

**CONTACT US****CHRIS FORMAN**

Phone: 604.687.4587

cforman@berkshire.ca

**MARK RICHARDS**

Phone: 604.484.4559

mrichards@berkshire.ca

**JUNE WOODWARD**

Phone: 604-484-4558

jwoodward@berkshire.ca

**COME AND VISIT US  
ON THE WEB!**[www.financialforman.com](http://www.financialforman.com)

OR

[www.berkshire.ca](http://www.berkshire.ca)**THE BOTTOM LINE**

MARCH 31, 2007

**The hardest thing in the world to understand is income tax. -Albert Einstein**

As I write this the Canucks are poised to make their first playoff appearance in three years and after a marvelous season we wish the boys the very best and we hope the season ends with a deep run into the playoffs! There is nothing like winning in the post season to bring a city/province together and after a rather long and arduous winter the collective spirits of our fair city could use some uplifting!! Go Canucks Go!!

Speaking of uplifting, the investment world has one again posted positive rates of return virtually across the board. The S&P/TSX index posted a very solid gain of 2.6% in the first quarter and when coupled with MSCI EAFE index gain of 4.15% it makes for a good start to the year for most investors.

In our State of the Union letter we suggested that market may wobble a bit given some of the unsettled aspects of the economy and indeed beginning in late February we experienced two rather sharp drops in the world's stock markets. We saw markets fall about 6% from their mid-February highs only to rebound in the last half of March to show positive year to date returns, in most cases, at the end of the quarter.

In recent weeks however the trend in the North American markets has been influenced by concern regarding the fallout from the so-called sub-prime lenders. In particular, as we have commented on in the past, the continued borrowing against the growth in home equity has created some pressure in other sectors of the economy. Although this is a concern, we feel that both Canada and the United States should continue to achieve moderated economic growth into 2008. To further bolster that view, the Federal Reserve Board in the US signaled its intent to pursue a less restrictive interest rate policy i.e. lower interest rates.

Looking ahead we still feel the markets could go through a more extensive contraction phase as the year progresses (isn't that a nice way of saying the markets may drop!) It must be emphasized though, we feel that this setback would be within the context of a longer term upswing.

**The Federal Budget**

In expectation of an election, the conservatives put together a "feel good" kind of budget which favoured families with small children and seniors. Most notably the seniors income splitting provisions, announced late last year, were formally introduced into the house. This policy change will be a wonderful opportunity to save taxes for many of our clients.

Other highlights include: increasing the age limit to 71 from 69 for converting registered retirement savings plans and registered pensions into an income. The age tax credit has been increased by \$1,000 (for seniors who qualify) to \$5066. RESP accounts will benefit from an increase in the maximum annual Canada Education Savings Grant amount to \$500 (from \$400). A new \$2,000 child tax credit will provide additional tax relief to most Canadian families. All in, most people should benefit very nicely from the assorted goodies in this package.

**Our Practice**

In our last correspondence we talked about the scope of our practice and that prompted several questions from our readers, so I thought it would be appropriate to quantify things a little bit.

Our Berkshire Securities Inc. book of business (which represents our individual clients) is about \$55 million and we assist about 200 families. This means we manage about \$275,000 in assets, on average, for our customers. We represent clients with assets ranging from \$100,000 to \$4 million and about 25% of our clients have in excess of \$400,000 in assets with us.

As compared to industry numbers, we have about half the number of clients and twice the average assets per family of the average investment advisor in Canada. We are very proud to say you are our client and we thank you for being a part of our little "family"!

## THE BOTTOM LINE

Do you realize the responsibility I carry? I'm the only person standing between Richard Nixon and the White House. —John F. Kennedy

### Our Practice (continued)

Under the Granville West umbrella, which represents our Group Retirement clientele, we have 44 organizations that use our services to assist their employees with their group RRSP or pension plan. Total assets under administration equals about \$125 million on behalf of about 3000 plan members. This works out to about an average account balance per plan member of about \$41,000, the sign of a fairly mature book of business. Our service model on the group side is quite different from others, in that we are dedicated to providing member level investment advice. Our goal is to educate/assist the plan member such that they make good investment decisions and ultimately accumulate a base retirement nest egg. If you would like to arrange for a one-on-one session for your group in the weeks ahead, please feel free to call us!

### Borrowing to Invest can be Advantageous to your Wealth

With interest rates close to 40-year lows, the concept of borrowing to invest is a strategy worth considering in building your long-term wealth. Prudent borrowing, and wise investment of the proceeds, can lead to significant wealth creation over time. The key is to invest in a good quality assets that will stand the test of time, a well-managed, diversified mutual fund avoids the risk of investing in a single business. Borrow only an amount that you can comfortably carry, and that won't cause you anxiety should your investments suffer a temporary decline in value.

Leverage is a powerful tool that cuts both ways. If you borrow to invest, whether you have gains or losses on your holdings, the effects will be magnified. For example, if you put \$100,000 into a mutual fund—using \$25,000 of your own money and a \$75,000 loan—and the fund gains or loses 10% or \$10,000, that would actually be a 40 per cent gain or loss on your original equity—before loan costs. There are also tax considerations that should be understood by investors contemplating a borrow-to-invest strategy. The Income Tax Act has rules that apply to the tax deductibility of interest, including:

- There must be a legal obligation to pay interest (a loan agreement signed by you confirming the interest charges you agree to pay and when).
- The amount of interest must be reasonable. Canada Revenue Agency (CRA) will accept the use of public lending rates charged by the banks.
- The purpose of borrowing to invest must be to earn income from a business or property. For example, borrowing to invest in a piece of real estate that provides monthly cash flow would qualify. Investing in stocks and bonds, or mutual funds that generate returns in the form of interest, capital gains or dividends would also allow the interest expense to be tax deductible.

### Interest is Tax-Deductible

Typically, you can borrow to invest at the current prime rate. However, for an investor in the top tax bracket, with deductibility of loan interest costs, the actual cost would be about half.

Remember that only half of any capital gains realized on your portfolio are taxable as income. And even if the value of your investment increases, a taxable capital gain is not actually triggered until the holding is sold or a manager realizes gains within the portfolio. If your mutual fund doesn't pay a taxable distribution, you may deduct annual borrowing costs from your other income.

### Important Variables Affecting Returns

Generally, borrowing to invest is considered an aggressive strategy that requires careful evaluation. Investments must be able to generate an after-tax investment return that is greater than the after-tax interest cost.

We also suggest the possibility of restructuring your finances if you currently have non-tax-deductible debt such as a home mortgage or a car loan, while also owning taxable investments such as stocks, bonds or mutual funds. You may be able to pay down your mortgage or car loan, and borrow against your investments instead.

By converting your non-tax-deductible interest expense into tax-deductible debt, you can reduce your overall borrowing costs without increasing your overall debt. Call us for more details!

### BOX SCORES

#### GIC Interest Rates\*\*2007 (%)

	Jan	Feb	March
1YR	2.03	2.63	2.63
3YR	2.33	2.88	2.88
5YR	2.78	3.13	3.13

#### Annualized Rates of Return to March 31 2007 (%)

All Cdn \$	1YR	2YR	3YR
TSX	30.2	26.0	11.2
S&P 500	7.8	8.5	-2.1
SCMU Bond	4.9	6.9	7.0
*EAFE	20.5	21.9	3.6

\*Europe, Australia & Far East Index

\*\*Bank of Canada web site

\*\*AIM Trimark