

Vested Interest

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MAIN FOCUS THIS QUARTER:

Value Investing and the importance of an investment process

Source: Brandes Investment Partners

Sitting in a traffic jam, maybe you've thought, "It took me 30 minutes to go one mile. At this pace, I'll get home tomorrow afternoon." Or perhaps, while playing golf, you made a birdie putt on the 13th hole and thought, "If I keep this up, I'll shoot 33 on the back nine!" These are examples of extrapolation—basing a longer-term forecast on an emotional reaction to short-term developments.

Extrapolation is one example of many systematic errors of judgment that impede our daily decision-making. Psychologists have studied these "biases" for decades to better understand human behavior. Studies of these biases among investors have led to the development of the field we now call behavioural finance.

Despite theories that markets are efficient, and that investors consistently make logical decisions, proponents of behavioural finance contend that investors make decisions that include psychological biases, generally without realizing they're doing so. These biased decisions contribute to the short-term irrationality of stock prices that value investors see as an opportunity. But value investors can only profit from these opportunities if they are able to resist the biases influencing others. That means they must be aware of these influences, and they must set up and follow a disciplined investment process designed to prevent them from falling victim to them.

THE DANGERS OF EXTRAPOLATION

There are a variety of behavioural tendencies that may contribute to poor investment decisions, including hindsight bias, optimism, faulty intuition, and myopia. Let's look at one, extrapolation, in some detail.

Like the traffic or golf examples cited above, many market participants often look at negative short-term results and think, "If this continues, I'll lose all my money in three weeks." Or if performance is good, they may say, "At this rate, I'll quadruple my money in six months!" From the tulip bulb craze in Holland during the 17th century to the Internet stock frenzy in the late 1990s, history is full of examples of

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Don't Forget: Important Deadlines for 2011

March 1, 2011:
RRSP Deadline for the tax year of 2010.

April 30, 2011:
Payment to CRA of your balance owing for 2010 personal income tax is due April 30, 2011, for all personal income tax filers including the self-employed.

TFSA – An additional \$5,000 in contribution room for 2011 for each individual resident of Canada aged 18 and older

Value Investing cont'd.



Thank you!

In 2010 we had more referrals in the history of our business; we take that as a sign of your loyalty and confidence within our firm. For that we are truly grateful, and we will continue to strive to exceed your expectations in terms of service and advice in the years ahead.

the dangerous effects of extrapolation. But the results are rarely as good, or as bad, as we initially envision. We often set ourselves up for disappointment or surprises when reality differs from our expectations. It's a quirk of human nature, and one that consistently has surfaced in the investment industry.

For example, Wall Street analysts often project sales, earnings, stock prices, and other statistics too far into the future, despite evidence that these quantities are inherently difficult to predict. Near the peak of the technology stock boom in early 2000, an analyst at a major Wall Street firm predicted the stock price for telecom company Qualcomm would climb to \$250 from its then-current price of around \$125. (Both prices have been adjusted for a subsequent stock split.) The analyst based his prediction on the extrapolation of cell phone sales over 20 years. Qualcomm's stock price didn't climb to \$250, as predicted. After rising to \$150 in early 2000, it fell below \$30 in 2002.

Value investors recognize tendencies such as extrapolation and establish predetermined processes based on objective analysis to guide their investment decisions. An understanding of behavioural finance can help value investors capitalize on these human foibles and achieve competitive long-term returns.

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Life... and death decisions Insurance planning and charitable giving

Source: Mackenzie Investments, Strategy Lab

The questions of one's own mortality is rarely a favourite topic of conversations, but an insurance strategy can provide dramatic benefits to those who are planning their charitable legacy.

Multiple donation options exist for those interested in making a charitable contribution: securities, cash, insurance and more. Life insurance provides a donor with the opportunity to achieve significant upfront or deferred tax benefits while creating a powerful future gift for the charity. While the charity typically receives the death benefit from the policy upon the death of the donor, there are two fundamental choices when it comes to receiving a tax benefit when donating life insurance.

The first choice creates an immediate opportunity for tax relief during the donor's lifetime; the second choice defers the tax relief, benefiting his or her estate at death.

Choice 1: Up front tax relief

By assigning permanent ownership of a life policy to the charity, the donor can receive an immediate tax receipt for the fair market value of the policy, along with tax receipts for any subsequent premium payments. At the death of the donor, the full death benefit is paid to the charity (with no additional tax benefit to the estate of the donor).

Sample case study: Bob Andrews

Bob Andrews, 50 year-old father of two teenage boys and successful veterinarian,

decides to make a large deferred contribution to his favourite charity. After careful consultation with his wife and their financial advisor, he decides to donate his existing whole life policy to the DogsRBest Foundation. The policy has a current fair market value of \$250,000 (as determined by an independent actuarial calculation) and a death benefit value of \$500,000. Bob assigns full ownership of the policy to the charity and receives an immediate tax receipt for the fair market value (\$250,000). He also receives ongoing tax receipts for any future premiums paid on the policy. The tax credit from the donation generates immediate tax savings for Bob.

At his death at the age of 85, the policy pays the death benefit of \$500,000 and increases capital for the ongoing preservation of the endowment fund that he created at the Foundation.

Choice 2: Deferred tax benefit

In the second option, the donor names the Charity as beneficiary of the policy but doesn't assign ownership (and thus leaves the door open to change their mind, if their circumstances changed for example). No tax receipts are issued during the donor's lifetime for the fair market value of the policy or any future premium payments, but on the death of the donor he or she will receive a tax receipt for the full death benefit of the policy. This strategy can provide significant deferred tax savings on the terminal tax return.

Sample case study: Gloria Hubble

Gloria Hubble, renowned heiress of the Portobello Bakeries empire, decides to name The Kids Can Bake Foundation as beneficiary of her life insurance policy. Gloria decides not to assign ownership of the policy to the Fund so doesn't receive any tax benefit at the time of her decision or during her lifetime. However, on her death at age 83, the policy pays the death benefit of \$500,000 to the Foundation which can then begin creating scholarships for future bakers. Her estate receives a tax receipt for the full death benefit of the policy.

Summary of benefits – Policy example

Whole life Insurance Policy

Death Benefit - \$500,000

Current Fair Market Value (FMV) - \$250,000

Annual Premiums - \$5,000

	Immediate tax benefit	Lifetime tax benefit	Estate tax benefits	Funding of Charity
Treatment #1 <i>Assigning Ownership</i>	Donation tax receipt for FMV of \$250,000	Annual donation tax receipts of \$5,000 when premium paid	None	Foundation receives \$500,000 upon death of donor*
Treatment #2 <i>No Assignment of Ownership</i>	None	None	Estate receives donation tax receipt for \$500,000	Foundation receives \$500,000 upon death of donor

*Foundation, as owner, reserves right to cash policy at any time

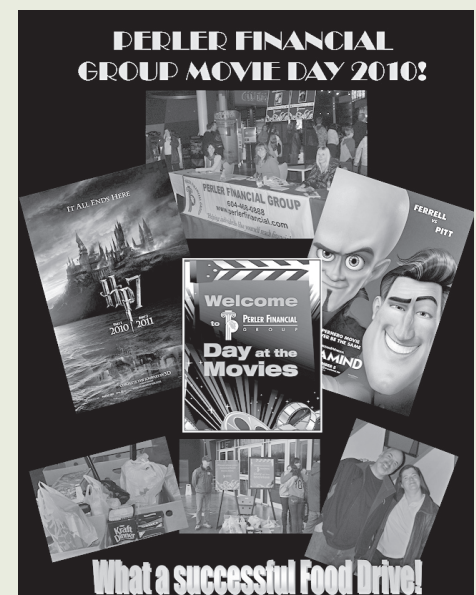
Tax incentives for testamentary donations

As a result of changes to the Income Tax Act over the years, testamentary donations (typically through wills, insurance policies or retirement plans) have the power to assist in dramatically reducing taxes payable during one's lifetime or upon death.

Success!

Perler Financial Group 2010 Movie Day was a great success!

Thank you to everyone who attended Perler Financial Group's 2010 Movie Day. Not only did we have literally hundreds of attendees come to watch the new Harry Potter film & the Megamind movie, but all the food that was brought for the Food Bank was simply amazing. Thank you to everyone for all your generosity. There is no doubt that you have made a difference to those less fortunate! Thank you!



"We simply attempt to be fearful when others are greedy, and to be greedy only when others are fearful." - Warren Buffett

"If you lend someone \$20, and never see that person again, it was probably worth it." - Unknown

"Money's only important when you don't have any." - Sting



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It is essential for individuals to consult legal and tax advisors when considering making this type of donation.

Be sure to speak with Fraser McDowell about what donations are right for you.

Strategies to make the best use of your RRSP refund

Since after-tax retirement income is the most significant long-term financial goal for most people, understanding and choosing the best refund strategy is critical. The following are five distinct RRSP Refund Strategies, each producing different levels of retirement income. To illustrate, let's assume you have \$1,000 to invest and are in the 43.7 per cent marginal tax bracket.

1. Spend your refund

Unfortunately, the most common RRSP Refund Strategy is to spend it. If your primary goal is to produce never ending retirement income, then you must realize that by spending your refund you significantly reduce the retirement benefit. The \$1,000 investment will generate a \$437 refund, reducing the after-tax cost to \$563. If you spend the refund, your after-tax commitment to your retirement goal is really only \$563.

2. Reinvest your refund

To get more retirement benefits from your RRSP, you can reinvest all of the refund back into your RRSP (assuming you still have contribution room available). Simply investing the 43.7 per cent tax refund increases your RRSP by the same 43.7 per cent. By investing the \$437 refund, your \$1,000 RRSP investment increases to \$1,437. You can also reinvest your refund into a child's RESP.

3. Gross-up

Consider borrowing additional funds to gross up your RRSP contributions* (assuming you still have contribution room available). As an example, for your \$1,000 RRSP contribution, you can borrow an additional \$1,000 to increase your contribution to \$2,000. Your \$874 tax refund is used to immediately repay most of the loan so you pay little interest. By 'grossing-up,' you get the maximum RRSP dollars working for each dollar you have to invest.

4. Top-up

Traditional RRSP loans present the opportunity to top up RRSPs to make the maximum annual contribution possible. If your RRSP contribution room for the year is \$5,000 and you only have \$1,000, you can borrow the extra \$4,000 and use the refund to pay off most, if not all, of the loan.

5. Pay off existing debt

Use your refund to pay down your existing non-deductible debt with money you would have paid in taxes.

*Interest expenses on money borrowed to contribute to RRSPs is not deductible for tax purposes.