

**"I can calculate the motions of heavenly bodies, but not the madness of people."**

-Isaac Newton [applies to the irrationality of stock market investors]

### New Israeli ETF available

Israel is a hotbed of advanced technology, products and entrepreneurial companies. Finally, a pure Israel ETF has emerged from the big players so retail investors can have easy access. iShares has launched the 0.68 % MER iShares MSCI Israel Capped Investable Market Index Fund (NYSE: [EIS](#)). For the 24-page fund prospectus visit [http://www.ishares.com/content/stream.jsp?url=/content/repository/material/prospectus/eis\\_prospectus.pdf&mimeType=application/pdf](http://www.ishares.com/content/stream.jsp?url=/content/repository/material/prospectus/eis_prospectus.pdf&mimeType=application/pdf) and get the fund fact sheet [here](#). The iShares page on the ESI is [here](#). Remember, the First Israel Fund ([ISL](#)) and the Amidex35 ([AMDEX](#)) also provide access to the Israeli market but investors may be waiting for an iShares-like product for some more trading liquidity. Amidex 35 Israel is a U.S. mutual fund but is not available in Canada for regulatory reasons.

#### **Some Key points:**

1) This ETF invests in local, Israeli shares, not ADRs. This is typically a good thing as some of the interesting things going on in the Israel thesis are taking place on the ground in Israel. You also have exposure to the Israeli shekel; the ETF is priced in U.S. dollars. Investors would benefit greatly from the currency exposure in a strengthening shekel environment and take a hit if (when?) the shekel begins to weaken, something the Bank of Israel is currently attempting to do. A movement in the exchange rate will affect returns one way or another, perhaps even inversely to the performance of the individual stocks that comprise the fund. Meaning, say the Israel market (specifically, these companies held by EIS, go up 15% (not a bad year) and the shekel depreciates vis-a-vis the Greenback by more than that, add in fees and you're looking at a down year.

2) *Teva Pharmaceutical* clocks in at a hefty 20%+ of total assets. On the [Tel Aviv Stock Exchange's TA-25](#), Teva is "only" 9% or so of market cap weighting. Still a lot but nowhere near 20%. That's a lot of exposure to one company and one industry when trying to get exposure to Israel as a market.

3) The Top 10 holding comprise over 60% of the ETF's holdings. We assume iShares did this because it needs liquidity in some of the bigger names but this somewhat skews the exposure to the Israeli market. It's a lot of concentration in just a few names and overweights health care and financial and underweights tech and telecom.

In addition to the normal risks associated with investing, international investments may involve risk of capital loss from unfavorable fluctuation in currency, from differences in generally accepted accounting/regulatory principles or from economic or political instability in other nations. The Mideast is not a bastion of stability. Investments in emerging markets such as Israel are subject to a greater risk of loss than investments in developed markets (Morgan Stanley lists it as an emerging market but next month the

FTSE Group will upgrade Israel to the same designation as the United States, Europe and Japan.). This is due to, among other things, greater market volatility, lower trading volume, political and economic instability, greater risk of market shutdown and more governmental limitations on foreign investment than typically found in developed markets. . Securities focusing on a single country may be subject to higher volatility .Any dividends received will not be eligible for the Canadian Dividend Tax Credit.NOTE: On May 27, the first overseas exchange-traded fund that tracks the Tel Aviv Stock Exchange's TA-25 began trading on the New York Stock Exchange under the symbol TAV.

### **MFDA confronts bad adviser behaviour**

The BC arm of the Mutual Fund Dealers Association of Canada ("MFDA" [www.mfda.ca](http://www.mfda.ca)) has announced that it has commenced disciplinary proceedings against Tony Lin. MFDA staff alleges in its Notice of Hearing that Mr. Lin engaged in the following conduct contrary to the By-laws, Rules or Policies of the MFDA:

*Allegation No.1: From December 1, 2005 to February 16, 2006, the Respondent engaged in excessive trading by facilitating 34 related redemption and purchase transactions of mutual funds in eight client accounts, with little or no economic benefit for the clients and with little or no rationale for the transactions other than the generation of sales commissions for the Respondent, contrary to MFDA Rules 2.1.4 and 2.1.1*

<http://www.newswire.ca/en/releases/archive/May2008/30/c6623.html>

This process is known as **churning** and is often associated with a strategy to maximize sales commissions for the “adviser”. Good supervision and control systems should detect such practices. . No doubt the firm will reimburse trusting investors for the extra costs incurred and associated tax liabilities. Or else, it’s on to OBSI.

Read *Your Money: Self regulation is a recipe for disaster* by Dan Braneff [http://www.carp.ca/article\\_display.cfm?documentID=3143](http://www.carp.ca/article_display.cfm?documentID=3143) The article asks *Why is nothing happening to correct a situation where investor protection is so slack ?* “For years the possibility of fraud and wrongdoing has been masked by industry and regulators. Self regulation, without control, simply does not work in a complex volatile industry. It is like expecting the unmanageable to keep order in schools and the workplace, or suggesting criminals run the justice system because of their experience.” You’ll want to read this one for sure.

### **Provincial Regulator deals could derail plans for national securities regulator**

The chairmen of provincial securities regulators in Ontario, Quebec, B.C. and Alberta and the chairman of the SEC announced they would complete a "process agreement" by mid-June to open the way for discussions on a U.S.-Canada "mutual-recognition" deal to allow brokerages and exchanges from each country to sell securities in the other market, while being regulated by their domestic overseer. The process agreement, once concluded, would open the way for substantive discussions between the CSA and the

SEC on the subject of mutual recognition. Mutual recognition could provide Canadian securities exchanges and certain other Canadian financial service providers with greater freedom to operate in the United States under Canadian regulatory oversight, while U.S. securities markets and certain other U.S. financial service firms could gain greater freedom to operate in Canada under SEC oversight. In this manner, dual regulation, redundancy, and regulatory overlap could be eliminated. While Federal Finance Minister Jim Flaherty's push for a national securities regulator was undercut, the deal could in principle make it easier for Canadians to purchase low-cost US mutfunds.

<http://www.sec.gov/news/press/2008/2008-98.htm>

### **Study says Canadians need extra national pension plan**

Impact on fund industry would be severe

*“... According to Statistics Canada, the answer is two thirds of RRSP households (i.e., 5.5 million) invest in mutual funds (mainly equity funds), and one-third have GIC investments, with other types of investments spread thinly among multiple other categories. As noted, research indicates that the high costs associated with choice of*

*investment vehicle can have a material negative impact on savings accumulation and hence income replacement...”*

Millions of middle-income Canadians need a new pension plan, argues pension consultant Keith Ambachtsheer an internationally known pension consultant, or their living standard will fall. National pension plans provide no more than about \$16,300 a year per person, and only a minority of private-sector workers have company pension plans. Many individual savers are not setting enough money aside, and those who do forfeit too much to investment-management fees and their own inexperience, he argues. In a new paper for the C. D. Howe Institute, he proposes a way to fill the hole. A worker with no private pension plan should be enrolled in a new national plan, or a provincial one, if the idea does not win national support. This plan would run parallel to the Canada Pension Plan, but piggyback on its efficient payroll deduction system. Employees and employers would opt out of the plan if they wished, or make whatever contributions they wished up to current limits. He predicts that very soon after implementation , billions of dollars would be available to invest, and the annual costs of running the fund would be a fraction of those for small pension plans or actively-managed mutual funds . Source: <http://www.thestar.com/article/434470> For the study *The Canada Supplementary Pension Plan (CSPP): Towards an Adequate, Affordable Pension for All Canadians*, [click here. \[http://www.cdhowe.org/pdf/commentary\\_265.pdf \]](http://www.cdhowe.org/pdf/commentary_265.pdf)

**“If you have more than \$50,000 to invest, you should fire your broker and find an investment advisor. Brokerage firms would like you to think they perform the same functions as investments advisors. Financial planners who are members of the National Association of Personal Financial Advisors...submit their work to peer review and are not supposed to charge anything but a fee”**

*-Arthur Levitt, Former SEC Chairman*

**"There's an element of the business that is successful not because of the value they bring, but because they're great salespeople"** -Dan Richards , investment industry consultant. Source: Rob Carrick , *How to find an adviser who will put you first*, Globe and Mail ,May 29, 2008 pg B13 [ this could be 2008's understatement of the year]

**"We know that if we want to get an adviser to pay attention to our material, we simply need to write 'Compensation Information Enclosed' on the outside of the envelope, and send it out."**

- marketing veteran of several fund companies

**Who speaks for Investors?** <http://www.ellenroseman.com/?p=126#comments> We urge anyone reading Ellen Roseman's blog to check out the UK's Financial Services Consumer Panel at the following link: <http://www.fs-cp.org.uk/> The UK has a strong, legislated ,independent, well-resourced body to represent investor interests in the financial services sector. Instead, the OSC's Investor Advisory Committee was unceremoniously done away with and dismissed with a comment that it had "run its course" which retail investors and participants were left to discover by accident in a IE article.

**Visit** [http://investorvoice.ca/Research/Black\\_InvolvingConsumers\\_23Jun06.pdf](http://investorvoice.ca/Research/Black_InvolvingConsumers_23Jun06.pdf) to read Julia Black's terrific paper on how regulators can engage those they are mandated to protect.

### **Attributes of the trustworthy adviser**

1 Is comfortable with speaking to clients about fees and commissions: Evasiveness on this topic is a warning signal.

2 Has good communications skills: Talks in everyday language and provides clear explanations for what little jargon gets used.

3 Asks questions: Displays curiosity and interest about you as a person.

4 Makes time for clients: Replies promptly to inquiries and doesn't make clients feel like they're imposing on a busy person.

Source: Rob Carrick , *How to find an adviser who will put you first*, Globe and Mail , May 29, 2008 pg B13 [ AND is trustworthy and a professional ]

### **CIBC shooting some funds**

Thankfully, CIBC intends to terminate the following funds in the fall of 2008: - CIBC North American Demographics Fund - CIBC Japanese Equity Fund - CIBC Japanese Index RRSP Fund .The latter fund has only \$8.1 million in assets and has racked up a 3 year return of -1.06% vs. 2.24% for the MSCI Japan Index( Cdn \$).Fundcos typically kill off funds with lousy track records often merging them and/or renaming them to

escape from the horrible performance history. Strangely, transactions will be accepted as usual in the Terminating Funds up to and including the last business day prior to the termination of the Funds. Unitholders will not be required to pay any charges or fees associated with the termination of these Funds. All costs associated with the terminations will be borne by CIBC. Taxes ? CIBC encourages Unitholders to speak with their financial advisor to discuss their investment options **across the CIBC fund family**. In accordance with securities legislation, notice will be sent to unitholders of the Terminating Funds no less than 60 days prior to the effective date of the terminations.

### **OSC finds lots of room for improvement in MRFP reporting**

The fund industry has always had problems with disclosures-fees, risks , POS, prospectuses , Annual Reports , client statements etc. Investor advocates have been complaining for years. Now, the Ontario Securities Commission has released its findings following an issue-oriented review of general compliance with National Instrument 81-106 *Investment Fund Continuous Disclosure* ( similar to corporate MD&A's ) . The 7-page OSC Staff Notice 81-709

[http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/sn\\_20080530\\_81-709\\_rpt-cd-inv-funds.pdf](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/sn_20080530_81-709_rpt-cd-inv-funds.pdf) summarizes the findings and comments arising from the continuous disclosure review program conducted by the Investment Funds Branch [ focus on conventional mutfunds]. Staff reviewed a sample of investment fund managers who, in total, manage approximately 45% of the industry's assets under management.

OSC staff noted several areas for improvement in terms of the quality of management's discussion, overall presentation and ongoing regulatory compliance. In particular, Commission staff emphasized that the management discussion of fund performance should provide a historical and prospective analysis of the operations of the fund so that, together with the financial statements, investors have a complete picture of the fund's performance. A sampling of findings:

- Approximately 65% of fund managers did not compare the relative performance of an investment fund to a broad-based securities market index. The discussion of the relative performance of an investment fund as compared to a broad-based securities market index is a requirement under Part B, subsection 4.3(3) of the Form. Instruction (3) to section 4.3 states that a narrowly-based securities index or a blended index may be used in addition to a broad-based securities market index but it cannot be a substitute for the broad based index.
- Approximately 40% of investment funds selected had financial statements that revealed significant changes in the fund which were **not discussed** in the results of operations section of the MRFP.
- Approximately 40% of fund managers did not provide an adequate discussion of risk.

As to fundco websites the OSC found that approximately 40% of fund managers did not provide easily accessible links to continuous disclosure documents on their websites. In one example, a link to the fund prospectus was available on the fund manager's website but not given much prominence. In another example, the financial statements, MRFPs, proxy voting records, and quarterly portfolio disclosure were not easily accessible from the fund's webpage as they were posted under a menu option that did not seem to relate to these documents. Staff also found that in some cases excessive drilling down was required to reach documents. All in all lots of room for improvement. Discouraging but not surprising for an industry that still can't figure out who the real customer is.

### **Government of Canada Attempts Improved Transparency of PPN's**

The Government of Canada claims to have improved disclosure regulations for investors who purchase principal protected notes (PPNs) issued by federally regulated [deposit-taking institutions](#) such as [banks](#). Typically, there are commissions when an investor buys a PPN, and continuing fees that can cut deeply into returns. Other criticisms are that PPNs are too opaque in terms of explaining how people can profit from the underlying investments in their notes, that it's too hard to monitor how PPNs are performing in the years before they mature, and that PPNs are hard to sell before maturity. Jim Flaherty, Minister of Finance, announced June 2, 2008 that regulations aimed at improving disclosure have been approved and will come into force July 1, 2008. In recent years, the increased variety and complexity of PPNs has raised serious concerns about whether previous disclosure regulations provided investors with enough information to make informed decisions.

The new principle based regulations may help ensure that investors are informed of the fees, returns, risks and cancellation and redemption rights associated with PPNs. They also require ongoing disclosures after a PPN is sold to aid consumers in monitoring and tracking their [investments](#). Where PPNs are sold on the basis that they are bank "deposits" (that are not also "securities") it follows that they will be sold on the corresponding assumption that they are not governed by the statutory civil liability provisions in provincial and territorial securities legislation –and without the resulting market discipline on the quality of disclosure. They are also not covered by CDIC protection. This, in our view, heightens the importance of ensuring strict compliance with the Regulations. How and by who compliance will be monitored and enforced by is not clear—we assume it will be the "feared" FCAC <http://www.fcac-acfc.gc.ca/eng/default.asp> **Related Document:** [Principal Protected Notes \(PPN\) Regulations](#) Investor involvement in development of the new regs was, as usual, minimal.

### **IAC killed off in night - Joint Standing Committee on Retail Investor Issues Established**

The Investment Industry Regulatory Organization of Canada, Mutual Fund Dealers Association, Ombudsman for Banking Services and Investments and the Ontario Securities Commission have formed a joint committee on retail investor issues. The death of the controversial IAC was not publicly announced. As usual, retail investors will of course not be represented. The committee will provide a forum in which retail investor

issues can be identified and discussed, and work can be coordinated. Visit <http://www.mfda.ca/investors/forum07/JSCTermsOfRef.Final.pdf> or [Click here](#) to read the Terms of Reference for the committee. One key point-no obligation or commitment to publicly disclose proceedings, progress or conclusions. We still feel an independent body established in legislation is the only way to go as in the U.K.

**“..The disappearance of the FDM and the closure of the IAC [OSC Investor Advisory Committee] provide the clearest confirmation (hard facts) that the current regulatory structure cannot be relied upon to protect and promote consumer interests...”-Andrew Teasdale**

### New research on Fund Distribution Channels- does channel cause fund churning?

A Dec. 2007 study examines the investment timing performance of U.S. equity mutual fund investors and its relationship to the distribution arrangement of the fund. The researchers found that investors who transact through investment professionals using conventional distribution arrangements experience substantially poorer timing performance than investors who purchase pure no-load funds. Investors in all three principal load-carrying retail share classes (A, B, and C) significantly underperform a buy-and-hold strategy. Among all load funds, Class B investors suffer from the poorest cash flow timing, underperforming a buy-and-hold strategy by 2.28% annually, compared with annual underperformance of 0.78% for investors in pure no-load funds. No-load index funds are the only funds found to show no evidence of poor investor timing. Although investors are ultimately responsible for their own investment choices, these findings question the value being added by investment professionals who sell mutual fund shares through conventional distribution arrangements. *Investor Timing and Fund Distribution Channels*

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1070545](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1070545)

### Redemption Fees Signal Mutual Fund Outperformance?

Should investors avoid mutual funds that charge redemption fees, or is there a good reason to accept this explicit hit to liquidity? In other words, do these fees protect underperforming fund managers or long-term investors? In their recent paper entitled "[Redemption Fees: Reward for Punishment](#)", David Nanigian, Michael Finke and William Waller study the impact of short-term redemption fees on long-term fund performance based on fee size and duration (effective time interval of the redemption fee after purchase). Using monthly after-tax returns for a very large sample of open-end US equity mutual funds over the period July 2003 to May 2007, *they conclude that:*

- The percentage of U.S. equity mutual funds charging a redemption fee increases from 3.9% in 2003 to 14.6% in 2007.
- Among funds imposing a redemption fee, the proportion with fee durations one year or longer falls from 29% in 2003 to 5.5% in 2007, while the proportion with fee duration one month rises from 14.4% to 48%.

- Funds with redemption fees tend to be small in size, have low expense ratios, favor value over growth and lean toward small capitalization stocks.
- Redemption fees mostly indicate fund outperformance, especially for fee durations greater than one month, as follows:
  - Funds with small redemption fees and long durations outperform funds with no redemption fees by about **3% per year**.
  - Funds with large redemption fees and long durations outperform funds with no redemption fees by about *1.2% per year*.
  - Funds with small redemption fees and short durations outperform funds with no redemption fees by about 0,9% per year.
  - Funds with large redemption fees and short durations underperform funds with no redemption fees by about 1.1% per year.
  - Funds that levy the full 2% fee allowed by the SEC tend to underperform funds with comparable durations but lower fees.

In summary, *properly structured mutual fund redemption fees tend to protect long-term investors by penalizing frequent traders. Small redemption fees of long duration are optimal for long-term investors.* Source:

<http://www.cxoadvisory.com/blog/external/blog4-23-08/>

### **AIM Trimark concedes strength of ETF's in new life cycle funds**

You have to read this Press Release. A major move to using lower cost ETF's by a fundco.

[http://www.aimtrimark.com/publicPortal/ShowDoc?nodePath=/BEA%20Repository/common/document/pdf/pr\\_2008/RPP\\_pressrelease08.pdf#viewrect=top,1eft&zoom=100,0,0](http://www.aimtrimark.com/publicPortal/ShowDoc?nodePath=/BEA%20Repository/common/document/pdf/pr_2008/RPP_pressrelease08.pdf#viewrect=top,1eft&zoom=100,0,0) On June 2, 2008 the firm marked the launch of Invesco Trimark Retirement Payout Portfolios, an retirement income solution from AIM Trimark Investments that combines Trimark, AIM and Invesco actively-managed mutual funds with PowerShares enhanced -index exchange-traded funds (ETFs) for diversification. The Invesco Trimark Retirement Payout Portfolios target 4 retirement dates - 2023, 2028, 2033 and 2038. All four follow an asset allocation strategy it terms "GlidePath," which becomes gradually more conservative the closer the retirement date looms. Unlike their traditional counterparts, PowerShares ETFs track non-capitalization-weighted indices constructed using such variables as a company's fundamental factors or history of increasing dividends. This slickly packaged product mostly will appeal to fund salespersons wanting to pacify their clients asking about indexing, or MFDA registered "advisors" who are not licensed to sell ETFs directly. Well, if you can't beat em, join em. Be sure to enquire about fees, adviser compensation (trailers}, income tax issues and terms and conditions. Read the prospectus before investing (the fees can be found on page 41) NOTE: AIM Trimark's parent company, Investco Ltd., acquired the PowerShares ETF group early in 2006 so that's why they got introduced into this "mutual fund" .We remain constructively critical of all life cycle funds. Read *Life Cycle funds-Do they make sense for you?* <http://www.canadianfundwatch.com/modules.php?name=News&file=article&sid=20>

## A peek at an IRC Report

We decided to have some fun and look at a few Independent Review Committee Reports. This time we look at TD Fund's report for the period ending Dec. 31, 2007.

[http://www.tdam.com/Download/IRC\\_TD\\_Mutual\\_Funds\\_Report.pdf](http://www.tdam.com/Download/IRC_TD_Mutual_Funds_Report.pdf) We learn the following:

- As at December 31, 2007, none of the members of the IRC beneficially owned, directly or indirectly, even one units of any series of a Fund covered by the report.
- The compensation paid to the IRC during the year ended December 31, 2007 was set by TDAM, in its capacity as manager of the Funds, and not by the members of the IRC.
- Wisely, none of the 3 members of the IRC serve as a member of an Independent Review Committee for the investment funds managed by another investment fund manager.
- The aggregate compensation payable by the Funds to the members of the IRC for the period commencing September 19, 2007 and ending December 31, 2007, was \$42,649, payable by each of the Funds based on its pro rata share of this compensation. Basically , per fund cost is minimal when spread over **44** funds.
- In accordance with the requirements of *National Instrument 81-102, Mutual Funds* and NI 81-107 and exemptive relief previously granted by the Canadian securities regulatory authorities, the IRC has provided approval for the Funds, subject to terms and conditions, to:
  - 1 1. Invest in or hold equity securities of related issuers. i.e. the funds can own TD Bank stock and vote the proxy shares as it deems appropriate
  - 2 2. Invest in the securities of an issuer where TD Securities Inc., TD Waterhouse, or any other affiliate of TDAM (the "Related Dealers") acts as an underwriter during the offering of the securities or at any time during the 60-day period following the completion of the offering of such securities. Thus , they could in principle be a source of offloading a poorly selling IPO and who would really know.
  - 3 3. Purchase equity or debt securities from or sell equity or debt securities to a Related Dealer [like TD Waterhouse ] , where it is acting as principal.
  - 4 4. Purchase securities from or sell securities to another investment fund managed by TDAM or an affiliate of TDAM (referred to as inter-fund trades or cross-trades). Can you imagine what could happen here?

Basically, every regulatory prohibition has been waived by the IRC as it had been when regulators were involved. The IRC can and does give TDAM standing instructions which enable TDAM to act in a particular conflict of

interest matter on a continuing basis provided TDAM complies with its policies and procedures established to address that conflict of interest matter Breaching Prohibitions thus become standard practice. Neat ,eh?

- Of 17 conflict-of-interest scenarios ,the IRC asserts it **is not aware** of any instance in which TDAM acted in a conflict of interest matter referred to the IRC for which the IRC did not give a positive recommendation. e.g. The Toronto-Dominion Bank acts as custodian for and holds cash of Funds which creates a potential conflict of interest as to its selection, and continued retention, as a custodian. There is no mention as to how the “sharp-eyed” IRC determined that TD Bank was the lowest , responsible responsive custodian or if the custodial service will in future be open to competitive bidding.

Generally speaking, it’s just not clear how the IRC makes its recommendations or how it follows-up on its decisions to ensure compliance and effective , fair operation of the fund. IRC’s do not have the mandate to review congruence with disclosed investment objectives , fees , manager performance or other governance issues. during the great 2003 market timing scandal several TD funds were attacked by affiliate TD Waterhouse. The IDA imposed fines and sanctions on TDW for its trading but no action was taken to deal with the fund governance breakdown. The IDA’s TD Waterhouse findings were particularly upsetting. The IDA found that TD Waterhouse Canada Inc. has admitted it executed trades for wealthy clients that financially hurt mutual fund investors - including those of a sister company- despite many warnings. TD market timed at least 20 fund companies for 5 major clients. For client A alone it executed over 4000 trades with the trades ranging from \$200,000 to \$82.5 Million .A TD Internal Report concluded that no due diligence review of clients B, D and E had been conducted. and quoted in a settlement document says that "senior management at TD Waterhouse may have encouraged and approved" the establishment of market timing accounts in "an attempt to generate additional revenues for TD. Re Dec. 16, 2004 Settlement Agreement with the IDA [ now the Investment Industry Regulatory Organization of Canada ]  
<http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=69F2709B78A24784AA92646CAC955854&Language=en>

**“ ...Asset class purity. Putting foreign equities into a Canadian equity fund has been a historical way of engaging in the financial services equivalent of steroid doping. Impurity also makes a mockery out of IPSs if IPSs are being used... “** -John DeGoey , investment adviser Source:  
<http://network.nationalpost.com/np/blogs/wealthyboomer/rss.aspx?Tags=Indexing&AndTags=1>

**“You could certainly find some examples of funds being stuffed into [wraps] that might not otherwise get net sales .I’ve seen new products launched by various companies and, shortly after, they’re added to the companies’ wrap program. The optics of it aren’t that great. The reality is most people have anywhere from five to 20 mutual funds, and each fund has an average of about 100 stocks. There’s a ton of overlap . For what you’re paying to get that kind of diversification, you should buy an index fund ”-Dan Hallett, president of Dan Hallett & Associates Inc. in Windsor, Ont. Source: G. Kirbyson, *Are wrap programs the best vehicle for clients ?* , IE June 2008 pg 20**

**Site for holders of retail ABCP crap notes [http://www.retailabcpinfo.com/index.php?option=com\\_frontpage&Itemid=1](http://www.retailabcpinfo.com/index.php?option=com_frontpage&Itemid=1)**

### **TO police charge former fund salesman with fraud**

Toronto police have charged a former mutual fund dealer sales rep with fraud. On June 5th, Calogero Arcuri, 32, of Toronto, was charged with three counts of fraud. He is scheduled to appear in court on July 7. Police allege that while under contract with a financial planning firm, Arcuri accepted funds from three clients and did not invest the funds as promised. Funds totaling \$45,000 are still outstanding, police claim. None of these allegations have been proven. Earlier this year, the Mutual Fund Dealers Association of Canada also initiated a disciplinary proceeding against Arcuri on similar allegations. According to the MFDA, he was registered with Quadrus Investment Services Ltd. <http://www.quadrusinvestmentservices.com/> from 2002 until March 2007, but is no longer registered in the securities industry. It also claims that he failed to cooperate with its investigation. The MFDA’s allegations have not been proven either. That hearing is scheduled to take place on June 18.

<http://www.torontopolice.on.ca/newsreleases/release.php?id=14197> Source:  
<http://investmentexecutive.com/client/en/News/DetailNews.asp?Id=44902&cat=8&IdSection=8&PageMem=&nbNews=&IdPub=>

**What you should know about taxation of index-linked deposits [http://www.acfc-fcac.gc.ca/eng/publications/index\\_linked/index\\_linked-11\\_e.asp](http://www.acfc-fcac.gc.ca/eng/publications/index_linked/index_linked-11_e.asp)** An “index-linked deposit” is a term deposit where any interest payment is based on the change in the value of an underlying point of reference or benchmark. The benchmark can be a market index such as the Standard and Poor's/Toronto Stock Exchange (S&P/TSX) Composite , a mutual fund, a stock/group of stocks, or an exchange rate.

### **How much CDIC coverage do you have ? Try this calculator**

[http://www.cdic.ca/index.cfm/ci\\_id/1661/la\\_id/1.htm](http://www.cdic.ca/index.cfm/ci_id/1661/la_id/1.htm) NOTE: Mutual funds and PPN’s are NOT covered by CDIC deposit insurance

### **QAIB 2008 again confirms fund investors underperform funds**

The decisions mutual fund investors or their advisors make are vastly more important to their long-term success than any individual fund performance, reports U.S.-based

research firm Dalbar Inc. Every year, Dalbar releases its Quantitative Analysis of Investor Behaviour, showing the results of its examination of investor behaviour going back to 1987. As in previous years, the most recent study's results show that the average American equity fund investor earned significantly less than fund performance reports would suggest. The study found that the average annualized return over the 20-year period was only 4.5%, whereas the S&P500 had an annualized return of 11.8%. Dalbar's analysis argues that it is investor behaviour, rather than the selection of specific funds, that causes this tremendous underperformance over time. The average hold period for U.S. equity fund investors is just 3.2 years.

In a recent research paper entitled *Investor Timing and Fund Distribution Channels*, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1070545](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1070545) University of Mississippi professor Mercer Bullard, along with University of Nebraska's Geoff Friesen and Iowa State University's Travis Sapp, examined the investment-timing performance of equity fund investors and the relationship of this performance to both the type of fund and the distribution channel. The study concluded that investors in actively managed funds leave 1.7% of their potential annual return behind because of poor timing, more than three times the index fund investors' shortfall of 0.5%. Those investors who stick with pure no-load funds don't do as poorly when compared with investors utilizing various intermediaries. This is true for both actively and passively managed portfolios. Whether these lackluster returns are the result of poor decisions by advisors or by investors cannot be determined, the researchers acknowledge.

<http://www.qaib.com/showresource.aspx?URI=advisoreditionfreelook&Type=FreeLook> and <http://www.investmentexecutive.com/client/en/News/DetailNews.asp?IdPub=164&Id=44859&cat=22&IdSection=22&PageMem=&nbNews=>

### **IFIC needs to focus on real issues**

Fund industry lobbyist IFIC CEO Joanne DeLaurentiis wrote an interesting piece in the June issue of Investment Executive. In it she decries the "rhetoric" of academics, investors, the media and investor advocates. She argues, correctly, that the MER is but one factor and goes on to list other benefits that mutual funds provide such as reinvested distributions and more efficient stock purchasing. To her credit she admits that the average holding period is just five years, not the 10-years considered by professional advisors to be the long-term. She is however missing the point. The "rhetoric" is over high Canadian MER's relative to the rest of the world not a comparison with other investment products. What we'd like IFIC to deal with besides high fees is better POS disclosure, improved client statements, improved fund performance and disclosure [MRFP's], enhancements to OBSI's mandate and initiatives to respond to the special needs of seniors. Perhaps next column. Reference J. DeLaurentiis, *Comparing apples to apples*, Investment Executive, June 2008, pg 32

**The IDA and RS Inc. merged effective June 1, 2008. The new SRO will be called the Investment Industry Regulatory Organization of Canada (IIROC) .New website : [www.iiroc.ca](http://www.iiroc.ca)**

### **New Federal Regulation on sale of Principal Protected Notes**

<http://canadagazette.gc.ca/partII/2008/20080611/html/sor180-e.html> June 11, 2008 The Regulations specify the content, manner and timing of disclosure that institutions are required to provide at the point of sale; the information that must be made available, upon request, to investors to monitor their investment; and restrictions on advertising. They require such information to be provided at least two days before the PPN is purchased, unless a two-day rescission right is provided. The Regulations represent a mix of principle-based regulation and specific requirements, and are applicable to Schedule I, II and III banks, credit unions governed by the *Cooperative Credit Associations Act* and federally-regulated trust and loan companies (Institutions). PPN's sold through other channels are not covered by this Reg. Investor input was minimal. The FCAC [www.fcac-acfc.gc.ca](http://www.fcac-acfc.gc.ca) is the designated compliance/enforcement Agency.

**Get your licks in to the Experts.** The Expert Panel was announced by the federal Minister of Finance on Feb. 21, 2008 to provide advice on the best way forward to improve securities regulation in Canada. You can make your views known by making a submission <http://www.expertpanel.ca/eng/index.php?PHPSESSID=9nofq43fd5ouku3nf37pif2u54>

### **Preparing an Investment Policy Statement**

<http://im.morningstar.com/im/InvestPolicyWS.pdf>

**MFDA Penalty Guidelines:** Visit <http://www.mfda.ca/enforcement/PG-PartII.html#Anchor-conflict> You may be shocked at the relatively soft touch of the penalties even for cases of forgery. It's not clear what conditions must exist before a file is shared with law enforcement. IDA equivalent at [http://www.iiroc.ca/English/Enforcement/Policies/Documents/IDADisciplinarySanctionGuidelines\\_en.pdf](http://www.iiroc.ca/English/Enforcement/Policies/Documents/IDADisciplinarySanctionGuidelines_en.pdf)

### **Are index-linked GIC's covered by CDIC?**

We asked CDIC and got this answer:

CDIC is a federal Crown corporation created in 1967 to insure eligible deposits at member financial institutions in case of their failure. CDIC's members are banks, trust companies and loan companies and cooperative credit associations that have CDIC membership.

CDIC insures eligible deposits at each member institution up to a maximum of \$100,000 (principal and interest combined) per depositor in each of the following categories:

- (a) savings accounts, chequing accounts, and term deposits,
- (b) deposits in trust for another person,
- (c) joint deposits (except in the case of joint deposits, the maximum coverage applies to all eligible deposits in the names of the same joint account holders at the same institution),
- (d) deposits in Registered Retirement Savings Plans (RRSPs),
- (e) deposits in Registered Retirement Income Funds (RRIFs) and
- (f) realty taxes on mortgaged property.

To be eligible for deposit insurance protection, deposits must be payable in Canada, in Canadian currency. Term deposits must be repayable no later than five years from the date of deposit.

Market-linked or index-linked GICs are GICs whose returns are linked to an increase in a stock exchange index. They are neither an insurance contract nor security. They are deposits redeemable at maturity. If an index-linked deposit meets the above criteria, an index-linked GIC would be insurable as a term deposit in category (a) above.

**E-mail from a reader:** I'm a 71-year-old retiree. My financial advisor keeps telling me to keep investing /allocate my assets. But I now need cash, tax efficiency and current monthly income. Capital preservation not the long term is my priority. I just realized that my "advisor" gets monthly commissions as long as I hold mutual funds she sold me. Could this be the reason she keeps nudging me to buy more funds rather than redeem funds and start enjoying life? Gilbert in Regina

Response: It could be but it may also be due to the fact that your advisor is not tuned to the special needs of retirees or pensioners. She may not have the qualifications or registrations necessary to address your needs at this stage of your life where capital preservation is paramount. Approach to money management is completely different when you're withdrawing rather than contributing. Dr. Moshe Milevsky is in fact making this point in his books and lectures [http://72.14.205.104/search?q=cache:rMe8TpmbLcQJ:www.bmonesbittburns.com/personalinvest/retirementyourway/pdf/Milevsky-E\\_Jul07.pdf+moshe+milevsky+pension+withdrawals&hl=en&ct=clnk&cd=9&gl=ca&client=firefox-a](http://72.14.205.104/search?q=cache:rMe8TpmbLcQJ:www.bmonesbittburns.com/personalinvest/retirementyourway/pdf/Milevsky-E_Jul07.pdf+moshe+milevsky+pension+withdrawals&hl=en&ct=clnk&cd=9&gl=ca&client=firefox-a). Realize however that any expenditures/withdrawals you make should anticipate a life span at least to the mid eighties and beyond. You don't want to run out of money hence the term longevity *risk*.

**Interesting article on retail investor behaviour** *Investors Behaving Badly* <http://www.camagazine.com/1/0/0/9/6/index1.shtml> The 2001 FRC study found that individual [U.S.] investors had consistently higher redemption rates and shorter holding periods than investors who used a financial adviser. In 1996, the average investor had held a long-term mutual fund for 5.5 years and the redemption rate was 17.4%. Four years later, at the height of the boom market, the typical investor held the same long-term mutual fund investment for an average of only 2.9 years and the redemption rate was up to 32.1%. In addition, individual investors compounded the negative effect of trading too often by making poor choices in terms of timing. The full study *Investors Behaving Badly: An Analysis of Investor Trading Patterns in Mutual Funds* can be found at [http://www.fpanet.org/journal/articles/2001\\_Issues/jfp1101-art11.cfm](http://www.fpanet.org/journal/articles/2001_Issues/jfp1101-art11.cfm) More recent research has concluded the opposite, possibly reflecting either smarter DIY's and/or greater corruption of the advisory channel via commissions and trailers. In Canada, with its more lucrative commission structure, the old maxim still stands *Mutual funds are sold not bought* at least based on what we observe.

### **Hedge fund con goes missing-biz card for sale on eBay**

Where in the world is Sam Israel, the hedge fund manager who defrauded investors out of \$450 million {U.S.}? That's what federal investigators are trying to determine after Israel's SUV was discovered abandoned on a bridge over the Hudson River, 40 miles north of NYC. Israel, who pleaded guilty in 2005 to charges of ripping off investors in his Bayou Group of hedge funds, was supposed to report to a federal penitentiary in

Massachusetts on Monday to begin serving a 20-year sentence. Instead, NY State Troopers discovered his SUV on the Bear Mountain Bridge. The words "suicide is painless" were written in dust on the outside of the vehicle. But while the superficial evidence on the bridge indicates that Israel may have jumped to his death, no body has been found in or near the river, leading some authorities to suspect that Israel might have staged a suicide and gone into hiding. An eBay seller is looking to cash in on the saga of Samuel Israel – an unidentified seller from Islip, N.Y., put what he claims to be Israel's business card up for auction on the Web site, calling for buyers to "bid for a piece of history." The card is from the Bayou Group, the hedge fund Israel helped establish in Stamford. A photograph of the card was posted as well, with the name "Sam Israel III" printed in the lower right corner and the company logo - a pelican - in the upper right.

### **Interested in ABCP, IFRS, accounting issues..?**

<http://www.accountabilityresearch.com/media.html> Passing *the buck* a great read  
<http://www.accountabilityresearch.com/documents/media/2008/Passing%20the%20buck.pdf>

**“..Ambachtsheer [Keith] told students and other interested observers at Rotman School of Business yesterday that a new supplemental pension could cost contributors less than 0.2 per cent of assets per year, or about 2 percentage points [200bps!] less than mutual fund investors typically pay. That savings could add as much as 40 per cent to the retirement income a person could generate from each dollar of savings...”** Source: J.Daw, *Pension idea needs your help*, Toronto Star, June 12, 2008 pg B3 [Internationally known pension consultant Keith Ambachtsheer has sketched out the rough design for a new national (or provincial) pension plan to supplement CPP, at least for those who can realistically afford to save. He estimates 3.5 million workers could benefit from an optional payroll deduction plan with low costs and professional management. Someone who started contributing early in life could bring their total retirement income up to 60 % of pre-retirement earnings by contributing 10 % of wages in excess of \$30,000 a year. Ambachtsheer proposes older workers be able to transfer in their existing retirement savings, and that everyone be able to purchase a low-cost annuity from the plan administrator to guarantee a portion of their income for life. Good for citizens not so good for mutfund industry. With defined benefit programs in decline, this could be a real boost to Canadian’s nest eggs and they wouldn’t have to deal with commissioned “advisers” Without a company pension plan, the odds are high they will fritter away a brighter future due to a lack of experience and the highest mutual fund fees in the world. ]

**“When you mix raisins and turds, you still have turds”** - Charlie Munger [Vice-Chairman of [Berkshire Hathaway](#) Corporation, the diversified investment corporation chaired by investor [Warren Buffett](#) commenting on overdiversified large mutual funds]

### **Is this you?**

1. look at the percentage gains and choose mutfunds based on the previous years returns.

2. chase after rising funds.
3. somehow always seem to look at "growth" funds.
4. switch between funds like a race driver switching lanes.
5. figure a 2.5 % expense ratio doesn't affect my investment returns.
6. no idea what I or what the mutual funds are doing and don't do anything about it.

Now 1-5 are all common silly mistakes but the real problem is no. 6. **You don't know what's going on.** Since you don't know what you are doing, you'll be making the first 5 mistakes. Put some effort into maintaining your financial health.

### **MFDA proposing amendments to RULE 5.3 (Client Reporting) and RULE 2.8 (Client communications)**

The proposed amendments will require Member firms to provide annual reports to all clients that show either the holdings in the account and funds invested and withdrawn from the account or provide annualized percentage rates of returns on investments in the account calculated per Rule 2.8.3. The proposed amendments will require changes to the reporting currently provided for client name accounts. Other minor changes have been proposed with respect to Rule 5.3.1(a), 5.3.1(c) and 5.3.3(c) to clarify existing requirements or to address inconsistencies with other provisions. Rule 2.8.3 will be amended to clarify the Member's supervisory requirements regarding client communications that disclose a rate of return. Members that allow Approved Persons ("salespersons") to provide such information to clients may be required to make changes to existing supervisory procedures. Some firms have adopted policies and procedures whereby they do not properly supervise performance reports generated by Approved Persons, but simply disclaims responsibility for the content of these reports. Quite rightly, the MFDA is of the view that such policies are inconsistent with business conduct requirements under MFDA By-laws, Rules and Policies. [and common sense] [http://www.osc.gov.on.ca/MarketRegulation/SRO/mfda/rr/srr-mfda\\_20080613\\_amd-rule5-3.jsp](http://www.osc.gov.on.ca/MarketRegulation/SRO/mfda/rr/srr-mfda_20080613_amd-rule5-3.jsp) The proposed amendments, which were approved by the MFDA board on May 22, are out for a 90-day comment period. We remain baffled that the MFDA does not require firms to provide personalized rates of return – a statistic that is fundamental to investing.

### **Fund adviser shows her stuff**

A young ventriloquist is touring the clubs and one night he's doing a show in Winnipeg. With his dummy on his knee, he starts going through his usual dumb adviser jokes when an MFDA authorized person in the 4th row stands on her chair. She starts shouting: "I've heard enough of your stupid adviser jokes. What makes you think you can stereotype fund salespersons that way? What makes you think mutual funds sell themselves? It's guys like you who keep people like me from being respected, at work, in the media and in the community and from reaching our full potential." The embarrassed ventriloquist begins to apologize, and the woman yells,

"You stay out of this, mister! I'm talking to that little shit sitting on your knee!"

### Joint Forum meeting summary-Concept paper 81-406 POS disclosure-industry wins

On June 18<sup>th</sup> the Joint Forum presented feedback to stakeholders in Toronto regarding their current thinking on mutfund/Seg fund Point Of Sale disclosure. About 80-90 people were in attendance, the overwhelming majority industry participants. It's clear industry has prevailed on a number of fronts e.g. m/m funds will not require a Fund Fact sheet even though billions of dollars are invested in this unduly high MER category and some are sold on a DSC basis .Key investor community suggestions were not adopted -TER will not be added; suggested risk metrics not incorporated. However, a controversial IFIC risk measure will be used. *Access equals Delivery* has by and large not been accepted by regulators. Funds purchased through Discount brokers will not require a FF although regulators should consider making it accessible in this case. However it wasn't clear how TD's eFunds will be treated. Questions on wrap accounts were deferred. The FF will now be provided only at time of initial purchase or if there has been a material change. Biggest issue- so-called " buyer initiated" purchases will not require delivery of a FF at all-a huge loophole that will create an enforcement nightmare. There were no handouts provided before, during or after the 1-hour briefing/Q&A.

In practice, relatively few advisers explain what the disclosure documents. are and why they are important to read. That's why our fund fees are among the highest in the world. Too many advisers trivialize these disclosures and this attitude turns off investors. At least investors will have 2 days after receipt of confirmation to extract themselves from a purchase according to the proposals. Penalties for not providing a FF are unclear. There will be yet another painful Comment period round, likely in the fall. The battle isn't over but the powerful fund lobby has won this important round. They had submitted about 75 of the 85 Comment letters. Investor advocates may need to now focus on a requirement for the provision of pre and post tax personalized rates of return. This may be more effective in opening people's eyes than POS rules albeit it's post mortem. The MFDA is proposing encapsulating this as an option only rather than a firm requirement for advisory firms. Regulators need to stop "striking a balance" in disclosure given the huge asymmetrical information gap between advisers and small investors and the horrific toll it is taking on Canadian's nest eggs. Whatever happened to the FDM?

### The Norbourg fund scandal: RCMP/IMET arrest 6

**" For many of the [9,200] victims, this fraud resulted in the loss of their entire life savings. This represents a violent form of crime."**- RCMP Superintendent Gaétan Courchesne, June 18 News Conference.

The RCMP has concluded its investigation to expose the criminal wrongdoings that affected approximately 9,200 investors of mutual funds managed by Norbourg Asset Management. Norbourg was shut down in 2005. This criminal investigation shows that

six persons allegedly participated in or facilitated the commission of fraud offences for a total of approximately \$95 million. As a result, the investigation carried out by the Integrated Market Enforcement Team (IMET) culminated in the arrest of six persons with close ties to Norbourg. The 6 suspects face charges of conspiracy to commit fraud, conspiracy to commit forgery, forgery, fraud and money laundering. Those arrested include a Norbourg ex-employee, an external auditor, and Jean Renaud, a former bureaucrat with the Quebec Finance Department.

The crimes for which the suspects have been charged were allegedly committed between Sept. 20, 2002, and August 25, 2005. The actions enabled CEO Vincent Lacroix (already serving jail time for related fraud.) to carry out a number of personal and corporate acquisitions according to IMET. A total of 922 counts of indictment have been laid overall as part of the IMET criminal investigation. [http://www.rcmp-grc.gc.ca/qc/comm/2008/06/080618\\_e.htm](http://www.rcmp-grc.gc.ca/qc/comm/2008/06/080618_e.htm) The RCMP hopes to use this case as evidence that it does conduct white-collar crime investigations, charge and prosecute those using capital markets to effect financial assault on Canadians. It's a MUST WIN for IMET to re-establish credibility. Canada has been singled out by investor advocates and the International Monetary Fund, among others, for its dismal enforcement record on the white-collar crime front. [Back in August 2005 the Norbourg developments led to the sudden resignation of the chairman of the Investment Funds Institute of Canada (IFIC), Michel Fragasso, who was listed on IFIC's website as a senior vice-president of Norbourg. That was the third time an IFIC chairman has had to resign amid controversy. Terrence Wright of Winnipeg-based Investors Group Inc. stepped down in 2004 following a market timing probe involving Investors Group mutual funds, and in 1998, then chairman Dax Sukhraj resigned over his involvement in a fund company that collapsed.]

### **Morningstar concludes US fund managers don't eat their own cooking**

Morningstar recently examined whether fund managers invest in the offerings they run, and their study revealed that skippers of most U.S.-stock funds have none of their own money invested alongside shareholders. This latest study, which examines fund manager ownership throughout the industry, reinforces what they've found through their work on Morningstar's Stewardship Grades for mutual funds: Most mutual fund managers' own financial interests are not well-aligned with shareholders'. Less than half of the 1,066 funds they grade received at least some credit for manager ownership. About 20% receive partial credit and 24% receive full credit, with the rest earning no points toward their overall Stewardship Grades.

That's disappointing because they grade primarily the industry's largest and best offerings. If managers aren't making meaningful investments in these funds, it should give investors pause. The best way to demonstrate a commitment to shareholders is to join them. Some of this industry's most-admired managers have invested millions of their own savings alongside fund investors', so they're subject to the same fees, taxable events, and volatility as those who have entrusted their life savings to the mutual fund. They're also showing conviction in their investment process. If managers aren't willing to put a

significant portion of their own money into their mutual fund, why should you? Source: *Does Your Fund Manager Feel Your Pain?*

<http://news.morningstar.com/articlenet/article.aspx?id=241755>

**NOTE:** Beginning in 2005, the U.S. Securities and Exchange Commission required funds to publicly disclose annually each manager's stake in every fund they run. Those investments are disclosed in ranges: 0; \$1-\$10,000; \$10,001 to \$50,000; \$50,001 to \$100,000; \$100,001 to \$500,000; \$500,000 to \$1 million; and over \$1 million. To receive full credit for the manager-ownership portion of the Morningstar Stewardship Grade (which represents up to 10% of the fund's overall grade), a manager of a core mutual fund should invest more than US\$1 million of his or her own money in the fund. That's an industry best practice and a high hurdle, but it's not unreasonable--fund managers commonly earn millions per year. Canadian regulators do not require this disclosure.

### **Choosing the right money market fund -FEES COUNT**

<https://www.phn.com/Default.aspx?tabid=1045> PH&N provides an example: Assume the average return (before fees) for a money market fund is 3.75%. If the average MER is 1.00%, the after-fee return will be 2.75%. But if you choose a money market fund with an MER of 0.50%, your after-fee return will be 3.25%. Assuming you made an initial investment of \$10,000 compounded over ten years, the fund with the lower MER would be ahead by \$652.43.

**From the BCSC** This [video podcast](#) looks at the risks of investing based on Fears, Assumptions, and Desires (FADs). Investing based on FADs is like gambling with your money - if you accept that risk then it is your choice to roll the dice. However, if you cannot afford to lose your money, then you need to learn how to separate the FADs from FACTs. [Watch this podcast](#) for tips and ideas on what you can do to protect yourself from an investment scam or unsuitable investment. Future episodes will delve into the topics of due diligence and the three "knows" in more detail - so stay tuned! In the meantime, you can check out more about these topics at [www.investright.org](http://www.investright.org).

### **Worried About Your Retirement? You should be according to Bloomberg**

[View video from Bloomberg.com](#)

Hidden fees and lack of disclosure significantly hamper retirement returns. Are YOU affected? Bloomberg.com details how as many as 50 million Americans are getting the shaft when it comes to growing their retirement nest eggs in 401(k) plans. Chances are, you're one of them. Read the article, and demand index funds options for your retirement plan. Index funds carry lower fees and more transparency. What you see is what you get with index funds. Don't settle for anything less. [Read More](#) Source: Bloomberg

**Are wraps for suckers?** In the fund world, there's an increasing movement towards funds made up of other funds, wrap programs and advisory relationships where a financial consumer allows a fund company to build a portfolio. Sometimes, it seems like the fundco doesn't want you to think about what's in your wrap, because it's not always their best funds. You're trusting a fundco to allocate your assets and they're not necessarily paying attention to the performance of any individual fund--some may be dogs they don't want to kill off because of attractive fees. This may be the heavy price

you pay for convenience, for having a fund family allocate your assets rather than having your adviser do it or doing it yourself. If you never look at what a fund-of-funds holds, shame on you, but if you do look at the funds and see a toxic one in there, you have a good reason to be concerned because you can't be sure that anyone is really looking out for your interests. Our view on wraps in general is at [http://www.canadianmoneysaver.ca/article\\_retrieve.aspx?article\\_id=1650](http://www.canadianmoneysaver.ca/article_retrieve.aspx?article_id=1650)

**“ DSC Funds”**: Deferred Sales Charge funds move the sales load from the front-end to the back-end, where it gradually diminishes the longer you hold your shares. For example an arrangement might call for you to pay a 6% load if you redeem your units during the first year, a 5% load if you sell during the second year, and so on until you pay no load at all if you hold on for six years or more. Your adviser /broker still receives a sales commission, but it comes from the fund organization rather than immediately from your account. How does the fund recoup this money? By adding it to the fund's annual expenses, which makes them higher than they otherwise would be. Surprise!, you're the one who ultimately pays; you just do it a little every day rather than all at once up front. After six or 7 years, some fundcos will automatically convert your DSC fund to a Front load Class (which pays lower—that is, normal—annual expenses) on the basis that by then you'll have "paid your dues." Other organizations aren't so fair-minded and continue to gouge you indefinitely. Beware *“There’s no sales load, so all of your money goes to work for you immediately.”* Believe us, there’s no free lunch. Trailers are alive and well.

**Good reads:** *Bad advice has consequences* <http://unbiasedportfolio.blogspot.com/> **Also,** *In Praise Of Portfolio Simplicity* <http://www.investopedia.com/articles/basics/08/simplify-investing.asp?viewall=1>

### **Adviser fined for making unsuitable income trust investments**

The Investment Dealers Association (now IIROC) has imposed discipline penalties on Steven J. Westman, at all material times an Approved Person with the Winnipeg branch of Merrill Lynch Canada Inc., an IDA Member firm. In an agreed statement of facts, Mr. Westman admitted that between May 1999 and March 2001, he contravened former IDA Regulation 1300.1(c) by making unsuitable recommendations for 2 clients. He also admitted that between Feb. and March 2001, he failed to adequately inform himself as to the nature or details of two income trusts that he had recommended. For his misconduct, the following minimal sanctions have been imposed on Mr. Westman:

- a modest fine of \$20,000;

- re-write and pass the examination based on the Conduct and Practices Handbook within one year of being re-approved for employment at any IDA Member firm although it was ineffective the first time; and

- strict” supervision for a period of one year upon re-approval.

Mr. Westman must also pay costs in the amount of \$18,000 and is prohibited from being Reapproved until the ordered fine and costs are paid. In determining penalty the following mitigating factors were considered:

(i) the clients suffered no losses; (ii) the 2 clients were relatively sophisticated and they, the corporate trustee, and the employing Member firm must assume some of the responsibility [ but not apparently accountability] for the investments not complying with the governing agreements; (iii) one of the unsuitable recommendations was suggested to Mr. Westman by his manager; (iv) Mr. Westman has no prior disciplinary record; and (v) Mr. Westman fully cooperated with the investigation. As you'd expect, Mr. Westman is currently not employed with an IDA Member firm and likely neither he nor the firm has paid any fines or costs.

<http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=24AC6CDC02D14EA99EBCEA6C919AE2FE&Language=en>

**“ It’s not going to happen here. It’s just not part of the Canadian justice system and Canadians aren’t looking for that ”** - OSC head of enforcement Mike Watson commenting with respect to lengthy sentences for white collar criminals. Nov. 2007  
Source: <http://www.thestar.com/article/298204>

### **Two charged in Bear Stearns hedge-fund collapse**

**“ This is not about mismanagement of a hedge fund .It is about premeditated lies to investors and lenders.”** - Mark Mershon, head of the New York FBI office

The U.S. enforcement process sure seems to work much faster than ours. FBI agents are scooping up two Bear Stearns managers over their role in a hedge fund collapse that happened just last summer. On June 19<sup>th</sup>, two former Bear Stearns hedge fund managers were hauled into jail and charged with lying to investors about the collapse of the subprime mortgage market, perhaps signaling the start of a wave of prosecutions arising from the housing meltdown. Ralph Cioffi and Matthew Tannin were accused of encouraging investors to stay in their hedge funds, heavily exposed to subprime mortgages, even as they knew the credit market was in serious trouble. They were indicted on conspiracy and fraud counts, the first criminal charges to hit Wall Street in the housing market meltdown. The eventual implosion of their two hedge funds cost American investors US\$1.8 billion and started the domino effect that led to the demise of Bear Stearns itself, which barely avoided bankruptcy in a rescue buyout by JP Morgan Chase & Co. The indictment describes a meeting of Cioffi, Tannin and two unnamed colleagues in which Cioffi confided the hedge funds had narrowly "averted disaster" in February 2007 — news that "led to a vodka toast to celebrate surviving the month."  
[http://news.yahoo.com/s/ap/20080620/ap\\_on\\_bi\\_ge/bear\\_stearns\\_investigation](http://news.yahoo.com/s/ap/20080620/ap_on_bi_ge/bear_stearns_investigation)

### **New regulations for PPN’s will help but no panacea**

At present, there are few regulations that dictate what Principal-Protected Note (PPN) managers must tell investors, so many investors may be being sold unsuitable products. Some have risky hedge funds as the underlying investment and high hidden fees. Currently, PPN’s are effectively unregulated. Effective July 1, 2008 such Notes will require greater disclosure to retail investors. New Federal regulations <http://canadagazette.gc.ca/partII/2008/20080611/html/sor180-e.html> are an improvement,

albeit 3 years after the horrific Portus and Norshield scandals have taken their toll. The regs were released without the benefit of meaningful investor advocate input.

The federal government took action because it, rather than the CSA, is responsible for regulating the banks that guarantee Principal-Protected Notes. Here's the highlights of the new disclosure regime:

- Clear and simple language that is not misleading.
- Written and verbal information from a financial institution at least 2 days before you agree to buy a PPN.
- Information about the term of the Note, how and when the principal is to be repaid and the interest, if any, is to be paid.
- A warning about any risks associated with the Note, including the risk that no interest may accrue.
- An explanation of the difference between PPN's and fixed-rate investments.
- If a PPN relates to a deposit that is not eligible for coverage by the Canada Deposit Insurance Corp. [www.cdic.ca](http://www.cdic.ca), that fact should be clearly delineated.
- Information about whether the Note can be redeemed before maturity and, if so, reveal that early redemption may result in the investor's receiving less than the principal (guaranteed) amount.

After the sale, institutions still have continuing disclosure obligations. They must tell investors "without delay" about the value of their PPN on any given day and how that value relates to the interest payable. If a PPN ceases to be linked to an index or reference point that was to be used to determine the interest payable under the note and, as a result, no interest will be paid, the institution must disclose that fact to the investor without delay. The regulations also contain specific advertising content rules- advertisements that contain examples of potential good results for holders must also give examples of bad results. For instance, an example that describes a situation where interest would be payable must be accompanied by an example in which no interest would be paid. Critics question whether this principle-based approach to regulation is robust enough to permit enforcement and whether FCAC is equipped to regulate this type of security.

While the Regulations impose obligations on institutions, they do not speak to the obligations of distributors, whether affiliated or not, who are selling PPNs (e.g. deposit brokers or dealers). We expect that issuers will ensure compliance with their obligations under the Regulations either by delivering the required disclosures directly to investors, or by contractually obligating their distributors to adhere to the requirements on their behalf. We urge investors to have their advisers show them the role such Notes have in their portfolios, the fees involved, tax issues, the expected range of returns and exactly who is providing the guarantee. To learn more about PPN's [http://72.14.205.104/search?q=cache:5hJ93Byv\\_QUJ:www.banffschool.com/documents/wealth\\_weekend/2007/mons\\_en\\_stephanie\\_principal\\_protected\\_notes.ppt+IDA+Due+Diligence+Guidelines+on+Principal-protected+Notes.&hl=en&ct=clnk&cd=5&gl=ca&client=firefox-a](http://72.14.205.104/search?q=cache:5hJ93Byv_QUJ:www.banffschool.com/documents/wealth_weekend/2007/mons_en_stephanie_principal_protected_notes.ppt+IDA+Due+Diligence+Guidelines+on+Principal-protected+Notes.&hl=en&ct=clnk&cd=5&gl=ca&client=firefox-a) and the IIROC's excellent *Due Diligence Guide for PPN's* ( March , 2007 ;74 pages) <http://docs.iroc.ca/DisplayDocument.aspx?DocumentID=C7E39CFDA3C842F5A2CA5B7AFC02995D&Language=en> .

**Adviser Factoids:** (1) More than half (51%) of financial consumers switch advisors just before (24%) or shortly after (27%) retirement per McKinsey & Co's *Cracking the Consumer Retirement Code*. (2) 70% of widows fire their husband's financial advisor within three years of his death. Source: J. Chevreau, *Wealth planning comes of age*, National Post, June 17, 2008 pg FP13

**Regulatory Factoids:** The Livent trial began in May [2008], 5½ years after charges were laid against ex-CEO Garth Drabinsky and Myron Gottlieb and nearly a decade after their company collapsed, insolvent. Six-and-a-half years after the alleged fraud at Nortel began, ex CEO Frank. Dunn has finally been charged. Ten years from the alleged fraud to the laying of charges –that’s how long it took to bring former Royal Group Technologies president Vic De Zen & Co. to court.

**“I don't think we should be fooled into thinking we have a system [regulatory enforcement] that's working really well,”** - Anita Anand, associate dean of the University of Toronto's faculty of law [commenting on the glacial speed and ineffectiveness of Canada’s regulatory enforcement practices. Canada has a sorry history of being soft on corporate bad guys. Provincial attorneys-general traditionally don't spend much effort on financial crimes; most such cases are handled through the provincial securities commissions, notoriously weak in this country. Not until 2003 - after Livent, Philip Services, YBM Magnex and, worst of all, Bre-X Minerals, and scores of other, smaller alleged stock market scams - did the RCMP set up its first specialized unit for capital markets crime. IMET has so far been a bag of wind. The penalties have ranged from NIL to wrist slap. Source: D. DeCloet, *Action is good but speed would be better*, National Post, June 20, 2008, pg B1

### **Actively-managed mutfunds continue to disappoint**

S&P reports that diversified actively-managed Canadian equity mutual funds lost 4.3 % on an average asset-weighted basis in the first three months of 2008, compared with the 2.8-% decline of the S&P/TSX composite total-return index. Just 8.2% of those mutual funds generated better returns than the S&P/TSX composite on a total-return basis, the company said in its quarterly Indices Versus Active Funds Scorecard. Over the previous 12 months, 14.5 % of actively-managed equity funds outperformed the composite index, and the average weighted decline was 0.6 %, versus a 4-% gain for the index. In the past five years, the track record for active management versus the index has deteriorated. Just 4.1 % (!) of those mutual funds have outperformed the composite over that time, while the average asset-weighted annualized returns of 15.6 % are almost 300bps below the index's total returns of 18.5. %.

<http://www.theglobeandmail.com/servlet/story/LAC.20080625.RSPIVA25/TPStory/Business>

### **Looking inside the no-load Scotia “Canadian” Growth Fund**

Are actively- managed fund names deceptive? Well, consider this. The Scotia “Canadian” Growth fund has a whopping 25.62 percent exposure to non-Canadian equities. It's top holding is the NYSE listed passively- managed iShares MSCI emerging market index ETF with a 4.93% percent holding .The 2007 turnover rate was 71.14% so the portfolio holding period isn't very long. Over five years to May 31 2008 the fund has returned 15.62 percent compound rate (pretax) versus 18.98 percent for the questionably chosen S&P/TSX composite benchmark index. So, this “ Canadian” fund has significant exposure to foreign markets and currency risk. Any dividends from non-Canadian entities it holds will not be eligible for the Canadian Dividend tax credit. Besides cash, part of the assets are in low cost US ETF's but you pay the full 2.18% MER anyways. Additionally, lack of fund purity makes asset allocation decisions using this fund all the more difficult. It does however comply with CIFSC category definition. Food for thought.

**Noted in Brochure: All of our funds are in the top 90%**

### **DISCLAIMER**

**Information contained herein is obtained from sources believed to be reliable, but the accuracy is not guaranteed. The material does not constitute a recommendation to buy, hold or sell. The purpose of this Document and others in the series is to educate investors by bringing together personal finance information from a variety of sources. It is not intended to provide legal, investment, accounting or tax advice and should not be relied upon in that regard. If legal or investment advice or other professional assistance is needed, the services of a competent professional should be obtained.**