

# Mutual Success

Your Fund of Information



Dec 5, 2008

## Common Sense in Uncommon Times

I have just come from having my haircut, an interesting thought as it is falling out faster than it grows these days, and as we tear our hair out trying to understand what is happening and why. As I relaxed while having my hair shampooed and my scalp massaged, I could still not escape from the dialog about the financial crisis and economy. Though I tried to relax in silence I could hear the stylists on either side of me discussing the current turmoil and its impact with their clients, and what became very apparent was the reality that everyone has been impacted either directly by losses in their retirement portfolios or by the contraction in consumer spending. One of the customers was bemoaning the fact that her husband was laid off at the beginning of the month, and that they would perhaps have to move for him to get a job in his field. The other was a gentleman who shared that he has to postpone his retirement for a few years because his portfolio had been ravaged by losses in excess of 30%. As we take stock of our own positions we need

to consider how best to proceed. As usual, good old-fashioned common sense is the key!

### The Importance of Planning

I have had a number of discussions with both existing and prospective clients in the last few days. It is evident that before deciding where and how to invest their funds, people should take a step back to determine their life priorities, legacy, and estate goals so that their financial needs can be fully quantified and personal risk-return model developed. What we wish to achieve personally and financially are key, and with less financial resources today than even a few months ago, it is even more important to have a real plan to achieve those goals. In low return environments and where interest income is fully taxed, tax structuring and planning will be essential to optimize financial outcomes. Common sense would indicate the best investment today is the time you invest in developing your goals and the plan to fulfill them.

### Rethinking Personal Investment Risk Tolerance

Our experience shapes our response to risk, and it is evident that the declines in the markets and the current uncertainty are causing many to rethink the amount of risk they are willing to take. Our view of investment risk is also changing as we have witnessed the declines in our investment portfolios. For some the belief is that the only way back is to hold fast to the market positions, hoping that a rebound will come. For others the fear of continued loss results in a desire to withdraw completely from the market. Yet others believe that while there is considerable market volatility, there will be some good investment opportunities to emerge from the current carnage. Common sense suggests that if you would not go out and acquire an investment you hold within your portfolio today, probably the most appropriate action is to sell it.

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## Rethinking Investment Risk and Portfolio Returns

The Depression in the 1930s was triggered not by the collapse of the stock market but by the failure of the banking system. While we may draw some comfort in Canada that our banking system is held in high esteem globally this week has again seen write-offs from exposure to the global banking crisis. The bailout of big name banks such as Citigroup and Royal Bank of Scotland as well as European Banks demonstrates that we are still not clear of the possible after shocks of this financial crisis.

It is uncommon for interest rates on guaranteed interest certificates to offer higher yields than the corresponding term government bonds, but as fear of deflation is increasing, the yield curve is being pounded down with 20 year Government bond yields below 3% as there is a flight to quality. Interestingly the yield difference between Bank of Montreal's quoted 4 year GIC of 2.4% and the yield on its bonds with similar maturity of 7.92% is over 5.5%. The top yielding 4 year GIC currently is from B2B Trust and is CDIC insured is 4.35%. GICs are generally illiquid during their term, but in a drive to attract deposits, some banks are offering teaser rates above 4% with interest adjustment if you withdraw during the term. The question is "Do you buy the Bank of Montreal's GIC, or its Bond, or its stock (which has a current dividend yield of over 8% if dividends are sustained)?" Certainly as markets stabilize, the risk premiums on bank and other bonds can be expected to reduce and bonds and bond funds will deliver capital appreciation. Common sense would suggest that we do not put all our eggs in the same basket.

Dependent upon our risk return objectives different combinations of income portfolio can be constructed with high yield interest accounts for liquidity, GICs for security and stability, well managed bond funds and dividend funds for yield enhancement.

## Insurance and Estate Planning Opportunities

**Guaranteed** Interest Accounts offered by Canadian Life Insurance companies are governed under the Insurance Act, and can be used to designate a beneficiary other than your estate and bypass the Probate delays and Probate Fees. There may be a small differential in yield between the banks and insurance companies, but where there is the estate planning objective to by-pass the Wills Variation Act or to avoid a delay in the probate process, the insurance option is a great solution.

**Term** Certain Annuities (TCAs) also offer an interesting option in part because annuity income qualifies for the Pension Credit, and therefore can be income split with a spouse, and because under certain circumstances the interest may be averaged over the term, resulting in a lower tax bill through tax deferral. TCAs also bypass the estate, and continue to be paid to the named beneficiary, a useful tool for providing for kids or grandkids without leaving a lump sum.

**Life** Annuities provide income for life, generally with a minimum guarantee period of 5 years. These annuities can qualify for the same income averaging tax treatment for non-registered funds, and can be

combined with life insurance to replace the capital to beneficiaries. The current equivalent pre-tax yield on a non-registered Insured Annuity varies between 5.5% and 7.5% dependent upon age and amount.

We have previously referenced the Guaranteed Withdrawal Variable Annuity products, which provide for cash flow guarantees for life with a variable estate value, that may take advantage of market performance to increase the drawings amount. Again in the right circumstances these tools will assist clients to create predictable cash flows which are a key to retirement piece of mind.

## What about the Market?

We are still of the mind that the sidelines will be the best place to watch much of the first half of 2009. Long term we believe that from the compressed position that the markets are in, there will be future growth, and we will be looking in the new year for signals to start dollar cost averaging into the market in measured steps according to the risk profile and objectives. With this



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in mind, we will aim to start meeting with every client family early in the New Year so that we can update your financial planning in the light of the changes. In the interim, we believe that patience is the key. Common sense suggests that we should complete the plans before we embark on major investment decisions.

### Constitutional Crisis and the Grinch!

I cannot give up the opportunity to comment on the carryings on we have witnessed in Ottawa this past week. We would not accept behaviour like that from our children, and we should not accept it from the politicians of this country. Demonstrating poor judgment in the light of the recent elections, the Prime Minister lost stature and the Opposition also lost credibility. In my opinion, our Government should not be bailing out failed business like the auto industry and the forestry industry any more than they did for the fisheries. It is time for common sense in Ottawa!



The key is to provide stability for people to stay in their homes, through proper Employment Insurance, the incentive to employers to employ new employees by transitional incentives and education investment incentives, and to make available through the Business Development Bank the start-up loans and working capital for small business to become the engine of renewal. I would like to see tax relief provided to those individuals who have seen losses in their retirement savings plans have the same option that pension plans have to top-up their funds with tax-deductible contributions.

The US model of bailouts is tied to trying to prevent their banks from failing. Failure of "The Little Three" US car manufacturers as they were referred to in the Senate hearings today will trigger collateral damage for insurance companies that insure their bonds and credit through credit default swaps and banks and pension funds who hold GMAC and Ford Credit Bonds. Acres of cars in lots around US and Canada point to the disconnect between production and

market demand. The excesses of easy credit have been entrenched in the fabric of these corporations. Now it is time for a reality check. History has shown that bailouts for US car companies by Canadian Federal and Provincial Governments have not provided any greater job security for Canadian workers. This is not the way to go, but no political leader in Canada wants to play Grinch, so I suspect we will now see some largesse in this area.

Common sense says that sustainable jobs come from sustainable businesses that add value. As we look forward to Christmas and New Year, we hope that the Investaflex Team can continue to serve and add value to your family's wealth and wellbeing. If you have any questions please do not hesitate to call.

Best Regards,



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