Wealth Matters - Summer 2006

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What's In a Name?

Our clients often ask why they see other company names besides Page and Associates on communications they receive from us. Page and Associates has been a financial planning firm for over twenty years, and because we believe that your financial decisions should be made in the context of an overall financial plan, we try to do most of our communication under this company name. When the time comes to implement your financial plan, financial services industry regulations often require that different financial products be purchased through separately regulated companies – and that communications relating to these products be done under the name of the respective distribution company.

For example, Page Deposit Brokers Corp. is the company which we have used for some years to obtain GICs and deposit accounts from over 25 financial institutions to get you the highest interest rates. Page and Associates Ltd. is an insurance agency representing over 10 of the most respected life and health insurers in Canada. Worldsource Financial Management Inc. is our investment funds dealer, offering access to thousands of mutual funds and institutional portfolio management services from the foremost money management firms in the world. Page Family Wealth Management – Worldsource Securities Inc. provides access to products traded on stock exchanges, such as index units, fixed-coupon and floating-rate bonds, exchange-traded funds, and individual stocks. By maintaining a network of professional advisors affiliated with these various entities, we can ensure that your financial plan is implemented with the financial instruments best suited to your unique situation – regardless of which regulatory regime governs those products.

Interest Rates

It seems that interest rates have finally normalized after a declining trend of many years. Rates have generally been rising since the low point in August of 2004. In the past year we have seen six increases in the Bank of Canada's 'Bank Rate', along with an increase in the top 1-year GIC rates from 3.1% in July 2005 to 4.5% in July 2006, and 5-year rates from 3.6% to 4.85%. While some analysts believe interest rates will continue to rise, most seem to think that recent increases are all the market needs, and that general rate stability is the most likely outlook.

Different interest rates are influenced by a variety of different factors. Short-term interest rates on terms of one year or less are influenced mostly by changes to the Bank Rate – this is the rate most often quoted in the press. The Bank Rate is used by the Bank of Canada to manage the economy's growth rate. If the economy is growing too quickly, the inflation rate will rise, leading to faster increases in the price of goods and services. To reduce inflationary pressure, the Bank Rate is increased to increase the cost of borrowing for consumers and businesses. This usually reduces overall levels of spending, which slows economic growth. If the economy is slowing too much, the Bank of Canada may lower rates in order to stimulate spending and economic growth. The Bank Rate is the only interest rate that is directly controlled by the Bank of Canada. All other interest rates in the market are driven by supply and demand.

Changes in short-term rates will affect long-term rates, but other factors also come into play. Long-term interest rates are primarily affected by expected future levels of inflation, economic growth and investor confidence. So long-term interest rates can change based on expectations for the future, even when short-term rates hold steady. Long-term rates are generally higher than short term rates, rewarding investors who can afford to commit to a longer-term investment. Our research shows that investors who always buy 5-year GICs (with similar amounts maturing each year, sometimes called a 'ladder') consistently earn more interest than those who invest for one year at a time.

The high interest rates characteristic of the 1970s and 1980s were largely a result of the high inflation rates during this period, and government borrowing to fund deficits. With inflation generally remaining within the 2-3% range, a balanced federal budget and strong Canadian dollar, there is little pressure for interest rates to rise.

Low Interest Rates – What to Do?

Despite recent interest rate increases, rates are still much lower than they were in the 1990s. If you're retired and living off the income from your investments, you may be making do with less income than you would like, or you may be spending some of your capital each year to supplement your interest earnings.

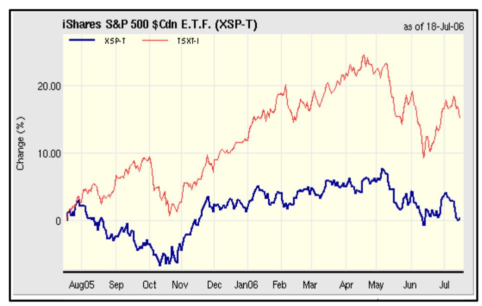
Many of our clients ask 'how long can I sustain my target income level without running out of capital?'. As financial planners, we can help you answer this question. We use computerized financial planning tools to forecast your financial situation many years into the future based on a number of assumptions about your income, expenses, savings, inflation, taxes etc. We then model different strategies to see which ones best help you achieve your objectives.

Depending on the outcome of our analysis of your situation and objectives, we may find that you can make use of a number of asset classes and financial products that can provide higher returns. These may include:

- corporate and foreign bonds – these often pay higher interest rates than GICs or government bonds.
- dividend paying stocks in large stable companies – dividend income is taxed at lower rates than interest
- a well-diversified stock portfolio – historically, equities on average have produced 2-4% higher returns than fixed income products such as GICs and government bonds. Stocks move up and down in price, but a diversified portfolio of stocks from different countries and industries will smooth out much of the price fluctuation.
- an annuity – provides annual or monthly income like a pension. Annuities can be set up so you continue to receive your regular income no matter how long you live. They can also be set up to ensure your beneficiaries receive a specified minimum amount of the principal on your death.

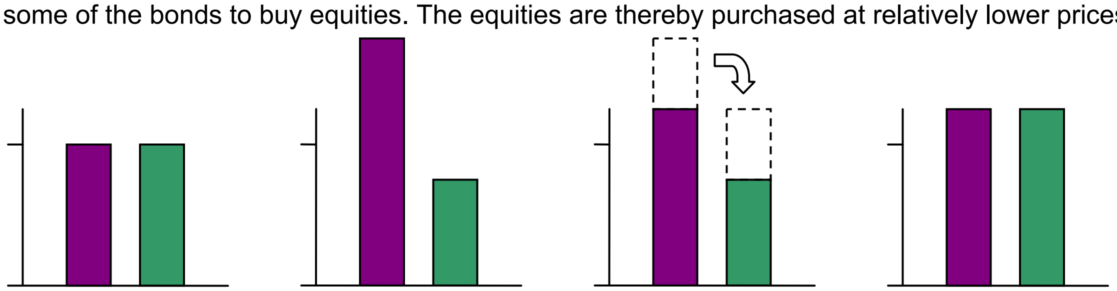
Equity Market Turbulence – Rebalancing Strategies

Most of our clients have a diversified portfolio of investment products to limit the month-to-month variation in the total portfolio balance. Even so, different elements of the portfolio will still fluctuate in value. This can actually be an opportunity rather than a drawback. We'll explain how below, but first let's put the recent market turbulence in perspective.



Over time, stocks (equities) have provided higher returns than bonds or GICs, but with greater fluctuation in their value. Over the past few years, the Canadian stock market has been one of the world's best performers. In the 10 months ending April 30, 2006, the TSX index was up over 20%. Most of these gains were coming from mining and energy companies, which comprise a large portion of the index. It was only a matter of time before investors re-examined the true value of these companies and allowed the prices to drift back to a reasonable range. For the year ended June 30th 2006, the TSX still returned over 15% before management fees and expenses (red line). The US S&P500 returned 0% in Canadian dollars for the same period.

How can such volatility be an opportunity? Periodic portfolio rebalancing automatically 'buys low and sells high' without having to guess which direction any particular asset class is going to move in next. In the diagram below, we assume that an investor begins with 50% in bonds, and 50% in equities. After some time, the bonds have gained through reinvested interest, and the equities have dropped due to price volatility. Rebalancing would restore the original 50/50 allocation by selling some of the bonds to buy equities. The equities are thereby purchased at relatively lower prices.



Initial Portfolio   Uneven Growth   Re-balancing Trades   Back in Balance

In practice, there would be 8 to 10 asset classes in a portfolio, with an expert investment manager assigned to each of them to choose the securities with the best prospects within each class. We recommend the initial allocation based on your risk tolerance and mathematical models that calculate the most 'efficient' combination. Rebalancing can be done at a scheduled time each year that we agree on to review your portfolio, or automatically by a rebalancing service which is available through several of the top money management firms that we engage to manage our clients' investments.

Joint Ownership

Many people hold investment assets in joint names 'with rights of survivorship' as an estate planning strategy, especially to avoid probate costs. Unfortunately, in many cases the joint ownership may not solve the problem, or could create other problems which are more costly than probate.

Probate is the process of confirming which of your assets will form part of your estate after your death, and must be completed before assets can be released to your beneficiaries. In Ontario, all probated assets are assessed a fee of up to 1.5% of the assets – a fee worth avoiding if you can. Holding assets in joint ownership can cause those assets to be considered not part of the estate, and therefore not subject to the delay and expense of the probate process. However, this is only true if the joint owners have a 'unity of interest' – in other words an approximately equal interest in the ownership of the property before the death of one of the joint owners. Achieving this unity of interest when the assets are currently not in joint names has several implications:

- The formerly 'single owner' asset is deemed to be sold when its ownership changes to joint – there may be taxes due when changing the ownership.
- If the joint owner is a spouse or a minor child, all investment income earned on the assets is still taxable to the original owner. If the child is an adult, he or she should declare their share of the investment income.
- If an adult child is the joint owner, then the entire asset is exposed to the claims of the child's creditors in case of a lawsuit, insolvency or bankruptcy, and is exposed to the claims of the child's spouse in case of a marriage breakdown.
- The asset can no longer be sold or transferred to another investment without the consent of the joint owner.
- If the asset is a residence, then both co-owners may lose their principal residence exemption and status as 'first time homebuyers' under the RRSP Homebuyers Plan.
- Any taxes due on the jointly-owned asset at death are payable by the estate – the joint owner receives the entire asset, so anyone who is a beneficiary of the estate may get far less than expected.

Fortunately, there are other means of achieving an efficient and effective estate distribution, some of which can also bypass the probate process and its delays and costs. These may include:

- the use of lifetime (inter-vivos or alter-ego or joint partner) trusts instead of a Will to ensure assets get to your intended beneficiaries
- the use of testamentary trusts, which could save each of your beneficiaries up to $14,000 in tax every year after your death
- the use of annuities and life insurance contracts, which can offer tax-preferred or tax-deferred accumulation of investment income, and a tax-free payout directly to your named beneficiaries upon your death

Once we fully understand how you wish your assets to be distributed after your death, we can help you make an informed decision about which strategy or strategies best fit with your goals and values.

Palmer House

Did you know that our building (on the southeast corner of Yonge Street and Major Mackenzie Drive) is considered a heritage building? Back in the late 1800s it was the home of John Palmer Sr., and his son was the proprietor of the Palmer House Hotel, the first inn in Richmond Hill. The original house was just the two-storey portion of the current building that contains our lobby. The one-story portions of the building were added much later, and we still have separate furnaces in each of the two basements. One of our clients recently told us that she was born in what is now a meeting room off our lobby!

Feedback

We hope you've enjoyed this newsletter. If you did, please let us know. If you have some ideas for improving the newsletter, or topics you'd like to see in future issues, please let us know that too!

Did you know? – you can receive this newsletter by email? We'd gladly give our environment a break by sending you the next newsletter by electronically. Please email contact@askpage.com with your full name, and we'll switch you to the email version next time. *Thanks!*