

# MUTUAL GAINS™



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



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## Some Good Tax News

The first bit of good news is that federal tax brackets have gone up in 2004 to keep pace with inflation. Last year, every dollar you earned over \$104,649 was taxed at the absolute highest rate possible. This year the highest rate doesn't kick in until you earn \$113,805. This is because tax brackets are indexed to inflation. The next highest federal tax bracket doesn't come into effect until you earn \$70,000. Last year it was \$64,369. The second lowest bracket starts at \$35,000 instead of \$32,184. And your basic personal exemption (the amount on which you pay no tax at all) is now \$8,012 instead of \$7,756. Bracket creep is dead. For that we can be thankful.

Another thing to make you smile is that the amount of CPP coming off of your paycheque didn't go up. This is the first time in several years there have been no increases. (CPP contributions are shared 50/50 between you and your employer, or a 4.95%/4.95% of your income. If you are self employed you have to pay both, 9.9% to a maximum of \$3,663 for 2004. Why no increase you ask? It appears that these contributions will keep the CPP going for the long term.

What does it mean for you? If you earn \$50,000 you will save \$210 in taxes in 2004, compared with 2003. You will save \$435 if your income is \$70,000. And if you're earning over \$113,804 in 2004, you will save \$710.

17 years ago when I started working as a Financial Planner I found myself continually writing about increasing income taxes. They reached their highest levels at over 54%. What a difference time can make.

## Using The Tax Bracket Indexing Trend To Your Advantage

As long as Ottawa doesn't increase tax rates, and your income remains relatively consistent from one year to the next, you'll come out ahead by delaying the payment of income tax to a future year. It's the proverbial "save tax now, pay it back later". As long as our tax system is indexed, which it has been for a couple of years now, deferring tax works in your favor, and the longer you can defer tax the more you will build your wealth.

Deferring a tax bill is an incredible wealth-building tool. How powerful would it be if you could pay absolutely zero income tax now, take that money and invest it or pay down debt and pay the tax well into the future? How much better off do you think you would be? Well of course you can't defer all of your income tax but you can do it with some.

These are the best ways to do just that. 1) Contribute to an RRSP or a similar deferred plan such as an "exempt" life insurance policy, 2) Defer taxable dispositions of assets until a future year (i.e. real estate), 3) Base your RRIF withdrawals on the age of the younger spouse (this must be done when setting up a RRIF), 4) Delay receipt of a bonus from your employer for up to three years, 5) Invest in mutual funds etc. that "buy and hold" their investments rather than continually trade them and 6) Avoid getting tax refunds by reducing your tax at source (you can find the form to do that at [www.careyvandenberg.com/Tax\\_Reduction\\_At\\_Source\\_Request\\_Form.pdf](http://www.careyvandenberg.com/Tax_Reduction_At_Source_Request_Form.pdf))

## When NOT to Contribute To An RRSP

Yes, there are times when you should either forgo an RRSP contribution or simply delay it. Here are a few instances when claiming an RRSP deduction may not make sense:

If you expect your income to be substantially higher this year than last it is probably best to save the RRSP deduction. Example: If you earn \$60,000 this year and \$85,000 next year, rather than save \$300 in tax for every thousand contributed into your RRSP why not save \$400 per thousand? Sure, go ahead, make the deposit but don't claim it on your tax return, at least not just yet.

If you don't have the money then it might not make sense to contribute to your RRSP. How is that for contradicting conventional wisdom. Sure you can get a loan and pay it off over the next year or two (or three). Sure interest rates are cheap however, if borrowing to make an RRSP contribution is an annual cycle for you then it may be time to put a plan in place to get ahead of the game. This will save you the interest you pay every year on an RRSP loan as well as making your overall RRSP portfolio perform much better.

If you expect that your retirement income will be at the bottom 1/3 of all retirees in Canada then an RRSP contribution may not be the best way to go. Why not? Because you could jeopardise receiving your full GIS (Guaranteed Income Supplement). This is paid to low income earners age 65 or over. Low income is up to \$18,720 for a single retiree and \$28,272 or less for a couple's combined retirement income. This is something that should be checked carefully with a financial planner to determine you aren't shooting yourself in the foot by trying to get an RRSP tax deduction now.

## Past History Is All We Can Go By

Over the past few years we have seen the lowest inflation, the lowest interest rates and the most tumultuous time for equities in well over 50 years. This makes today a perfect and balanced time to really look at the average investment returns for several asset classes (10 year averages ending Dec. 31<sup>st</sup> 2003). What I mean by a perfect and "balanced" time is that interest rates are low (bad for savers) and equities have done poorly in the shorter term. -->

What can you gather from this? If most of your investments are in cash or deposit type investments you can expect to earn no more than 5% per year and your "financial plan" and the long term projections that are used should assume slightly less than that.

Consumer Price Index (Canadian Inflation)	1.77%
Scotia 91 day T-Bill Index (Canadian T-Bills)	4.61%
5 Year Average GIC Rate (Canadian Bank GICs)	5.19%
Scotia Universe Bond Index (International Bonds)	7.87%
S&P / TSX Composite Index (Canadian Equities)	8.47%
Standard & Poor's 500 Index (U.S. Equities)	10.32%
Dow Jones Industrial Average (U.S. Equities)	12.34%
All returns are show in Cdn \$ and include the reinvestment of dividends and interest	
Sources: Globe HySales, Micropal	

Is that money outside of a "Registered" plan (i.e. RRSP or RRFIF)? You need to subtract inflation and your tax rate to determine how much you are moving ahead (or behind?). Your tax rate will be the deciding factor in that regard. In dollar terms that would look like this:

$\$100,000 @ 5\% \text{ Interest} = \$105,000 - 1.8\% \text{ Inflation} = \$103,200 - 40\% \text{ Income Tax} = \$101,280 \text{ or } 1.28\%$

That 1.28% is what is called your "real return" and in this case it ain't much. If you can compound at over 3% or more in real terms, which a "balanced", pension style portfolio has shown to do over time, you will have considerably more income in retirement.

## The Risk Is In You Not Investing

The cost to mail a letter in 1983 was 30 cents. Today it's 49 cents. That's a 36% increase or 45.5% with GST.

That is inflation in action. With tax and inflation eating away at your money the cancerous way you have to ensure your money doesn't die of these two money cancers. I would suggest that if your money is smoking either savings account or bank deposit interest, cancer is going to kill it.

You may have experienced first hand the risk of fluctuating equity investments. Over the past 75 years, equity investment risk hasn't been more evident than it has over the past 3 years. However now, a little over a year later the rewards have also shown themselves. Risk..... reward..... reward..... risk..... Reward..... reward. 2 steps forward..... 1 step back..... 2 forward..... 1 back. That is the way it has gone, year in and year out for hundreds of years, yes hundreds of years.

Pension plans as an example know this. That is why a typical pension plan will have a mix of 50% in equities, 40% in bonds and a bit of cash. They do so because they know that is the safest way to get the best return possible so that they can pay retired workers like you the highest amount of retirement income for life. Is your money invested just like a pension plan? If not, I can guarantee you will pay the price during your retirement.

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As long as you hold HIGH QUALITY INVESTMENTS THAT HAVE BEEN PURCHASED AT A GOOD PRICE you will be well rewarded over time. You just need patience and to hold on. The latter of course is best done in partnership with an investment advisor or Financial Planner you trust, one who will ask tough questions of you when you are most vulnerable to folding.

## **You Understanding You and Your Behavioural Diseases**

You understanding “you”, and how you react to negative and positive events is more important to your financial success than choosing the best investments. The study of how you view and react to money situations is called “Behavioral Finance”. It shows how significantly investor traits and behavior impact invest decisions and investment success in the long run.

Here are some negative behavioral examples:

**Loss Aversion:** I know you hate losing more than you like gaining. As a result, you may be reluctant to sell a bad investment. I hear this very often in the common words of, “I’ll wait until it gets back to what I paid for it” or “...as soon as it gets to this price (amount) I’ll sell it”. If this is you, you now know what to call this behavioral condition.

**Anchoring:** You may believe that the investment you bought, you bought at a “good price”. This is often associated with Loss Aversion. Common saying is, “It will come back”. If you are so convinced then why not load up on a lot more now? As I suspected, anchoring.

**Mental Accounting:** This is a common disease in all areas of finance, not just investment portfolios. Instead of analyzing your total wealth, my guess is that you tend to subdivide it into “accounts”. For instance, you may be dissatisfied that one “account” didn’t do as well as another, or one did worse than the other. Look at your hands in this context. Your right hand may be more useful than your left hand most of the time (or vice versa for you lefties) however they both serve an important purpose in the overall scheme of things.

**Representativeness:** We tend to see a trend when in fact there is no evidence of a trend. The classic example is the gambler with the “hot” hand. When things are going well the belief is that it will continue and when you are losing you will continue losing. The belief is that the recent past will repeat itself. This disease was most widespread in late 2002 through early 2003.

These concepts are useful because they explain how “irrational” our behavior can be. We all have these diseases flowing through our psyche. Know them. See them. Face them head on and fight them.

## **TPSP Along With Your RRSP Yes? No? May be so?**

A TPSP is not a new concept and, before you get excited, it is still not available in Canada. If a TPSP sounds familiar, it may be because I wrote about it a few years ago. I am mentioning it again however because it still shows up on the radar screen of our Federal Government.

A TPSP or “Tax Pre-Paid Savings Plan” is a plan that, unlike an RRSP doesn’t give you a tax deductions it does however allow you to put money into a plan and have the interest it generates compound tax free. The idea shows some light in it becoming available in Canada as there was an encouraging reference to TPSPs in the last federal budget and currently, the Department of Finance has been gathering information with pension consultants and actuaries. Similar savings plans were put in place in the U.K. in 1987 and in the U.S. in 1998.

This could be a very effective plan for those who have interest bearing investments outside an RRSP. However, its availability may only be to income earners below a certain threshold as it is in the U.S. Sure its only an idea floating around in government circles however because of the added scandal Auditor General Sheila Fraser has recently uncovered in the Liberal government’s money handling, Paul Martin may just make this idea a reality in the interest of procuring votes. Stay tuned.

## **A Henson Trust For Your Disabled Child**

As with all government income assistance programs, as soon as you reach a certain income threshold your government assistance is clawed back. This is the case with GIS and OAS as mentioned earlier in this letter and it is the case if you have a disabled child.

When you die and you pass on your assets to your disabled child directly they will most likely have to invest the money they receive through your will. Most likely it will be invested to earn them an income. Unfortunately, that income could push them into a position where social assistance payments related to their income and their disability will stop.

The way to work around this is to set up a “Henson Trust”, a trust that can only be set up when the beneficiary suffers from a several and prolonged mental and physical impairment. The trust is a separate taxpayer or “person”. It is considered as a separate taxable entity, files it’s own tax return and pays tax at graduated rates based on the trust’s income.

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Why is all of this so significant? One, you can reduce your own personal tax now by transferring assets into a "Henson Trust" and growing those assets very tax efficiently. The other is that the trust can pay out income to the disabled child on a discretionary basis so as not to disqualify ongoing social assistance. This is very important as, with a disabled person, if you are disqualified from social assistance once it can be difficult if not impossible to re-qualify. And because the trust is a separate entity it doesn't die when you do.

Should you wish to look more closely at this idea I invite you to call me. Together we can, along with the legal and accounting professionals within my network, make a "Henson" Trust work very well for you.

## HHHMMMMMMmmmmmmmm.....

CML Healthcare, a small company that does both medical testing and drug research, added \$200-million to its market capitalization. Its announcement that it would split itself into 2 separate companies, one of which would be an Income Trust, triggered this 29% one day share price increase. And it didn't even create one measly penny of additional profit or cash flow.

The average consumer in Canada has taken on 18% more debt since 1999. (Ipsos-Reid)

The ratio of vehicle ownership to members of the driving age population is greater than one to one (100%) in the U.S. In other words, there is a 1:1 relationship for those who have driver's licences to vehicle ownership. In Canada the numbers look quite different where just 69% of the driving age population owns a vehicle. (DesRosiers Automotive Consultants Inc)

OAS benefits have recently risen by 0.2% to a basic rate of \$462.47 per month, while CPP benefits have risen 3.2%.

Since 1914, inflation has averaged 3.14% (Bank of Canada)

Thanks to the strength of the Canadian dollar, Toronto is now a more expensive place to run an office than downtown Manhattan.

The cheapest and largest labour pool is in China. In the industrial, north east section of China the average hourly wage is US\$0.60. Mexico, by contrast is US\$2.26.



CFP, Chartered Financial Planner

PS. Important Note for those making their 2004 RRSP contributions: The maximum RRSP contribution limit has gone up to \$15,500.

PPS If you aren't viewing this on the web I would like to bring your attention to the fact that it is available now at [www.careyvandenberg.com/mutualgains.pdf](http://www.careyvandenberg.com/mutualgains.pdf)

PPS Are you kept up to date on timely financial news, investment updates, tax saving ideas etc.? If you haven't subscribed to the "Mutual Gains E-Loop" you can do that by e-mailing [cheryl@careyvandenberg.com](mailto:cheryl@careyvandenberg.com) or you go directly to [www.careyvandenberg.com/eloop.php](http://www.careyvandenberg.com/eloop.php)

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