



CPA SECURITIES INC.



CORPORATE PLANNING
ASSOCIATES

ADVANCING

SUMMER 2008 • VOL. 15, No. 3

I S S U E S

An Economic Overview

By John W Davis, *Senior Vice President*

A key benefit to CPA and our clients of becoming part of the Scotiabank family is access to Scotia's senior advisors. In our quarterly meetings in early June, we took advantage of this opportunity to have a private audience with Dr. Warren Jestin, Senior Vice-President and Chief Economist, Scotiabank. His Economics team provides in-depth research on global economic policy and financial market developments. Dr. Jestin is also Senior Vice-President of the bank's Public and Corporate Affairs Department, which includes corporate communications, government relations, corporate sponsorships and donations.

Much like the "Oracle of Omaha" Warren Buffet at a Berkshire Hathaway shareholder meeting, Dr. Jestin shared his views on a variety of topics in our two-hour meeting that we have summarized below.

WARREN JESTIN ON CANADA...

Domestic Economy

Dr. Jestin commented that Canadian business has successfully responded to the rising Canadian dollar by orienting operations toward distribution and outsourcing manufacturing. Niche small and medium enterprise manufacturers can continue to survive and thrive in Canada as long as they offer differentiated products and services. Provincially, the negative impacts from our rising dollar have been offset by tax surpluses derived from booming commodity prices (i.e. grain, oil & metals). Furthermore, federal tax surpluses have been distributed to provinces via the Federal Government transfer system, with Quebec and Ontario being

cited as the biggest benefactors. Domestic demand for goods and services is strong (a positive spin off of the continued strength in commodities), as the Canadian public continues to experience wage increases, as well as stable employment and housing markets.

Canadian Dollar

Although forecasts for the dollar do range from \$0.92US to \$1.02US, the consensus of the big six banks for the coming year is closer to \$0.92US. Scotiabank Economics believes that our dollar will fluctuate within a range of \$.95US and \$1.05US. For 2009 and beyond, they have an expectation of further strength relative to the U.S. dollar due to Canada's continued fiscal and trade surpluses, and a lower relative outlook for inflation. Dr. Jestin also notes that there is significant interest globally to invest in Canada's commodity based economy, which is causing increased demand for our currency.

Interest Rates

Dr. Jestin expects that by the third quarter of 2009 overnight rates will have been reduced by 0.75%. He described this however as a short-term "head fake" as interest rates may rise thereafter to address domestic inflation concerns.

Commodities

Dr. Jestin feels that the demand for commodities will remain strong for the next decade as copper, zinc and nickel were highlighted due to their function as primary components in the growth of China and India (which combined account for 1/3 of the world's population).

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US Real Estate, When is the Right Time?

By Bryan Monchamp, *Senior Vice President*

“THE GREAT THING IN THE WORLD IS NOT SO MUCH WHERE WE STAND, AS IN WHAT DIRECTION WE ARE MOVING.”

Oliver Wendell Holmes

In his book ‘Irrational Exuberance’ (Princeton Press 2000) and its subsequent second edition (2005), Writer, Economist and Yale Professor Robert Shiller successfully predicted the collapse of both the Tech Bubble and the US Housing Market. As we are well aware, the US housing financial crisis is one in which the world’s financial community and investors alike continue to seek resolution. While following correct prognostications such as Shiller’s can limit one’s risk and earn profit for savvy investors, it is during times when the future is not yet clear that we ask- what do we do now?

Canadians have excellent reason to pose the question of when is the right time to purchase real estate down south. Having by and large kept the gains achieved in real estate investments, profiting from the best five-year history in Canadian markets, hearing friends and associates relate stories of fire-sale real estate prices in popular US cities, combined with a currency that continues to hover near parity, many affluent Canadians are now looking south of the border to take advantage of perhaps the best relative prices in over a generation.

Consider for example, a property purchased for \$200,000USD on June 2, 2008 when the Canadian dollar closed at an all-time high of \$1.103USD (*B of C*). For the purchaser, this home may have cost as little as \$181,323CDN. Compare this to our dollar’s all-time low of \$.6179USD on January 21, 2002 (*B of C*) this same property would have cost the Canadian investor approximately \$323,676CDN. While this simple example does not consider the difference in value over the six-year period, it is a good indication of why the question of when to buy is now so prevalent.

At the same time, affluent Canadians who have the financial capacity to add a vacation home in popular destinations such as Miami, Phoenix or Palm Desert are inundated with press headlines such as “U.S. housing slump deepens”, “Overwhelmed US consumers suffering crisis in confidence” or “Real estate’s rocky road” (*GlobeInvestor, Globe and Mail, GlobeInvestor*). In addition to negative headlines, investors must make sense of a number of market and tax related variables.

Canadian real estate investors have not experienced the violent downward price movements in residential real estate that our neighbours to the south have witnessed as a result of Canada’s continued economic prominence, far less speculation by investors in Canada, and prudent lending practices displayed by Canadian banks.

Despite the 78% increase in the Canadian dollar from its all time low (*StatsCan*), the sales recorded by Canadian manufacturers have continued to improve albeit at reduced velocity compared to the

early part of the new millennia (*StatsCan*). Notwithstanding recent announcements of automotive sector plant closings, Canadian producers have weathered the storm by adjusting their business models and investing in productivity enhancing equipment (*StatsCan, nmtrade.com*). In conjunction with the strength in the commodities markets, continued construction activity in large Canadian cities, and balanced federal and provincial budgets, all Canadians have reason to view the present and future with greater optimism than do Americans.

Maybe it is just the conservative nature of Canadians but residential real estate speculation never reached the fervour pitch that it did in states such as Florida, Arizona and Nevada. The sheer volume of home sales in the Phoenix housing market in 2005 (196,000) lead planners to conclude in error that the population would double by 2030 (*AZCentral.com*). Another all too common story at the height of the boom was that of investors in Florida real estate who could earn quick 100% returns on options to purchase condominium units yet to be built. One only has to look at the sheer number of reality TV programs that depict amateurs acting as their own general contractor flipping residential properties to realize that the US housing market was out of control. In Canada, some speculation did occur in cities such as Calgary where the market experienced a “buy and build” phenomenon. “Buyers and builders” are homeowners who also contract to build new properties to benefit from rising prices. In Calgary there were numerous homeowners that were “buyers and builders” and in concert with dwindling migration to the city lead to too many homes without eligible purchasers. The result has been a 100% increase in housing inventory since May of 2007 (*CREB*). Despite this, the market from a historical perspective is now seen as balanced with small year over year price declines (*CREB*). Other markets, such as Saskatoon and Winnipeg, have supply shortages that are expected to produce double digit growth in the next year, but on a nationwide basis, housing price increases reflected improvement in affordability that resulted from a very low interest rate environment.

In addition, while Canadian banks have been impacted by the sub-prime mortgage mess in the USA, they never duplicated the lending practices made by many US banks. It is true that until recently 40 year or no money down mortgages were only a dream of Canadian borrowers, the Canadian banks did stop short of loose lending criteria such as “NINJA loans.” “NINJA loans” are loans made to home purchasers in the USA where they could still qualify with no income, no job and no assets (*wordspy.com*). When

one combined these lending terms with the sheer number of speculators (those purchasing for the purpose of quick sale) again the result was inevitable.

It is clear that Canadians looking to invest in US real estate should not assume that market conditions are similar to those they are accustomed to in Canada. Consideration of anticipated construction activity, rental vacancy rates, current inventory and sales numbers that can be obtained from a good realtor, each area's Real Estate Board (or its website), should be assessed to give a picture of current and future market conditions. These factors among others should be assessed as well as the direction of interest rates. While it looks less likely as time goes on, if inflation does increase in the US, it may force the FED to raise interest rates, affecting those whose term on their mortgage is variable or set to expire. This may force highly leveraged homeowners to sell even more of their properties at an inopportune time.

While off its all time high, our Loonie now sits just below par, an attractive level historically. Ask the Chief Economist of any major bank in Canada and they will admit the difficulty they have in producing an accurate forecast because currencies just do not respond when and how they expect. Movements in currency can be as a result of commodities markets, the federal budget, relative interest rates, inflation and mood of the market. Investors open themselves up to the risk of currency movement once they commit to purchasing a property. Two options to consider if this risk is of concern: 1) enter into a forward contract with your bank, a form of insurance, or 2) slowly accumulate currency (or US dollar denominated money market instruments) leading up to the closing date. While forward contracts can seem complicated they are simply an agreement with your bank to purchase US dollars on a future date at a set price. Currency risk is then eliminated.

While currency can impact the price one pays, US Estate Tax is a broader concern for anyone investing in US real estate. US Estate Tax can impact anyone owning U.S. based assets greater than \$60,000USD. Several strategies that are available to help mitigate US Estate Tax include having a spouse with a modest net worth purchase the property, using a trust or Canadian Limited Partnership, obtaining a non-recourse mortgage from a bank in the USA, or insuring against potential tax liability. We would be happy to add this to an upcoming regular meeting for a discussion specific to your family's situation.

To summarize we would stop far short of proclaiming, "the meek shall inherit the earth" as it relates to US real estate. Clearly though, an understanding of macro-economic factors, examination of individual market conditions as well as taxation is well warranted until the final chapter has been written on this most recent "Shiller" bubble.

MESSAGE FROM THE PRESIDENT:

Staying the Course

By P. Lee Fisher, *President & CEO*

Investment success is measured over the long-term, not based on what happens on a given day, week or month. There are two times when investors are most likely to forget this – when markets are rising and when markets are falling. Staying focused on your long-term goals will ensure that this period of increased volatility doesn't cause you to make decisions that will pull your plan off track.

History has provided the best lessons about why it's the long-term that matters. Think back to all of the events that have taken place over the years. As an example, in the late 1990's and early 2000, the Asian currency crisis and the technology bubble made headlines. These events were all significant shocks to the economy but despite the periods of volatility that followed, capital markets recovered.

Year	Return	Return in following year	Average return for next 5 years
1974	-25%	+18.5%	+22.3%
1981	-10.2%	+5.5%	+13.7%
1990	-14.8%	+12.0%	+10.8%
2002	-12.4%	+26.7%	+18.3%

Based on returns of the S&P/TSX Composite Total Return Index.

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Retirement Announcement

CORPORATE PLANNING ASSOCIATES WOULD LIKE TO ANNOUNCE THE RETIREMENT OF KAREN WILLIAMS. AFTER OVER 25 YEARS OF SERVICE WITH CPA, IT IS WITH GREAT APPRECIATION AND MUCH GRATITUDE THAT WE SAY GOOD-BYE!



Karen Williams first became a consultant to CPA in 1982 with responsibility for clients' tax return preparation both personal and corporate, tax planning research, liaison with the Canada Customs and Revenue Agency and other tax related matters for CPA's clients.

Please join us in thanking Karen for 26 years of outstanding service with CPA and in wishing her well as she prepares for retirement.

An Economic Overview

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WARREN JESTIN ON THE USA...

Dr. Jestin feels that the United States is in the early stages of a recession that will be shallow but lengthy by historical standards. That said, the picture in the U.S. will become visible only after the end of 2008, once the temporary effects of the tax rebates work their way through the economy. He foresees no immediate end to housing market woes and weak U.S. consumer spending. Households will continue to be impacted as weakness in housing trickles into job creation, unemployment and a restrictive credit environment. Due to a low U.S. dollar, a few positives can be found in U.S. based multinationals who earn a large percentage of their revenue in foreign currencies, an increase in U.S. exports, and the return of some manufacturing to Middle America.

WARREN JESTIN ON INTERNATIONAL MARKETS...

Dr. Jestin notes that it is not the U.S., Japan or Europe driving the global demand for commodities but rather Russia, Brazil, India and China. While the countries of the G-7 are in slow growth mode, the growth rates of these emerging markets are 3 to 5 times that of developed nations. He sees no end to this trend.

WARREN JESTIN LOOKING FORWARD....

In his role as Chief Economist, Dr. Jestin travels the world speaking with counterparts at foreign banks and senior government finance officials. As a result, he provided a couple of brief observations that will be key economic and political factors in the future. Dr. Jestin sees in the short-term a continuation of the themes of flat to decreasing interest rates, continued downward pressure on the U.S. dollar, slow growth among G-7 countries, and in contrast strength in emerging markets. He shared concerns on the upcoming U.S. election and the Democrats' economic platform, which could reduce the "openness" of U.S. borders to imports. He predicted

that both China and Australia will face severe fresh water shortages in the coming decades, which will support investment in environmental technologies.

CPA SECURITIES ON WHAT THIS MEANS FOR YOUR PORTFOLIO...

From CPA's investment policy discussions with clients to the securities selected by our GoldLeaf Approved managers, the perspectives of economists such as Dr. Jestin are utilized in portfolio construction.

Still, understanding the difference between economic news and investment value is essential in a dynamic and evolving global marketplace. Over the past thirty years CPA Securities has experienced many economic cycles and events such as the current global credit crisis. As investors we believe in the value of diversification, the need for rigour in the development of an appropriate long-term asset mix and the selection of quality investment solutions. Time has demonstrated that through good times and bad, long-term investors will benefit from the adherence to these enduring investment principals and a stated Investment Policy.

Staying the Course

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When it comes to investing, market volatility is unavoidable. And when volatility increases as it has recently, it's natural to take a closer look at your investments. This may be the perfect time to rebalance your portfolio back to your Target Allocation, i.e. buy low, sell high.

PUBLISHED QUARTERLY BY
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