last year. The losses are due to the way taxes are paid. Income Trusts don't pay any tax at the corporate level. Trusts pay little if any corporate income tax. Instead, a trust's cash flow is distributed to investors who are then taxed on at their personal tax rates which are lower.

It is expected that closing this loop hole could come in the next Federal budget either by an increase in taxes on income trust distributions or a tax cut for dividends on traditional companies.

Note: Income Trusts are nothing new. They started in 1984 as a vehicle to sell portfolios of aging oil wells to retail investors. It has been only in the past few years that almost every other business has been looking at converting to an income trust.

Interest Rate Inversion

An interest rate inversion is like a temperature inversion. It happens, but not very often. In the case of temperature it is when the atmosphere is warmer the higher up you go. An interest rate inversion is when short term interest rates are higher than long term interest rates. The most famous event of this was in the early 80's when short term interest rates were 18 – 19% but long term interest rates were closer to 11%.

This looks like what is happening today, but at much lower levels. Normally this means that an economic slowdown could be just around the corner. A weakening economy often brings about lower long-term interest rates because it reduces inflationary pressures and demand for credit.

Chasing Hot Performers Kills More \$ Than It Grows

RRSP investors in particular are often tempted to boost the growth of their investment portfolio. This can lead to increasing risk to potentially devastating levels because 80% of investors often buy those hot investments at their

peak performance levels leading to several years of mediocre performance or chasing the next hot investment, again, when it's too late.

The mathematical fact is that if something has done abnormally well in the shorter term, it will struggle for an equally long period of time after that. Here are some recent market numbers:

Take note, that these are not mutual funds but indexes so management has no bearing on performance quality as there is no management. It simply comes down to deviation from their respective averages and what is most likely to happen going forward.

Index (Cdn \$)	1 yr returns	3 yr returns	Since Inception
S&P 500	3.1%	5.2%	10.5%
MSCI World	9.6%	9.0%	12.4%
TSX 60	31.1%	24.0%	10.8%

Source: Morningstar, to Sept 30th 2005

So where are you going to add more money? Are you going to chase or anticipate?

Asset Allocation – A Comparison Between Tactical And Strategic

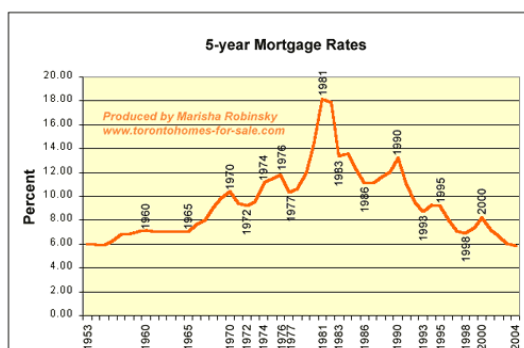
I believe most of us are long term investors. However, if you are like me, I'm sure you have thought about how to capture the swings in an investment or "market". In other words, trying not to succumb oneself to an investment that is falling in price. There is often a lot of guessing to that kind of strategy. It's also triggered by emotion which can more often than not lead to poor results. That is typical of a Tactical Asset Allocation (TAA) approach. Here are the comparisons between TAA and Strategic Asset Allocation (SAA):

- TAA attempts to time the market based on short term expectations / outlook.
- ✓ SAA gradually adjusts portfolio balance in response to changes in long-term trends.
- TAA can swing from fully invested in cash to 100% in high risk assets.
- ✓ SAA is based on pre-determined balance parameters and periodically brought back to balance.
- TAA often holds too much cash when least advantageous, negatively effecting long-term results.
- ✓ SAA rebalances, selling assets that have over-performed and buying assets that may be undervalued.

The Wealth Effect – The Risk Of Feeling Good

TD bank came out with a warning in a recent report. TD says that the engine of U.S. economic growth has been led by the U.S. consumer feeling good about the wealth they have accumulated through their home's rising value. When house prices inevitably slow their sharp, 4 year upward race, the U.S. economy will falter. This could send a ripple effect throughout the world. It will likely begin in the second half of 2006.

U.S. house prices have risen at an average annual rate of 9.4 per cent since interest rates plunged in 2001. This boom in price appreciation "dwarfs past periods that were known to be bubbles". The fruit of this boom has created an unprecedented "wealth effect" which has triggered consumers to spend more money by putting more and more debt on their homes through home equity lines of credit (in the U.S. any debt against a home is tax deductible).



Today, U.S. household debt is in "uncharted territory" at 121 per cent of after-tax income.

So what does it look like here in Canada? According to a "just out" CIBC report, quite similar, both from a price appreciation perspective as well as a borrowing perspective. In Canada, borrowing against home equity rose by 25% last year. This added \$30 Billion (with a B) in cash to consumer wallets. Almost every home purchase in Canada last year generated \$25,000 in additional spending (reno's, furniture etc), a total of \$10 Billion. Just like in the U.S., this spending has kept the Canadian economic party going.

The housing markets on both sides of the border are expected to level off in 2006. This means that consumer spending will taper off dramatically and the general economy will follow in this cooling. As it says in the CIBC report, "there are reasons to believe that the housing market is in the early stages of levelling off. Residential real estate investment is very close to it's resistance level of just over 7% of GDP (we last time we saw this was in 1988-89 and 1972-76)

U.S. Pension Plans Are Using Hedge Fund To Smooth Portfolio Returns

For many pension funds, particularly in the U.S., the trend to invest in Hedge Funds and Managed Futures funds is being driven by simple arithmetic as returns from stocks and bonds in recent years have not kept pace with payout demands pension funds face.

State pension plans such as the New Mexico State Investment Council this year allocated US\$1-billion to hedge funds, which promise returns not correlated to wider markets. If stocks or bonds perform poorly, hedge funds pick up the slack. In other words, when equity markets zig, hedge funds tend to zag. The New Mexico's pension plan must pay at least 5% a year to educational institutions. To keep pace, the pension plan must generate returns of least 8.5%, adjusted for inflation.

With the aging Baby Boomers, many public employee pension plans must payout higher and higher amounts. To offset shrinkage in assets, they are increasingly looking to diversify into hedge funds, which have traditionally been a mainstay for university endowments and foundations.

How Many Apples Can Grow From An Apple?

One of the first books I read 18 ½ years ago when committing myself to the financial advice profession was reading "The Richest Man In Babylon" and shortly after that the "The Wealthy Barber", which is the modern day version of the very same principle.

These 2 books are foundational in understanding that creating wealth is quite a simple concept. That simple concept which was originally referred to by Einstein as the 8th wonder of the world, is "compounding".

Here is away to explain this in simple terms to your young kids or grandkids. Take them to an apple tree loaded with apples. Pick an apple and cut it open. Ask the child to count the seeds in the apple. Ask them how many apples they think can grow from those seeds, extrapolating that over many seasons. That's compounding.

Insuring YOU - Definitions

Whole Life Insurance: gives you the low-cost protection of term insurance with a savings / investment component that is invested in an account that grows within the policy TAX FREE.

Universal Life Insurance: allows you to shift money between the insurance and savings components of the policy, creating more flexibility than whole life insurance.

Long-Term Disability Insurance: pays you a monthly income in the event you can't work or are forced to work less due to illness or injury.

Critical Illness Insurance: pays you a lump sum if you get a serious illness (cancer, a heart attack or a stroke).

Long-Term Care Insurance: pays out a monthly income for life should you become chronically ill or are disabled and can't care for yourself.

Combo Insurance: a new kind of policy that wraps Long Term Disability, Critical Illness and Long-Term Care Insurance into 1 policy.

Protecting Your Records – Lessons From New Orleans

With the natural disasters we have seen over the past 10 months (tsunami, hurricanes, floods and earthquakes) you have to ask yourself, "is my important information, priceless pictures and other things I can protect easily, safe from permanent loss?"

One of the wonders and graces of the computer / softcopy age is that all sorts of information, documents and pictures can be easily duplicated making it very easy to protect information that, if lost, could prove to be catastrophic or emotionally devastating.

One of the ways to protect your data is by way of a portable hard drive. Everything from music, pictures to tax returns can be transferred or backed up to an external hard drive no bigger than a average hardcover book. External hard drives can store much more information than CDs, DVDs or keychain-sized flash drives, from 40 to 500 gigabytes, and many can be set to periodically back up important files or your entire computer.

For smaller files and blocks of pictures you can also burn these to a CD (or 2 or 3). One of the bonuses of putting your important documents on a CD is that they can duplicated multiple times, allowing family members or friends who live in other areas to store an extra copy for you.

A more convenient, though somewhat pricey option is an online storage service, which allows you to upload important documents to the internet, then retrieve them from any web-connected computer.

If the portable hard-drive option appeals to you, a good place to find one very reasonably priced is on Ebay (it's the first place I look when looking at purchasing anything that can be shipped).

HHHhhhmmmm.....

Many emerging market countries are soon to be net creditors in the world's financial system for the first time since the "emerging markets" asset class was created.

Canada's current unemployment rate of 6.8% is the 2nd lowest on record.

While oil prices are about 45 percent higher than a year ago, they are still below the inflation-adjusted peak set in 1981.

Enerplus Resources Fund, a large, well-run royalty trust, is trading at 2006e 10.8x price/cash flow. Canadian Natural Resources, a large oil and gas producer is trading at 2006e 3.8x price/cash flow. Based on this valuation metric, investors are paying almost 300% more for Enerplus than Canadian Natural Resources. In general investors are paying more for royalty trusts relative to comparable common equities. Source: Cypress Capital Management, Vancouver

Small retail investors control well 60 – 65% of the more than \$160-billion income trust market. Pensions hold less than 1%. (Globe & Mail)

Ontario Teachers Pension Plan has \$4.8-billion invested in hedge funds and managed futures, 5.7% of its \$84.3 billion in investment assets. (Globe & Mail)

Health insurance for a U.S. family cost \$10,880 this year, with the employer paying \$8,167 and the worker \$2,713. That is almost exactly the total annual earnings of a person working full time at the U.S. minimum wage. (Kaiser Family Foundation)

The rate for a 5 year mortgage in Canada is the 2nd lowest ever recorded. (CMHC)

200 years of interest rate history shows that the low to mid single digit interest rates we have been seeing are very normal.

The median sale price of a previously owned home in the U.S. rose to \$220,000 in August, up 15.8 percent from the same month last year -- the fastest 12-month pace in 26 years (National Association of Realtors)

In the high priced real estate markets of San Diego, Atlanta, San Francisco, Denver, Oakland and San Jose, more than 40% of mortgages require only interest only payments.

1/5th of new, high ratio mortgages in the U.S. are interest only. (CIBC World Markets)

Bankruptcy in Canada is has been increasing by 10% on a year over year basis. (CIBC World Markets)

The Canadian personal savings rate is below 0%. This is the lowest level since the 1920's. (CIBC World Markets)

Nearly 1 in 8 workers in the United States have at some point worked at McDonald's Corp. (*Fast Food Nation* by Eric Schlosser)



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