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An Investment Update

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MCIVER WEALTH MANAGEMENT
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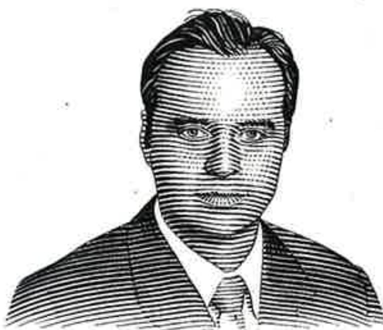
What's News

By Neil McIver



Context can be everything when we consider the investment climate and the potential for investment returns into the future. We remain in a secular bear market that began in 2000, 13 years ago, following an 18-year secular bull market that ran from 1982 until the Great Tech Wreck of 2000. With that in mind, it is important to consider three natural and normal phenomena which affect all asset classes including real estate, stocks, bonds, and commodities. Firstly, all asset classes have normalized long-term rates of return that represent the *average* rate of return that any asset class has provided over the longest time frame for which there is data. Secondly, all asset classes experience extended periods of time in which they either under or over-perform their normalized long-term rates of return. These extended periods are called "secular" bull and bear markets to differentiate them from shorter-term "cyclical" bull and bear markets. Lastly, these secular bull and bear markets eventually reverse themselves.

Following a secular bull market in any asset class, the asset class as a whole becomes over-valued (as measured by various historical metrics such as price to earnings, price to book value, etc) and prices are sustained primarily by waning but stubborn expectations for future price gains. However, as expectations dampen further, the market finally rolls over and the asset class begins to drop in price and very often will fall into a secular bear market as the over-valuation is burned away over time. Of course, the reverse happens with an asset class which has experienced an extended secular bear market.

In almost all circumstances, the reversal from bull to bear and bear to bull happens when people least expect it and usually the reversal is contrary to popular thinking at the time. For instance, when the 1966 – 1982 secular bear market in stocks reversed itself and turned into what became an 18-year spectacular secular bull market, no one really believed it for a full two years at first. Who could blame individual investors for not believing it? In 1982 there were protests in the streets as wages were still being eroded by inflation, interest rates were nearly 20%, real estate prices had collapsed, many homeowners were upside-down on their homes and could barely afford their mortgages. All the while unemployment was over 10% and the stock market had not advanced in 16 years. It was not the type of environment that would have felt conducive to the stock market finally breaking out.

Given these normal and natural price movements and the capriciousness of the reversals, it is important to know where we are in the bull and bear secular phases for various asset classes. After 13 years of being in a secular bear market in stocks, we are certainly closer to the end of this phase than the beginning. Technical research (charting) would suggest that we are anywhere from 18 months to perhaps 4 years from the anticipated reversal. It is also very likely that we will experience a bout of inflation before the reversal will take place as the current "cyclical" bear market rally that we have been experiencing has been built on excessive liquidity creation and money-printing.

In contrast to stocks, real estate prices in most major cities in Canada are clearly over-valued after a secular bull market in this very impactful asset class. Most independent technical analysis supports this view. Mark Jasayko and I correctly called for a 10% reversal in urban residential real estate prices in 2012 and we have called for more of the same in our published forecasts for 2013. While the duration has varied from one city to the next, in general the secular bull market in Canadian real estate began in 1999 and by last year had become long-in-the-tooth with prices well above what most prospective homeowners could afford. (As the subprime mortgage and credit bubble collapsed in the U.S., there was a slight dip in Canadian prices from the summer of 2008 to the spring of 2009, but that would qualify as a "cyclical" bear market within the longer-term "secular bull)

Common sense would dictate that as these opposing long-term trends in real estate and stocks reverse, investment capital should gravitate away from real estate assets and towards financial equity assets.

Keep in mind that it is those who are already in the stock market when the secular bear-to-bull reversal takes place that will profit the most in the first critical months and years when a majority of investors still do not believe that the reversal has taken place. The key is to responsibly and intelligently invest in the financial markets by managing risk as the first priority while patiently waiting for the reversal.

In that regard, your properly Asset-Allocated non-correlated portfolio managed in accordance with our models is the perfect vehicle to carry you through to the other side. The performance over the past year was excellent with much less volatility than the over-all market.

On the Mark

By Mark Jasayko

From Innovation to Inflation

A widely referenced paper published last August by Robert Gordon, a professor at Northwestern University in Chicago, discussed the possibility that the age of rapid innovation is behind us and, as a result, slower growth is ahead of us.

The thrust of Gordon's argument is that innovation emanating from the current information-driving industrial revolution is significantly less in terms its effects on daily life compared to previous industrial revolutions. The 1st industrial revolution (the steam engine and railroads) ignited economic growth where there really wasn't any prior to 1750. The 2nd industrial revolution (electricity, the internal combustion engine, running water, indoor toilets, communications, entertainment, chemicals, and petroleum) took us from the beginnings of electrification in the late 19th century to the jet age, significantly improving the levels of comfort and convenience for all of us.

The 3rd industrial revolution (computers, the internet, and mobile phones) has not fundamentally changed the way we live compared to the 1960s. In fact, since then, one important benchmark, the speed of transportation, has actually decreased with the retirement of the supersonic Concorde.

Bill Gross of PIMCO (the world's largest bond manager) has also written about a secular slowdown in economic growth, calling it *The New Normal*. However, his views have focused more upon deficits and money-printing resulting from borrowing from the future to enjoy robust economic growth. But now, *that* future has arrived.

Jeremy Grantham of GMO (one of the preeminent value managers in the world) has recently chimed in on the slow growth theme as well. In the November edition of his *Quarterly Letter* the topic headline was "On the Road to Zero Growth." His argument focuses on the detrimental effect of rising real prices for increasingly scarce commodities. He also touches on the economic destructiveness of ageing and low birthrate demographics. Grantham warns that industries, government policymakers, and politicians are erroneously expecting that real and unassisted economic growth will return and help save us from the financial wreckage and the temporary Band-aid solutions that resulted from the credit crisis.

All of these viewpoints have some validity. Each of them represents a scenario that has some probability of occurring. However, there are a few counterpoints to these dour prognostications.

History is replete with examples of prominent people and leaders proclaiming an end to innovation and growth. In many cases it is hard for them to imagine how things could get much better after the progress that they themselves have experienced. Also, progress and the commercialization of technology often occur by stealth or by accident where the applications were not previously seen. A case in point is the communications backbone that become the internet was originally created by the U.S. government to ensure reliable military communications in the event of thermonuclear war. When the foundations of the internet were being laid down in the 1970's, not a single person envisioned people buying books, arranging travel, or doing their banking on it.

Another factor is that it takes time for innovation to translate into economic growth and life-changing aspects. In the case of the first two industrial revolutions, it took more than half a century for average people to reap the major benefits of the original discoveries. In the case of electricity, it was a long journey from Edison's invention of a system for power distribution to the electrification of most homes. It was also half a century from the Wright brothers' first flight to convenient transoceanic jet travel.

Finally, as a contrarian, one would expect that when there are a rising number of voices against the prospects of future innovation and economic growth, we might be surprised by an unexpected renaissance.

If there are glimmers of innovation adding to an eventual real economic recovery, it is unlikely that the dovish central bankers throughout the world would extinguish it with "exit" strategies whereby they finally drain the trillions of injected emergency liquidity. But not exiting will significantly increase inflationary pressures.

With this in mind, it is also important to note that the U.S. clearly voted for inflation in the last general election. Voters knew, or should have known, they would be getting U.S. Federal Reserve chairman Ben Bernanke for at least another year and a half as well as the very likely appointment of another dove as chairman after him (the leading candidate is Janet Yellen, someone who makes the dovish Bernanke look Scrooge-like).

While a nascent recovery generated by unforeseen innovation may be spared, bond investors won't be. With no protection against the toxicity of inflation, they will have no choice but to sell, thereby driving interest rates higher.

So, my guess is that innovation is still alive and well and in better condition than the recent worrywarts have suggested. Also, our ability

to adapt to the changing supply and demand for resources is remarkable (remember the energy crisis of the 1970's and the gloomy visions of the future with no oil?) Demographics are likely the greatest concern, but that issue is still a few economic cycles away from eroding economic potential. That said, the less that we have to worry about innovation, resource scarcity, and demographics, the more we have to worry about inflation.

With that, we continue to invest the Asset Allocated Portfolios in gold, commodities, agriculture, inflation-resistance consumer staple stocks, and inflation-protected bonds.

Good Karma

By Karm Bhatti

It's RRSP Season Again!

I have mailed to each of you who have an RRSP Portfolio with us a complete RRSP Package which includes a quick reference guide with important information in addition to a convenient postage-paid-reply-envelope if you wish to mail your contribution.

RRSP Contribution Deadline and Limit

This year's contribution deadline is **Friday March 1st, 2013.**

The maximum contribution limit for the 2012 tax year is **$22,970.** There are two ways to ensure that you make your contribution on time:

Cheque by Mail - Please notify us that you have mailed a cheque so that we know your contribution is on its way. Ensure that the cheque is made payable to "Richardson GMP" and on the memo line of the cheque please write "2012 RRSP Contribution". Lastly, please ensure that you mail the cheque leaving ample time for it to reach us via Canada Post.

Transfer from your Non-Registered Investment Portfolio - Your RRSP contribution may be made by a transfer of cash or securities from your Non-Registered Investment Portfolio to your RRSP Portfolio. Please call me directly at 604-678-6563 with the details of the amount that you would like to have transferred and I will arrange this for you.

Preserve and Protect

Mike George

Deductibility of Investment Counsel Fees

The McIver Wealth Management Consulting Group offers Discretionary Portfolio Management in exchange for a fee that is a percentage of a client's assets under management. Often, these fees are referred to as "investment counsel" fees. Their tax treatment (specifically deductibility) can be different from commissions or fees charged by other types of advisors (stock brokers, investment advisors, financial planners, mutual fund sales people). And, as this is tax season, it is always valuable to review those differences.

Comprehensive investment counsel fees are often charged to clients based on the value and composition of their assets. The fees charged typically cover a range of services including investment advice and account management services. In some circumstances, these fees may be deductible by clients for tax purposes.

Most investors will take advantage of Paragraph 20(1) (bb) of the Canadian Income Tax Act (ITA) which allows them to deduct fees, other than commissions. In order to be deductible the fees must be paid to a person or company whose principal business includes the administration/management of investment securities (which is the principle business of the McIver Wealth Management Consulting Group at Richardson GMP).

Investment counsel fees paid are deductible where the fee is reasonable. In determining whether a fee is reasonable, the amount of time spent and the type of work done by the person providing the advice or service will be taken into consideration. Fees paid for other types of advice such as general financial counselling or planning are not within the provisions of paragraph 20(1) (bb) even though the principal business of the advisor otherwise qualifies.

The following services normally qualify:
- Investment/Portfolio Management
- The Custody/Safekeeping of Securities
- The Maintenance of Accounting Records

Fees that are not commissions but otherwise meet the requirements of paragraph 20(1)(bb) are not disallowed solely because they are computed with reference to the fair market value of the portfolio.

However, it is important to note that Investment Counsel Fees charged on registered accounts such as RRSPs, RRIFs or RESPs, and on TFSAs, are *not* deductible as the securities of the plan belong to the trust and not the annuitant (the person or persons whose names the account is in). This is the case regardless of whether the fees are paid directly from the assets within the registered account or from outside the account by a separate payment from the annuitant.

All clients should consult their tax advisors for advice on matters relating to their income tax return and deductible expenses.

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