Enterprising investors fight the good fight

INVESTMENT STRATEGY

By Jon Kanitz

Recently, I attended a redundant seminar for investment advisers on the subject of wealth management, defined as follows:

"A comprehensive dialog, approached holistically, to discuss your client's financial dreams, goals and life needs. The process should address all aspects of a client's financial life, taking into account their personal profits and losses and balance sheet, both assets and liabilities. It is effectively done in a consultative way."

This definition is congruent with many recently published books and articles on the subject. However, it does not describe what I do as an investment adviser: The word financial is used twice. The word investment is not used at all.

The seminar leader said that two thirds of high net worth clients want financial planning advice and advice on other assets such as real estate.

In my extensive reading of the many recently published books and articles about high net worth clients, I have run across similar characterizations. However, only a miniscule percentage of my high net worth clientele has ever said anything about a desire for such advice.

This is despite the fact that financial planning has been included in my list of services and capabilities for over 20 years.

Next in the seminar, a survey of clients of several investment firms was presented which indicated that more than 75 per cent of clients are interested in or would consider fee-based programs, and more than 50 per cent are interested in or would consider managed programs.

If you take in hand any trade publication that is widely circulated among investment advisers nationwide, you will find plenty of evidence that a majority of industry practitioners are making increased use of fee-based and managed programs. However, not a single one of my clients has any such program with me.

Average assets per household under administration with me are around $300,000. This number is at the high end of a typical range at many firms. Also quite typical is my mix of clients. They include a fairly balanced group of some high net worth investors, professionals of all kinds, baby boomers and retirees.

So what's not typical? Simple. Virtually each one of my clients wants me to handle a stock-only portfolio. And since virtually all of my assets under administration consist of stock-only portfolios, I am also not typical.

This fact was somewhat disparagingly announced at the seminar when one participant stood up and reported to the 99 or so others present that I was "a dinosaur."

'A comprehensive dialog, approached holistically.'

No real American capitalist value investor could possibly be offended by that, and so I wasn't. Nor am I interested in presenting a refutation.

Instead, let's consider the facts from a scientific point of view. This metaphorical dinosaur has a career-long record of not only survival but prosperity. What follows is my dinosaur manifesto.

The survival of any species on earth depends upon both its innate characteristics as well as its environmental conditions. My species survives because it has some investment skills, the ability to write about them, a receptive readership and a favourable climate in the upper echelons of its firm.

In academe, there is the maxim "publish or perish." Ditto for yours truly in this business. Virtually all of my clients have come to me, and it hasn't been the other way around for over 20 years.

Preferring to rely exclusively on my writing, I have never once asked for a referral. Despite its humble origins 20 years ago in the very first issue of *The Bottom Line*, the entire evolution of my investment ideas is most fully contained in this publication.

Since some investors are interested in managed or fee-based programs, it follows that others are not. I suspect that my fans are in this group.

As long as there is a stock market, there will be enterprising investors who prefer to make individual stock selections either on their own or with the assistance of an adviser.

If half of these investors prefer assistance, then 12.5 per cent of investors prefer to make individual stock selections with the assistance of an adviser.

It would be reasonable to conclude that this segment of the investing public finds the conception of wealth management as defined above to be deficient insofar as there is an insufficient emphasis on investment management.

It is not an instructive oversimplification but an outright falsification to represent an investment adviser who appeals to a relatively small segment of like-minded investors as an extinct species.

Natural selection favours the happy accidents at the expense of the less fortunate ones in the evolution of a living species.

The happy accidents with high survival value in this case are that enterprising investors exist and that they tend to establish one-to-one symbiotic relationships with stock pickers.

By sheer dint of perseverance and learning, a small band of stock pickers become value investors. Their survival in the domain of the disgruntled depends on the fact that there are few competitors and virtually no predators.

Eventually an even smaller number of value investors venture to revise traditional doctrine here and there, for the sake of greater simplicity or better experimental links. These are the scientists.

Jon Kanitz Ph.D., is a first vice-president and Investment Advisor with CIBC Wood Gundy in Toronto. He and his clients own securities mentioned in this column. His views do not necessarily reflect those of CIBC World Markets Inc.

Misconceptions can cause unnecessary hardship

By PETER MERRICK

When the topic of life insurance comes up, both in the financial planning community and among the general public, several misconceptions inevitably arise.

These can result in inadequate coverage and unnecessary financial hardship for families who suffer the loss of a loved one.

I have rarely met anyone who bought life insurance and then found any enjoyment from spending their hard earned money on premiums. However, I have never heard of a life insurance beneficiary saying their dearly departed had bought too much life insurance.

Life insurance offers financial protection in the event of premature death. For most people, not owning life insurance at death would leave outstanding obligations and a lack of funds to support dependents, to educate children and to pay taxes and mortgages.

In essence, one buys life insurance because they either love someone or they owe someone.

Canadian consumers, as such, should apply what is called the six-step life insurance needs process to determine if there is a need for insurance and how much to buy.

The primary reason for purchasing life insurance is to protect those who are dependent on your income.

For example, if you are the owner of your own business and you die prematurely, you might need insurance to contribute to the company's cash flow to replace yourself as a contributing member to the bottom line.

If you are married with children your family will receive enough money to replace you as the breadwinner of your family. Some of your needs for life insurance coverage might be, such as university fees and mortgages.

If you have accumulated wealth, you may need life insurance to pay estate taxes after death.

It is a major misconception that only the family breadwinner needs life insurance. Although the stay-at-home parent may not contribute cash income to the family, he or she provides services that would be costly to replace.

On the other hand, if you are young and single with no children and no aging parents, chances are you don't need life insurance.

Understandably, some single people still want life insurance for funeral expenses, to retire debt or to fulfill bequests to charities or special individuals. Still, this is the exception rather than the rule.

MERRICK

Since life insurance needs vary, determining the right amount takes homework.

You need to inventory financial resources and think long and hard about how much it would take for your family to maintain its lifestyle without you.

A balance sheet is created, which adds up all your life insurance policies and other financial and material assets, then subtracts liabilities, including "human value,"

which is based on the value of one's contribution to their family's income and lifestyle, today and in the future. To calculate life insurance needs of a stay-at-home parent, for example, one would determine how much it would cost each year to pay someone to provide those services for as long as your family would need them.

The difference between a person's assets, liabilities and their human value represents the amount of life insurance needed.

The next step is to decide what type of insurance best suites your situation.

If the amount you can spend on life insurance is limited, or if you have a temporary need, consider only term insurance, whose premiums are higher but remain constant for the term of the policy. If you need lifetime protection, consider permanent life.

While the primary reason for any life insurance purchase should be income protection for your family, permanent insurance policies, including whole life, universal life, or variable life, provide long-term, investment-like features.

With these policies you can build a cash accumulation value from which you can withdraw during your lifetime, 'though doing so may affect your death benefit and have tax consequences.

If you're looking for pure return on capital, other investments usually provide better results. Keep in mind, too, that the premiums on these policies are higher than on term insurance policies.

Continued on page 24

Suffer from year-end pain?
REVIEW ENGAGEMENT
JAZZ-it!
EXTRA STRENGTH
Fast Relief of Engagement Pressure
For use with CaseWare
115 Templates
www.jazz-it.ca

After the cottage life

TYERS

By the time you read this article I will be winding down my 30th summer at our cottage in Muskoka. Purchased when I was 20, the cottage has certainly been an important part of my family's life. It is also treasured by the CRA.

When my wife and I die and the cottage is passed on to our kids, this transfer will result in a significant tax bill paid before the kids get anything. While we will have to decide whether our home or cottage is our principal residence, let's assume for this article it's not.

An asset like our principal residence is, of course, exempt from this type of taxation. Generally, a cottage won't be exempt and it will be considered a capital asset and consequently, subject to a capital gains tax liability at death.

With the recent real estate boom in Canada, cottages and other vacation properties have increased significantly in value.

Our property is now worth substantially more than the purchase price. At death, 50 per cent of this increased value is subject to taxation.

It's a tax time bomb that many of your clients are either unaware of or have not planned for.

A number of options will provide the cash required to pay this tax liability at death. It's important to make the best choice for your situation. Some of my own family's alternatives are:

We can start saving today for the future tax liability;

Our heirs can borrow the required funds from a bank at the time the tax is due;

Our kids can sell the cottage to pay the tax bill; or

We can purchase life insurance to cover the growing tax liability.

In my opinion, life insurance is often the most cost-effective planning tool to cover the tax liability at death. Life insurance provides cash to pay the tax exactly when it's needed, helps ensure our heirs receive what we intend them to receive and puts our mind at rest because we know we've taken care of this important issue.

A little planning can ensure that our dream of passing the family cottage on to our heirs will come true.

Here is my personal example for the cottage I bought 30 years ago to illustrate this problem: ***(See charts 1 & 2)***; Life insurance solution: ***(See chart 3)***

Reasons why the life insurance option is best:

- The numbers show that unless I live to 101, it is the cheapest way to cover this hidden and growing liability
- It allows us to custom design a solution to meet our specific needs
- It creates immediate estate liquidity to pay for the tax
- We can choose a death benefit that increases over time to match the growing tax liability
- We can customize the amount and number of deposits we make into the plan to suit our needs

The financial services affiliate working with your accounting firm, or another insurance advisor to whom you refer, can provide the expertise to help with tax situations like this.

I believe it is vital that as your client's primary tax advisor you be engaged in this estate planning exercise.

Paul Tyers, CA, CFP, is president of True North Wealth Management Inc. and can be reached at: (905) 891-6052, 1-866-515-5045, or at: *paul.tyers@raymondjames.ca.*

Chart 1

Year	Market/Future* Value	Original Cost	Capital Gain	Tax payable**
Present	$600,000	$100,000	$500,000	$112,500
In 20 Years	$1,924,281	$100,000	$1,824,281	$410,463

*Assumes 6 per cent growth rate
** Assumes 50 per cent of Capital Gain is taxable at a personal rate of 45 per cent

Chart 2

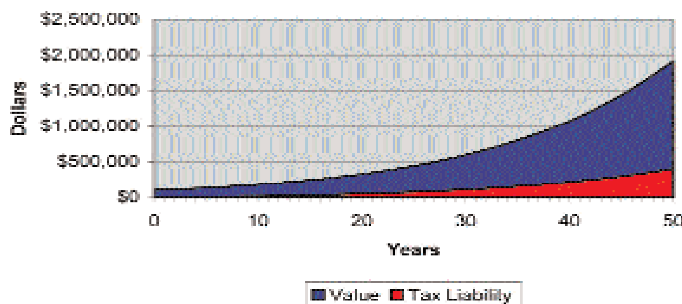

Chart 3

Year	Payments	Death Benefit	IRR
5	$17,505	$196,877	95.34%
10	$35,010	$214,439	31.75%
15	$52,515	$307,396	20.17%
20	$70,020	$408,435	14.92%
25	$70,020	$476,426	11.74%
30	$70,020	$560,953	9.91%
35	$70,020	$663,948	8.73%
40	$70,020	$788,241	7.92%
45	$70,020	$937,542	7.33%
50	$70,020	$1,116,303	6.88%

Yes, insurers do go bust

Continued from page 23

Avoid purchasing a life insurance policy that you can not afford (20 per cent of life insurance policies lapse for non-payment of premiums during the first year.)

How much you pay for life insurance will depend on a number of risk factors, including your health, your age, your family's medical history, and the type and amount of insurance you are looking to purchase.

Each insurance company has different cost structures for their term, permanent and universal life insurance products.

Although life insurance products are becoming more commodity like and insurance companies are continuing to lower premiums to remain competitive, there are still price variables.

Shopping around for low-cost life insurance policies can save you thousands of dollars during the lifetime of a policy.

And yes, insurance companies do go bankrupt. While there is some protection against loss of benefits or unpaid claims under life insurance contracts, there is no guarantee that either a defunct company will pay the death benefit. It is therefore important to know how a company is rated by rating agencies.

To receive the right advice and to be sold the right policy, you should consider your agent's experience and professional qualifications.

Certified financial planners and chartered life underwriters are technically competent and must meet education, examination, experience and ethical standards.

Peter Merrick, CFP, is designing the Certified Employment Benefit Specialist program offered in Toronto by Dalhousie University He can be contacted at: *www.merrickwealth.com* or at: *peter@merrickwealth.com*, or at: (416) 854-1776.

The Rankin file

OSC touts its victory

Continued from page 2

"You have to judge each case on its merits."

Some executives may have been acquitted, but the courts still come down heavily on people who demonstrate criminal intent and those who continue to commit questionable acts over a lengthy period. As for Stewart, she was charged with lying, Sofer said.

"If Martha Stewart wasn't Martha Stewart, she wouldn't have been prosecuted," he said. "But lying is not on."

'If Martha Stewart wasn't Martha Stewart, she wouldn't have been prosecuted.'

Many people were surprised that Ebbers received a 25-year-sentence, a penalty usually reserved for the worst offenders. But Sofer said that penalty was really a message from the courts that corporate fraud is being taken seriously.

Len Brooks agrees: A professor of ethics and accounting at the Rotman School of Management at the University of Toronto, he favours bringing corporate criminals to justice.

"These people have got off the hook for years and years," he said. "In the past, they would rarely have been charged."

He does not necessarily disagree with severe penalties. "Relative to violent crimes, these (corporate) issues have not attracted a satisfactory penalty," he said.

The courts may well pull back from the severe penalties seen this year, but he said it would be a mistake to back off much. "It is the jail time that deters further activities in this regard. A modest penalty is a waste of time."

Brooks supports the *Sarbanes-Oxley Act* because it obliges executives to take a good, hard look at their activities and correct any mistakes. "It sends a signal to corporate executives who are ready to take a gamble on questionable acts that may be illegal," he said.

And he denies that *Sarbanes-Oxley* is prohibitively expensive.

"People are looking at the cost and negativity of it, not the positive aspects," he said. *Sarbanes-Oxley* is only expensive if there are issues that have to be fixed, he said. The cost is not high if everything is being done right.

Canadian officials are closely watching the U.S. courts, as they continue to prosecute corporate crime in this country.

In mid-July the Ontario Securities Commission scored a major victory when it convicted investment banker Andrew Rankin for tipping a childhood friend about corporate secrets.

OSC spokesman Eric Pelletier also pointed to the formation of the Integrated Market Enforcement Team, a federally funded joint task force that was set up in 2003 to boost investor confidence in Canadian financial markets.

That team is led by the Royal Canadian Mounted Police, but includes Justice Canada, securities regulators, lawyers and local police. It has a budget of up to $30 million a year to detect, investigate and deter serious capital markets fraud.