

THE BOTTOM LINE

JUNE 30 2005

UPDATE

Well another year has past and remarkably we are very near the midway point of the decade. As a kid I would envision that we would all be soaring around in little Jetsonsque flying cars, with robots to take care of our every whim, at this point. I wonder if my parents who would have been my age now, back then, entertained the same notions. In a nutshell, was that vision a child's naivety or society's?

In any case 2004 was a pretty good year all in, at least from an investors point of view. Modest gains were to be had from virtually all asset classes and geographic regions, making it two positive years in a row.

As we look ahead we expect to see more of the same. Interest rates in the US should continue to rise, housing prices continue to be at risk, trade deficits in the US continue to rise and the US dollar continues its downward trend against the Euro and the Yen. We foresee a slowing of profit growth in the next year to 18 months in North America although growth just the same. How this all translates into investment returns we don't know. To have three positive years of stock market growth in a row is historically much more common than three losing years; however we feel there are still significant risks in the economy such that we wouldn't be surprised to see a flat year of returns this year.

CASE STUDY

In our last issue we introduced you to Fred and his "investor psychology" and how things had gone for him over the last 12-14 years. We now wish to review the story of Harvey whom we met at approximately the same time as Fred and who had about the same initial investor objectives. Here then is the story of Harvey.

I first met Harvey in late 1993. He was 62 and just in the throes of leaving a long term job. He was expecting a significant severance package and had accumulated about \$500,000 in his Group Plan at work. Again since we were dealing with someone at or near retirement we suggested a very conservative asset allocation of about 60% fixed income and 40% stocks. Here are the highlights. After consolidating things we established the following portfolio in late 1993:

\$ 30,000	1 Year GIC@ 4.00%
\$ 30,000	2 Year GIC@ 4.625%
\$ 30,000	3 Year GIC@ 5.75%
\$ 30,000	4 Year GIC@ 6.00%
\$ 30,000	5 Year GIC@ 6.25%
\$150,000	GWL Mortgage Fund
\$ 25,000	Trimark Sel Grwth Fund
\$110,000	Trimark Sel CDN Fund
\$ 40,000	Templeton Emerg Mkts
<u>\$25,000</u>	Templeton Grwth Fund
\$500,000	

In early 1994 Harvey received a retiring allowance to the tune of \$100,000 into his RRSP (under the old retiring allowance to RRSP rules) which we allocated to the existing funds. By the end of the first quarter Harvey had about \$615,000 in his RRSP plan with a purchase value of about \$600,000. Harvey also had a penchant for trading venture capital stocks and began his first foray into this in June of 1994 when he purchased a small IPO for about \$50,000. Things progressed well for this particular purchase throughout the balance of the year. In the meantime the mortgage fund was not doing well since interest rates were rising and Harvey decide to sell the amount in excess of \$100,000, or about \$80,000 and we recommended that he invest the proceeds into the Trimark RSP equity fund. The remaining \$100,000 was switched into a money market fund at GWL. In early 1995 we sold out of the GWL MMF and used the proceeds to purchase a strip bond with a 7% yield to maturity - perfect timing for that one! So at the end of 1994 with all toing and froing Harvey finished the year with a balance of about \$775,000.

In early 1995 we purchased a US denominated Mortgage pool and a short term note to the tune of about \$80,000 with the proceeds from the sale of a portion the strip bond. Harvey finished the year with an account balance of about \$717,000 - losses primarily due to the venture capital stock falling in price from around \$5.00 per share in early 1995 to \$1.00 by the end of the year.

In early 1996 with the proceeds from maturing GICs we purchased about Ivy Canadian Fund and United Canadian Growth fund for \$15,000 each and also purchased \$22,000 of an Ontario strip bond due in Feb 2004 with a 7.33% yield. Harvey also transferred his venture stock out in kind to another issuer. At this point that investment was worth about \$25,000. At the end of 1996 the account was worth \$730,000.

Throughout the course of 1997 there was very little action such that by the end of December this account was worth just less than \$800,000. In late '97 the short term note paid out we purchased the stock of a well known Canadian utility with the proceeds for \$32.00 per share. By the middle of 1998 we were at \$825,000 even though the Emerging Market Fund had been hit hard. In July of 1998 we suggested that Harvey sell off \$100,000 of the Trimark RSP Equity fund and rebalance that cash to a strip bond given that the fund had performed very well since we purchased it 1993 and was worth about \$282,000 (up from a purchase price of \$190,000) at the end of June 1998. Sadly, Harvey did not act then, but chose to sell off \$185,000 worth of equities when the market fell later that year. The TSE fell from 7383 to 5401 between July 1 and October 5, 1998. Harvey sold off on October 8, 1998. That was exactly the lowest point in the cycle; hence the worst time to sell off and by the same time

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CLIENT STORY CONT

the next year the TSE was back up to 7116. Harvey's account finished 1998 at \$710,000. At this point the account held Nova Corp, TransCanada pipelines, \$22,000 worth of Ivy Canadian and \$207,000 of Trimark RSP Equity the rest of the account was in Money Market funds, GICs and bonds for an asset mix of 70% fixed income and just 30% in equities. A significant departure from our goal of 60/40.

We met in early 1999 to devise a strategy to buy back into the market on weakness, meaning when markets were lower than they were that day, which does seem a bit ironic doesn't it? Willing to sell low and at the same time wanting to buy low. Somewhat unbelievably we were instructed to sell a further \$120,000 of the Trimark RSP Equity fund and purchase foreign investments including a Japanese fund and an International equity fund. All the while on non-registered side of the equation we had been trading several different small cap/venture stocks with varying degrees of success.

By the spring of 1998 we had sold out of \$60,000 worth of the MMFs and re-allocated the funds to an income trust – one of the early business based trusts offered on the TSE. We also sold another \$10,000 of the Trimark RSP fund to pay out to Harvey as income. In mid year we bought back into the Templeton Growth fund with MM funds and purchased another \$30,000 of an income trust and \$30,000 worth of a tech fund. We also paid out second \$10,000 withdrawal from the proceeds of a further MMF sale.

In July of 1999 the account had rebounded back to \$760,000. We converted to the TD system in late 1999 and when everything finally was allocated to his account in January 2000 Harvey had an account balance \$770,000. The summary transfer statement issued by the previous trustee listed 96 separate transactions in that account from January 1st to Dec 15, 1999, including interest and dividend payments. The portfolio was now 65% invested in stocks and 35% invested in fixed income. Pretty much the exact opposite of our initial target. At this point, I wish to make a confession. Harvey was one of my top ten clients in terms of assets and as a result I would try to meet his demands to make him happy although that is not what the outcome has been. By March of 2000 the US mortgage pool was distributing capital repayments to investors and we received a \$70,000 capital repayment from that in addition to the proceeds of the sale of one the income trusts to a third party purchaser. This created an influx of cash to the

tune of about \$135,000 which really should have been reallocated entirely to the fixed income side but as you recall interest rates were pretty low then and of course the world was going crazy with the tech boom and the dot com mania that had gripped the world.

We did manage to get \$90,000 or so back into bonds, however Harvey, always looking for higher returns without necessarily accounting for the higher level of risk that comes with higher expected returns, instructed us to purchase further Japanese funds and more tech funds as well as an international clone fund. On August 31, 2000 the account was worth over \$830,000.

In October of 2000 we converted Harvey's RRSP into a RRIF and began to pay him the minimum amount on a quarterly basis which worked out to be around \$10,000 a quarter. We also took the opportunity to purchase Nortel after the first wave of bad news for that stock in the \$70 range. We converted \$807,000. On December 31, 2000 after the freefall in stock markets began this account closed the year at \$785,000. Harvey finished the year 70% in stocks. By March 2001 it was down to \$730,000, in June the account closed at just over \$700,000. In 2001 there were another 60 plus transactions again including interest and dividend payments, and finished the year at about \$700,000 even. By the end of 2002 the account was worth \$625,000 although over the course of the year we were able to rebalance the account to 50/50 fixed income to equities asset mix. Again we had an incredible number of trades and transactions something in the area of about 55. So by now it is probably apparent where this going and it is plain to see that all the tinkering and second guessing added nothing to the return and arguably took something away. In any case, the account as of December 31 2004 is worth \$583,000. Using the same rate of return process we did for Fred, Harvey's account has earned an annual compound rate of return of approximately 3.24% over the last 10 years. He started with approximately \$600,000, withdrew about \$265,000 over the ten years and finishes with \$583,000. Interestingly, today there is nothing in this account we had when we started.

So there you have it. Fred and Harvey. One is happy, the other, not so much.

BOX SCORES

GIC Interest Rates 2005 (%)

	April	May	June
1YR	1.48	1.48	1.28
3YR	2.23	2.23	1.93
5YR	2.78	2.78	2.48

Annualized Rates of Return 2005
June 30 2005(%)**

All Cdn\$	1YR	3YR	5YR
TSX	18.0	13.6	1.1
S&P 500	-2.3	0.8	-6.0
SCMU Bond	12.0	8.8	8.3
*EAFE	4.4	4.3	-4.3

* Europe, Australia & Far East Index

**source: Great West Life.



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State of the Union 2004

Unbelievably we are staring the midway mark of the new millennium's first decade square in the face while it seems like just yesterday we were all going to, in the words of the artist known as Prince, "party like its 1999".

In 2004 we saw huge change and no change at all. In the US the electorate saw fit to reinstate a regime characterized by fear mongering, protectionism, and the systematic reduction of civil rights by re-electing the neo-con, Bush led, Republicans to a second term. Did you know that in the 30 years that Saddam Hussein ruled in Iraq he reportedly killed 300,000 civilians? Did you also know that in the 18 months Bush has ruled Iraq that 110,000 civilians have been killed. Tell me again, who exactly is the tyrant?

In Canada, we too, went to the polls and while the outcome was the same, Ontario once again elected the Liberals, although the Prime Minister is new. Paul Martin becomes our new leader after years of toiling in the shadow of his hated rival Jean Chrétien (whose legacy by the way, will be refusing to participate in Iraqi war - and I can't believe I'm saying this – rightly so).

A curious observation about the fundamental difference between Canadians and Americans for those of you looking for such things. In the US, Bush is revered for his religious beliefs and no reporters ask him (or if they do there is no evidence of it in the media) if he believes in Adam and Eve and creationism and yet in Canada, a man with essentially the same ethos is soundly beat up in the press as being a zealot and consequently his political career has come to an end. Peculiar isn't it?

From an economic perspective we saw very robust growth throughout the world due in large part to the inimitable US consumer whose unrelenting spending is what legends are made of. Depending on the method you choose to calculate world GDP growth, it comes in between 4.1% and 5%. Very impressive in either case. In Canada we had a somewhat subdued but sustainable 2.9% growth level which was lower due to the strength of the Canadian dollar. Canada's slower growth notwithstanding, the TSX stock market index was among the top performers in the G8, growing by a solid 13% in 2004. Upon closer inspection however, we can see the index was driven upwards by

resource based companies in response to the general increase in resource prices over the year, most notably oil prices.

In other stock markets we saw the Dow Jones Average up 3.2% year over year, Britain up 7.2% and Japan showing a solid GDP growth in the 3.9% range and the Nikkei Index gaining 7% in response to the solid growth numbers. That makes two pretty good years in a row, will 2005 make it three? Don't count on it!*

From a local perspective BC's economy was humming along in fine fashion for the first time in a decade. Premier Gordon's plan to eliminate the deficit and encourage business investment seems to be working, just in time too, given that he has to call an election in the next year. In my travels I can say that the optimism and positive expectations about the prospects for BC are at the highest level I've seen since the mid 80's. This is good news for all of us, I'd say.

In the world of sports we saw the Tampa Bay Lightning win the Stanley Cup and both fans really got into it. Will that be the last Cup? With the NHL in the midst of a very serious labour dispute it is possible we won't see professional hockey for a year or two yet. So let's get this straight, the NHL is going to let a season or two go by the wayside so that teams in hockey hotbeds like Tennessee, Florida, Carolina, Ohio and Arizona can make a go of it? Does the NHL really think the 5,000 fans that went to the Carolina games in 2003/2004 will remember the rules when the NHL starts up again or more importantly, will they care? I think the NHL, with their non-existent US TV contract, should transfer all the Sun Belt teams to Canadian cities such as Halifax, Quebec City, Regina/Saskatoon, Winnipeg and Hamilton and set up an US division and a Canadian division and go from there.

Since there is no NHL hockey the diehard fan has had his eyes glued to the World Junior Tourney, as I do. As I write this, Canada has just defeated the Russians 6-1 to take the gold medal for the first time since 1997. I think it's safe to say that the junior team Canada iced was the best ever. They simply crushed their opponents in all manner of speaking. The Canadians outscored their opponents 41-7 in the 6 games. WOW! Good work Lads!

The Boston Red Sox have to be the heartwarming story of the year. After shaking off nearly 100 years of ineptitude the Bosox finally defied the curse of the Bambino to win the World Series. Best of all, was the comeback victory against the New York (can you say chokers) Yankees. The new England Patriots once again took the Super Bowl and in the "well isn't that a nice change of pace" category, Vijay Singh took Golfer of the Year honours and the Number 1 ranking away from Tiger Woods after his five year reign as King of the course

Down the coast in LA, the Oscar for Best Actress went to Charlize Theron for her role in the underrated movie Monster, while Best Actor went to Sean Penn for his portrayal of Jimmy Markum in Clint Eastwood's Mystic River. Best Picture

went to Lord of the Rings: Return of the King the final segment of the mega trilogy.

As with any year there were those that left us and in many cases left the world a lesser place than when they were with us. Pierre Berton, Ronald Reagan, Canadian golf legend Moe Norman, Superman Chris Reeve, King Kong's love interest Fay Wray, the Tonight Show's Jack Parr, Marlon Brando and Bob (Captain Kangaroo) Keeshan and Law and Order's Jerry Orbach, Ray Charles and Tony Randall, of The Odd Couple fame all moved on in 2004. As did one of history's more notorious characters Yasser Arafat, long time leader of the Palestines, died at the age of 75 leaving the Middle East in a worse condition than when he started, if one could believe that it could get worse.

Amongst the war and terrorism and other follies of man, Mother Nature rarely plays second fiddle with her wrath and so it was this year. As we were shopping for Boxing Day bargains, an earthquake in the Indian Ocean sent a Tsunami through the region not seen in many years. At this moment the death toll sits at more than 150,000 and is still climbing. Say a prayer for those who have lost their families and loved ones in this tragic example of the fury of nature.

The year 2004 saw another name change for us on our securities side and we are now operating under the Berkshire Securities banner for this part of our business. We view this change as a very positive development for us as we are now able to utilize more sophisticated technology, generally a better support system and access to a wider range of products.

As a general comment, we are very pleased with our client portfolios both from a performance and a composition point of view and we hope you are too. As always, if you have any questions about any aspect of your account or financial/retirement planning in general, please feel free to call us.

Note that for RRSP contributions in respect of the 2004 tax year this year's limit has been increased to 18% of your 2003 income to maximum of \$15,500 (less your PA, if any). The last day to make a contribution in respect 2004 is March 1, 2005.

Mark Richards CFP, will celebrate his fifth year anniversary with us on March 1st-where does the time go? -and he has done a terrific job rebalancing client portfolios over the past few years to get everyone's account the way we want to look for the next number of years. Mark is dedicated to his craft and is completing his Certified Investment Manager (CIM) designation as we speak, a highly recognized industry designation. While not a service available through Berkshire, this designation qualifies individuals to manage discretionary funds. Congrats Mark! He is also taking his MBA through Dalhousie University and expects to complete that program in the next 18 months or so. Mark is always

available to take your calls and we encourage you utilize his expertise in the event you are unable to reach me when you call.

For her part, Kelly will have been with us for two years on January 22 and Kelly has battled the ghost of Ann very effectively. I thank her for persevering through a somewhat tough transition for all of us. Kelly continues to take courses to assist her in helping you and she will be completing her Canadian Securities Course in the first quarter of this year. A significant milestone for anyone! In the course of time Kelly hopes to move into an advisor role and we will certainly try to accommodate her in achieving that goal.

We sincerely thank you for your business and we recognize you have trusted us with your hopes and dreams, a responsibility we take very seriously.

Please have a safe, healthy and prosperous New Year.

Yours truly,

Christopher M. Forman CEBS

** Source: the Economist-online edition December 28, 2004*

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