A&Q Update

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September 2002

Volume 4, Issue 3

Dealing with Market Decline and Volatility

It is no secret that world stock markets have been particularly volatile over the last two years. There is no geographic region where equity investors could be fully shielded from the drop in equity prices. How does one deal with this on both a psychological and practical level?

The first thing to recognize is that stock markets fluctuate based largely on the emotional reaction of investors to current events, good or bad. The share price of a particular company can be driven down by these reactions even though economic indicators and the company's business fundamentals remain strong. The share price is no longer indicative of the value of the company. If this is the case, investors must resist the urge to 'do something'. If the investment remains a good one, stay the course.

Recent market conditions also accentuate the need for a conservative approach to investing. Many investors will find that their portfolios have indeed fared better than what they might expect based on stock market indices and media commentary. A well balanced portfolio, containing a blend of asset classes, reduces the impact of market volatility. Take solace in the fact that your portfolio has faired well relative to stock market performance. The loss of value is the cost of the superior long range growth potential offered by equity investing.

Difficult markets give good money managers the opportunity to add real value. William Sterling, a fund manager for C.I. Group of Funds, once stated that 'when a heavy wind blows even turkeys can fly', meaning that you don't have to be a good

manager to produce good returns when stock markets are on an upward tear. Effectively protecting the downside is what makes a great manager.

Now is an excellent time to review your portfolio. Take this as a call to action. Reviewing your investment holdings is something you can *do* to deal with anxiety over market volatility. Portfolio review is a valuable service we provide both clients and non-clients.

A strong personal reaction to current conditions may indicate a need to reexamine your portfolio with a new perspective on your personal tolerance for risk. Upon completion of the portfolio review adjustments may or may not be appropriate, but at the very least you can move forward with the confidence that you continue to take the correct approach with your investment plan.

Another important thing to remember is that the conservative approach used in developing our financial plans contemplates this type of market performance. Many clients are relieved to discover that they are still well on target with their financial goals. The recent market dips will have no impact on their future lifestyle.

The conservative rate of return numbers used to project future asset values, and therefore future income levels, take into account that there will be down periods in the market. The negative impact of bear markets is offset by the periods of exceptional growth during bull markets. The importance of the financial planning framework is never as evident as it is during periods of negative investment growth.

Inside this issue:

Worthwhile stops on the information highway...

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Maintaining a long term view is the single most important strategy in dealing with a period of poor market performance. Putting the current period into historical perspective is particularly helpful. The current downturn in the markets is in no way unique. We have been here before and we are sure to be here again. The general upward trend in equity values is what we will benefit from over the long term.

New Management for AGF International Value

In our last newsletter we indicated that a change of advisor would be taking place on one of our core international funds. In June, AGF announced that David Herro and Edward Loeb of Harris Associates L.P. would take over management of the AGF International Value Fund. Of the hundreds of available international advisors, this Chicago based firm was deemed to be the most qualified and the best fit for the fund's mandate.

Harris Associates L.P. was founded in 1976 and is one of the top-ranked value investment firms in the world. In the U.S. market they are best known as managers of the Oakmark Family of Funds. Past performance figures place it among the most well-regarded fund families in that market.

Their investment style can best be described as taking a bottom-up value approach. In other words, they look at the business fundamentals of individual companies rather than at a particular industry or geographical sector , and purchase stock in companies whose share price is trading at a significant discount to the company's real value. Country allocation is determined by the location of attractively valued stocks.

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At this point transition of the portfolio to meet the new manager's guidelines is almost complete. Their stated intention at the outset was to make use of 'tax loss selling' during the transition period to improve the tax position of investors in the fund. One complaint with the past history of the fund while under the management of Brandes Partners, was that year end distributions were often substantial, resulting in an immediate tax liability if held in non-registered investment accounts. AGF has stated that Harris will be more active in managing the fund from a tax-efficiency point of view.

We continue to recommend this as a core foreign holding in client portfolios. Our position is based largely on Harris's consistent track record of disciplined value management. We will continue to closely monitor the management of this fund.

Tax Efficient Investment Income

One problem encountered by investors drawing cash flow from their non-registered investments is that an immediate tax liability typically results. A tax receipt is issued for the income generated by the investment and, depending on whether the income is classified as interest income, dividend income or capital gains income, it is taxed accordingly.

Investment structures which produce income in the form of *return of capital* have recently come into favour . With a return of capital there is no immediate tax consequence. In the eyes of Canada Customs and Revenue Agency the cash flow from the investment is a return of the money initially invested. Rather than the income being considered taxable at the time of receipt, the investors *adjusted cost base or ACB* is reduced by the amount drawn. The ACB is the figure used to determine the amount of the capital gain at the time the investment is sold. Over a period of time the ACB can be reduced to zero. A low ACB will result in a larger capital gain.

Eventually the investor will be required to pay tax on this capital gain, but the strategy ultimately means that they will pay less tax. Firstly, capital gains income is taxed at a rate lower than both interest and dividend income. Secondly, payment of the income tax is deferred until the investment is sold. This means that the amount left growing inside the investment is larger. Deferral of the tax is particularly beneficial if the investor will be in a lower tax bracket in future.

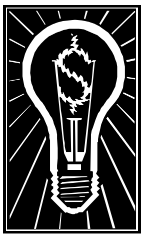
There are three different investment vehicles now available which provide cash flow in the form of return of capital. Although they have different investment mandates, all rely on deferred capital gains for tax efficiency.

Firstly, funds that invest primarily in income trusts often provide this type of cash flow. Income trusts are publicly traded securities that hold income producing assets. These assets provide solid and predictable cash flow. Income trusts are commonly set up for things like non-renewable energy resources or real estate holdings.

The second vehicle making use of return of capital is set up in the form of a more conventional income fund. The fund holds a number of different asset classes and generates a regular distribution each month. The fund manager attempts to produce a rate of return such that the monthly payouts do not erode the investors capital. They also attempt to provide as much return of capital income as possible.

The third vehicle is slightly different than the income fund described above. T series funds are versions of existing mutual funds which feature a systematic withdrawal program and provide income in the form of return of capital. Again, the return of capital reduces the ACB of the investment. With T series funds the investor can move back into the regular mutual fund if they want to discontinue the withdrawal or if the ACB of the investment has been reduced to zero.

After-tax income is all that matters. It is the only income that you can actually spend. For this reason, the tax treatment of an investment is often more important than the rate of return posted by the investment. We would be happy to provide further details to anyone interested in the above investment products.



Lighting the Lanterns

Every now and then we hear a real life story that is truly inspiring. The value of the story goes far beyond the individuals directly involved, and gives us all food for thought. The following story comes to us firsthand from one of our clients and is recounted here with their permission.

Once upon a time, not so very long ago in India, there was a girl living in the village of Thillaisthanam. There was very little money in the village, and she, like many others walked to school each day in her bare feet. She was a very bright girl and she had a strong desire to learn.

When she reached the age of fourteen her uncles expressed concern over her situation. Having reached puberty she was thought to be a liability to the family. They felt it was time she should marry. Because of their poverty it was not possible for the family to pay for her high school education. Worse yet for the girl, there was no money for a dowry. This meant that the potential marriage would be to a nice local boy destined for a life of low-paying manual labour. By the time she turned nineteen she, likely already a mother of two or three children, would be entrenched in a life of poverty, and the cycle would continue.

In the class structure of India, education is very important. Both earning power and status increase dramatically with an increased level of education. The financial position of one's potential mates also increased with this increase in status. Education was the only way to break this cycle of poverty.

The girl begged her mother to somehow fund her high school education. She promised that she would pay her mother back in full once she was employed and that she would fund the university education or marriage expenses of her two brothers and one sister. Seeing the lantern burning within her daughter, the mother relented and said that she would somehow find the money to send her to high school. For poor families in India in the late 1960's, as remains true today, there was no way to borrow money. The family pawned anything of value that they owned, and the girl was able to continue with her education.

The girl was thrilled to have the opportunity to continue in school, and she excelled in her studies. Her education made her desirable to employers, making it possible for her to land a well-paying job. Every bit of money earned was sent home to the family.

With the added income provided to the family the light of the lantern was now being used to light other lanterns. Her teenage cousin was now given the opportunity of an education, while a brother's startup business and a sister's marriage expenses were paid for.

The girl went on to complete her masters degree in languages, and had the choice of several suitors. The man she eventually married had a masters degree in engineering. The new family immigrated to Canada and continued to work hard to help the family back home. The husband re-qualified as an engineer in Canada and became employable in their new country, while the woman pursued a career in teaching.

Thirty five years later the story came full circle. The girl who attended school in her bare feet now had a fourteen year old niece living in a small village in India. The family's concerns were the same as 35 years previously, and there was little money for a dowry. With little chance of continuing her education both the girl's spirits and her school grades were very low.

The niece from India sent her 'rich Canadian aunt' a letter requesting the money to attend grade eleven. The aunt sent a reply letter promising that if the girl worked hard and her marks improved she would, based on the approval of the

girl's father, send her a cheque for $300 to cover her year at school. The girl's spirits soared and so did her marks at school. The Canadian aunt had lit another lantern. For $300 the life of a fourteen year old girl had been changed immensely.

In the past year the barefoot girl, now benefactor aunt, attended our Retirement 101 course. By going through the planning process she hopes to crystallize her retirement dreams. When she retires she intends to devote her time, effort and money to starting a school in India, where intelligence and eagerness are in abundance but where the money needed for educational facilities and teachers is in critically short supply. Her retirement plan is to light as many lanterns as possible.

We have the ability to make a difference in the lives of the people we care about. These people may be family members, members of our community, or members of the world community. It is up to each individual to decide what is important to them. Often it takes less time and money than one might think.

What *is* required though is goal setting, planning and focus. Once we decide that something is important and we put structure to our efforts, we are much more likely to succeed. Many people find that making this kind of contribution, be it of time or money, becomes a real passion. It becomes one of the most positive things in their lives. In an attempt to help others, they benefit at least as much as

> The greatest good you can do for another is not just share your riches, but reveal to him, his own.
>
> Benjamin Disraeli

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"Providing Sound Financial Direction"

John Armstrong is a Certified Financial Planner. Financial planning and financial planning education are his key areas of interest and expertise.

Achieving balance in our lives is critical; a balance between work and family, a balance between living for today and planning for the future. Because we all have competing goals, striving for balance influences many decisions in our day-to-day lives. One thing is certain, the juggling act we do requires a long-term view. Sometimes we need to take a step back to put things into perspective.

It may sound cliché, but having a plan in place goes a long way in helping to achieve both our long and short-term goals. Simply put, planning assistance is the service we provide. We are committed to helping you find that long-term view for the good of today and tomorrow.

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Dealing with the Family Dynamic

As with so many things in life, communication is one of the keys to success in dealing with family financial matters. General discussions on attitudes towards spending, saving, debt and financial goals can help avoid conflict down the road.

An informal discussion of family policy can set the stage for smoother decision making, and having a big picture discussion on financial goals before facing specific spending decisions allows for an objective view on the possible impact of future decisions. Take this as an opportunity to put priority on specific goals. Family members often have competing goals and objectives. Recognize this upfront and deal with them as openly as possible.

Developing a written financial policy on particular issues may be going a little too far for most people, but simply taking the time to have these discussions is the important thing. Consider the following questions as a starting point: What are our targets for paying down debt? Under what circumstances do we find the use of credit acceptable? How large an emergency cash fund do we need to feel comfortable? What are our long term savings goals? In what way will extended family members impact our financial situation?

Parents are advised to discuss attitudes toward financial issues with their children. This is particularly important as our education system devotes little time to the practical side of personal finance. Attitudes developed early on will certainly impact children in their adult lives.

Great Response to the Fall 2002 Client Appreciation Event

The response to our Stratford Festival outing has been fantastic. Within three weeks of invitation mailing our block of tickets was completely spoken for. We look forward to seeing all those who will be joining us for a meal at the Waterlot Restaurant and the evening performance of 'My Fair Lady' on November 9th. Those who expressed interest after the outing was fully booked remain on a waiting list and will be contacted in the event that we have cancellations.

Please contact us if you have any suggestions for future client appreciation events. Like this one, many of our past outings were organized at the suggestion of clients. Your input is much appreciated.