# A&Q Update

John Armstrong, CFP

July 2005

Volume 7, Issue 1


## The Current Investment Environment

As of the end of the second quarter, 2005 has provided exactly what many analysts expected—plenty of uncertainty. Canadian equities continued to do well, but market volatility remains high.

The rising price of oil continues to be the single largest contributor to market uncertainty, with energy sector companies doing well as a result of higher prices and oil dependent industries like airlines doing poorly as their expenses rise.

A steady diet of interest rate increases from the Federal Reserve Board in the United States has decreased the spread between Canadian and US interest rates. This may well put the brakes on the rising Canadian dollar versus the US dollar, a trend which has punished the returns of US investments held by Canadian investors.

Even given the interest rate increases over the last year, we are still experiencing a very low interest rate environment. GIC investors continue to receive very modest returns on their investments. Bond investors, on the other hand, have not been punished by the increase in interest rates because the increases have been at a very measured rate.

The US economy remains on shaky ground, with little effort being put into dealing with the twin deficit situation. Favourable news resulting from earnings reports or other positive economic indicators is often overshadowed by the threat of higher oil prices and world security issues. At the time of writing, major US indices range from slightly negative to slightly positive for the year to date.

Major international markets have generally outperformed the US markets so far this year, with the one exception being Japan, whose Nikkei index is down slightly.

Canadian income trusts remain a hot topic among Canadian investors. While their stellar performance over the last couple of years has created large investment flows into the asset class, many analysts advise caution.

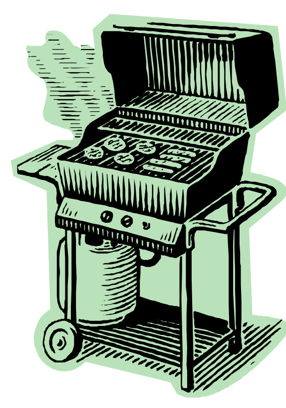
On the positive side, there are plans to introduce income trusts to the S&P TSX index this summer, resulting in additional dollars gravitating to trusts. Additional to this, many of the barriers to entry for institutional investors have been removed, resulting in more market participants. On the negative side, many pundits believe that the market is overheated and that some of the trusts now available are either overpriced or are inappropriate for the income trust structure.

In terms of our investment policy, the uncertainty mentioned above bolsters our position that diversification is the single most important element of investment strategy. The complex web of economic factors that impact the investment environment means that attempts to time entry into and out of a given asset class or sector is often difficult and risky.

Acknowledging that there is a very definite relationship between risk and return is critical. Understanding where the investor's objectives fit into this relationship determines the investment mix, and ultimately the portfolio volatility. Diversification by asset class, geographic region, management style, and other factors is our method for confronting this market uncertainty.

Inside this issue:





**Have a terrific summer!**

# Where Does all the Money Go? An Effective Strategy for Saving

You've just finished filing your 2004 tax return. In the process, you had to calculate your income for the year. Did you find yourself looking at that dollar figure and wondering where all the money went? If so, you're not alone. Many people wonder how they can save for their long-term goals while still having a reasonable lifestyle today. Spending a little time analyzing where the money goes can help to reach your personal financial goals.

Here is an approach we have used successfully with many clients:

1. **Figure out what it costs you to live.** Include all of your living expenses as well as any important discretionary expenses like hobbies and vacations. Include any ongoing investing activity as part of this figure.

2. **Establish a figure for your yearly household income** (after taxes and other deductions).

3. **Calculate the excess cash available.** Theoretically, the difference between the above figures should be available for long-term savings or for reaching other financial goals like debt reduction. Is the figure you have arrived at a realistic representation of what builds up in your bank account over a one year period? In our experience, the answer here is most often 'no!'. The figure is usually considerably more than what you are actually saving.

4. **Go on a money hunt.** What things have you spent money on that are not accounted for in step one? A quick scan of your credit card bills and your cheque register may provide some insight. If the expenditures you find represent regular ongoing expenses, or provide real value to you and your family, add them to the number you came up with in step one.

5. **Clearly state your savings goal.** The new savings figure established after making the adjustments to your expenses is probably still higher than the amount you are saving each year, but consider making this your savings goal. Divide the yearly

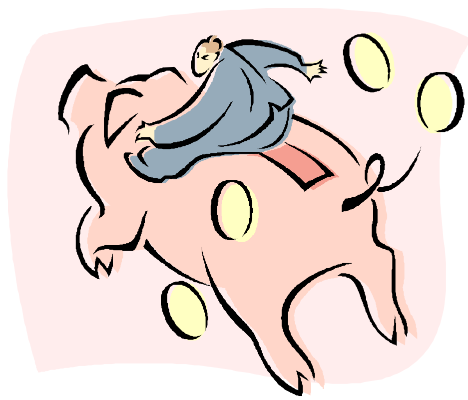


figure by 12 and commit to saving this amount each month. We refer to this as a *stretch goal*, one that can be reached but that requires a little effort.

6. **Be proactive in saving.** Set up your savings plan using an automatic monthly payment from your bank account. This sets a high priority to your savings targets and somehow makes the process more painless. People often say that once the money is gone from the bank account they don't miss it.

**Tip:** If the commitment makes you nervous, direct the savings amount to an investment that: has little or no risk, is very liquid (easy to cash in), and has no penalty associated with withdrawals. High interest savings accounts and money market funds are two possibilities. Once you become comfortable with the amounts being saved, consider moving to an investment vehicle which has characteristics suited to your objectives and time horizon.

This approach can benefit investors at many different stages of life. For investors contemplating retirement, this approach has a two-pronged benefit: it gives them a feel for living on a lower level of income (as they will likely have to do in retirement), while at the same time helping them to accumulate long-term savings that can be used to provide added lifestyle benefits in retirement. Younger investors on the other hand, benefit greatly from the development of good saving habits.

The financial planning process we work through with our clients includes establishing these income and expense figures, estimating the long-term financial needs, and setting the savings targets. The resulting written financial plan provides a framework for these financial decisions.

The key to establishing an effective savings program is the recognition that some things you spend money on provide real value to your life, while others provide little or no value. In many cases, if the latter are taken out of the budget they are hardly missed.

# Budget Impact on RRSP Accounts

The contentious budget which recently passed through the House of Commons will have a number of implications for investors. The two most important are the elimination of foreign content restrictions on RRSP accounts, and an increase in RRSP contribution limits.

With no foreign content restrictions, investors will no longer need to hold at least 70% Canadian content in their RRSPs. This may or may not be a factor for the investor, depending on the asset allocation of their portfolio. Once the legislation becomes law, we will see the elimination of the RSP eligible versions of the various foreign equity funds. In most cases the funds are expected to be merged into the underlining foreign fund.

RSP contribution room remains 18% of earned income, but the maximums will change as follows:

| | |
|---|---|
| 2006—$18,000 | 2007—$19,000 |
| 2008—$20,000 | 2009—$21,000 |
| 2010—$22,000 | 2011— indexed |

Because the 18% still applies, this will only impact those earning $90K plus.

# Do Mutual Fund Managers Provide Value?

Some members of the Canadian financial media advocate investing in low cost index funds rather than in mutual funds which charge a fee for active management. Keeping in mind that mutual fund returns are always quoted after the deduction of management fees, here are some statistics to consider:

As of the end of February 2005

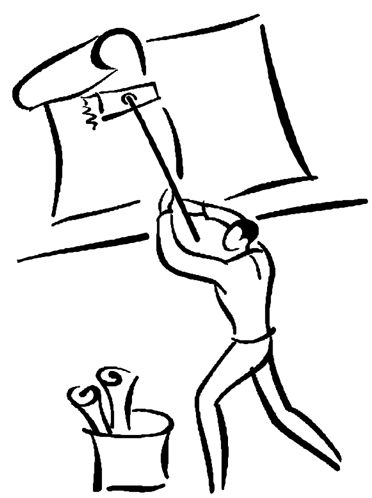
- 86% of Canadian Equity Mutual Fund Assets Outperformed the S&P/TSX Composite Index over the last five years.
- 75% of Global Equity Mutual Fund Assets Outperformed the MSCI World Index over the last five years.
- All 10 of the Largest Canadian Equity Mutual Funds have outperformed the S&P/TSX Composite Index over the last five years and have a volatility level considerably lower than the index.
- 8 of the 10 Largest Global Equity Mutual Funds have outperformed the MSCI World Index over the last five years.

# Investing in Home Improvements

When faced with spending decisions regarding home improvements, people often wonder what the improvements will translate to in terms of the increased market value of their home. The following data was taken from a recent piece provided to us by AGF Group of Funds.

From this data one would conclude that generally, one should make decisions regarding home improvements based on the use value they provide rather than on their investment value. Obviously there will be exceptions to the rule, particularly when something is in obvious need of repair and detracts from the appeal of the house to perspective buyers. Home improvements can be very worthwhile and can greatly increase the comfort and enjoyment of our lives, but remember not to overstate the investment value provided when considering these decisions.

| Money Back on Each Dollar Invested | Renovation Type |
|---|---|
| 75-100¢ | Bathroom Renovation, Kitchen Renovation |
| 50-100¢ | Exterior Paint, Interior Paint |
| 50-75¢ | Basement Renovation, Recreation Room Project, Fireplace Installation, Flooring Upgrade, Furnace/Heating System Upgrade, Window/Door Replacement, Roof Shingle Replacement, Adding a Deck, Building a Garage |
| 25-75¢ | Central A/C |
| 25-50¢ | Landscaping, Installing a Fence, Interlocking Paving, Asphalt Paving |
| 10-40¢ | Adding a Swimming Pool |
| 0-25¢ | Installing a Skylight |



Source:2004 Clayton Research based on data from The Appraisal Institute of Canada (2004)

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.*

279 Weber Street North
Lower, Suite 3
Waterloo, Ontario
N2J 3H8

Phone: 519-576-5766
Fax: 519-576-0192
Email: johna@a-q.com

Newsletter Editor : Rich Weiler

# It's a Girl!

Kelly & John Armstrong are pleased to announce the arrival of a new family member. Victoria Armstrong was born on June 16th weighing 8lbs. 1/2 oz .

Gemma (6) and Alexander (2) are very excited to have a little sister. Gemma loves to help her mother with the baby, and Alexander can't wait until Victoria is a little bigger so that he has another playmate.

Kelly & John would like to thank KW Midwives for all their care and advice before and after Victoria's arrival. They would also like to thank all four grandparents, Barb & Art Weiler and Sheila & Ken Armstrong for their ever-present support.

The staff of Armstrong & Quaile Waterloo would like to extend our very best wishes to the Armstrong family!

# RESP Notes

Given the above article, it seems appropriate to revisit Registered Education Savings Plans. Here are a few key points to remember:

- Annual contribution limit of $4,000 per year per child
- Annual maximum Canada Education Savings Grant (CESG) of $400 per child (20% of the first $2,000 of contribution)
- Aggregate lifetime maximum contribution of $42,000 per child
- CESG contribution room can be carried forward. If eligibility from previous years is available, the child will receive the 20% grant on up to the $4,000 maximum. In the case of a $4,000 contribution the grant would be $800. This is twice the yearly maximum grant amount. In other words, each year that you contribute the full $4,000, you catch up one year of grant money from years in which no contribution was made.
- Contributions are not tax deductible but income earned accumulates tax-free until withdrawn; income withdrawn is taxed in the hands of the child at the time of redemption.
- Parental control over the money is maintained, whether or not the child pursues post-secondary education.
- Plans can be set up on an individual or family basis.

**The Canadian Education Savings Grant is what makes RESP investing so attractive.**

- Redemptions from the plan can be used to fund a variety of education expenses and require proof of enrollment.

More on RESPs in the next newsletter!

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.