



THE BOTTOM LINE

MAY 2004

ECONOMIC AND INVESTMENT UPDATE

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The first quarter of 2004 started out considerably better than the similar time frame in 2003 when, as you will recall, the economy and stock markets were spooked by the pending Iraqi war.

After a powerful upward movement in the world's stock markets in the fourth quarter of 2003, it appeared that the markets paused for thought in the first quarter of 2004 taking a "show me" attitude, as in show me more growth in the economy, jobs and profitability of companies. As such, we experienced relatively modest growth in the stock markets, the exception being Canada where the TSX Capped index rose 4.9% to the end of March. In the US we saw a slightly more reserved 3.4% (CDN) growth rate in the S&P 500 index and similar numbers from the balance of the world stock markets indexes.

Economic growth is important because in general terms, if the economy is growing then company profits on the whole are increasing and increasing profitability translates into rising stock prices. While the emotion of the markets may price a stock (or a market for that matter) at a level higher or lower than it should be at any given point in the cycle, over the long term economic growth is going to drive stock markets. What drives the econ-

omy though is consumer spending. If we are out buying houses, cars, microwave ovens and cell phones then the economy grows, companies make money, stock markets go up.

Therefore on the near term it is important to note we feel there are several risks in the economy that may have an adverse effect on economic growth. Specifically, given the low level of interest rates we have enjoyed over the past several years, debt levels have tended to rise, particularly in the US where consumers have taken to borrowing the equity in their increasingly higher priced homes to finance current spending. While this in its own right is not a bad thing- in fact this type of borrowing and spending was helpful in averting a full scale economic melt down in the post 9/11 world, the risk lies in increasing interest rates.

The US Federal Reserve bank has hinted at raising interest rates which given large enough rate increases could have the negative impact of bursting the residential real estate "bubble". This would mean at the very least households who can quite comfortably pay their mortgages and continue to spend at a good clip, may now find that more of their income is being allocated to paying the debt and therefore they have less money for discretionary spending.

In a worst case scenario, home owners may find they have to sell their house since they are no longer able to cover the mortgage payment. At this point they may find that many other households are in the same boat and therefore in order to sell their house they need to drop the asking price considerably to sell it. The hope is they are able to sell it for more than they owe on it.

In any case, if the US consumer reduces spending then the impact on Canada will be immediate -in fact we may already be seeing some of the impact of slower consumer spending as Canadian GDP growth for the month of February was down 0.1 % from January - a disturbing statistic for sure! What does this mean to you? Well, we have seen several situations where, after warily evaluating risk tolerance levels and asset allocation strategies as a result of poor stock markets in 2000, 2001 and 2002, people are abandoning their carefully laid out plans because of the strong market based performance of 2003. Given the potential risks in the economy we still feel investors should err on the side of conservatism and maintain exposure to fixed income vehicles.

THE BOTTOM LINE

" I JUST THINK YOU WESTERNERS SHOULD TAKE OVER THIS COUNTRY IF YOU THINK YOU ARE SO SMART!"

Pierre Trudeau

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BERKSHIRE SECURITIES INC.

As you know TWC Securities was bought out late last year and effective April 19 2004 the transition from TWC Securities Inc.'s administrative platform to Berkshire Securities Inc.'s platform successfully took place. As we have indicated in previous correspondence, we feel this a great move for us, as we will have the benefit of Berkshire's more sophisticated systems and greater depth of operations across the board.

From your perspective you should only see a different name on your statement, otherwise it is still TD that is the trustee and custodian of your

account. Since we are so early in our new relationship with Berkshire we have nothing to report at this time but as the weeks go by if there any issues that pop up either at our end or at yours, please feel free to call us.

Please note our email addresses have changed as follows: Chris; cforman@berkshire.ca, Mark; mrichards@berkshire.ca and Kelly; kriggs@berkshire.ca please update your address books! All other contact information remains the same.

CASE STUDY

In our day to day travels we run into unique and varied situations that require some "thinking outside the box" to come up with suitable solutions. This is such an example.

We first met Marilyn through her husband Jim who was a member of one our Group RRSP clients. Sadly, Jim was suffering from terminal cancer and in an effort to try all remedies he spent the majority of his retirement savings. After Jim passed away the full impact of the financial devastation became evident in very short order. Marilyn had a home worth about \$125,000 with a mortgage and an outstanding Line of Credit (LOC) worth about \$155,000. There was about \$20,000 left in the RRSP plan and about \$200,000 in life insurance proceeds.

For her part Marilyn was unable to work and received a disability income of about \$17,000 per year. Marilyn needed another \$10,000 after tax, per year, income to make ends meet. So what to do?? The first thing we did was pay off the mortgage and LOC with the proceeds from the life insur-

ance policy. We then arranged for an investment LOC, using the home as collateral for the maximum value the bank would give us- in this case 75% of the value of the home or \$85,000.

Next we invested the proceeds of the interest only, at prime LOC into a well managed international equity mutual fund and arranged for an automatic monthly withdrawal from the account in the amount necessary to pay the interest on the loan – about \$360 per month. To provide the extra \$10,000 in 2003 and 2004 we suggested the she withdraw the funds from the remaining RRSP assets. This would allow her to leave the mutual fund alone for a few years and give some taxable income from which to deduct the interest cost on the loan since that expense is tax deductible to her. With remaining proceeds from the life insurance of about \$47,000 we suggested that she buy a bond with a yield at that time of about 5%. Ultimately Marilyn chose to use these funds for a small home renovation, a much needed vacation and

to assist her son with his university education requirements.

Once the RRSP funds are depleted we will then increase the monthly withdrawal from the mutual fund to fill in some of the income gap created by the used up RRSP money.

What has happened since we implemented this plan in early 2003? Marilyn has benefited from the strong stock market growth of the past year and as a result we actually switched her investment from the international equity fund to a more conservative Canadian balanced fund in late 2003, after capitalizing a sufficient gain to pay the interest costs on the LOC for the balance of the 2004 year. Marilyn has also withdrawn \$10,000 in additional funds in order to do a few other things. She currently has about \$90,000 in her investment fund and she will re-evaluate her income needs at the end of this year. In a nutshell, we were able to turn a dire looking situation into a positive position by maximizing tax efficient assets and income streams. This is one good example of what we call retirement income planning.

BOX SCORES

GIC Interest Rates**

| | 2003 (%) | | |
|-----|----------|------|-------|
| | Jan | Feb | March |
| 1YR | 1.18 | 1.18 | 0.93 |
| 3YR | 1.98 | 1.98 | 1.73 |
| 5YR | 2.63 | 2.63 | 2.38 |

Annualized Rates of

Return to March 31 2004 (%)*

| All Cdn\$ | 1YR | 3YR | 5YR |
|-----------|------|------|------|
| TSX | 37.7 | 6.0 | 7.1 |
| S&P 500 | 20.5 | -5.4 | -3.9 |
| SCMU Bond | 10.8 | 8.3 | 6.9 |

*Europe, Australia & Far East Index

**source: Bank of Canada web site.

MILESTONES

No, not the restaurant! Congrats to Kelly Riggs who has been a part of our team for one year now and to Mark Richards who has been working with me for four years now – wow how time flies!!! Both Kelly and Mark welcome your calls with any questions or comments you may have.

Member CIPF

Published By: Chris Forman of Berkshire Securities Inc.

Member IDA

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THE BOTTOM LINE

JUNE 2004



CASE STUDY

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As we introduced in our last correspondence we thought it would be nice if we could share some real life examples of how we assist people in making their financial decisions.

The following story is about Bob. Bob was a 63 year old retired mechanic who I met in June 2002. Bob had a Money Purchase Pension (MPP) plan with his former employer; in addition he had some life insurance proceeds from the death of his wife and RRSP assets with another advisor. In total, he had about \$550,000 made up of about \$175,000 in his MPP, \$200,000 in non-registered assets and another \$175,000 in his RRSP. Bob had two advisors – one for the non-registered and one for his RRSP. As is often the case in these situations, decisions were being made based on the account at hand not the entire asset base. Further, as you may recall the stock markets had been very poor for an extended period. By the time June 2002 rolled around, Bob had seen considerable deterioration in his accounts over the preceding 20- 24 months and it was safe to say he was scared. In our experience the main pitfall of having two advisors is that the asset mix is almost always wrong. This was the case with Bob. At the age of 63 Bob had only 19% of his assets in fixed income investments, bond funds at

that, and a disproportionate allocation to growth style equity funds including several different tech funds. So severe was his paralysis that he was afraid to take money out of his savings to live on and was borrowing money (i.e. taking money from a line of credit) to make ends meet.

The first thing Bob needed to do was to establish an asset allocation strategy that provided him an income stream and peace of mind. We prepared our plan and presented it to Bob in early July 2002. However by the time the assets transferred to us in October of 2002 they had dropped a further \$80,000 to about \$470,000. Undaunted, we began to implement our plan to make him more efficient and to ensure he could sleep at night. Bob had indicated that he wanted an income of about \$24,000/year to supplement his CPP and small British pension he was receiving.

The first thing we did was sell off all of his bond funds, and since the pension and the RRSP had transferred in cash, we were able to re-allocate all his fixed income to a laddered bond portfolio that matched his desired income stream over the next 8-10 years. In his RRSP, we purchases a series of bonds coming due in '05, '06, '07, '08, etc. successively, all maturing at \$16,000. We matched these with similar maturity dates which were to come from the Locked

– In (pension) fund in the amount of \$8,000, for a total of \$24,000 per year. The balance of the funds could now be invested into the equity markets to ensure the long term integrity of the portfolio. To this end we reconstructed the equity portion to include more value oriented style managers that previously had been used to reduce the overall volatility of the asset base. Two main advantages come out of this structure; 1) Bob can sleep easier knowing that his income is coming from a well managed bond portfolio and no matter what happens to the stock market in the short term he income is “fixed”. 2) With the portfolio structured the way it is we can now quantify the sell decision on the equity side of the portfolio. This means once an equity fund generates a certain rate of return, say 9.5% in a year we can sell off the gain and dump the proceeds into a bond to come due at the end of the laddered portfolio. In this way we sell the equities at a gain and keep the fixed income portfolio topped up! This is a powerful retirement income portfolio structure that we have used successfully in many different situations. Quantitative sell decision, conservative asset allocation, low management fees on the bond portfolio, it's a beauty!

THE BOTTOM LINE

CANADA IS AN INTERESTING PLACE, THE REST OF THE
WORLD THINKS SO, EVEN IF CANADIANS DON'T.

~TERENCE M. GREEN

MARKET UPDATE

After several quarters of positive stock market results, the world markets seemingly took a collective pause to review exactly what was going on in the second quarter. The end result is that markets gave back much of their year-to-date gains in the second quarter despite, reasonably good economic news through out the period. Job creation remained strong in both the US and in Canada through out April and May and with inflation on the rise, due primarily to increasing oil prices, the US Fed saw fit to increase interest rates and the Bank of Canada may follow suit when they next meet in July. Markets have been rather jumpy with the pending increases in interest rates but there are those who feel the central banks have little choice but to tighten today's extraordinary loose monetary policy. The trick of course is to do this without derauling the economy. Why all the concern? As we have discussed before, the world's economies face several risks in the face of continued low interest rates

not the least of which, is the world's residential real estate market bubble. Low interest rates drive ever increasing demand for housing which of course results in higher and higher housing prices. The risk of course is that if inflation takes off unabated, the central banks will increase interest rates to stem inflation. Since the vast majority of North American homeowners are in short term mortgages, their mortgage costs will increase substantially, which at the very least, means they will be spending less. As we know, consumer spending is what makes an economy go and a reduction in consumer spending generally means a slower economy, which in turn results in flat or falling stock markets. Over the summer period, the markets are expected to remain flat, and into September. The upcoming presidential election could impact the U.S. markets as we come closer to the November poll date.

BOX SCORES

GIC Interest Rates**2004 (%)

| | April | May | June |
|-----|-------|------|------|
| 1YR | 0.93 | 1.08 | 1.28 |
| 3YR | 2.13 | 2.28 | 2.63 |
| 5YR | 2.88 | 3.13 | 3.38 |

Annualized Rates of Return to June 30, 2004 (%)

| All Cdn\$ | 1YR | 2YR | 3YR |
|-----------|-------|-------|-------|
| TSX | 24.48 | 5.24 | 5.73 |
| S&P 500 | 12.79 | -4.72 | -4.02 |
| SCMU Bond | 3.29 | 7.81 | 6.71 |
| *EAFE | 31.39 | 0.02 | -1.46 |

*Europe, Australia & Far East Index

**source: Bank of Canada web site.

MERGER UPDATES

Berkshire Securities Inc. / TWC Securities Inc. Merger:

Happily, the conversion from TWC to Berkshire went off with out a hitch on April 18 2004 and everyone will have now received at least a couple of statements from Berkshire Securities Inc. We have been impressed with the new format of the statements and we hope you are too. A couple of notes to be aware of;

1. Berkshire does not produce monthly unless there is a transaction in your account. An interest payment does not constitute a transaction.
2. On your RRSP statements you will find your book value listed separately by asset class as opposed to by specific holding.
3. Historical book value information for your RRSP is carried over from TWC.
4. TD Trust continues to be the trustee and administrator of your holdings.
5. You may now get view only access to your account on line (where you will be able to see book value per security). If you would like this access please feel free to call/email Kelly at 604 484 4558/kriggs@berkshire.ca and she will get you set up.

Lastly and most importantly the Investment Dealers Association (IDA, the industry regulator) has asked that Berkshire have all new Know Your Client (KYC) forms for all former TWC clients. To this end, as we meet we will be asking you to sign a new update of your investment objectives, risk tolerance levels and asset base- which again, is a good thing as it provides us with valuable information about your current circumstances. In some cases we will send this form to you for your signature completely filled out for you in advance. If you receive a New Account Application Form (NAAF) in the mail please read through it for accuracy then simply sign it where we have high-lighted it and

return it to us in the enclosed addressed envelope.

Great West Life (GWL) / Canada Life Merger:

In July 2003 the GWL acquisition of Canada Life was finalized and the integration of the organizations continues. In October 2004 Group Retirement Plans currently administered on Canada Life's VIP system will begin to convert to the Group Pension Administration System (GPAS). GWL anticipates this transition will be completed in early 2005. If similar conversions are any indication we expect that smaller simpler plans will convert first so that any "bugs in the system" can be corrected before larger more complex plans are converted over. At this point we do not have final conversion dates but we do expect to have some idea of the schedule before the summer is out.

A recent GWL communication made the following comment,

"During the conversion, it will be necessary to transfer the assets in the Canada Life segregated funds to London Life segregated funds. We will create the London Life segregated funds using the current fund managers and maintain the same goals and objectives. In a very limited number of situations, we are unable to accommodate certain funds particular to unique clients. In these situations, sponsors... can choose from our extensive list of fund managers to find appropriate alternatives. We'd be pleased to review any specific situations with you and can assist with any required adjustments."

At this point we do not know for sure if any of our Group RRSP/ Pension clients are affected by this but we do not believe this will be an issue for our existing Canada Life Clients.

Canada Life plan sponsors will begin to receive information concerning the conversion in the weeks ahead and as always if you have questions or comments as we go through this change over please feel free to call us.

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OCTOBER 2004



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CASE STUDY

In preparing to write this newsletter I came across an early edition of this correspondence (known then as RRIF RAP) wherein we were reviewing the economic and stock market performance of 1992, and I quote; "the year 1992 was not a banner year economically. Canada continued to battle a sluggish, albeit growing, economy and the financial markets reflected some of the battle scars." Sound familiar? The TSE 300 index closed that year at 3350, down 4%. This got me thinking about the long term rates of return and the value of an articulated asset mix strategy and whether or not "tinkering" helps or hurts long term performance. I thought I could probably find two real life examples to compare and report on. The result follows:

Let's start with Fred. As it happens, I met Fred in 1992, and at that point he was 55 years old, looking to retire at 60 or so. He had accumulated approximately \$250,000 through his group plan at work and his individual savings. Shortly after I met Fred he accepted a package that provided for a retiring allowance of around \$20,000 and he topped up his RRSP to the tune of about \$17,500. So in nutshell when we began to consolidate all of his holdings we started with about \$287,000.

When we prepared our plan for Fred we suggested an asset allocation of 50% fixed income (GICs, bonds, mortgages, etc) and 50% equities (stock mutual funds). To that end we established the following portfolio as of September 1992:

| | |
|------------------------|-----------------------|
| \$20,000 | Trimark Sel Grwth Fnd |
| \$20,000 | Templeton Emerg Mkts |
| \$20,000 | Templeton Growth Fnd |
| \$50,000 | 3 Year GIC @ 7.825% |
| \$50,000 | 5 Year GIC @ 8.25% |
| \$25,000 | GWL Mortgage Fnd |
| \$25,000 | Everett (TD) Mrtg Fnd |
| <u>\$82,000</u> | GWL Equity Index Fnd |
| \$292,000 Total | |

The account remained virtually untouched, (other than when we sold off \$50,000 of the GWL Equity Index to keep the fixed income portion of the portfolio at the 50% mark), until December 1997 at which time Fred established a RRIF to commence monthly income payments of \$800 in 1998. We converted \$388,899. Again the account remained essentially untouched - other than the GICs matured and we reinvested them into a US dollar denominated mortgage pool- until August 1999 at which point you may recall we became an IDA regulated firm under the name of Altara Securities.

The IDA did not allow us to have insurance company products and securities products in the same account therefore we were forced to sell the GWL Equity Index. The timing of this change was particularly of note because as you may recall the world's stock markets were on a relentless upward move not seen since the 1920's.

"This Time It's Different", "Why Stocks Will Continue To Go

Higher" the headlines screamed. The pressure to get into tech was enormous, but as you all know, we limited our clients' exposure to tech to no more than 10% in the vast majority of cases. In this situation we purchased \$20,000 (which was about 4% of total portfolio) of the Trimark Discovery fund, \$20,000 Trimark RSP Growth and \$22,000 Ivy Canadian, to replace the Equity Index. The one move we have made since is to sell off the tech fund, in hind sight, an ill conceived choice in the first place.

Fast forward to September 2004, Fred has about \$420,000 in his RRIF after making almost \$110,000 in withdrawals over the last 6 years. While actual rate of return calculations are very difficult Fred has earned approximately 5.88% compound annual rate of return since 1992. The TSX has generated a rate of return of approximately 8.4% per year in that same time frame. Fred is delighted with his long term return and clearly he benefited from staying the course in tough times when other "investors" were running for the exits! By the way, Fred's Trimark Select Growth fund is worth \$50,500 today; his Ivy Canadian is worth \$37,500.

In our next edition we will review a client that started with essentially the same portfolio at the same time, and the same investment objectives, but traded on market emotion and short term "noise". It will make for an interesting read!

THE BOTTOM LINE

THE INCOMPETENT OR THE INCOHERENT.....?

COVER OF THE ECONOMIST OCTOBER, 30, 2004

ON VOTER CHOICE IN THE U.S. ELECTION

BOX SCORES

GIC Interest Rates 2004 (%)**

| | Aug | Sept | Oct |
|-----|------|------|------|
| 1YR | 0.98 | 1.23 | 1.38 |
| 3YR | 2.28 | 2.23 | 2.43 |
| 5YR | 3.03 | 2.88 | 3.03 |

Annualized Rates of Return to October 31, 2004 (%)

| All Cdn\$ | 1YR | 2YR | 3YR |
|-----------|------|------|------|
| TSX | 18.9 | 10.2 | 6.2 |
| S&P 500 | 6.4 | -3.5 | -4.3 |
| SCMU Bond | 4.8 | 7.2 | 7.3 |
| *EAFE | 14.1 | 1.3 | -3.8 |

*Europe, Australia & Far East Index

**source: Bank of Canada web site.

MARKET UPDATE

Well, here we are again, three quarters through the year and nothing much has changed since the beginning of the year. Iraq is still a mess, the Liberals are still in power, the stock markets are flat and George Bush is still the President. Generally the economy is moving along well both here in Canada and around the world. In fact, some forecasters expect the world GDP growth to rise by a scorching 5% in 2004. That would be the fastest world growth rate in 50 years. China is HOT, HOT, HOT. Even Japan has perked up finishing the second quarter with a year over year GDP growth rate in excess of 4% for the first time in 10 years!

But the big story of 2004 is the strength of the Canadian dollar vis-à-vis the US. Of course, with Bush spending money like "he's going to the chair" and the relentless trade deficit with China one would have expected the US dollar to flag a bit. However when you throw in oil at \$50 plus a barrel then the CDN dollar looks pretty attractive for a change. So what does all this mean? Are we on the verge of a long term growth spurt in the world that will result in stronger stock markets for years to come? Not likely.

What can we expect to see happen? There are some identifiable trends that can give us some hints as to where things are heading. One of the most interesting notes is related to expectations. A recent poll of homeowners in several different cities around the world conducted by the Economist magazine indicated that homeowners expected their house values to increase at

annual rates of between 12% and 14% for the next twelve years! Similar expectations are indicated for stock markets. These are simply unsustainable growth rates in a world that is growing at 4% per year with interest rates at their lowest points in 50 years. History shows us time and again when expectations are in the stratosphere things tend to go the other way.

Here is our take on the state of the nation: We expect to see the Toronto stock market to trade in a range between say 8,000 and 10,000 for the next several years and we anticipate that we would see similar patterns in stock markets around the world. Contrary to all the media attention given to China we do not expect the Chinese to take over the world as we know it. We do not expect China to consume all the world's natural resources and we do not expect the Chinese economy to overtake the rest of the world in the next decade. We do expect the US dollar to drop as a result of the trade deficit with China, we do not expect the CDN dollar to reach par in the next two years. We do expect that stock markets will generate nominal rates of return of between 5-7% per year over the next ten years. We do not expect interest rates to climb substantially in the next two years, and ergo we do not expect inflation to rise much beyond the 2% range. So in a nutshell we expect that a balanced portfolio with 50% stocks and 50% fixed income to generate a long term rate of return of about 5.5%. All in all, pretty consistent with what has happened over the last ten years.

CONGRATULATIONS

Please join me in congratulating Kelly on her recent nuptials! Kelly and John Steiger were married October 2, at the Flying U Guest Ranch in 70 Mile House.

Kelly's new last name brings with it a new email address, which is ksteiger@berkshire.ca, all other contact information is the same.

We wish Kelly and John a long and happy life together!

GWL / CANADA LIFE CONVERSION

If your group RRSP / Pension Plan is with Canada Life, your plan will be converted to the Great West Life administrative platform over the course of the next few months. Once your plan has converted, you will need to get a new PIN number in order to access your account information on-line. Otherwise all other aspects of the plan will remain essentially the same.