HIGH NET WORTH JOURNAL

An Investment Update

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McIVER WEALTH MANAGEMENT
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What's News

By Neil McIver

Is Cautious Optimism Warranted? 2011 was a challenging year for the markets as global growth slowed and, unfortunately, politics became increasingly influential in the capital markets. Political interference in the capital markets is the inevitable result of governments that seek to solve problems through massive spending and borrowing. Eventually they grow to control a daunting percentage of what once was the domain of private industry (for example, in B.C., the Provincial Government has grown to now directly control over 20% of the economy). Governments are not known for their efficiencies mainly because its resources are often governed to satisfy the short-term needs of the politicians and not to maintain the long-term strength of the economy. In addition to this troubling trend toward state-run capitalism, the severity of the European debt crisis worsened during 2011.

2011 was also a challenging year in the U.S as the effects of the 2008 financial crisis were still being felt. While money-printing in the form of Quantitative Easing 2 (QE2) from the U.S Federal Reserve did initially help the financial markets, higher commodity prices slowed growth and, accordingly, the U.S market ended the year where it had began.

Despite these troubles, your Strategically-Asset-Allocated Portfolios performed nicely. With very little risk (or volatility) they produced 2-Year Annualized Returns of 4.62% for the P1 Very Conservative Portfolio on the low end, and all the way up to 7.68% for the P5 Growth Portfolio.[1]

Getting back to the central question: Is cautious optimism warranted? The proverbial elephant-in-the-room remains Europe. The primary concerns here are the high absolute debt levels, the ability of the Europeans to sustain this debt, and the exposure that financial institutions have to this debt if there is a real or perceived risk of country defaults (in addition to Greece, which we already assume will experience a "structured default"). We feel that there is a 30% chance (this number has decreased recently) that some sort of "unstructured default" takes place this year, and a 70% chance that the Europeans can reach a consensus and find a way forward. Keep in mind that they are not stupid and do want their wealth to rapidly evaporate.

While the overall amount of debt tends to dominate the news, we cannot forget that the Europeans have gone a long way in reducing government spending and entitlements and, in some cases, raising revenues (taxes). In 2009, European debt service levels (the total interest costs) exceeded 9% of GDP (Gross Domestic Product), which was clearly unsustainable as there was no chance that European GDP would grow at 9% a year. Debt service levels have now fallen to a more manageable 4%. However, as European governments spend less there will be a natural contraction in the economy as a result (excessive government economic involvement resulting from state-managed capitalism will have to shrink) and it is very likely that Europe, the world largest single economic zone, will fall into a recession during 2012.

Europe will probably get worse before it gets better. There is a reasonable chance that the recession will be shallow and may very well be over in the second half of this year. We will remain very cautious regarding Europe.

There were a number of times during 2011 in which the market seemed to question the sustainability of China's growth as interest rates and inflation grew. But it is important to keep in mind that the difference between China and the West is that China has high reserve levels, is not in a debt crisis, and has the means to stimulate its economy by increasing fiscal spending or pursuing a more accommodative monetary policy. China therefore has the potential to better weather the current storm than the West.

Like China, Canada is in an enviable position compared to the G20 and has a low debt to GDP ratio of 35%, versus over 100% for many countries. Our equity market, however, is reflecting this confidence and is the most expensive market in the G20. This ensures we will remain cautious.

There are a growing number of positive signs in the U.S that their economy finally recovering. Although 8.5 million jobs were lost during the recession and fewer than 2 million have been replaced thus far, U.S. corporations have surprised the market with reasonably strong earnings in a very difficult environment. This suggests that when the U.S economy does begin to accelerate again, corporations will able to take full advantage of this growth and investors should profit handsomely.

Is there cause for cautious optimism? I can comfortably say yes, with emphasis on the word cautious.

[1]Performance returns are as of February 29, 2012 and are based on actual representative accounts. Please note that past performance is not necessarily an indicator of future performance. The indicated rates of return are net of fees. Individual results of clients' portfolios may differ from that of the representative portfolios as fees may differ, and performance of specific accounts is based on specific account investiture. The noted representative portfolios may not be appropriate for all investors.

On the Mark

By Mark Jasayko

Good Things in Big Packages

I was recently struck when watching a market analyst on television who said we shouldn't fret about the future because of the growth packages on which Europe, the U.S., and China were working. He seemed to imply that if we are ever faced with economic slowdown, politicians can implement a 'growth package' and things will be back on track.

Maybe this is the new thinking. I am old enough now to have been following the markets and the economy for over 30 years. I can attest that this was not the thinking 30 years ago. Back then, most government attempts at responding to economic concerns were usually ignored by investors and consumers, and often just made things worse. Now, we are led to believe that a 'growth package' of fiscal and monetary gimmicks is the same as installing a new battery in a toy. Voilà! Good as new.

I think I understand were the new thinking came from. After the monumental battle with inflation had been won, the power of monetary policy increased dramatically. The U.S. Federal Reserve Board was now able to increase liquidity without immediately adding to inflationary pressures and expectations. In addition, the peace dividend from the end of the Cold War and the massive expansion of global manufacturing capacity into lower-wage emerging markets placed a heavy lid on any inflation risks.

As a result, there were now only two settings for monetary policy: liquidity expansion and faster liquidity expansion. If the economy slowed down, Alan Greenspan threw money at the problem with impunity. If he wasn't sure, then he threw money at the economy anyways. Why not? What was the risk? Certainly inflation wasn't. And, he was convinced that financial engineering had discovered ways of managing the debts that grew exponentially as it became cheaper to borrow.

Things were further amplified when governments became perpetually growth-orientated with the taxation and spending policies that were legislated. It became hard to tell the difference between Republicans and Democrats, and between Conservatives and Liberals. They were all keeping taxes steady while ramping up spending. Because of the peace dividend and impressive advances in technology that created solid economic growth, government surpluses actually appeared in the later 1990's. But, when surpluses turned into deficits, no one got too stressed. Thanks to all the monetary liquidity pumped into the economy, it was cheap and easy for governments to borrow. When there was the threat of an economic hiccup, the spending spigot flowed.

As investors and consumers began to react positively to news of growth-orientated monetary and fiscal policies, confidence increased. Consumers would borrow and spend more, and investors would invest more. A cycle was set in motion, reinforced by the next policy announcements and subsequent consumer and investor reactions. Eventually, a very entrenched Pavlovian behavior was established as people were conditioned to expect more spending and lower interest rates and then reacted on cue when they were given what they were expecting.

It is remarkable how entrenched this behavior became. In the early 2000's, the gains from technology and global expansion slowed considerably. Almost all economic gains beyond that point were the result of financial engineering; fiddling with interest rates or using derivatives and creative accounting to hide poor results and debt burdens. The solid and balanced economic fundamentals that powered real growth for much of the 1990's had eroded. All of this became apparent during the financial crisis beginning in 2007. And yet, five years after that, and 10 years after real economic growth petered out, there are still numerous market analysts appearing on TV telling us about the promised potential of further 'growth packages.'

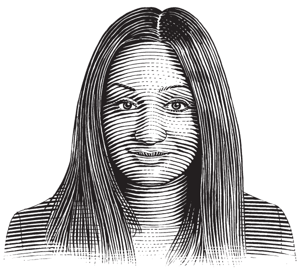
Simple common sense tells us that real economic growth is not the result of magical 'growth packages.' Deep down, we know that it is the result of an environment that is characterized by a skilled labour force that meets current demands, efficient taxation, low debt burdens, an absence of ill-conceived regulations, and by the free mobility of goods and labour. Anything less is a hindrance which gimmicky growth policies can't overcome in the long-run.

The saving grace is that developed economies are often self-correcting in spite of knee-jerk government rescue plans. There have been many cases where, in retrospect, economies have mended themselves before the effects of policies materialized. Real economic growth can be aided by economic participants' natural choices and behaviors which become more prevalent after failed and ineffectual policies have lost their seductive appeal. At least we have that going for us!

And yet, despite common sense, we are still inundated with a never-ending stream of contrived Band-aid packages with slick sounding abbreviations and acronyms: QE1, QE2, TARP, TALF, PPIP, LTRO. Policymakers and politicians are still hoping that we are Pavlovian dogs.

Good Karma

By Karm Bhatti



Launch of New High Net Worth Weekly

We are proud to announce the re-launch of our High Net Worth Weekly Email to mark its upcoming 5 year anniversary! As most of you are aware, this email-only publication is designed to keep you informed in a quick fashion. This is achieved through both Neil and Mark's market-related commentary and my report containing the Portfolio Model performance table and the Asset Class performance heatmaps. In addition to that, our tax & estate professional Mike George offers suggestions and recommendations for wealth preservation. If you are not currently receiving this email publication and would like to, please email me directly at karm.bhatti@richardsongmp.com and I will add you to the list.

Tax Filing Deadline

The deadline of April 30th, 2012 to file your personal income tax return is rapidly approaching. Please keep an eye out for tax slips that will be mailed to you. If you have any questions or concerns, please call me directly at 604-678-6563.

Preserve and Protect

By Mike George

Spring time is tax time. Don't forget to maximize your Tax Credits and Deductions and ensure you meet your Filing Deadlines.

Tax credits and Deductions

There are a number of ways to reduce taxes and keep more money in your pocket, so don't forget to claim all the tax deductions and credits available.

Deductions

The most common tax deductions are RRSP, Child Care and Moving Costs. However many HNW clients should review their situation to see if they have stock option deductions, carrying charges and interest as well as Exploration and Development Costs or Allowable Business Investment Losses. And don't forget the most significant deduction - Pension income splitting. Pensioners that qualify for the Pension Tax Credit can allocate up to 50% of that income to their lower income spouse.

Tax Credits

The most commonly claimed credits include the Basic Personal, Age, Spouse and Pension Amounts. Employees typically claim amounts for Canada Employment as well as CPP/EI contributions and Public Transit. Families also have available credits for children, tuition, education and textbooks, as well as the Children's Fitness and the new Children's Arts amounts. There are also amounts available for those with medical expenses, caregivers or are disabled. Note that certain credits may be subject to reductions or restrictions.

Medical expense credit

Generally you may claim medical expenses that exceed 3% of your net income to a maximum threshold. Amounts in excess of this threshold are eligible for the credit. To maximize your refund most families combine their medical expenses and claim them on the lower income spouse's tax return. However, you may want to consider whether a higher income spouse's surtaxes could be reduced by claiming the credit, albeit with a higher 3% threshold.

Credit splitting

If you have insufficient income these credits may be transferred to your spouse. Where there is a choice, the higher income spouse may want to claim them to reduce surtaxes (where applicable). The age, disability and tuition/education credits are all eligible for transfer if one spouse (or in the case of tuition, your children or spouse) is unable to utilize the credit.

Charitable donations

In developing your charitable giving strategy make the best use of the tax incentives available. In addition to donating securities or life insurance to your favorite charity, keep the following in mind. Ensure your receipt displays a valid registration number. The maximum credit available is 75% of your net income (any unused amount may be carried forward five years). Amounts claimed over $200 can provide a refund of up to 50% in certain provinces. To maximize your claim consider combining your family's donations and claim on one return.

Filing deadlines

The filing deadline for most individuals is April 30th; however if you or your spouse carried on a business then you are not required to file until June 15th. If you owe taxes and you have not paid them before April 30th, you will be subject to penalties plus non deductible interest on any overdue amounts. The penalties and interest increase with additional offences. In addition, if you have missed the filing deadline, payments for the GST/HST credit, the Canada Child Tax Benefit and Old Age Security may be delayed.

Don't wait until the last minute, gather and organize your receipts now

The more organized you are, the more likely you will remember that lost donation receipt or day care expense. In addition, providing your accountant with a well organized tax package will help you save money by reducing your fees and speeding up any tax refund.

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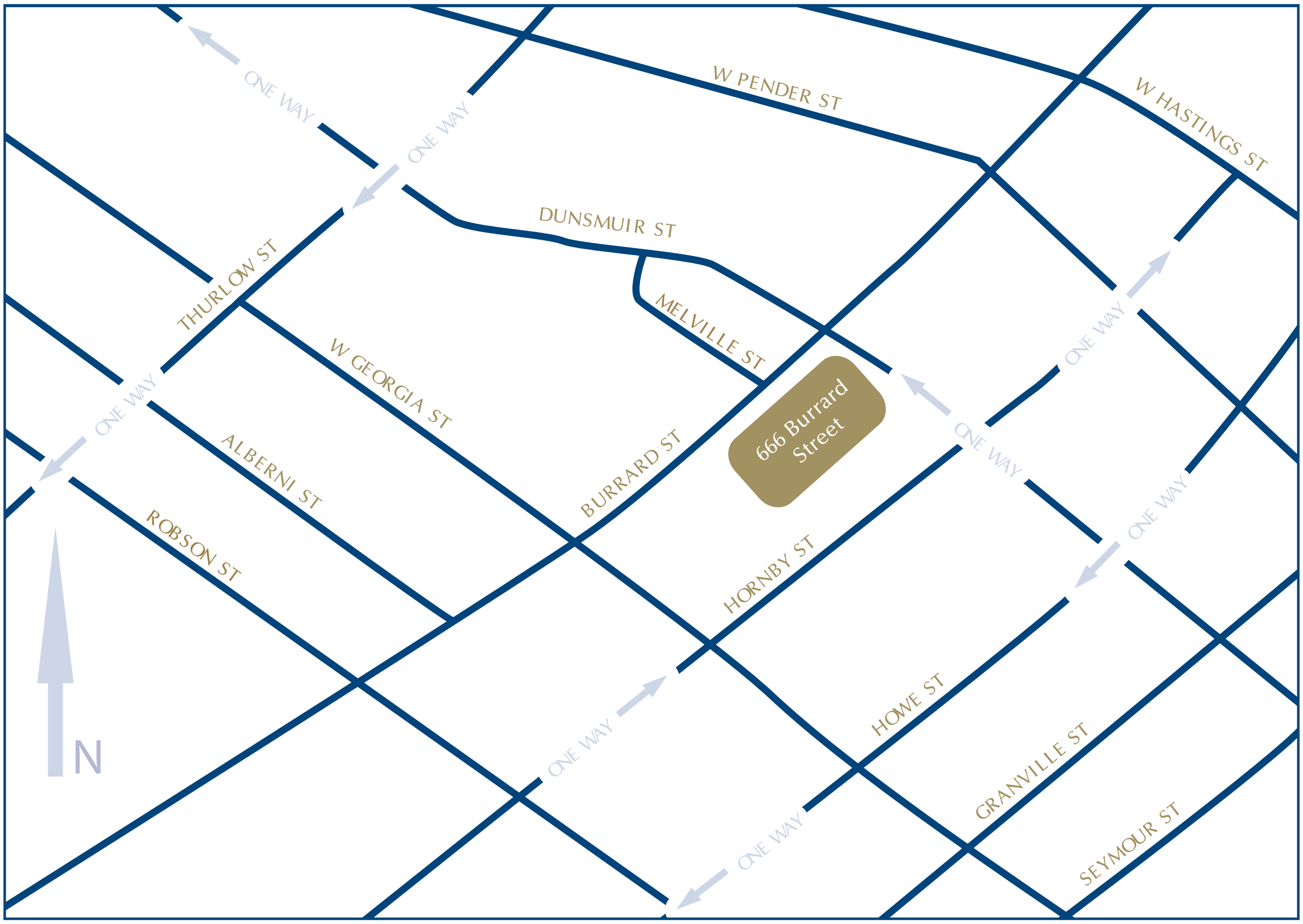

RICHARDSON GMP LIMITED

Park Place • 666 Burrard Street, Suite 1800 • Vancouver, British Columbia • V6C 2X8

Toll Free: 1 (866) 364-7735 • Phone: (604) 678-6561 • Fax: (604) 678-6640

www.mciverwealth.com

Neil R. McIver	Director, Wealth Management	(604) 678-6561	Neil.Mciver@RichardsonGMP.com
Mark Jasayko, MBA, CFA	Associate Portfolio Manager	(604) 678-6562	Mark.Jasayko@RichardsonGMP.com
Karm Bhatti	Associate	(604) 678-6563	Karm.Bhatti@RichardsonGMP.com