A&Q Update

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Avoid the Noise and Keep It Simple

We find ourselves in an era many have dubbed 'the information age'. Never before have we had so much information at our fingertips. The internet readily provides more data on more topics than we could have imagined 20 years ago; and the proliferation of specialized media channels means that willing viewers are hit with a constant barrage of news and business coverage.

While much of the content is interesting, and some of it is even relevant, many people are neither willing nor able to sort through this onslaught of information. As investors though, it is hard not to be distracted by the noise surrounding the investment markets.

In our opinion, much of the content provided has a very short-term focus. While the market gyrations the media focuses on are certainly based in fact, at the end of the day it is much ado about nothing for the long-term investor. Unfortunately, it leaves investors concerned and confused as to what implications current events have for their investments and what action, if any, should be taken. Here are five fundamental touch points we rely on to provide the much needed clarity in today's information age:

- Understand your investment objectives; what is the money for and what kind of growth do you need? This sets a framework for all other investment decisions.
- Understand your timeframes and the implications this has for your investments. When do you need the money?
- Consider where you are on the risk/reward continuum. The investment vehicles you choose must match your tolerance for investment volatility.
- Rely on sound diversification rather than on trying to time entry and exist from a hot sector, a particular asset class, or a particular geographical region. Knowing what will happen in the markets is one thing, knowing precisely when it will happen is a different matter. This is where the professional money management can add value.
- Understand the impact inflation and taxation have on your investments. After-tax dollars are the only ones you can spend.

Clearly this is not rocket science; but in most cases, reviewing these five points can simplify investment decisions that are otherwise daunting.

Inside this issue:

Holiday Season Office Hours...

December 26 & 27—Closed

December 28-30— 9am to 2pm

January 2—Closed

Charitable Donation Notes

- Charitable donations are claimed on a calendar year basis
- Assuming that your charitable donations are less than 75% of your net income, here are the resulting combined federal and provincial tax credits for Ontario residents:
  - For the first $200 of donations — 22%
  - For total donations exceeding $200—40%
- Consider grouping your family donations under the name of one taxpayer to maximize the tax credit

Get out there and support your favourite charities before the end of December!

Centre for Family Business

The Centre for Family Business services Central Ontario, and exists to help family businesses reach their greatest potential. By delivering relevant educational programs and providing the necessary support, the centre helps family businesses to achieve their enterprising goals, fulfill their dreams, and strengthen their families.

John Armstrong has been a member of the organization for several years, and currently sits on the membership and recruitment committee. As such, it seems appropriate that we make sure that our many contacts are aware of the centre and the many benefits it provides.

Family businesses offer both unique opportunities and unique challenges to those involved. Because career and family relationships often become intertwined, there are issues that arise in family business that are not a factor in other kinds of organizations. Centre for Family Business members deal with these unique issues on an ongoing basis and provide their peers with a powerful support network.

For further information please contact John at our office. Information is also available on the web at:

www.familybizcentre.com .

Received any unexpected cheques from your investments lately?

Mutual fund managers have a duty to act in the best interest of the unit holders of their funds. No group of investors should be given preferential treatment to the detriment of other investors. It is therefore the responsibility of the manager to have regard for the potential harm caused to long-term unit holders by the trading strategies used by some investors.

In 2003 the Ontario Securities Commission (OSC) did an audit on the Canadian mutual fund industry. This investigation was undertaken as a result of inappropriate trading activities which had come to light in the American mutual fund industry. The OSC focused their audit on two particular trading practices: late trading, and market timing. While no evidence of late trading was found, market timing trading was uncovered with five Canadian mutual fund companies.

Market timing is the rapid trading in and out of mutual funds, taking advantage of short-term pricing discrepancies between the stale value of securities within the fund and the current market value of those securities. In the case of an international equity fund, the time difference between market closings means that the closing price of international equities within the fund will be known hours before the closing of the North American markets and the time at which the unit price of the fund is calculated. Further to this, there is a strong relationship between international markets. For example, if North American markets rally, there is a strong probability that international markets will rally on the following day.

To execute the market timing strategy, these investors usually move quickly in and out of a mutual fund by switching back and forth from a money market fund. The gains made on each unit are very modest, but when the dollar amounts being shifted are very large the strategy can be quite profitable. This trading activity may impair the long-term performance of the fund while the market timers experience significantly higher gains than other unit holders.

While this activity is not specifically prohibited, and the fund managers had no direct involvement in these trading schemes, the fund companies were found to be at fault for not protecting the interests of long-term unit holders. The simplified prospectuses provide the fund companies with the ability to effectively eliminate the profitability of the strategy by charging a 2% switch fee on the trades. The fund companies found at fault had not done this.

The OSC determined that investors in the various funds should be compensated for the money lost as a result of market timing activity. Five fund companies were found at fault: AIC, AGF, CI, Investors Group, and Franklin Templeton. Cheques were issued by these companies earlier in the fall to any investors who were unit holders of the funds in question over the period where market timing was evident.

The question then arises, how should investors treat this revenue for tax purposes?

- If the pay-out is as a result of a mutual fund held within an RSP, the payment amount must be treated as additional income for 2005.
- If the fund was held in a non-registered account and has since been sold, the payment amount must be treated as a capital gain for 2005.
- If you continue to hold the fund in a non-registered account, you can declare the amount as a capital gain for 2005 or you can reduce the adjusted cost base of the investment by the amount of the payment.

For further information on this situation please give our office a call.

Income Trust Update

While income trust investors have been handsomely rewarded for their participation in that asset class over the last three years, it has been a very volatile autumn in that market. Why is this and what can trust investors expect in the days to come?

The month of October brought with it a substantial correction in the income trust market, due primarily to the uncertainty created by the federal government's announcement that as a result of a tax leakage problem, they intended to revisit the preferential tax treatment enjoyed by the income trust structure. The trust market, already overheated in the opinion of many, experienced a dramatic drop in unit prices as a result of this uncertainty.

After a number of weeks, finance minister Ralph Goodale announced that no new tax would be applied to income trusts and that to address the disparity between stocks and trusts he intended to level the playing field by making the tax treatment of dividends more attractive to investors. Since this second announcement, trust unit prices have recovered much of the ground lost.

Erratic shifts in the price of oil have further contributed to volatility in the trust market. A substantial portion this market is made up of oil and gas royalty trusts, whose fortunes ebb and flow with world energy prices.

We continue to believe that income trusts represent a distinct and valuable asset classes. An aging population means that there is a high demand for investments that produce an ongoing yield for investors. With the baby boom generation starting to move into retirement, strong demand for investments producing current income will continue for some time to come.

We caution however, that income trusts should be viewed as high yielding equities. Trusts should be held with the expectation of producing the yield they pay out to unit holders rather than for the capital growth experienced over the last few years. Many income trust mutual funds have experienced annual rates of return in excess of 20%. Clearly this is not what investors should expect going forward.

Income trusts provide additional diversification to a portfolio because they perform differently than stocks, but the percentage of a portfolio they represent should be monitored. Because of the substantial gains made over recent years, investors are well advised to revisit the income trust weighting in their portfolios and adjust accordingly.

RESPs: Drawing Money from Education Savings

How does the beneficiary receive payments from the RESP?

Payments made to the beneficiary of an RESP are called Educational Assistance Payments (EAP). They consist of income earned on contributions plus Canadian Education Savings Grant (CESG) amounts. Most RESP withdrawals are a combination of the initially invested capital and the EAPs.

In order to qualify for the EPAs the plan subscriber must provide details of current full-time enrollment at an eligible institution. Most institutions have a standard form which provides the details necessary. No receipts for expenditures need to be provided.

What if the beneficiary does not pursue a post-secondary education?

You have several options:

1. *Change the plan beneficiary.*

In the case of an individual plan, in order to be eligible for the CESG money, the new beneficiary must be under age 21 and either brother or sister of the original beneficiary or both the former and the replacement beneficiaries must be related to the subscriber by blood or adoption.

In the case of a family plan, in order to be eligible for the CESG money, the replacement beneficiary must be related to the subscriber by blood or by adoption. A maximum of $7,200 of CESG money can be used by each beneficiary of the plan. Any excess CESG money must be repaid.

2. *Withdraw the original contributions.*

You may redeem your original contributions to the plan tax-free, paying back any CESG amounts. Growth that has occurred while in the plan may be received as payments under certain conditions. If you are a Canadian resident, if the RESP has been in existence for at least 10 years and if none of the intended beneficiaries are pursuing a post-secondary education by age 21, you may transfer up to $50,000 to the RSP of yourself or your spouse as long as the RSP contribution room exists. Any growth you receive that is not transferred to an RSP will be fully taxed in your hands at your top marginal tax rate. In addition, you will pay a penalty of 20% of the withdrawn growth.

Alternatively, you may choose to give the growth portion to the educational institution of your choice. Unfortunately, you will not receive a contribution receipt.

Armstrong & Quaile
ASSOCIATES INC.

"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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Ode to Winter

By Barbara Weiler

I remember blue skies
Over glistening mounds of white,
And skiing through the woodlands
'Til we were out of sight.

I remember baggy ski pants
And soggy stockings too
I remember burning fingers,
Woolen mittens soaked right through.

Set them drying by the woodstove,
Or the fireplace, if you've got one,
While you sip on hot chocolate
And gobble up a hot bun.

I remember skating
On a silent starry night
And sledding down our neighbour's hill
Holding on real tight.

I remember bedtime
Under cold sheets shivering
Feet on hot water bottle,
Freezing toes quivering.

I remember frosty feathers
Upon each window pane
We scraped away the fuzzy stuff
But it came right back again.

I remember building snowmen
Coal eyes and carrot nose
Trying to find the right chapeau
Before our fingers froze.

Yes I remember winters
That happened long ago
Storms and drifts and shovels,
But still, I loved it so.

Winters haven't changed so much
Since the time when I was small
But now it is our grandchildren
Who go out and do it all.

Merry Christmas and Happy New Year
From the entire Armstrong & Quaile Team!

John Rich Sharon Cindy Joe

Note: Mutual funds are sold by simplified prospectus only. Before investing , obtain a copy of the prospectus and read it carefully. Unit values and investment returns for mutual funds will fluctuate. Funds are sold through Armstrong & Quaile Associates Inc.