Quarterly Exchange

Q3 2012

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Through the *Quarterly Exchange*, we'll keep you up-to-date on current investment trends and strategies. We are committed to working one to one with you to help you achieve your financial goals. Please contact us if you have any questions or wish to discuss any of the articles in this newsletter.

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Muddy Waters

Avery Shenfeld, Chief Economist, CIBC World Markets

The outlook for Canada would be crystal clear, if not for the muddy waters running elsewhere. Emerging markets are growing at a much slower pace. More troubling, much of Europe is in recession, and questions still swirl surrounding sovereign debt and bank stability. The US, for its part, has improving fundamentals, but whatever clarity those bring to the 2012 outlook vanishes as one looks out into the uncertain fiscal policy regime for 2013.

That leaves Canada's fate tied to policymakers doing what's needed to turn the global ship around. In China, Beijing is on the job, easing the monetary and fiscal policies that squeezed 2012 growth to less than 8%. Elsewhere, however, doubts remain.

Europe isn't without options. A gentler path towards lower deficits would ease the drag on growth, and bond purchases by the European Central Bank could keep financing costs for weaker economies low enough to make fiscal progress. The banking system will in some cases need government equity to shore up the capital needed to permit lending growth. Should these decisions fall into place as we expect, Europe would return to growth come 2013, and equities would gain relief from current fears of a financial collapse. But there still are some big "ifs" in that outlook.

The US is seeing support for consumers from low rates, and home building has passed its lows, pointing to roughly 2.5% GDP growth this year. But Washington needs to soften the huge dose of tax hikes and spending cuts currently slated to hit the economy come 2013. Even then, the swing to fiscal tightening could dampen growth a bit in 2013, keeping the US Fed on hold at near zero interest rates until 2014.

With Canada closer to full employment, a modest dose of rate hikes by the Bank of Canada can't be as easily ruled out. But if there's any tightening here, it will be held in check by several factors. Canadians seem to be suffering from borrowing fatigue, which will keep consumer spending moderate, exports will feel the pinch of slower overseas conditions, and real government spending will retreat due to federal/provincial belt tightening. Growth should still run in a respectable 2.0-2.5% range through 2013, but gains in equity markets, particularly for cyclical industries, will need public policy steps abroad to clear up the muddiness of the global environment.

The Case For
Perpetual Preferred Shares

Jason Castelli, CFA, Investment Strategy Group

Perpetual preferred shares are the most interest rate-sensitive preferred shares. With interest rates likely only to move higher from their current near-record lows, investors may instinctively avoid this class of preferreds in favour of ones that will be less impacted by rising yields. However, depending upon how quickly you expect interest rates to rise, straight perpetuals may still have a place within your portfolio.

In its simplest form, investing requires making decisions between competing securities and asset classes. As an investor, you work with your Investment Advisor to assess the potential return and risks associated with each investment. If you are considering an investment in straight perpetual preferred shares versus comparable fixed income products, there is a yield advantage in holding preferreds. But is the higher yield enough to offset the risks associated with a potential rise in interest rates down the road?

The main drawback of straight perpetuals is that there is no fixed date at which one's principal is returned, as the investor is lending money to an issuer in perpetuity and the call feature resides with the issuer. This long time horizon makes the price of these securities particularly sensitive to interest rate fluctuations.

With interest rates at what appears to be a floor, one may instinctively want to limit exposure to highly interest rate-sensitive securities (if interest rates are more likely to move higher than lower over the next few years, interest rate-sensitive securities are more likely to fall in price). While this is true, the yield advantage offered by straight perpetual preferreds may provide a sufficient cushion for modest increases in rates.

Consider this simple example: The average current yield on a non-cumulative straight preferred share is 5.06% (interest-equivalent yield of 6.73% assuming a 1.33 interest equivalent factor). Comparable Government of Canada fixed-income products yield 1.94%. Assuming that an investor holds each security for only 10 years, does not reinvest dividends, and the face value does not change over the period, the cumulative interest-equivalent return on the preferred share is 67% while the Government of Canada bond earns 19%. Said another way, the preferred share could fall 48% in value before the total return would be equivalent to purchasing a ten-year Government of Canada bond. Is a 48% drop realistic? It certainly can not be ruled out. If inflation starts to rise faster than expected, it could cause the price of the highly sensitive perpetual preferreds to drop significantly. However, if rates stay low for longer than economists expect (as we have seen over the past several years), investors could benefit from the higher yielding product.

According to CIBC Economics, the Government of Canada ten-year yield is only expected to rise by 49 bps by September 2013. Moreover, central banks appear committed to keeping interest rates low for the foreseeable future. The U.S. Federal Reserve, for example, has indicated its benchmark interest rate will likely remain near zero through 2014. This could leave investors with time to reassess the interest rate environment and to move out of the perpetuals should inflation and interest rates start to percolate.

Do You Know What Investment Return You Need **To Retire Successfully?**

Nearly half of Canadians don't know what rate of return they require on their investments to achieve their retirement goals, according to a recent poll.

Key findings of the poll include:

- **45 percent** of all Canadians say they do not know the annual rate of return they need from their investments to meet their retirement goals
- In choosing investment products **57 percent** said they are most interested in low risk, guaranteed or no-risk (i.e., leave in cash) investment options

Recent CIBC polling found that **31 percent** of Canadians aged 55-64 and **47 percent** of Canadians aged 45-54, say they do not feel financially prepared for retirement.

While nearly half of Canadians responded that they did not know what rate of return they require on their investments to ensure they are financially prepared for their retirement, most are looking at investing in products that generate little in the way of return – and in many cases less than the rate of inflation. The poll found:

- Over half of Canadians **(57 percent)** indicated they were most interested in low risk, guaranteed and no-risk investment options
  - **29 percent** are most interested in low risk products
  - **16 percent** are most interested in guaranteed products
  - **12 percent** are most interested in no-risk products
- **29 percent** were most interested in medium risk investment products, like fixed income and balanced mutual funds
- **7 percent** are most interested in higher risk products

This type of investment approach is actually putting Canadians further out of touch with their retirement goals. It is critical for you to understand and manage to market volatility. As your Investment Advisor, I can help you to review what is in your portfolio and look at new types of investment solutions, carefully constructed to give you an advantage in the volatility that is the new market reality.

If at any time you have questions or concerns regarding your retirement savings, we encourage you to contact us and we'll discuss your personal situation.

The Benefits Of RESPs

The cost of post-secondary education is rising. According to the Scholarship Consultants Of North America, the estimated cost for four years of university, including books, tuition and living expenses by 2017 is $96,831. That's why it's never too early to start saving for your children's education through a Registered Education Savings Plan (RESP). An RESP is a tax-deferred investment that allows you to contribute a lifetime maximum of $50,000 per beneficiary to fund your child's education. In addition, the government may pay a Canada Education Savings Grant (CESG) of up to a lifetime limit of $7,200 per child.

When the money is withdrawn once your child attends a qualifying post-secondary education program, the funds are then taxed at their, usually lower, marginal tax bracket. An additional RESP benefit? You retain ownership of the RESP and you, not your children, have complete discretion over the funds.

Because not all families are alike, there is a great deal of flexibility when choosing an RESP. There are single plans for one child, or family plans, where all your children's RESPs are pooled together. There is a wide range of investment choices, from mutual funds to individual securities. And an RESP can be held for up to 35 years, regardless of your child's age - giving him or her time after high school to pursue other interests, if school is not an immediate priority.

Should your child decide not to attend university or college, there are a few options you may explore, including rolling the RESP into that of a sibling or topping up your RRSP (up to $50,000 in accumulated income as long as there is contribution room in the RRSP and the RESP is at least 10 years old). You may also withdraw your contributions from the RESP before your child attends a post-secondary program, however, you will be subject to a clawback of all CESG payments. Therefore, it's important to review your options carefully.

Contact the office to discuss how an RESP can help secure your children's future.

Changes To Old Age Security

This year's federal budget contained some sweeping changes to Old Age Security that may affect you. To obtain a copy of CIBC tax expert Jamie Golombek's analysis, contact our office.