

**The Future of Investing: A 2020 Vision**

*“..BusinessWeek asked financial professionals and academics their thoughts on what the financial landscape will look like in the year 2020. The experts foresee a world where investment banks will look more like government-backed depository institutions, mutual funds will be fewer, and stock exchanges will become international with super-governmental bodies regulating them. "A lot of the frameworks and walls built because of the old financial world we grew up in will come down," says Tanya Styblo Beder, chairman of the SBCC Group and a member of the board of directors at the International Association of Financial Engineers..... Mutual funds might diminish, too. Today, increasing numbers of investors are diversifying their portfolios by purchasing exchange-traded funds [ETFs], baskets of stocks whose value corresponds with a broad index like the Standard & Poor's 500-stock index. In 2000 there were 80 exchange-traded funds that held roughly \$45 billion in assets, according to the Investment Company Institute. Today there are 697 such funds holding \$578 billion. As investors flock to the funds' low management fees and built-in diversification, actively-managed mutual funds that charge higher fees will lose their appeal. "You will find the actively-managed mutual fund industry shrinking pretty dramatically," says Darrell Duffie, finance professor at Stanford's Graduate School of Business. "And individuals will become more capable of managing their own financial affairs."....”* Source: Business Week online, Aug. 14, 2008 <http://asia.news.yahoo.com/080814/7/3nnrb.html>

**Misconceptions in Online Investing Advertisements**

[http://www.oag.state.ny.us/investors/1999\\_online\\_brokers/misconceptions\\_advertisements.html](http://www.oag.state.ny.us/investors/1999_online_brokers/misconceptions_advertisements.html) NY Attorney General's website

**Take a gander at the 43 page April-May, 2008 IROC Disciplinary Case summary.** Some interesting cases and still more interesting decisions.

<http://docs.iroc.ca/DisplayDocument.aspx?>

[DocumentID=37202AC8CAFF4167B322B5C33B639E68&Language=en](http://docs.iroc.ca/DisplayDocument.aspx?DocumentID=37202AC8CAFF4167B322B5C33B639E68&Language=en) Note the high level of fines –IROC financial statements should be overflowing with cash. Well-intentioned signature forgeries, lack of client harm due to misconduct, inability to proceed due to limitation Act, lack of enrichment, lack of a previous record, inadvertent rule-breaking, small dollar amounts involved, reimbursement of monies etc. all reduced in reduced or cancelled sanctions. Some of the sanctions include exam rewrites, increased supervision, modest fines and sales commission disgorgement. A very large number of cases are 5 years or more old. A very significant number of people seem to have left the industry after sanctioning so it's unlikely the stated fines were collected. We also note that most actions are against a small player, a small firm, or a lone broker-almost never is it against a major firm.

**“ I hope I break even, I need the money ”** – Joe E. Lewis, late American nightclub comedian [maybe he was talking about PPN's]

**Harry's Law of Acronym Eschewal** (Never buy any newfangled security that is described by an acronym, like SIV, ABCP, etc.). –Harry Koza, senior Canadian markets analyst at Thomson Financial and a columnist for [GlobeinvestorGOLD.com](http://GlobeinvestorGOLD.com). [We could add PPN among others]

### **Financial products to avoid**

A great article appears in the Sept. issue of Canadian MoneySaver .It warns retail investors about LSIF's, collectibles, hedge funds, derivatives and GMWB products. On the latter point the author had this to say about Guaranteed Minimum Withdrawal Benefit Products:

“ Judging by the glut of new products on the market, baby boomers nearing retirement are gobbling up Guaranteed Minimum Withdrawal Benefit (GMWB) products, e.g. Manulife's IncomePlus GIF Select, SunWise Elite Plus, Desjardins' Helios, etc. These products are a form of variable annuity that guarantees monthly payments no matter the current return rate of the underlying investment. They are usually based on specialized versions of regular mutual funds. Investors pay the fees charged by the underlying mutual funds plus extra fees for the GMWB option. For example, at the beginning of each year, Manulife charges 0.25% to 0.75% (depending on the risk level of the underlying funds) of the value of the holdings for the GMWB option. GMWB products are complex, expensive and since they are annuities, the purchase is irrevocable. With a little research, investors or their financial advisors can set up a stable flow of retirement income with similar risk and at lower cost than buying a Guaranteed Minimum Withdrawal Benefit Product. That's the reason why I think most investors should avoid GMWB products.” Source: G. Bebee, *Investment products to avoid*, Canadian MoneySaver, Sept. 2008 pg 31 This publication is investor-friendly, carries no ads and is inexpensive.

**New opportunity for an SRI fund:** Capital markets and Jewish teachings  
<http://www.kayema.com/docs/Capital%20Markets%20and%20Jewish%20Teachings.pdf>.

“Judaism and its ancient sources *do* provide ample basis for the principles under which a Jewish-based ethical fund could be established for operation in today's capital markets. Such a fund would maintain a unique perspective on minority-shareholders, and the general principles of this fund could be categorized under seven headings: abiding by Jewish law; abetting; justice and goodness; abiding by contracts; preserving life (*pikuach nefesh*); settlement of the world (*yishuv ha'olam*); and Sabbath, festivals and Kosher food ”

**New website:** To remind investors of their risky nature, one web site has been created to track the bad news about hedge funds; and what could be worse than hedge funds which literally implode. A web site has been created to do exactly that: see **Hedge Fund Implode-O-Meter** [www.hf-implode.com](http://www.hf-implode.com). As you will see, there is a lot of bad news out there that does not necessarily get picked up in the daily press.

**Hedge fund managers are very well paid.** If the financial system goes to pot, we won't need to worry about the top hedge fund managers; see the [study by Kaplan et al 2007](#).

[income inequality](http://independentinvestor.info/PDF-Downloads/ALTERNATIVE-INVESTMENTS-19/doc.832-Kaplan%20Raugh%202007%20income%20inequality.pdf) doc.832. Source: <http://independentinvestor.info/PDF-Downloads/ALTERNATIVE-INVESTMENTS-19/doc.832-Kaplan%20Raugh%202007%20income%20inequality.pdf>

**Despite what mutual fund insiders have been saying for years, exchange traded funds are indeed a threat to mutual funds.** According to a Report released Aug. 29, 2008 from research firm Cerulli Associates Inc. of Boston, challenges are increasing as ETF's become mainstream. Advisers are using ETFs in multiple ways, in both the core and satellite allocations, as well as in the active and passive slices of investors' portfolios, according to the report. And advisers who employ a tactical-asset-allocation approach in their clients' portfolios may use ETFs because they offer continuous liquidity and access to commodities and other markets where they want to make a concentrated bet.

**What's going on here?** The Mutual Fund Dealers Association of Canada (MFDA) is seeking to extend the ability of fund dealers to use personal corporations for another two years, until the end of 2010, but regulators in several provinces want to see the issue dealt with sooner. A joint notice published today indicates that the MFDA has submitted an application to the regulators in British Columbia, Ontario, Saskatchewan, and Nova Scotia to extend the suspension of its rule outlawing the use of personal corporations, which currently expires on Dec. 31, 2008, to Dec. 31, 2010.

[http://www.gov.ns.ca/nssc/CSANotices/jointMFDANoticeAug\\_29\\_2008.pdf](http://www.gov.ns.ca/nssc/CSANotices/jointMFDANoticeAug_29_2008.pdf) Rule 2.4.1 requires MFDA dealers to pay any remuneration, e.g. trailer commissions, for business conducted by advisers on the Members' behalf directly to and in the name of the Approved Persons. Let us know what you think about this rule.

### **Online Calculators & Planners**

[http://www.atb.com/Dev/calcs/calcs\\_index.asp](http://www.atb.com/Dev/calcs/calcs_index.asp)

If you need help working out some of your financial details, find out how the numbers add up with Edmonton –based ATB Financial's financial calculators. These online calculators can steer you in the right direction, and perhaps give you an indication of what your financial goals should be. Here's a few samples:

- [Loan & Mortgage Calculators](#)
- [Retirement Calculators](#)
- [Investment & Savings Calculators](#)
- [Currency Exchange Rate Calculator](#)
- [Personal Planners](#)

<http://www.dinkytown.net/java/ca.html>, another calculator site, has 300 financial calculators, each with dynamic graphs, customizable page layouts, colors and reports. The Investor Education Fund 's *Mutual fund fee impact calculator* can be found at <http://www.investored.ca/IefCalculators/Calculators/MutualFundFeeImpact/default.aspx>

**Interesting Primer on Investing:** This new self-published book is written by a retail investor who suffered through the school of hard knocks. Navigating through all the beartraps of the Canadian financial services industry isn't easy -this plain language investment primer will definitely help. The author, Gail BeBee, doesn't come out of the industry and she is definitely pro-investor in her writings. Her academic background includes undergraduate studies in biology and a Master of Environmental Engineering so already we can relate to her. Stan Buell, also an engineer, President of the Small Investor Protection Association [www.sipa.ca](http://www.sipa.ca) says *"It is refreshing to read this book...rather than books by industry insiders. It provides an objective look at investing and, will be of great benefit to all small investors."*, The sections on investment funds and structured products hit the nail on the head –conflicted advisers, high fees and unmanaged tax exposure. If you avoid just one of the toxic products she identifies you'll recover the price of the book many times over. For less than \$25 bucks you can save yourself a lot of money and pain by digesting this easy to read book. *No hype- The Straight Goods on Investing Your Money* ISBN: 978-0-9784455-0-8 208pgs

All the investing basics for Canadians from a savvy financial industry outsider  
The Ganneth Company, 17 Blithfield Avenue, Toronto, Ontario M2K 1X9

Web: [www.nohypeinvesting.com](http://www.nohypeinvesting.com) Sample Book Review at

<http://www.canadiancapitalist.com/2007/12/11/book-review-no-hype-the-straight-goods-on-investing-your-money> [ Disclosure : I'm an engineer too]

**Q:** If inflation is running at 3.5% and the average MER of a fund portfolio is 2.5% when will the purchasing power of my portfolio be reduced by half?

**A:** Using the familiar rule of 72 we have  $Ni = 72$  where N is a number of years and i is the interest rate (in this case the decay rate of 6%). Here we have  $N = 72/6 = 12$  years Hence in only 12 years, you'll need twice as much money to buy what you can buy today after taking fees and inflation into account. Your mutual fund will need to earn more than 6% annually to add to your Net worth. AND we haven't yet figured in income taxes.  
Freedom 55, oh yeh!

### **Lobby group wants more blood on proposed POS rules**

Notwithstanding significant watering down of proposed rules for the new regime for point-of-sale disclosure for both mutual funds and segregated funds, the Investment Industry Association of Canada wants still more concessions. In a Aug. 12, 2008 letter to the Joint Forum of Securities regulators the powerful lobbyist notes that it has so far been able to obtain removal of the perpetual right of rescission, elimination of disclosure for any subsequent fund purchases of the same fund and obtain exemption of money market funds altogether. Now, it warns regulators about uncertainty about whether a trade is considered recommended by the advisor or initiated by the investor. IIAC also worries that these proposals will put full service firms at a competitive disadvantage with the discount brokerage firms who will be exempt from the requirement to deliver a Fund Facts document to DIY's. IIAC continues to press for an "access equals delivery" approach to keeping fund investors in the dark. Finally, they want the Joint Forum to consult with industry self-regulators before making any rash moves You can read the anti-investor diatribe at [http://www.iiac.ca/Upload/POS\\_Mutual\\_Fund\\_Seg.pdf](http://www.iiac.ca/Upload/POS_Mutual_Fund_Seg.pdf) Investor

advocates have their work cut out for them with IIAC (and IFIC, another lobby group, that must also be simultaneously contained).

**Email from a reader:** To the fund OBSERVER; can you please tell me why virtually no Canadian Bond funds beat the index even after five to 10 years? –Harry, Calgary  
Response: Easy. Fees. In the case of Canadian Bond funds, and to a lesser degree balanced funds, fees can make a world of difference. The bond market is so large and efficient that brains, inspiration, hard work and intelligent research provide little advantage. The only way a Bond fund manager can get a leg up is by taking greater risk. In other words, with more corporate bonds, some with lower credit worthiness. Fund investors could learn a thing or two from the fundcos- they've been slashing expenses, reducing overheads and killing off unprofitable funds. Why not do the same to your portfolio?

**Fund Factoid:** The DeltaOne Energy Fund LP has returned –77 .0 % in the year ended July 31, 2008. For 5-years the fund has a –42.4 % compound average return. Hope you don't have too much tied up here.

**“ The whole restructuring process infringes on Canadians right to due process, to go to the courts for redress”** – Mike Miles, Victoria B.C. [Mike also expressed “nothing but sympathy” for corporate ABCP Noteholders like Ivanhoe Mines] Source: R. Trichur, *Ivanhoe seeks appeal of ABCP ruling*, Toronto Star, Aug. 20, 2008 pg B1

<http://www.thesqueakywheel.com/> -- **Gotta complaint with your fund dealer or mutual fund?** TheSqueakyWheel.com, based in Toronto, gives individual consumers more power than ever before. 24 hours a day, 7 days a week, it works to make sure that complaints cannot be Ignored. How does it work? An unhappy consumer simply fills out a complaint form, clicks OK, and the complaint instantly gets turned into a web page that is available to more than 40 million Internet users. And just to make sure that each complaint gets the exposure that it deserves, complaints are automatically submitted to at least five Internet search engines. When someone searches for the company/product that you complained about, it is likely that both the company's web page and your complaint page will come up in the search result list. And what Internet surfer can resist clicking on a "Why I hate ... company" link?

**Guide to Filing a Complaint Letter** <http://www.complaintsboard.com/articles/guide-to-filing-a-complaint-letter.html>

**The Irish Financial Ombudsman Office website provides some interesting cases and lessons we can learn about fair dispute resolution**

<http://www.financialombudsman.ie/making-a-complaint/> SAMPLE case: A customer who held a mortgage with a Bank was told that his mortgage repayments would now have to be made by a different method. The customer was advised that all direct debits, standing orders and other payments would be automatically changed and that the customer was not required to take any action. However, it turned out that the Bank made a number of errors as a result of which the Complainant's mortgage fell into arrears. Although this arrears situation was entirely the fault of the Bank, the customer began receiving threatening letters from the Bank demanding immediate payment of arrears of

€6,000. The Complainant changed his mortgage to another bank and subsequently brought a complaint to the Ombudsman against the first Bank. The Ombudsman found that the Bank was entirely responsible for the debacle and noted that while the Complainant had not lost any money, he concluded that the Complainant had been put through a great deal of stress and annoyance. The Ombudsman took account of the fact that the Bank had written to the Complainant stating “*the conduct of your account is totally unacceptable*” when the fault turned out to be entirely that of the Bank. In view of this and in view of the fact that the matter remained uncorrected for 5 months, the Ombudsman awarded €4,000 in compensation for the Bank’s failure and for the distress which occurred. Sound familiar?

### **Few Poles dancing for mutual funds**

What has gone wrong with Polish mutual funds? The Polish government controversially requires that Polish funds invest 95% of their assets in domestic stock and bonds (remember when Canadian RRSP’s had foreign content restrictions?). While the stock market was rising, this policy helped drive prices ever higher as Poles ploughed money into mutual funds, putting some 35-40% of their savings in mutual funds, compared with just 10% in Hungary and the Czech Republic – and funds chased too few available assets. "Three years ago, nearly 8% of society had any savings; now one-third declare they save every month," says Tomasz Korab, board member of Opera Investment Fund.

However, the global credit crisis and slowing growth at home turned the tide. The Polish stock market is down by over 25% since the start of 2008 and in June hit its lowest level since Nov. 2005. This has had a devastating effect on domestic funds, which saw massive withdrawals of money by investors. The more the stock market fell, the more money was pulled out of funds, so causing the stock market to fall further. The flow of money out of the funds has inevitably hit the country's banks hard. The rise of the fund industry proved a goldmine for Polish banks, boosting profits for those most active in the business - the margin on mutual fund products reached 3-4%, twice as much as on deposits – and propelling valuations for the sector upwards. Wood & Co reckons that, "as a rule of thumb, each 3% reduction in mutual fund assets will reduce Polish bank profits by approximately 1%." Given the more than 20% decline in mutual fund assets this year, the Prague-based brokerage calculates an almost 13% fall in BZ-WBK's profit and 10% for Millennium's, both of which are the most exposed Polish banks to the business. In July, 2008 Millennium said the value of funds in its investment products fell by nearly half in the first half of the year. Source: <http://businessneweurope.eu/story1201>

**Interesting article:** In *Small payback belies big impact of 2003 mutual-funds scandal* Chuck Jaffe points out that while restitution payments to U.S. investors abused by the market timing scandal will be small (e.g. about 66 bucks per affected Putnam account and \$55 per Janus shareholder), the fund industry may claim the small-dollar repayments to shareholders proves that the scandals were overblown. He reminds us that they weren't, because they showed a fundamental weakness in the system - and in management's character - that needed to be fixed before it was exploited further. Ditto for Canada.

[http://www.hedgeco.net/news/news\\_land.php?  
i=http://seattletimes.nwsourc.com/html/business/technology/2008149146\\_jaffe31.html](http://www.hedgeco.net/news/news_land.php?i=http://seattletimes.nwsourc.com/html/business/technology/2008149146_jaffe31.html)

### **Canadian taxpayers subsidize ABCP**

According to a report by investor advocate Diane Uquhart, Canadian government-related entities own nearly \$19 billion of Non- Bank ABCP .So the ABCP CCAA Restructuring Plan has been heavily supported by public funds in the amount of \$10 billion of marked-to-market losses estimated by JPMorgan, which are borne by Canadian taxpayers and buyers of government services from crown corporations. When the 18 government-related entities identified in her analysis failed to sue the banks, securities dealers and others for remedy of their marked-to-market losses on Non- Bank ABCP, or were denied that right to sue in the legal release within the Purdy Crawford led ABCP CCAA Restructuring Plan, these government-related entities provided public funds indirectly to fund the Non- Bank ABCP bail-out plan. These government marked-to-market losses are directly to the benefit of the banks, securities dealers and others who manufactured and sold this flawed Non Bank ABCP product to these governments as well as to retail investors, pension plans, universities and corporations. As Ms. Uquhart notes, the Canadian federal and provincial governments failed to protect the retail owners of Non-Bank ABCP by approving a series of banking, securities and bankruptcy law and regulation amendments since 2004 that facilitated the manufacture and sale of the Non-Bank ABCP in a negligent, and potentially fraudulent manner, and then aided and abetted the banks in the CCAA Restructuring process itself.

The Canaccord and Credential Securities Relief Plans for the retail customers owning less than \$1,000,000 ABCP do not release their cash until the ABCP CCAA Restructuring Plan is implemented. The Co-Counsel of the Ad Hoc ABCP Retail Owners Committee support the ABCP CCAA Restructuring Plan, so that the under \$1,000,000 ABCP retail owners can get their money back. But Co-Counsel and the ABCP retail owners group is also pursuing the Ontario Government for an order that the securities dealers release their cash now, without further delay and regardless of the Supreme Court decision. This government order should cover all retail owners without limitation, including all individuals, family trusts and personal investment holding companies. The Supreme Court may well determine that the current ABCP CCAA Restructuring Plan needs amendment for justice and accountability to be added to the equation, but in no circumstance should the retail owners be left without an immediate cash settlement for recovery of their life savings through no fault of their own.

**For some eye-opening commentary, go to [www.advisor.ca](http://www.advisor.ca), click on FORUMS and choose FREE FOR ALL.** It's an interesting insight into the attitudes, concerns, priorities etc. of our trusted brokers and advisors. Here's a small sample:

<http://forums.advisor.ca/thread.jspa?threadID=278>

Thread: Investors Group vs. Bank owned/independent dealers

Query: "Has anyone here worked at Investors Group before? Their comp is among the best in the industry. I interviewed with them and their culture seems very "Amway" like. The person that interviewed me was pitching IG hard. It seems like they will hire anyone

off the streets, which is scary since consultants there do comprehensive financial planning, well more comprehensive than typical brokers anyway. I know IG does not have a very high prestige factor but other than that what are the downsides to working there. I know their training program is good but I have previous financial sales experience as well as the CFP, PFP, FMA, CSC, etc so I probably won't benefit from the training as much as someone that is totally new to the industry. -johndubois”

Responder: “I was with IG for the first 5 years of my career. It is 100% a sales culture. They reported weekly sales for each agent, division and branch in news bulletins circulated throughout the company. Think "Glengarry, Glenross". Cadillac, steak knives, you're fired. There were rewards and accolades given for high volumes of sales, especially during the 4 annual sales campaigns. There were no rewards or accolades given for preparing wonderful financial plans, or doing what was best for the client. IG's compensation is NOT among the best in the industry; although the MERs on their mutual funds are among the highest. The simple explanation is the top-heavy sales pyramid. An agent's earnings have to support themselves, a division manager, a branch manager, a regional vice president or two, and all sorts of associated staff; then a reasonably extensive head office and executive corps.....” Mike H.  
[thanks to John Reynolds , author of *the Naked Investor* for this one]

### **Joint Standing Committee want Your INPUT**

The Joint Standing Committee on Retail Investor Issues is made up of the IIROC, the Ombudsman for Banking Services, the MFDA and the OSC. They are seeking feedback from investors on issues relating to the suitability of investment products available to, and recommended by advisers to, retail investors. To review a brief overview of this topic and participate in this consultation, [click here](#). Here's the initial set of questions:

1) *What information about an investment does your adviser give you before and after you buy it? Is there any other information you would like?* [assumes you have an adviser]  
2) *Should specific investment products be prohibited from sale to the public, or should all products be available to investors and investors be allowed to make their own choice?*  
3) *Should regulators focus on regulating specific products or on regulating how products are sold and distributed?* [How to submit your answers](#). You can use email or snail mail- no FAX option is provided-target date Oct. 9. [many feel that the OSC FDM proposals answered most of these questions but it was killed off by industry objections and resistance from other provinces] Among the criticism that emerged from the non-bank ABCP fiasco was the view that the industry was able to ratchet up the risk of products sold to retail investors apparently outside the purview of regulatory enforcement. PPN's SPAC's would be other toxic examples.

**“Would the Standing Committee please sit down!”- JL in Ste Agathe, PQ**  
**"A committee is a group that keeps minutes and loses hours" - Milton Berle**  
**Standing Committee:** A permanent Committee that goes on and on.

## **OSC releases results of 2008 fund compliance reviews**

The Ontario Securities Commission (OSC) has just published its 2008 Compliance Team Annual Report (27 pgs), which summarizes the findings of compliance reviews of investment counsel portfolio managers, investment fund managers and limited market dealers. Sample size was not disclosed nor were any specific firms named. The results read like those in prior years with little indication of improvement. Reviews of investment fund managers resulted in an average of 7 deficiencies per firm reviewed-on average 2 of these deficiencies were significant. The top three deficiencies were in marketing (inappropriate benchmarks, exaggerated claims and defective performance data), oversight of service providers (inadequate performance measurement of suppliers such as transfer agents), and trust accounts (several deficiencies per Part 11 of NI81-102 including not paying interest). Six per cent of those managers scrutinized during the three-year period were referred to the OSC's enforcement branch. Among limited market dealers, the top deficiencies were in the "**know your client**" area this year, with about **64%** registering "significant" deficiencies such as failing to collect or document information necessary to determine the suitability of investments – No mention is made of any fines paid or sanctions applied. See OSC Staff Notice 33-731 [http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/sn\\_20080904\\_33-731\\_2008-compliance-rpt.pdf](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/sn_20080904_33-731_2008-compliance-rpt.pdf)

## **Want a second opinion on your portfolio?**

A Professional Second Opinion (allegedly without pressure to change advisors) at the 30,000-foot level is now available. Many investors seek out second opinions in order to make sure they are receiving proper service and advice. But if you ask another advisor for a second opinion they may be motivated to use high-pressure sales tactics if they only receive compensation for transferring your assets. Toronto-based adviser Preet Banerjee B.Sc, DMS, FMA, who is a strong ETF passive investor believer, believes a better alternative is to formalize the process of a second opinion such that the conflict of interest is removed through an upfront fee of \$100 for the second opinion. You Receive the Following in Writing

1. Analysis of the compensation method being employed by your advisor
2. Estimation of the total fees being paid
3. Estimation of the compensation being earned by your advisor
4. Description of alternative fee arrangements for consideration
5. Analysis of investment product suitability
6. Analysis of portfolio's diversification
7. Investment performance comparison to relative and absolute benchmarks
8. Analysis of your Financial Plan and projections provided (if applicable)
9. Analysis of your Investment Policy Statement (if applicable)
10. Analysis of the client service received

With all of the above, investors will have a better idea as to the value you are receiving for the fees that you are paying. We haven't tested the system but if interested, go to <http://www.executivefinancialplanning.com/2008/01/second-opinion/>

### **S&P: Actively –managed funds again fail to deliver**

Extract: "The majority of active funds underperformed their respective S&P benchmark over one, three- and five-year periods. Only 15.2%, 11.6% and 6% respectively, of active Canadian Equity funds were able to outperform the S&P/TSX Composite Index over these periods respectively. For active funds in the Canadian Focused Equity category 47.8%, 41.7% and 49.4% of funds outpaced the blended S&P/TSX Composite benchmark index over the one, three- and five-year periods respectively."

[http://www.tsx.com/en/news\\_events/news\\_releases/9-3-2008\\_TSX-IndexScorecard.html](http://www.tsx.com/en/news_events/news_releases/9-3-2008_TSX-IndexScorecard.html)

["This latest SPIVA results highlight the volatility of shorter-term outperformance for active funds," says Jasmit Bhandal, director at Standard & Poor's. "When compared to Q1 2008, some active funds fared better than their respective benchmark during the second quarter; however, a review of performance over the long-term indicates that a majority of active funds continue to underperform their respective benchmarks."]

**“Remember when you buy a commodity, you're not buying something that generates earnings and profit. You're buying a hard asset and hoping another buyer will be willing to pay more for that asset in the future”-- Matt Krantz, USA Today, 06/23/2008**

**IDEA:** Google the name of your adviser. You might find some interesting results.

**Second Opinions has recently developed a new online ‘Scorecard’ which investors can use to measure whether you’re being dealt with fairly by your advisor.** There are 42 questions in 14 categories to be marked as True or False. Submit your response and get a score back with a comparison with the mean score of others that have participated. <http://www.secondopinions.ca/tools/AdvisorScoreCard.aspx> These hard-hitting questions aren’t the kind you’ll find on an IFIC Investor Survey.

### **At least U.S. brokers being held accountable**

“The Financial Industry Regulatory Authority announced that it has banned two brokers and suspended a third, for misconduct in the sale of complex Collateralized Mortgage Obligations\* to retail customers. The brokers neither admitted nor denied the charges, but consented to the entry of FINRA's findings. Two brokers were permanently barred from the securities industry, and the other was suspended for two years. FINRA found that they made unsuitable recommendations and misrepresented material facts in connection with sales of these complex products. They also failed to conduct proper suitability analyses, it said...”[In Canada, brokers who sold non-bank ABCP to retail investors remain at large] [<http://www.investmentexecutive.com/client/en/News/DetailNews.asp?id=45916&IdSection=8&cat=8&BImageCI=1> \*A CMO is a security that pools together mortgages and issues shares - called "tranches" - with various characteristics and risks. The underlying mortgages serve as the collateral for the CMO and provide principal and interest payments to shareholders.

### **MRFP Scan: The Norrep 2007 Flow-through Limited Partnership**

This issue we review this flow throughs' interim report for the 6 mos. ending June 30, 2008. The following observations pop out from the pages.

- 1) While the NAV increased 9.7% it did not come close to matching its chosen index, the BMO Small Cap energy equity total return index which returned 33.9%.
- 2) The manager blames the underperformance on the fact that the rally favoured large caps but does not connect the dots to the underperformance against the small cap index. There is no comparison to peer funds or any acknowledgement of bad investment decisions.
- 3) There is no explanation provided for the 23 bps increase in the MER to a whopping 2.64% on a 8% higher asset base or 17X increase in TER to 0.17%
- 4) The manager points out that things aren't all that bad; after taking the benefit of tax deductions the fund ended up with a **-0.020 %** annualized after –tax return. Should we feel better?
- 5) To its credit, the manager warns of a global slowdown but nevertheless believes, without any supporting rationale, a small cap strategy is still the recipe for success. The financial statements show that the fund has lost money on 52 of its 77 investments not counting any they may have disposed of during the reporting period. They also show the fund has only \$818 K in cash so has not taken a defensive position given the expected downturn.
- 6) Some of the losses are spectacular –MGM Energy Corp. alone has lost about \$3 M . Radius Resources Corp. more than \$1.7 M Bayswater Uranium Corp. \$1.2 M. Were they asleep at the wheel or hoping for better times that now look elusive?

Conclusion? By its poor performance, high costs, poor disclosure and sour outlook the fund manager seems to be saying GET OUT.

### A seasonal guide to the stock markets

Brooke Thackray, a specialist in seasonal investing patterns, has produced data showing how stock indexes have performed on an average basis each month between 1985 and 2007:

	J	F	M	A	M	J	J	A	S	O	N	D
<b><u>S&amp;P/TSX composite</u></b>												
Average return	1.8	0.8	1.1	0.4	1.7	0	1	-0.5	-1.4	0.5	0.8	2.6
Percentage of time returns this month are positive	65	52	65	57	70	48	65	48	35	65	61	96
Rank by average monthly gain	2	7	4	9	3	10	5	11	12	8	6	1
<b><u>S&amp;P 500</u></b>												
Average return	2	0.6	0.9	1.1	2	0.5	0.3	-0.4	-0.9	1.1	1.5	2.1
Percentage of time returns this month are positive	74	65	65	61	78	61	43	57	43	70	70	83

Rank by average monthly gain            3 8 7 6 2 9 10 11 12 5 4 1  
THE GLOBE AND MAIL // SOURCE: BROOKE THACKRAY  
Source: R, Carrick, *Seasonal disorder :It's time to avoid the markets*, Globe and Mail,  
Sept. 6, 2008, pg B13

**Investors may not have a Bill of Rights but Air Travelers now do**  
[www.tc.gc.ca/flightright](http://www.tc.gc.ca/flightright)

**“The decision of the OCA [Ontario Court of Appeal], if left to stand, would enable financially powerful third parties to use the CCAA process to 'cram down' upon the creditors of an insolvent company comprehensive releases for the third parties' benefit, merely by making such comprehensive releases a condition *sine qua non* of the restructuring, opening the way to abuse”**- James Woods, a lawyer for a group of Quebec challengers including Domtar, said in a submission to the Supreme Court regarding the \$32-billion asset-backed commercial paper restructuring. Source: BOYD ERMAN, ABCP *challengers plan to defend their right to sue*, Globe and Mail, Sept. 3, 2008

**Risk averse? Take this simple test:** "If you had to invest \$25,000, which of the following investment choices would you find most appealing?" – (a) 60 per cent in low-risk investments, 30 per cent in medium-risk, 10 per cent in high-risk; (b) 30 % in low, 40 % in medium, 30 % in high; (c) 10 % in low, 40 % in medium and 50 % in high; or (d) 70% in low, 25% in medium, 5% in high

**Latest on Daniel Duic “tipping” case at**  
[http://www.osc.gov.on.ca/Enforcement/Proceedings/ENR/enr\\_20080903\\_duicd.jsp](http://www.osc.gov.on.ca/Enforcement/Proceedings/ENR/enr_20080903_duicd.jsp)

**Dual occupation rule for fund salespersons changes proposed:** According to a report in the September issue of IE, the MFDA is reforming its rules to remove the provision that allows reps to conduct planning through an outside firm that is supervised by a professional association. MFDA Director of Compliance Karen McGuinness explains that no professional association really has enough clout to be effective in that role; as there isn't an association that can meet the MFDA's approval. So, the SRO is eliminating the provision. The proposed amendments to Rule 1.2.1(d)(vii)(A) will continue to permit Approved Persons to engage in financial planning as an outside business activity provided the Approved Person is regulated by a governmental authority or statutory agency. The proposed amendments will remove the reference to “another person” and “widely recognized professional association”. The comment period ended July 28<sup>th</sup>.  
[http://www.bcsc.bc.ca/uploadedFiles/Proposed\\_amendments\\_to\\_MFDA\\_Rule\\_1.2.1\\_D.pdf](http://www.bcsc.bc.ca/uploadedFiles/Proposed_amendments_to_MFDA_Rule_1.2.1_D.pdf)

**Research paper of cost of equity in Canada:** Jon Witmer’s study is unique in that it uses a different measure of investor protection, which may better reflect regulatory differences across countries, and it shows this relation holds for developed countries. After controlling for the characteristics of firms that analysts choose to cover in each country, differences in the properties of analyst forecasts across countries, and

differences in accounting standards across countries, Canada's cost of equity is statistically different from a handful of countries and is about 20 to 40 bps higher than that of the United States. Lowering Canadian firms' cost of equity by this amount would have large economic benefits given the size of Canada's capital markets.

<http://www.bank-banque-canada.ca/en/res/wp/2008/wp08-21.html>

### **Quebec going after wrongdoers-looking for blood**

The **Autorité des marchés financiers** has laid 459 charges under the Quebec Securities Act against the four advisors, who are alleged to have lost more than \$10 million belonging to former clients, some of whom were celebrities. The AMF has charged Guy Charron, Richard Lanthier, Huguette Gauthier and Gérald Turp for offering illegal investments through **Gestion Guychar (Canada) Inc.** and associated companies. Charron, Lanthier and Gauthier operated a financial planning firm in downtown Montreal; Turp is Gauthier's spouse. The AMF is seeking a maximum of 5 years less a day of jail time for each upon conviction, plus fines totaling more than \$8.3 million. The four former advisors allegedly issued IOUs to clients between 1994 and 2007, promising above-market interest rates of 6%-18%. "These were investments without a prospectus," AMF lawyer Nicole Martineau says. Source: D. Macdonald, *AMF to ask for jail time for four Montreal advisors*, Investment Executive, Sept. 2008

**Market Volatility got you down?** Fidelity Investments Canada has launched 4 online tools that illustrate how global markets and asset classes have reacted and recovered from major upsets. The tools are available at [www.fidelity.ca/volatility](http://www.fidelity.ca/volatility).

### **Q3 regulatory developments and disappointments**

Again, the situation is bleak for retail investors. We learned that ultra-risky SPAC's have been given a greenlight by regulators. A Special-purpose Acquisition Company (SPAC) is an investment vehicle that allows unsophisticated retail investors to invest in areas sought by private equity firms. SPACs are shell or blank-check companies that have no operations but that go public with the intention of merging with or acquiring companies with the proceeds of the SPAC's IPO. A Hearing Panel of the Central Regional Council of the Mutual Fund Dealers Association of Canada approved a Settlement Agreement with Altimum Mutuals Inc. Altimum admitted that it acted contrary to the public interest by contravening advertising and sales communications rules and by distributing misleading sales communications to clients wrt Portus funds. OSC Staff notice 11-763 provides a summary of the review findings re fund valuation practices and expense allocations. By and large they claim to have found few problems but recommend some pretty significant, fundamental improvements.

On July 17, 2008 the Supreme Court of Canada released its unanimous decision in *Canada (Privacy Commissioner) v. Blood Tribe Department of Health*. The Supreme Court upheld the Federal Court of Appeal's decision to vacate an order by the Privacy Commissioner compelling the production of purportedly privileged material so as to assess the privilege claim. More broadly, this ruling now represents a significant hurdle

for administrative and regulatory bodies seeking to compel documentary production of privileged materials in the context of investigations or other administrative undertakings. This ruling comes on the back of an Ontario court ruling that blocked IIROC's attempt to discipline a former member which is now under appeal by the OSC. IIROC ([www.iiroc.ca](http://www.iiroc.ca)), the industry self-regulator that regulates investment dealers ("brokers") and the trading of securities is proposing really minimum standards for stockbrokers who supposedly do financial planning. Also, we learned that the Joint Forum is considering watered down proposals for POS fund disclosures after extensive industry lobbying. The OSC presented its 2008/2009 Statement of Priorities – many hard to measure and retail/senior issues given token attention. What else is new?

Triglobal, an MFDA member, was regarded as a leading Quebec-based financial solutions provider. Now, it appears \$86 million is missing and the AMF is investigating. Incredibly, after a three-year investigation of the Crocus LSIF's fund's collapse, the RCMP assert that they have not found any evidence of fraudulent misconduct, deception or other criminal wrongdoing. This, despite demonstrably poor fund governance, a shockingly weak-investment management process, a fundamental lack of internal controls and deficient expense management and outright false asset valuation reports that overstated the fund's worth. On Sept. 19<sup>th</sup> 2008 the Supreme Court of Canada decided to not hear the non-bank ABCP case that several corporations and individuals had filed regarding giving all the fiasco-creating parties immunity from lawsuits. The Federal and Provincial governments and provincial regulators were not helpful to retail investors in obtaining restitution. Indeed, many retail ABCP owners were shocked to learn that governments actually facilitated the sale of this toxic money market product into the unsophisticated retail marketplace through multiple law and regulation changes, enforcement blindness and exemptive relief decisions that allowed the securities dealers and banks to side-step investor protection laws that Canadians fought years to achieve. Many regard this decision as one that will provide safe harbour for future scoundrels unless the Companies Creditors Arrangement Act is changed to explicitly restrict the right of judges to approve debt restructuring plans that deny the right of creditors to sue solvent third parties who exposed Canadians to harm. Maybe they should look at rating agencies as well. And finally, we are still waiting for IIROC to deal with Canaccord and Credential for their false representations, aggressive sales and other alleged misdeeds on ABCP to unsuspecting retail investors.

Finally, Farm Mutual Financial Services (MFFS) asserted that the MFDA does not have jurisdiction over Limited Market Dealer (LMD) registrations with the Ontario Securities Commission. It argues that the MFDA does not have jurisdiction to regulate Farm Mutual's activities as an LMD in part because the OSC only recognizes the MFDA as a self-regulatory organization for mutual fund dealers- not as an SRO for LMD's. MFFS is registered as a mutual dealer and as an LMD dealer (nearly 50% of MFDA members are also LMD's). LMD's can sell exempt securities to accredited investors while MFDA-only members do not sell exempt securities. The Farm Mutual case could have quite a range of impacts on the industry because it affects the entire limited market dealer regime. . This lack of regulatory clarity could impair investor protection. <http://www.mfda.ca/enforcement/hearings08/NOH200812.pdf> [A June 2006 OSC Staff

Notice 11-758 revealed a wide range of regulatory deficiencies among LMD's - [http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/sn\\_20060616\\_11-758\\_It d-market-dealers.jsp](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part1/sn_20060616_11-758_It d-market-dealers.jsp)

That's enough for one Quarter.

### **Ambiguous references for fallen fund executives**

(these should not get you in trouble with the law)

“We haven't seen anybody quite like him in the financial services industry.”

“I simply can't say enough good things about her.”

“Angela didn't think much about the extra time she had to work at RSP season.”

“He's a man of many convictions.”

“He was always high in my opinion.”

### **“ Financial porn is not a victimless crime”**

-Consumer activist Ben Yevzeroff

**Fund Factoid:** The median U.S. equity fund has lost 15.1 per cent over one year, and an average annual 4.6 per cent and 1.2 per cent over three and five years respectively.

Source: R. Luukko, *Wall of worry in U.S. funds*, Sept. 6, 2008 pg B7

<http://www.chambresf.com/csf/anglais/index.asp> Quebec's regulator overseeing the training and ethics of 31,000 members who work in six sectors, that is, group savings brokerage, financial planning, scholarship plan brokerage, investment contract brokerage, insurance of persons and group insurance of persons. Their 22 Page standard for the use of business cards is something to behold. [

<http://www.chambresf.com/csf/pdf/anglais/divers/guide.pdf> ] This is a government agency NOT an SRO like the MFDA.

**NOTE:** On Thursday Sept. 17, 2008 Putman Investments, a U.S. unit of our own Great-West Lifeco Inc. (GWO: TSX), decided to close its \$12-billion Prime Money Market Fund, and return investors' money. Institutional clients were pulling cash out of the fund even though it had no exposure to troubled firms like Lehman Brothers Holdings Inc. At present there does not appear to be a similar situation facing Canadian m/m funds.

**Volatility versus risk:** Volatility is a characteristic of the market for a security reflecting the variation of its price. Risk is a characteristic of the Company that issues a particular security. A mutual fund holds securities and thus exhibits characteristics of volatility and risk. These 2 factors often appear in the same places and many regard them as relatives but they are not identical. The purpose of a mutual fund is to diversify away specific-company risk. A broadly-based mutual fund will do this a lot better than a focused sector fund concentrating on one industry.

### **Be suspicious when a proprietary fund is promoted**

A proprietary fund is a fund managed by the same firm or an affiliate selling you the fund. Such funds typically carry MER's well above industry averages and pay more lucrative trailer commissions to advisors. The higher MER's reduce investor returns while advisors and the fund company earn higher commissions and management fees. Some firms allegedly establish preset quotas for the sale of in-House funds thus creating a powerful conflict-of-interest. Further, proprietary funds can be difficult or impossible to transfer should you change accounts to another firm. If your advisor suggests an in-House fund, be sure to ask why and get the answer in dollars and cents

**MFDA warns about misleading investors re borrowing to Invest:** "MFDA staff continues to note issues with respect to misleading statements made by Members, Approved Persons and loan providers or intermediary entities involved in the marketing of leveraged strategies. Some examples of such misleading communications include statements such as:

- suggestions that leverage is appropriate for all clients;
- promises to clients to "make your mortgage tax deductible";
- recommendations for the use of borrowed funds with "no additional risk";
- projections that presume unrealistic returns or feature overly optimistic examples; and
- statements that promise returns but provide no disclosure or inadequate disclosure of downside risk or potential negative returns.

Members and Approved Persons are cautioned against making or including misleading statements such as these in their own sales communications or other materials provided to clients..." <http://www.mfda.ca/regulation/notices/MR-0070.pdf>

#### A note on mutual fund "Distributions"

Too many investors do not understand fund distributions. Suppose John D. invests \$100,000 in a Dividend and Income fund at \$10.00 per unit to purchase 10,000 units for a non-registered account (not a RRSP). The mutual fund has been, and intends to, continue paying \$0.035 per unit per month. i.e. 4.2% annual yield. John will be delighted to receive a monthly cheque for \$350 much of it tax-advantaged as dividend or capital gain income. But unknown to unsuspecting John, the fund has realized considerable capital gains during the year. On December 31, the fund declares a distribution of \$1.00 per unit taxable as a capital gain in the current tax year. John must declare a capital gain of \$10,000 (\$1.00 x 1000) and that will result in an income tax liability of about \$1800-\$2500 depending on his tax bracket and province of residence.

Assuming John reinvests the distribution in units of the fund it will cause no change in his gross monthly income. Each fund unit will now have a NAV of \$9.00 as cash has left the fund. Gross monthly distributions remain the same but there being more units, the

distribution per unit will decline accordingly. John will now own his original 10,000 units at a cost of \$10 each and will have purchased \$10,000 worth of new units at the reduced price of \$9.00 per unit for a total of 1,111.11 units. The Adjusted Cost Base for income tax purposes will be \$111,111.11 so that he or his estate will realize that much smaller a capital gain upon disposition.

The bottom line is that John must pay income taxes now in exchange for reduced capital gain and tax liability downstream. In effect he is providing an interest-free loan to the government for the term from April of the following year until he liquidates the holding. Additionally, if John doesn't have the cash he may have to sell some of his investments to pay tax, thus reducing his ongoing income. That can be especially disturbing if he paid a sales commission on purchase or must pay a DSC early redemption charge. If however he has net capital losses for the year there is no tax problem. Note also that any dividends paid out are after deduction of the MER and brokerage expenses –if the dividend yield is 2.5 % and the MER is 2.25 %, he'll actually earn very little income.

### **Read about the Couch Potato portfolio approach**

[http://www.canadianbusiness.com/my\\_money/investing/article.jsp?content=20060405\\_152254\\_1452](http://www.canadianbusiness.com/my_money/investing/article.jsp?content=20060405_152254_1452)

*Psst...Want to hear how to achieve an outstanding return that's entirely free of risks? Simple. Pay off your credit cards and mortgage.*

**Jeff Sanford warns about SPAC's (Special Purpose Acquisition Company):** Read the Sept. 29,2008 edition of Canadian Business about these new “blank cheque” investment vehicles. They're great for the TSX as there will be plenty of new listings. But is this another non-bank ABCP fiasco for retail investors? Visit [www.SPACAnalytics.com](http://www.SPACAnalytics.com) to learn more. Jeff advises that SPAC's have returned –15.9 % annually after they have made their acquisition. Maybe they'll make LSIF's look good. CAVEAT EMPTOR . [Investopedia defines a SPAC as a publicly-traded buyout company that raises money in order to pursue the acquisition of an existing company. SPACs raise blind pool money (most of which goes into a trust) from the public for an unspecified merger, sometimes in a targeted industry. Each SPAC is typically sold at \$6 per unit for one share of common stock (to be publicly-traded in the future) and two warrants that can purchase additional shares. If an acquisition is not made in two years, the money is returned to the original investors.] Hopefully, the OSC will put all kinds of regs around these beartraps so retail investors aren't hurt.

**The ETF: iShares CDN Value Index Fund (XCV: TSX):** The iShares CDN Value Index Fund seeks to provide long-term capital growth by generally replicating the performance of the Dow Jones Canada Select Value Index. The Index is comprised of securities of Canadian issuers selected by Dow Jones & Company, Inc. based on criteria for identifying companies that demonstrate value characteristics. MER=0.50 %. Banks and Insurers dominate the top 10 holdings but the fund holds 72 stocks. It came into being Nov. 6, 2006 so its track record is mixed given the turmoil in the financial sector.

Over the longer term, actively-managed funds will not find it easy to beat this ETF. [http://ca.ishares.com/product\\_info/fund\\_overview.do?ticker=XCV](http://ca.ishares.com/product_info/fund_overview.do?ticker=XCV)

### **Should money market funds be better protected?**

As regulators are well aware, recent market events have caused a number of managers of money market funds to purchase assets from their funds in order to forestall loss of principal. The market for structured investment vehicles backed by mortgages and other assets has experienced a significant downturn and reduced or no liquidity. Money market funds are permitted to hold these securities provided that the funds satisfy the maturity, quality and diversification requirements of mutfund regs. Some money market funds' holdings of structured investment vehicles/ABCP Notes have created the risk that the funds' net asset value would break their par value. To prevent this occurrence, some fund managers have voluntarily bailed out their mutfunds at the Notes par value.

As money market funds are the safe part of retail investor portfolios, they deserve greater investor protections. There's about \$70 Billion invested, much more than in bank deposits. Yet the latter is under robust OSFI oversight and the CDIC protects these deposits up to \$100,000 with insolvency insurance. Mutual funds are not under a strong governance regime, are not regularly monitored by provincial regulators and no insurance scheme is in place. We question the prudence of continuing to rely so heavily on fund managers willingness to bail out their money market funds when loss of principal is a threat.

Managers of money market funds may have regulatory as well economic incentives not to bail out their money market funds in certain situations. For example, banking regulators have occasionally expressed concern regarding the risk that banks and bank affiliates might be deemed to be guarantors of their money market funds, and they have been mollified only by reassurances that ultimately a fund manager would not be legally obligated to bail out its money market fund if regulators considered doing so to be imprudent. Banking regulators' primary concern is the safety and soundness of banks, **not** the safety and soundness of money market funds.

Since the ABCP meltdown, we are not aware of Securities Commissions' having taken any additional steps to evaluate and enhance the safety and soundness of money market funds, which play an increasingly important role in Canadian's' financial security and the stability of our financial system. We therefore recommend that the CSA act promptly to protect money market fund unitholders by requiring that all money market funds make non-public monthly electronic filings of their portfolios to enable Commissions to monitor and evaluate the risk of loss of principal on an ongoing basis. These disclosure reforms could be implemented in conjunction with the CSA's ongoing XBRL roll-out, which would provide a low-cost, highly functional format for delivery and analysis of money market portfolio data.

<http://www.behaviouralfinance.net/> -- all you ever wanted to know about how investor behavior influences decisions and investment results. Contains good glossary of terms.

## **Forensic accountant Rosen continues to warn about IFRS**

“The global shift toward adopting International Financial Reporting Standards is in full swing, much to the delight of corporate auditors around the world. Unfortunately, investors are being left out in the cold because they don't pay the auditors, and, frankly, the auditors want nothing to do with them. So ignored are investor needs that even frank commentary from the auditors detailing the weaknesses of IFRS inevitably concludes that switching standards was somehow a fait accompli. While possible, that still does not address why Canada has rushed so blindly and prematurely into the fray.

The United States is currently requesting feedback on the idea of switching all public companies to IFRS by 2016. That would be five years later than the date Canada has already cemented for the change. Canada has further decided to eschew adopting any improvements made to IFRS over the next few years. This means that Canada will initially adopt standards that have only been tested in the market for three years, whereas the United States will be looking at using standards that have been proven and strengthened for more than a decade...” Source: A. Rosen, *Delighted auditors pass the cookie jar: Huge scope for manipulation under lax new standards*, National Post, Sept. 10, 2008 <http://www.nationalpost.com/related/links/story.html?id=780677> [Under IFRS, executives have much greater leeway to play with key numbers, which are paramount to investor interests, despite being given short shrift by accountants. Fund analysts and others will have a very tough time in their analyses and comparisons]

### **What is absolute ZERO?**

That's when a mutual fund returns ZIP. The TD Monthly Income fund returned exactly 0.00 % for the first 6 months of 2008. That's \$2.9 billion dollars that didn't produce a cent for investors. It did provide TD 1.40% however. The low 6.15% portfolio turnover and 0.00 % TER make it obvious the manager did absolutely nothing to protect fund assets by moving into cash (only 5.1% at June 30, 2008). The fund has been monotonically in decline since 2003. Shame also for a lame explanation of fund underperformance, not citing a benchmark and including important notes in a font size so small we had to get a magnifying glass to read them. Contact [td.mutualfunds@td.com](mailto:td.mutualfunds@td.com) if you want to complain

**“..The moment the ABCP crisis erupted in August 2007, control was seized not by the Canadian government, and not even by a known SRO, but rather by a makeshift alliance of lawyers, institutional investors and various other parties. While the funds remained frozen, vital information was withheld, delay after delay surfaced, highly inventive legal maneuvers took place and, over a year later, many institutional investors have been bullied into accepting unnecessary losses. While there are many parties that need to share the blame, it is clear that our government oversight failed miserably...”** –Al Rosen, *Get a Grip : Why does most securities enforcement and regulation rest on conflicted SROs and ad hoc committees?* , Canadian Business, Sept. 29, 2008 Issue

## Free Guide to Canadian ETF's

<http://www.wheredoesallmymoneygo.com/storage/CanadianETFGuide.pdf>

### Mutfund voting pattern revealing

A recent SHARE [www.share.ca](http://www.share.ca) shareholder voting study looked at more than 4,800 ballots at 286 companies and included data collected from 175 mutfunds from 21 different mutual fund companies. You have to wonder if funds are really looking after unitholder interests. We quote: “.Other proposals also showed some interesting voting patterns among the mutual funds. For instance, one shareholder proposal at Quebecor World asked that shareholders be given the opportunity once every three years to vote “for” or “against” the continuation of Quebecor World’s dual-class share structure. The proposal garnered support from most of the mutual funds that hold Quebecor World shares including AIM, CI, RBC, Templeton and AIM Trimark. Not all of the funds voted for the proposal, both AGF and Desjardins funds didn’t bother to vote on the proposal at all. It is interesting to note that AGF funds are ultimately controlled by a company with dual-class shares.

That wasn’t the only shareholder issue that AGF refused to vote on, the other was the 2006 re-appointment of Deloitte and Touche as auditors of Nortel. Most of the time, re-appointment of auditors is the least controversial item on the shareholder ballot. However, Deloitte was Nortel’s auditor during the period when the technology company was forced to restate years of financial results that substantially reduced the earnings it had reported to investors, which cost the company hundreds of millions of dollars to settle shareholder lawsuits and could still result in criminal charges being laid against some former Nortel executives. With that track record, you would think investors might want a fresh set of eyes watching over Nortel’s books, but 80 percent of the funds that voted supported the re-appointment of Deloitte as Nortel’s auditor. AGF did not vote and only two mutual funds — McLean Budden, and Phillips, Hager and North — went so far as to withhold their votes for Deloitte...” Source: John Gray, *Mutual support?* , Canadian Business Online, June 17, 2008 [http://www.canadianbusiness.com/my\\_money/article.jsp?content=20080617\\_154212\\_10392](http://www.canadianbusiness.com/my_money/article.jsp?content=20080617_154212_10392) Study (Proxy voting by Canadian Mutual funds) available at: ([http://www.share.ca/files/MutualFund\\_Voting\\_Report\\_0607.pdf](http://www.share.ca/files/MutualFund_Voting_Report_0607.pdf)

### **Should the CSA reassess securities lending?**

Back in 2001 the mutfund industry got permission from regulators to enter into securities lending with some constraints. The idea was that that the fund could earn some extra income by lending securities to third parties, including hedge funds, for a fee. The risks inherent in any securities lending program — including market, credit, liquidity, operational, legal, and regulatory — are all relevant to the principal common objectives shared by participants, namely stability of income and preservation of principal. Of these, market, credit risk and liquidity risk are now at high levels.

With today’s volatile markets, credit constraints and the failure of some huge institutions, should Canadian retail mutual funds continue to be exposed to this risk. [Susan

Christoffersen, a professor of finance at McGill University in a 2005 paper, *Vote Trading and Information Aggregation*, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=686026](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=686026), found share borrowing increased dramatically prior to a company's AGM date of record, and then fell just as dramatically afterward. She concluded "The only explanation for the spike is that investors are borrowing the shares to increase the number of votes they can cast". This further increases the risk to the market in general ]. Maybe it's time to keep mutfunds more pure?

### **Bank funds like a say on executive pay, sort of**

Banks are not only some of Canada's largest public companies; they also own many of Canada's largest mutual funds. The funds in turn own millions of bank shares. So when shareholders **asked** to have a say on executive pay at the big banks, SHARE decided to look at how the banks' own mutual funds cast their votes. Meritas Financial Inc., an SRI fund manager, filed a proposal that shareholders voted on asking the banks (CIBC, BMO, Royal Bank, TD, and BNS) to allow their shareholders an annual, **advisory vote on executive compensation**. Although management of each bank recommended that shareholders vote 'AGAINST' the proposal, it garnered significant support from shareholders at each bank. The overall average vote 'FOR' the proposal was 40.5%. Although the advisory vote proposal was not well received by the management of each bank where it was filed, some bank mutual funds indicated solid support for the idea. TD and RBC funds voted 'AGAINST' at almost every opportunity, but BMO Mutual Funds voted all shares 'FOR' the proposal, Scotia funds voted 90% of their proxies in favour of the advisory vote and CIBC funds provided support for it with over 70% of proxies voted. The SHARE report, *Mutually exclusive? Bank-owned mutual funds split their vote on 'say on pay'*, found it difficult to figure out why, a single fund would vote the same governance issue differently from bank to bank. Source: <http://www.share.ca/en/node/1732>

**U.S. money market funds not so safe:** Signaling the depth of the current financial crisis, the money market fund, once considered to be a safe haven for investors, took a hit September 16<sup>th</sup> when the U.S.'s oldest money market mutual fund, The Reserve Primary Fund (RPRXX), lost value and "*broke the buck*." U.S. funds attempt to maintain a fixed \$1.00 net asset value for their mutfunds. The fund fell below \$1 in net asset value because of its exposure to \$785 million of debt from Lehman Brothers Holdings Inc., which filed for bankruptcy. The event marked only the second time a money market fund has broken the buck. The Reserve Management Co. Inc. of New York announced in a statement that redemptions could be delayed for up to 7 days, but said those requests that came in prior to 3 p.m. Sept. 16th would be redeemed at \$1 per share. As of 4 p.m. Sept. 16, the firm's board of trustees determined that the Lehman holdings had no value. Shares of the money market fund are now valued at 97 cents U.S. [http://www.reservefunds.com/pdfs/Press%20Release%202008\\_0916.pdf](http://www.reservefunds.com/pdfs/Press%20Release%202008_0916.pdf). Hopefully, there's no rat's left lurking in Canadian mutfunds.

**"The current financial crisis calls out for new products and services as well as more, not less, information about what is safe and profitable in the future**

**environment ”** -Jeremy J. Siegel, *The Wall Street Journal*, “The Resilience of American Finance”, 9/16/08

**Restructured notes may end up relatively illiquid: Ripples** from the latest turmoil in the U. S. financial markets are threatening to create more trouble for the proposed restructuring of \$32-billion of non-bank asset-backed commercial paper that has been frozen since August 2007 in Canada. Despite a controversial no-fault provision, the Supreme Court of Canada is expected approve the massive workout in the next few weeks despite strenuous objections from several corporations, clearing the way for the seized-up ABCP to be converted to long-term notes and for some 2000 distressed retail investors to get their money back. Stay posted. If the deal fails, retail investors will likely need to file civil claims, participate in a costly class action or use OBSI [www.obsi.ca](http://www.obsi.ca).

**Check out this video on YouTube:**

<http://www.youtube.com/watch?v=dE-LDfrolw> *Wall Street Meltdown*

**Canadians have about \$210 billion in near- zero interest savings accounts –How Come?** Why not look at ultra low -cost money-market funds or premium savings **accounts** at Alterna Savings, Canadian Tire Bank, ICICI Bank Canada etc. and earn over 3.4 %? Check terms and conditions before you sign up.

**Email from a reader:** Sir, I was relieved to hear that all the legal obstacles are out of the way and I will receive my money tied up in illiquid ABCP Notes next month. However, over the past year I’ve incurred significant loan interest expenses, early redemption penalties on my mutual funds and VISA card interest because I did not have access to my money. I also stopped a DRIP program which cost me money as the stock went up. Shouldn’t someone reimburse me for these additional expenses?

Ans: You are not alone. Other readers have incurred a variety of expenses they otherwise would not have if it were not for the Notes freezing up. We don’t provide advice but we point out that OBSI is set up to handle complaints that will make you whole if you have a valid case. According to OBSI, the restriction on legal suits does not apply to ombudsman cases. Additionally, IIROC should act on your complaint and sanction the brokerage but it won’t get you your money back. As always, approach your broker first and give them a chance to provide satisfaction. Most importantly, get your money back first from your broker under their relief program before filing an auxiliary complaint!

**IFIC still screaming and yelling about proposed new fund POS disclosure rules**

IFIC and the industry it represents still can’t seem to get their head around the idea that retail investors need better information before they are sold a fund. An article in [advisor.ca](http://www.advisor.ca) lists their gripes and whinings: (1) other products don’t have this disclosure constraint; (2) funds bought thru discount brokers won’t have to deliver any disclosure documents; (3) they don’t like the Joint Forum’s Consultation process; (4) massive CYA files will be required; and (5) Investors will have fewer choices and new product innovation will suffer. Source: [http://www.advisor.ca/news/article.jsp?content=20080919\\_152349\\_14852](http://www.advisor.ca/news/article.jsp?content=20080919_152349_14852) .POS: Missing the point, Philip Porado, Sept. 19, 2008

[Just remember this-Canada has the highest fund fees in the world bringing in over \$10 billion annually AND the literacy level of the average fund buyer has been established as Grade 5. Canadians own more than \$700 billion in mutfunds and Seg funds ]

**Learn more about Transamerica's settlement with Seg Fund investors**

<http://www.transamerica.ca/english/pdf/Media%20Final.pdf> Under the agreement in principle, Transamerica will compensate policyholders who invested in various Investment Manager Series ("IMS") Segregated funds for any excess management fees charged and for related losses. Compensation will be paid pursuant to a restitution program to be agreed by the parties and approved by the Ontario Superior Court of Justice. The proposed settlement will affect over 100,000 policyholders from coast to coast.

**"It appears that expediency, at least in this instance, trumped the application of entrenched legal principles"** - Lawyer Howard Shapray, who represented Ivanhoe Mines, which holds about \$70.7 million locked up in the frozen commercial paper commenting on the Supreme Court decision not to hear the case. [the restructuring plan would prevent ABCP holders from suing brokerages, financial services companies, the banks and Rating agencies – except in the case of certain types of fraud. That restriction has been opposed by those caught in the middle – investors too big to qualify for some of the side deals that are protecting individuals who have less than \$1 million in ABCP Notes, yet without the pensions' large pools of capital and long investment horizons.]

<http://www.thestar.com/article/502815>

**"I am pleased that the [ABCP workout] cleared its final legal hurdle this afternoon with the Supreme Court of Canada's decision not to hear an appeal of the Ontario Court of Appeal's ruling in this matter"**- federal finance minister Jim Flaherty [The most controversial aspect of the convoluted restructuring was a clause providing legal immunity for the banks and financial institutions that created and sold the notes, a provision that critics and investor advocates said would allow current and future some players to avoid the consequences for wrongdoing by merely declaring bankruptcy. Sept 19, 2008, the day the Supreme Court decision was released, a day that will live in infamy in the annals of investor protection.]

**The AIC Global Advantage Fund –show me the advantage**

The fundamental investment objective of the Fund is to maximize long-term capital growth by investing primarily in equity securities of companies throughout the world. A current objective of the Fund is to invest in the global financial services sector including insurance, securities brokering, banking and wealth management. Its 5-year pre-tax return is **-3.2 %**. Its 7<sup>th</sup> biggest holding is AIG at 4.9 % as at June 30, 2008. For one year to Aug. 31, 2008 it returned **-34.33 %**. MER? -a mere 2.8 %!

**“There should have been e-mails, faxes or phone calls going out last week [the week the U.S. market went berserk], saying okay, here are the headlines, here's what your exposure is or is not”** - Kelly Rodgers, whose firm, Rodgers Investment Consulting, helps high-net-worth individuals and non-profit groups find the right investment manager. Source: R. Carrick, *Advisers: Your silence is deafening*, Globe and Mail, Sept. 23, 2008 pg B18 [It appears that “advisors” weren’t at their clients side during this period of market turbulence]

**New Paper *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry*:** Many investors purchase mutual funds through intermediated channels, paying brokers or financial advisors for fund selection and advice. This October 2007 paper attempts to quantify the benefits that investors enjoy in exchange for the costs of these services. The authors studied broker-sold and direct-sold funds from 1996 to 2004, and failed to find that brokers deliver substantial tangible benefits. Relative to direct-sold funds, broker-sold funds deliver lower risk-adjusted returns, even before subtracting distribution costs. These results hold across fund objectives, with the exception of foreign equity funds. Further, broker-sold funds exhibit no more skill at aggregate-level asset allocation than do funds sold through the direct channel. The study found that common adviser practices didn’t add value to the average investor’s returns. These included: account churning/ chasing higher returns; market timing; trying to pick the next 5- star mutual fund or wrap account; risky asset allocations; and high trading, product and account costs. The results are consistent either with conflicts- of- interest between brokers and their clients or substantial non-tangible benefits delivered by the broker-distributed sector. Tufano et al, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=616981](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=616981)

### Top seven symptoms of a poor adviser

1. **Frequent portfolio changes.** Once you have the right asset allocation, there should be little reason to change it. With the exception of periodic rebalancing, it should work through good markets and bad. Modifications are fine, but wholesale changes may signal a bigger problem – like an adviser changing course to put money in their pocket, not yours.
2. **Pressure to invest in new products.** Be wary of advisers who want to keep you chasing the next big new product. New products generally have no track record and likely come with high costs. If you use managed products or index units, stick to proven ones where the cost is in line with the potential returns.
3. **Stock trading.** Very few professional managers (such as mutual fund managers) trade well enough to beat a benchmark. Meanwhile, advisers have far less time, resources, or training to be good at this. And because most investors don’t get information about their total returns, it’s hard to tell if trading is a benefit for you or the adviser.
4. **No return calculations.** How can you tell if you are getting value?
5. **Frequent capital losses.** This refers not just to a drop in the value of your investments, but where you are regularly selling a significant portion of your

portfolio at a loss and moving on. This is not a normal part of investing. It means that your portfolio has the wrong products and/or your asset allocation needs to be changed.

6. **Too much contact.** Advisers call to generate commissions, not to socialize. Hot stock? Market rising? It is all just chasing returns, a practice that can reduce your returns by up to 80%.
7. **No contact/unexplained absence.** Much cheaper than too much contact, and probably better for the long-term investor -- but then why pay for it?

Source: <http://www.investored.ca/News/adviser-article-creating-value.htm>

**ALERT: RBC Directinvesting is running bold ads that suggest that a 1% cash bonus is payable when you transfer \$25,000 or more to your RBCdirectinvesting account.** Hidden in the asterisked micro font at the bottom of the page and subsumed within standard boilerplate is a requirement that only transfers from another investment dealer are eligible. Deceptive and misleading are the only words to describe this nasty ad. [ RBC has also run into trouble with the SEC's Enforcement Branch regarding misleading disclosures regarding the safety and liquidity of Auction -Rate Securities – more next month]

#### **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.**