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Financial Services

Sound Advice

Rod Tyler, CFP, R.F.P. , CLU

Captain Kirk versus Mr. Spock

By Rod Tyler, CFP, R. F. P. , CLU

One of my passions is that I enjoy science fiction, especially in movie form. My guess is that most of you at one time or another watched the long-running television series Star Trek. Whether it was the original version, starring William Shatner as Captain Kirk and Leonard Nimoy as the Vulcan, Mr. Spock, or one of the subsequent series, all of them have continued with the same theme. I'm not referring to the long running mission of the Starship Enterprise ***"to boldly go where no man has gone before"*** or the encounters with innumerable aliens. I'm referring to a very consistent theme that pervades all the episodes in the series, and is embodied by two opposing, yet mutually supportive qualities of human existence: emotion versus reason. As you may remember, whether it was Captain Kirk as the original Star Trek captain, and subsequently Captain Kathryn Janeway (Katherine Mulgrew), or Captain Jean-Luc Picard (Patrick Stewart), each character was placed in a position of making decisions based on emotion or reason. Each of the captains had as a crew member, a counterpoint character who embodied pure reason, whereas the captains were left to wrestle with their dual human natures. They were making decisions of great importance, often involving the survival of the ship and crew, while grappling with their emotions and simultaneously allowing reason to prevail. Captain Kirk had his opposite in ***the Vulcan named Mr. Spock***; Captain Kathryn Janeway's counterpart was the cyborg character, Seven of Nine as her voice of reason; and Captain Jean-Luc Picard had the android ***Lieutenant Commander Data*** as his rational colleague. In each case, the captain was required to continually balance the essence of humanity in making key decisions, a balance of emotion and reason. The resulting decisions usually ended with humanity prevailing.

So why, you may ask, am I writing about science fiction and the Star Trek franchise? I am doing so because these episodes contain a concept that also captures the essential qualities of successful investing.

Whether it is you as the investor, or whether it is a professional investment manager who is managing your money, you are both subject to these twin decision-making challenges. In both cases, you and the professional money manager face the same dilemma as every human being who seeks to accumulate and maintain wealth during their lifetime. Each person will constantly be buffeted by the power of emotion

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as different investment fads come and go. Both you and the money manager must resist the temptation to make investment decisions that may seem popular but will ultimately prove unwise. It is best if both of you think like Mr. Spock, Seven of Nine or Lieutenant Commander Data while feeling like an ordinary human being with all your emotions.

In a future article that I am planning, I'll help you understand why the pressure to act like everyone else is so powerful, and sometimes destructive, especially in the business of investment management.

Once again, why am I writing about emotion versus reason? What does science fiction have to do with your success as an investor? The answer is quite simple.

If you want to succeed as an investor, it is best to overcome the first emotional challenge: spending all your money and everything you earn. If you never save any of your money, then investing will not be a problem. You simply let your emotions rule – spend now and worry about the future later…much later. In the second instance, if you allow emotion to rule your behavior, you may sell your investments when you hear bad news and the price temporarily declines. Translation: Buy high, sell low. This is a recipe for failure. Conversely if you put emotion aside and you buy low and continue to buy and capture as much value as you can as long as it is available, you will ultimately prosper.

Reason over emotion. Value over price. That is what works in the world of successful investment. Finally, if you use an investment manager who chooses value over price, reason over emotion, you will likely prosper even further. If you would like to know more about how we choose investment managers who follow this method of investment selection, please call or email us. We will be pleased to share our thoughts and methodology with you.

In the end, you and I, like Captain Kirk, Captain Janeway and Captain Jean-Luc Picard, are captains of our own ships. We, as your advisors, together with investment managers who we choose for you, will act as Mr. Spock, Seven of Nine and Lieutenant Commander Data. Together we will go where few other mortals are likely to have gone on their own – successful long-term investing as you journey through life.

Bridghouse is once again accepting submissions for it's scholarship program.

The deadline for this year's selection is July 2, 2014. For more information about how to apply visit the Bridgehouse scholarship program website at **http://bridgehousescholarship.com**

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The 5 Basic Investment Commandments of Warren Buffett

By Rod Tyler, CFP, R. F. P. , CLU

Recently I was sharing with a friend about how excited I was that it would soon be the end of February. My friend thought I was relieved that spring was coming soon, or that the RRSP season would be over. I did say that I was looking forward to warmer temperatures, and I assured him that while I appreciated the sentiment, I don't pay much attention to that RRSP season idea anymore. Most of our clients either contribute early, or do so regularly throughout the year. Rather, it was because the end of February marks the date when Warren Buffett releases his annual Berkshire Hathaway shareholder letter, and that as soon as it is available on the Berkshire website, I am printing and reading it. I have just finished reading this years' letter and it contains, once again, a fabulous pearl of wisdom from the world's greatest investor. Reading this annual letter inspired me to share with you the five basic investment commandments as practiced by Warren Buffett.

1 Buy a great business.

I think one of the reasons Warren chose this as his number one commandment is because he once owned a really poor business. The legendary investment fund he has built was once a failing business. Berkshire Hathaway was once a manufacturer of textile goods. In the 1960's I wore dress shirts to my all-boys high school, most of which were emblazoned with that label, Berkshire Hathaway. The shirts were fine, but the business was not. Berkshire's business of selling textile goods was quickly becoming marginalized by cheaper imports from South East Asia. Warren tried for several years to fix up the business. Finally he realized he was fighting a losing battle. He sold the operational assets, retained the proceeds of the sale, and proceeded to invest the money in a number of great businesses. The rest, as they say, is history. You can see the results by the stock chart of Berkshire Hathaway, in the graph below.

2 Insist on a margin of safety.

This idea is a direct result of Warren's time spent working with his mentor, Columbia University professor, Benjamin Graham. It was through studying and working with Graham, author of two of the most widely read books on value investing, **Security Analysis** and **The Intelligent Investor**, that Warren's ideas of value investing were forged. Let me explain. When a value investor speaks about a margin of safety, he is really speaking about the price you pay for a share of ownership of a business. First you need to buy a great business, as noted in commandment number one. Bad businesses are just bad ideas, and usually bad investments. Also regardless of which business you are buying, you also need to pay the right price. If you over pay, you don't leave any room for error or a setback. A sufficiently low price provides that margin of safety. It is very difficult to make money on a good business if you over pay. That is why many of his investments over the years, seemed very boring and unlikely to prosper. It is also why they ultimately provided great investment results. **A low enough price paid on a great business, is the best bargain of all.**

3 Be patient.

This is a really simple idea, and a very hard thing to do. Warren has famously said that investing is a lot like being at bat in a baseball game, where there is no limit to the number of balls pitched that can be called balls. It means that you can stand at the investment plate, figuratively speaking, all day, waiting on the perfect pitch, the one right down the center of the plate that almost anybody can hit. That's when you swing, or in his case, that's when Warren buys his shares of great businesses. Then, once he owns the shares, he waits for the management of his company to begin delivering results. This requires patience. Often when he acquires a company it has some challenges. However, even if there are problems that need to be resolved, good management can accomplish good things given enough time for the results to surface. Warren always insists on good management. Besides, if you refer back to commandment number one, you already know it's a great company. It just needs time for results to improve.

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4 Avoid acting on emotion.

This has to be the toughest commandment of all. We are all human and we all have emotions. When something seems too good to be true, then it probably is best to avoid investing in that idea. That takes emotional courage. For example, when everybody else is doing something, such as investing in gold, then it takes courage to buy a railroad. That's exactly what Warren Buffet did at the height of a financial crisis in 2009. Today, that railroad, Burlington Northern, is gushing profits, including hauling a lot of oil from the Bakken oil field in North Dakota and Montana. Warren has often noted that he could give away 20 points of IQ and still be effective as an investor, but he would not give away any of his emotional temperament, sometimes known as EQ ,or emotional quotient. If you are really interested in the concept of how emotions can affect your financial decisions, you may want to read my other article in this issue **"Captain Kirk vs Mr. Spock"**.

5 Finally, own a concentrated portfolio.

Let me explain this by a simple example. If you have a closet full of clothes, chances are that you really only wear a few, your favorite outfits. Why? Well, probably because they fit you, look good, and are well made. But what about all those other bargains you picked up at a sidewalk sale, maybe because they seemed cheap at the time. Why are they still hanging there, virtually unworn? It's probably because they really aren't that fashionable anymore, don't fit you, etc. In other words, you'd be better off to clean out your closet, donate those unused articles of clothing, and go and buy a few great garments.

The same thing happens with the business of owning businesses. When a business owner or a portfolio manager over diversifies, he ultimately harms his own results. In portfolio management, it is not uncommon to see a portfolio of equity investments containing a hundred or more holdings. How can you possibly be aware of what is happening in that many businesses? The answer is; you can't. In that case, you and I are better off just buying an indexed fund, probably as an ETF or exchange-traded fund. You may not get exceptional results, but at least you will not be paying much for so-called management fees. On the other hand, don't you wish you had bought the shares of a great performing investment fund with a concentrated portfolio and excellent results? The exceptional results of Warren Buffett's investment record have been achieved owning a concentrated portfolio of a few great businesses.

If you would like to know more about how we use the wisdom of Warren Buffett's 5 Investment commandments in the portfolios we recommend to you, please call us. We're always happy to share this useful knowledge with you!

Al Kimber, BComm , CFP, R.F.P.

Tax Free Savings Accounts – Good or Bad?

By Al Kimber, BComm, CFP, R.F.P.

One of the questions I am often asked is,

"Are Tax Free Savings Accounts a good choice for investment?"

In order to answer that question, let's first look back to the introduction of the ***Tax Free Savings Account***, or ***TFSA***.

You may recall that in 2008 the government of Canada introduced a new savings vehicle called the ***Tax Free Savings Account***. The original idea for this account had been around for some time, but it wasn't until this legislation was announced in the federal budget of 2008 that it became a reality. In fact, because most financial institutions required more time to reprogram their accounting systems, the Tax Free Savings Account was not actually available to the public until January 2009. The reason this new type of account was created was based on the premise that if the public was prepared to save money for retirement, then it should not be penalized by having to include the earnings of these accounts each year on their tax return. Governments in Canada have known for some time that many Canadians are not saving enough for retirement and that the government would be called upon to increase public retirement payouts before too long. They could also foresee that the savings deficit would be followed by a retirement income deficit or crisis. This is the part of the story that is most logical and seems, generally, to be good policy. What you might not know is what is now called the Tax Free Savings Account was once originally dubbed the ***Tax Free Investment Account***.

Now for a bit of history. When Registered Retirement Savings Plans (RRSPs) were originally introduced in 1957, very few Canadians and very few financial institutions paid much attention to them. The original RRSP contribution was a mere $2,500 or 10% of income. It is now 18% of income up to a maximum contribution of $24,270 for 2014. That contribution limit will continue to rise according to an indexing formula. History shows that Canada's biggest financial institutions, the banks, largely ignored the RRSP market until very late in the last decade. Having had to play RRSP catch up has been a valuable lesson for Canadian banks. Therefore, this time, when a new investment choice was announced, the banks were ready and fully prepared. This new account ws originally called the Tax Free Investment account, but the Canadian Banking Association lobbied to have it changed. The name change to the Tax Free Savings Account may seem subtle, but it's been very effective. It sounds like the kind of account you can only get at a bank or credit union. This time around, instead of the banks losing all of these investments dollars to competing choices, such as mutual funds, the money has largely been placed in bank savings accounts.

One additional historical note will help you understand how successful these accounts have been for banks, if not so successful for the banks' customers. The first $5,000 contribution that was possible was on January 1st, 2009. Do you remember what was happening five years ago? The financial crisis was in full swing. The overwhelming portion of contributions that year and for several years after have gone into low interest rate savings accounts in the banks. This has been a ***bonanza for banks, if not for customers***.

Because savings deposits count as so called Tier 1 Capital, you might say the Canadian public was partially responsible for helping our Canadian banking system to not only weather the financial crisis, but to earn the world's respect as the safest place to invest. ***We Canadians are such helpful folks!***

Returning to my story about ***TFSAs***, as of this year, your overall contribution limit has increased to $31,000 ($5,000 each year from 2009 to 2012 which was then increased to $5,500 in 2013). If both spouses contribute, that represents $62,000. So far, so good. However, low interest rates have punished savers who are relying on traditional savings accounts and term deposits for investment income and growth. The graph below illustrates the difference between a 2% and a 6% rate of return over a 10 year period of tax-free savings and contributions. Can you see the difference? And that will only grow as the next 10 years go by.

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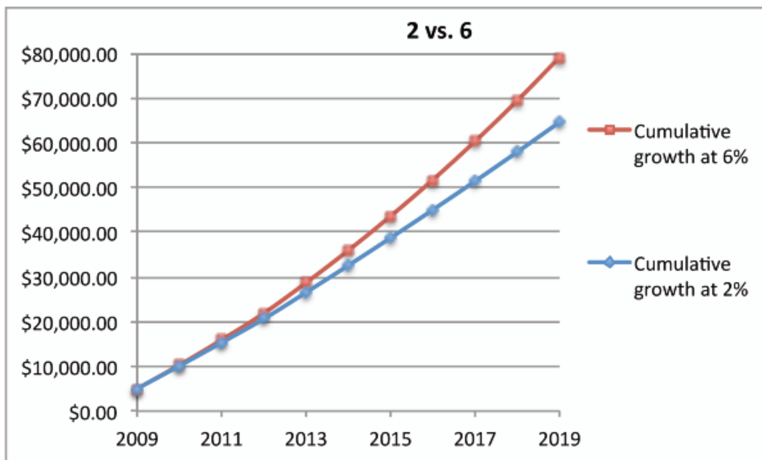

This graph illustrates annual TFSA contributions of $5000 from 2009 to 2012 and $5500 from 2013 to 2019 at a 2% and a 6% rate of return.

Here's my point.

Even though it's officially called a Tax Free Savings Account, we firmly recommend that you treat it as a Tax Free Investment Account. A well-chosen investment approach could truly produce a worthwhile result. So to answer the question; "TFSAs - good or bad?" depends on how you invest the money.

In our next installment of *Sound Advice*, I'll provide you with our advice of how to maximize the results of the Tax Free Savings Account. If you can't wait until then, please call us and we'll be happy to share that advice with you and your family!

How are We Doing?

We recently sent you the
Advisor Impact Client Survey
on April 1st, 2014.

We look forward to your responses as they help us continue to improve our service to you.

For those who respond to the survey before the April 28th, 2014 deadline,
your name will be entered in a draw for one of three $50 restaurant gift certificates.

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