2006 was another mixed year for investor protection

Two steps forward,3 steps back**.** Investor protection sliding backwards in Canada.

Q1: On Dec. 12, 2005 TD announced its plans to terminate and liquidate its 4 TSX listed Index ETFs thereby reducing the level of competition in Canada effective March, 2006. Investment "consultant" Robin Anderson was dealt with by the MFDA for misappropriating more than $362,000 from mutual fund clients. The New Brunswick Securities Commission [NBSC] ordered Investors Group Financial Services Inc. [IGFS] to pay an administrative penalty of $63,220 plus $5,000 in costs for trading in New Brunswick without being registered and permitting its sales staff to trade without being registered in the province. Quebec's financial-services regulator sought 51 securities-act charges against the founder of fund company Norbourg and asked for the maximum penalty to set an example. Norbourg president Vincent Lacroix was accused of misappropriating **$130 million** from 9,200 investors, mainly in Quebec, between 2000 and 2005. According to the Standard & Poor's Indices Versus Active Funds Scorecard (SPIVA) for Canada, the S&P/TSX Composite Index outperformed 87.1% of actively-managed Canadian Equity Funds in 2005. A temporary cease-trade order, dated March 8, 2006, was issued on securities of the two mutual funds managed by Juniper Fund Management Corp http://www.juniperfund.ca/, pending a hearing scheduled for March 23.On March 9, 2006 CIBC Asset Management Inc., CIBC and Talvest received controversial NI81-102 exemptive relief from the Ontario Securities Commission allowing a certain selection of their mutual funds to engage in short selling up to 10% of net assets, subject to a number of conditions.

Q2: On April 3, 2006 TD Asset Management announced that it would shorten the period for which early redemption fees apply to its mutual funds and make them mandatory Earl Crackower the ex-certified planner and mutual fund salesman pleaded guilty in court to defrauding 43 people, including seniors, of about **$3.4 million** between 1989 and 2003. *"Wall Street Versus America: The Rampant Greed and Dishonesty That Imperil Your Portfolio"* by Gary Weiss was released. The former Business Week writer Gary Weiss has nothing good to say about mutual funds in his latest scathing examination of the way the world of high finance works. The OSC **did not** hold an Investor Town Hall in May as a promised follow-up to the May 31, 2005 Event. OBSI **turned down** a formal Kenmar request for a meeting to discuss necessary reforms claiming their " agenda is full". The 2005 OBSI annual report was finally released and thankfully for the first time stopped saying that firms have never, ever rejected one of their recommendations. A Hearing Panel of the Investment Dealers Association of Canada, found Denes Luciano Fransesco Peroni and Robert Paul Joseph Hétu, advisers at the Sudbury branch office of Berkshire Securities Inc., an IDA Member firm, guilty of knowingly filing inflated expense claims. The Hearing Panel found that between Jan. 2002 and Feb. 2003, Messrs. Peroni and Hétu failed to advise Berkshire of the true cost of 3 fund marketing campaigns carried out in cooperation with 3 mutual fund companies.

Q3: Calgary-based Financial Advisor, Kevin Cork set out to do some MER research .He looked only at mutual funds with a 10-year return history. He studied rates of return over 1 year, 5 year and 10-year periods to see how fees impacted the different time frame returns. Four different categories of funds: Bond Funds, Balanced Funds, Canadian Equity Funds and Global Equity Funds were considered. One key conclusion :"For the 25 funds with the lowest MERs compared to the 25 funds with the highest MERs, the returns over a 10-year period, for funds with low MERs performed 25% better than funds with high MERs. The "Code of Silence Award" - handed out annually to the country's most secretive government body - was awarded this year to Michael Bryant for the "extortionate" fees his department charges to view and copy public court documents .In July the CSA released National Instrument NI81-107 *Independent Review Committees* to thebitter disappointment of investors, CARP, SIPA and investor advocates who had persuasively argued that full boards, not restricted committees, were what was required to adequately protect unitholders. Larry Elford www.investoradvocates.ca, started producing a self-funded documentary film on the Canadian investment industry - the working title *Breach of Trust* (*The Unique Violence of White Collar Crime*). The film is in the tradition of the Michael Moore documentaries like Roger and Me and Fahrenheit 9/11. The 2006 OSC Stakeholder survey Wave 4 report revealed that only 18 % of investors felt the OSC was *very effective* in fulfilling its investor protection mandate.

Q4: A research paper *Mutual Funds Fees Around the World*, by Ajay Khorana, Henri Servaes and Peter Tufano putting Canada at the top of the heap stirred a lot of debate and possibly some counteractions. A new Study by Professor Cuthbertson et al on UK mutual funds- *" Mutual Fund Performance: Skill or Luck? "* http://www.cass.city.ac.uk/facfin/papers/WP2005/MutualFundPerf.SkillorLuck.pdf or http://papers.ssrn.com/sol3/papers.cfm?abstract_id=665744 The study strongly rejects the hypothesis that poor performing funds are merely unlucky**. These funds actually demonstrate 'bad skill'.** According to a report in the Montreal Gazette, the Quebec Govt. said it would be holding hearings regarding the collapse of the Norbourg fund. TD Asset Management Inc announced that it will implement a controversial new pricing scheme that will turn some variable administrative costs into fixed costs [in percent] in early December. On Oct. 5, 2006 Morningstar, Inc. announced it is providing new data for open-end mutual funds and exchange-traded funds to capture how the average U.S. investor fared in a fund over a period of time (Canadians are still in the dark in this area but it's well known that asset-weighted returns are worse than published fund returns). The Task Force to Modernize Securities Legislation concluded its 16-month study with a comprehensive set of recommendations to bolster the international competitiveness of Canada's capital markets. There was however no mention of changes to some key weak elements –limitation Acts, adviser certification, dispute resolution, investor restitution.

Read *The Market timing Scandal* at
http://www.fundlibrary.com/features/columns/page.asp?id=12197 A tremendous historical perspective of what happened and to who.

" The committee is very unhappy with enforcement and have sensed that for a long time, there hasn't been vigorous prosecution of crimes in the security sector"

- Senator Jerry Grafstein, Senate Banking, Trade and Commerce Committee
Source: Theresa Tedesco, *Market crime fight failing*, National Post, November 22 006 page SP1

Fidelity Canada Growth calculator instructive

This useful calculator shows the growth of a lump sum or periodic investment in a given number of years [25 is default], investment rate of return, inflation rate, and marginal tax rate. **Growth calculator** [the Growth Calculator is under Calculators in the Education/Planning section of the site]. If you subtract the (MER+TER) from the long-term average return performance of the fund's asset class, you'll get an idea of how big an impact fees, taxes and inflation have on your nest egg. Substituting 0% in the text box for tax rate allows you to figure out end balances in a tax-deferred account like an RRSP.

Canadian Investment Awards announce winners

For those who might be interested, the 2006 and prior years winners are tabulated at www.InvestmentAwards.com. Allan Jacobs from Sceptre Investment Counsel Ltd. was named Morningstar Fund Manager of the Year. The winner in the controversial Canadian Income Trust Fund category was the Dynamic Focus+ Small Business Fund. The new IFIC Investor Education Award went to Mackenzie Financial Corp. There are no Awards for Fund Governance, Best MRFP, Customer Service or Investor Satisfaction.

Back in time: The 1998 Sceptre Annual Report shows that the Sceptre Equity Growth fund owned 811, 000 shares of YBM Magnex International Inc., a firm investigated by the FBI after Russian mobsters were found to be involved .YBM Magnex Int'l is an especially interesting case because the TSE had been forewarned about its criminal background before it was listed. Nevertheless it was listed and was made part of the TSE 300 Index. Interestingly, despite the warnings, the TSE approved the IPO. Several Canadian mutual funds including **Sceptre funds** (who had a significant investment) were adversely impacted in 1998 when the Company went under after a FBI raid revealed a money-laundering scheme by Russian mobsters - unitholders had to bite the bullet for millions of dollars.
http://www.osc.gov.on.ca/Enforcement/Proceedings/RAD/rad_20000211_ybmmagnexetal.jsp

SEC discloses details of Fidelity [U.S.] probe

Fidelity Investments' money management arm may have "directly or indirectly" defrauded some clients or potential ones during the period from 2002 to 2004, and those actions may have kept Fidelity customers from obtaining the best deals possible on stock trades, according to court papers filed by federal regulators yesterday [Nov. 30, 2006], the Boston Globe reported. This is the first time the Securities and Exchange Commission has publicly disclosed some aspects of its long-running probe of Fidelity, the newspaper said. Fidelity spokeswoman Anne Crowley told the Globe that the Boston-based company had already confirmed some parts of the SEC's investigation, and that it had

disciplined 14 traders for violating its policies. Source: K. O'Donnell, *Details of Fidelity probe disclosed*, Dec. 1, 2006 http://www.investmentnews.com/news.cms?newsId=3053

" I used to think that paying an extra 1% in mutual fund fees was no big deal. Boy, was I wrong" –Duncan Hood, Features editor, MoneySense magazine www.moneysense.ca Do *fees really matter?* , Moneysense, Dec./Jan 2007 pg 16

"Over longer time periods, we continue to see indices outperforming the majority of active funds" - Steve Rive, S&P's vice-president of Canadian index services. Source: T. Perkins, *Time to shine as stocks soften*, Toronto Star, Nov. 30, 2006

TD fund unitholders have some tough decisions to make now

In the last issue we talked about several concerns we had with the proposed changes to the TD family of funds. It now appears that unitholders, in their wisdom, have approved all of the TDAM proposed changes. Some sample implications:

1. the TD Dividend Income fund which had as an objective a high level of *after-tax* return now has an investment objective merely to provide " income"
2. the TD Emerging Markets fund which was to be managed so as to be prudently diversified at all times among different regions, countries and securities now has the simple one-liner " The fundamental investment objectives is to seek to achieve long-term capital growth by investing primarily in equity securities of issuers in emerging markets"
3. the TD European Growth fund which had limited its investments to the European Union (mature well regulated markets) and Switzerland now can invest in any country in Europe including some which could be considered emerging markets with higher risks
4. the TD Global RSP bond fund which has justifiably been in monthly net redemptions over the past five years has a massively expanded investment objective but it's unclear where all the additional analytical and stock-picking talent to professionally explore these opportunities will come from. [the fund's 10-year return to Oct. 31, 2006 is a puny 2.22 %; the MER is 2.19 % - maybe this fund should have been shuttered rather than renamed and encouraged to mismanage a more diverse set of securities?]
5. the Canadian Blue-chip Equity fund now can invest up to 49% in large-cap equity securities outside of Canada so you get more currency risk and foreign market risk. For some strange reason, the fund's name remains the same adding to the confusion.
6. Fund expenses may unduly increase if fund AUM grows because the Administration fee is now based on AUM taken as a percentage and not actual costs incurred [the fund will also cease disclosing important expenses such as legal and audit fees]

So what you have now is generic, broadly defined investment mandates lacking specificity, major changes in the risk profiles of the funds, increased fund impurity making it much harder to put together meaningful TD fund portfolios and changed, but undisclosed, benchmarks. We also don't know what changes, if any, TDAM has made to

supervise these new investment objectives. Either you and/or your adviser, if you have one, might want to re-examine your portfolio fund composition, asset allocation and risks in light of the sweeping changes.

A new, small fund with a silly name - the **Chicken Little Growth Fund** - carries an expense ratio of 3 percent, even after waivers, but manager Stephen Coleman makes no apologies...Rather, Coleman says that he "loves" his clients, and love "has a metric"...Practitioners of the world's oldest profession have long attached a metric to love, and we're surprised that Coleman would want to make that kind of association.....In any event, Coleman says that his clients should be "happy to pay for the work of an aggressive portfolio manager" who makes caring for his clients the key to his business.....According to well-placed *FundAlarm* spies, Coleman is **serious** about this touchy-feely stuff, and the next version of his fund's prospectus will take his **lovefest** to a level never before seen in the fund industry:

Annual Fund Operating Expenses (expenses that are deducted from Fund assets)	
Hugs all around	2.50%
Kisses, kisses, kisses, kisses	0.50%
And, oh yeah, some stock-picking	2.28%
Total Annual Fund Operating Expenses	5.28%
Fee Waiver[3]	2.28%
Net Expenses	3.00%

"Small Investment Firm's Chicken Little Fund a Risk Worth Taking," Christopher Boyce, theledger.com, November 3, 2006

Source: www.fundalarm.com Dec. 2006 Highlights and Commentary

Feedback from our readers-Kent Shirley paid a heavy price

We received wads of email on the controversial Canadian Business Brian Mallard piece we covered in the last edition of the Fund OBSERVER. Here's a very typical comment:

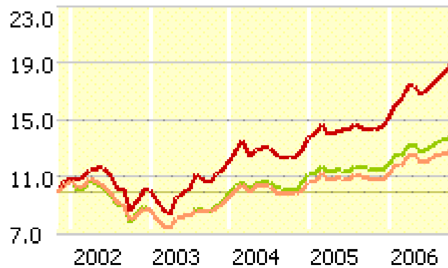
“I think there are many discrepancies in the article but this one disturbs me most. Mr. Mallard ("Mallard") is described as a "guy of integrity" who had oddly "predicted" Kent Shirley's death. Despite his obvious awareness of Kent Shirley's deteriorating condition and imminent death, he continued to bombard him with the harshest legal action, dropping the "nuclear weapon" or the Anton Piller Order just two months before he died (would most of us survive such an attack?). How does a person of "integrity" knowingly facilitate the destruction of another human being, especially such a vulnerable one, and how can so-called neutral journalists portray Mallard as the victim and hero, and not ask that question? The reference to Mallard as God ("He was God. He was great") is in my opinion offensive to God and his/her followers.” The comment that Investor advocates are a bunch of "losers" attracted a lot of hostile feedback, unfortunately not printable.

High fees, high returns –it’s possible according to Carrick Research

We're always on about how high MER's impair long-term performance. Here's a list of mutual funds with high management expense ratios that have justified their fees with very solid pre-tax returns in the intermediate term.

FUND	MER	ASSETS ($million)	One-year return	Three-year return
AGF European Equity Class	2.99%	$1,400	+36.90%	+20.40%
Category average	2.8		+26	+15.7
AIM International Growth Class	3.12	$115.60	+25.4	+16.6
Category average	2.55		+18.5	+12.4
Bissett Microcap A	3.72	$57.20	+24	+22.8
Category average	2.55		+19.4	+17.3
DMP Resource Class	4.72	$197.20	+48.1	+29.5
Category average	2.7		+21	+27.6
Excel India China	3.37	$14.80	+38.9	n/a
Category average	3.06		+30.2	+10.9
Investors Mergers & Acquisitions A	3.19	$460.90	+14.2	+15.6
Category average	2.35		+8.2	+11.3
Investors Tactical Asset Allocation A	3.02	$1,250	+10.8	+9.7
Category average	2.64		+9.3	+6.9
Stone & Co. Dividend Growth A	2.99	$65.50	+21.4	+18.4
Category average	2.36		+15.7	+14.4
Talvest Global Health Care	3.14	$1,073	+11.2	+8.4
Category average	3.07		+6.4	+5.9

" Funds like AGF European Equity certainly make a case for buying the manager, and not the fee, but don't be fooled into basing your fund selection on this idea. A better suggestion: Find the smart managers running low-fee funds."- Rob Carrick



Growth of $10,000 since Nov. 1 2001

Top 5 holdings (%)
Royal & Sun Alliance Insurance Grp 9.8
Societe Generale Grp 8.7
BNP Paribas 6.3
ABN AMRO Holding 4.9
France Telecom Sa

AGF European Equity Morningstar.ca	●Fund:	AGF European Equity Class
Worst 1 yr. result -26.5 %	●Index:	MSCI Europe C$
Source: www.morningstar.ca	●Category:	European Equity

When considering funds such as these, consider volatility , after-tax returns and suitability .Also, compare to the Index not just category peer funds. List Source: R. Carrick, *Fee hogs that bring home the bacon: Mutual funds with high MER*s should generally be avoided, but some still manage to outperform their peers, Globe and Mail, Dec. 2, 2006

Selected Income Trust clippings

1. If you invested $1000 in Superior Plus Income Fund on December 1, 2005 it would be worth $521 a year later.
2. " As for mutual funds that invest in trusts, [Diane] Urquhart (a former Bay Street brokerage analyst) would like to see the income and return of capital portions of distributions reported separately. This would help alleviate the widespread confusion over trust yields." Source: R. Luukko, *How to measure the value of trusts*, Toronto Star, December 2, 2006 pg D5
3. The CI Income fund incurred a **one-day drop of about 22%** the day after finance Minister Jim Flaherty announced that income trusts would be subject to corporate tax
4. According to the Canadian Association of Income Funds, 61 per cent of income trusts are held in RRSP's or RRIF's

Zero Alpha Group (ZAG) Study: Huge "Broker Penalty" Sees Unwary Index Fund Investors Paying 3 Times More in Fund Expenses Listen Now Also, a major new study by the Zero Alpha Group (ZAG) and Fund Democracy. *The Costs of Using a Broker to Select Mutual Funds*, **November** 2006. Key Finding:
"On a $10,000 investment earning an annual return of 10 percent over 20 years, the average investor in no-load, no 12b-1 fee index funds would pay approximately $2,582 in operating expenses. The average investor holding a no-load fund that charges a 12b-1 fee would pay $3,744, while the average investor holding load index funds would pay $7,600 in operating expenses. Although one would expect using a professional adviser to improve an investor's performance, instead the investor pays a significant penalty … We found that load index funds charged substantially higher fees – even before counting the fees paid to the broker – than true no-load (no 12b-1 fee) funds. In other words, when investors used brokers they paid twice:

first, they paid the broker; second, they paid a broker penalty in the form of higher fund fees."

In reference to the ZAG study, Richard Bennett, principal and financial advisor, Savant Capital, Rockford, IL., said: **"This study is a powerful illustration of why investors who are dealing with glorified commissioned salespeople need to find a fiduciary … and fast. You can think of the index mutual fund 'broker penalty' this way: If a consumer spends $4 for a loaf of bread when an identical loaf on the same shelf cost $2, it is no defense for a 'bread broker' who recommends the $4 loaf to argue that it cost more because the baker has higher production costs than the baker of the $2 loaf. The extra $2 paid by the consumer is a broker penalty, and the fact that the consumer pay for that advice simply adds insult to injury."** Does anything seem familiar here?

Received response from Independent Review Inc. (IRI)
www.independentreviewinc.com

By and large, IRI answered our questions forthrightly. They advised that:

a. Any and all IRCs that they help create or run will comply fully with NI 81-107
b. NI 81-107 does not require that IRC members are securityholders in the investment fund (s) which they serve, but it clearly contemplates that they might well be, since the Instrument requires public disclosure of the IRC members' aggregate holdings at or above the 10% level. i.e. IRI IRC members don't have to be unitholders
c. Every IRC member must be independent pursuant to the Instrument. IRI team members will only serve on the IRC's of funds in respect of which the meet the independence test.
d. Members serve on an IRC as individuals and do not vote as a block.
e. The individual members of an IRC have term limits, pursuant to the Instrument. If the IRC is operated by IRI on an outsourced basis, the service will be provided under a service level agreement, which can be terminated, just as other third-party services (such as outsourced administration) are provided to investment funds today. [and Arthur Anderson provided to Enron]
f. The IRI's "for profit" model should not, in their view, conflict with the provision of professional services to IRC's any more than the profits currently made by legal, accounting, administration, or other third-party service providers to investment funds conflicts with their duties to provide those services and/or advice professionally and in accordance with the terms of their appointment.
g. IRI offers to run IRCs that are "shared" between fund families – that is, the same committee serves more than one fund family. IRI believe that the managers of smaller families of investment funds will find that this is the most cost-effective way to establish a first class, professionally run IRC for their investment funds.
h. Members of an IRC are not directors or officers of the investment fund(s) that they serve, or of the manager – and they do not, therefore, assume the fiduciary duties of a director. However, the Instrument does impose duties (e.g., the

standard of care) on the individuals who serve on an IRC, *qua* members of that independent review committee.

i. IRI will also be held to the requirements of the Instrument – in particular, the requirement of the Instrument that the fees and expenses of the IRC are "reasonable" – and the provisions of its service level agreements.

So there you have it. A completely outsourced IRC solution. Our worries- there could be conflicts between fund families and between hedge funds and mutual funds within the family; respected investor advocates and qualified individual may be pre-empted from becoming IRC members; IRI's team as delineated may not have the direct exposure and sensitivity to the grass roots issues/complaints facing retail mutual fund investors (corporate-friendly IRC's existing at the time of the market timing scandal all failed to stop the abuse); the maximum number of funds per IRC handled by IRI is not defined, the idea of outsourcing an important element of fund governance to a "for-profit" institution runs contrary to our philosophy that IRC members should be acting solely for the best interests of the fund and not be tied to IRI corporate profit objectives or any other distraction (such as contract renewal or increased business); and the possibility that NI81-107 conflict-of-interest governance/investor protection will be hi-jacked by IRI. for entire families of funds. We're lukewarm , at best, to **IRC's R Us**.

Access to US mutual funds coming?

We nearly missed an interesting article in the Toronto Star. Basically, the article suggests that Canadians could bolster their retirement nest eggs if they were allowed to purchase lower MER United States mutual funds. Two quotes are of particular interest:

1. *"They [Canadian fundcos] can do this [charge more] partially because Canadian consumers know nothing about how low MER's should be and partially because they don't have to disclose what their trailer fees - the amount of fees paid to the broker – are. This is notoriously higher in Canada than in the U.S. but no one knows by how much because they don't have to disclose them"* - Karen Ruckman, professor of business at Simon Fraser University
2. *" Opening borders to competition, not just the US, but also Europe, provided that Canada gets full reciprocity, would help investors in securing a much wider range of services and introduced innovation. This would also contribute in reducing fees that remain far too high in Canada."*-Robert Pouliot, vice president of the Center for Fiduciary Excellence.

Source: T. Srikanthan, *Move afoot to ease US sales: Some say investing expenses would plummet with more competition*, Toronto Star, Nov. 3, 2006 pg L3

Quebec again leading the reform charge: We'd like to mention the Coalition pour la Protection des Investisseurs. This Quebec coalition is focused upon a new anti-fraud protection fund for mutual funds, better specification of fiduciary duties of all professionals involved in managing and distributing pension funds and mutual funds, mandatory investment management certification and ratings, and an open border for

mutual funds to drive Canada's excessive fund MERs down. More information and videos (in French) at:
http://www.giref.uqam.ca/representation.htm Another good Quebec site on general consumer protection issues is http://www.protegez-vous.qc.ca/

More fund games-brokers overcharge fundcos! : A hearing panel of the Investment Dealers Association of Canada (IDA), has imposed penalties on Denes Luciano Fransesco Peroni and Robert Paul Joseph Hétu. The 2 were with the Sudbury, Ont. branch of Berkshire Securities Inc. Following a disciplinary hearing held between April 3- 6, 2006, the hearing panel found that Peroni and. Hétu had knowingly engaged in conduct contrary to the public interest by failing to advise Berkshire of the true cost of 3 advertising campaigns carried out in cooperation with 3 mutual fund companies and by misrepresenting to Berkshire that an advertisement had appeared 12 times in a newspaper when it had only appeared 4 times. After an assessment of written submissions on penalty, Peroni and Hétu have each been fined $25,000 and must jointly pay $50,000 in costs. For a complete summary of facts, please see IDA Bulletin 3588 www.ida.ca Related Documents. Source: IE, IDA *fines Berkshire reps for concealing advertising costs*, Dec. 6, 2006

PPNs –retail investors jumping from the frying pan into the fire?

Principal-Protected Notes are the shocking beneficiary of the income trust meltdown. According to media reports, OpenSky Capital, BMO Nesbitt Burns Inc., and other firms report November sales of the Notes have been robust and are well ahead of 2006's pace. This structured product has so many issues surrounding it that the CSA issued an **Investor Watch Alert** in July, 2006 http://www.csa-acvm.ca/home.html Investor Watch: Principal-Protected Notes (PPNs) Do your homework; ask questions, validate portfolio suitability.

QUIZ: The PH&N Bond fund won the 2006 Canadian Investment Award in the fixed-income category. What was the key factor in the fund's success?:

a. uncanny ability to forecast interest rates
b. a low MER
c. superior bond selection
d. minimal portfolio turnover

HINT: Management Expense Ratio (MER) = 0.59%

Fund brokerage expenses coming down?-Instinet to launch Canadian Alternative Trading System

On Dec. 4, 2006 Instinet Inc. announced its intention to launch ICX (Instinet Canada Cross), an Alternative Trading System that will operate as a continuous, electronic auction market for the trading of Canadian exchange-listed securities. ICX, which is expected to launch in 2007 and will be operated by Instinet I-X Ltd., a soon-to-be-registered Canadian investment dealer. This should improve price discovery in the

Canadian equities market through increased transaction speed, greater liquidity, lower transaction costs and ultimately improved investor performance. Will mutfund brokerage fees really decrease as a result? Will soft dollars finally bite the bullet? http://www.newswire.ca/en/releases/archive/December2006/04/c3204.html

It's RRSP time-avoid chasing returns

A Nov. 30 James Daw column seems most apt at this time of year. He warns retail investors to think carefully about chasing hot funds. We quote directly "

"..One of the more dramatic cases of herd mentality in Canada took place when investors poured $2.7 billion into the flagship fund of AIC Ltd., which is ironically a champion of the buy and hold philosophy. AIC's Advantage Fund had turned in an average return of more than 30 per cent during the five years ended in 1994. So, money flooded in, much of it too late to enjoy the full benefit of a 66 per cent return in 1996 and 43 per cent in 1997.The fund's return since has been far less spectacular, including years of losses (minus 22.2 per cent in 2002) and other years when the fund trailed overall market returns. So, investors pulled out $1.7 billion by the end of 2005, just in time to miss this year's market-beating 19 per cent gain." Source: J. Daw, *Chasing hot funds can hurt, study finds,* Toronto Star, Nov.30, 2006 pg L2

Income trusts mangle some fund returns

"..November was an excellent month all around for mutual funds. Forty-one of the 42 Morningstar Canada Fund Indices gained ground, according to preliminary data on investment-fund performance released today by Morningstar Canada.The lone exception was the Morningstar Canadian High Income Equity Fund Index, whose constituent funds include many that invest heavily in income trusts". [return= -4.7 %; the top fund Category was Precious metal Equity with a return of 13.2 %] Source: http://www.morningstar.ca/globalhome/Industry/News.asp?Articleid=ArticleID121200614581 *Income trusts the only blemish on an otherwise spectacular month for mutual funds*

Interested in Islamic mutual funds? Read *Performance of Islamic mutual* funds http://www.erf.org.eg/12thAnnualConference/FINANCE/presented/Hassan&Elfakhani.pdf Said Elfhakani and Kabir Hassan, Dec. 2005. For Islamic investing rules visit also http://www.financeprofessor.com/islamicfinance/islamic%20finance.htm

"Classic indexing has been overwhelmed by what I call *indexing nouveau*, represented by the ETF "- John Bogle in a Oct. 26, 2006 speech. to the CFA Society of San Francisco [His complaint is that exchange-traded funds, which unlike standard mutual funds trade continuously on stock exchanges, have been marketed as vehicles for trading and short-term speculation rather than long-term investing.]

Chuck Jaffe announces winners of the 11th annual Lump of Coal Awards

The Awards recognize managers, executives, firms, watchdogs and other fundies for action, attitude, performance or behavior in 2006 that was offensive, disingenuous, duplicitous, reprehensible or just plain stupid. The management at Abacus Bull Moose Growth, won for the year's **Tackiest Marketing Tactic**. This small fund has tried to reflect the strength and vigor that Teddy Roosevelt saw in the creature that became the namesake of the progressive political party he founded, and it has done reasonably well in its short history. But that didn't draw assets, so management recently changed the fund's name to Roosevelt Anti-Terror Multi-Cap; the investment objective is the same, except for an afterthought noting that the fund avoids "companies that have ongoing business relationships with countries that sponsor terrorism. "Playing on fear - and implying that other funds might be "pro" terror - is small-minded; in this case, it turned an issue that was shaping up to be a solid fund into a gimmick. Source:http://www.philly.com/mld/inquirer/business/16203412.htm

Gee, I wish I hadn't said that

" The government continues to overtax Canadians and run multi-billion dollar surpluses, yet their first instinct is to attack an investment vehicle [income trusts**] that can make the difference between bare survival and a dignified retirement for millions of Canadians" –**PM Steven Harper , Oct. 26, 2005

2007 approaches - time for the annual risk capacity survey
http://www.ifa.com/SurveyNET/index.aspx

Birds of a feather –According to a Dec. 11, 2006 Globe and Mail report, Power Financial Corp. (PWF: TSX) has made the final round of bidders for Boston-based money manager Putnam Investments ($187 AUM). The paper said Power Financial, was closing in on a $3.5 billion-plus acquisition of Putnam, which would give it a foothold in the U.S. mutual fund industry as it runs out of expansion room in Canada. Power Financial, controls Canada's largest mutual fund manager, IGM Financial (IGM: TSX). IG funds were required to pay $19.2 million in restitution per a negotiated settlement with the OSC for their unholy role in the market timing scandal. Additionally, Investors Group Financial Services Inc. was compelled to pay $5.3 million in restitution and fines by the MFDA for aiding market timers to exploit the IG Funds and abuse long-term investors.

And Putnam*?* - In April, 2004, the SEC announced the settlement of an enforcement action against Putnam Investment Management LLC (Putnam), in which the Commission ordered Putnam to pay a $50 million USD civil penalty and $5 million in disgorgement for violating federal securities laws by failing to disclose improper market timing trading by Putnam portfolio managers. All of the money obtained by the Commission was distributed to investors financially assaulted by the market timing trading.
http://www.sec.gov/news/press/2004-49.htm

"In investing, what is comfortable is rarely profitable."
- Robert Arnott , Chairman, Research Affiliates

Fidelity Mutual fund traders succumb to the finer things in life. To woo business from Fidelity Investments traders, Jefferies & Co., a New York brokerage firm showered them with pricey gifts such as private vacations and golf outings, tickets to a Justin Timberlake and Christina Aguilera concert, parties at the 2004 Super Bowl in Houston sponsored by Playboy and Maxim magazines, and a dozen bottles of Chateau Petrus wine worth $625 apiece. On Dec. 4, 2006 Jefferies & Co., agreed to pay more than $10 million USD to settle regulators' claims that it had violated gift limits designed to ensure that brokerages compete for business fairly. What an interesting industry!

Worst Investment Fund for November? Canadian Income Management Trust; Fund Sponsor: Sentry Select Capital Corp. **Return= - 65.56 %** .For 6 months to Nov. 30, 2006 return was –61.67 % per Globefund.com. Any MER is too much for this fund (TSX: CNM.un).

Investor Education Fund Chair Paul Bates announces Thomas M. Hamza as President of the Investor Education Fund. Most recently, Mr. Hamza was VP, Financial Services and Chief Compliance Officer at KidsFutures Investments where he was responsible for developing its financial services strategy.
http://www.newswire.ca/en/releases/archive/December2006/11/c5848.html

In Your Best Interest http://www.inyourbestinterest.ca/**,** is the personal website of Hank Cunningham, the author of "*In Your Best Interest, the Ultimate Guide to the Canadian Bond Market*" published by Dundurn Press (ISBN: 1-55002-578-3; 244 Pages; Paperback). Lots of info on fixed income investing especially the Learning Centre section of the site. If you buy and read the book, you'll definitely think twice about investing in bond mutual funds.

"Admissions" Excerpt from the Boyd Group Income Fund 2005 Annual Report

"The Fund has, since its inception in 2003, believed it important to maintain distributions for the benefit of its equity holders. Accordingly, the Fund continued to pay distributions throughout 2005, even though those distributions were in excess of distributable cash generated for the same period, drawing on its available cash reserves to do so. In time, the excess distributions served to increase deficits, reduce working capital and reduce available cash for operating purposes, thereby weakening the Fund's financial position. In December 2005, it was determined, that a temporary cessation of distributions would help the Fund rebuild its balance sheet and improve its financial flexibility. Further, in November 2005, the decision to temporarily discontinue issuing units under the Fund's DRIP prevented further dilution resulting from these programs. With these two actions in late 2005, combined with the replacement of prepaid rebate arrangements and debt facilities in 2006, the Fund has taken steps towards achieving a stronger and more flexible capital position. The Fund recognizes the importance of regular distributions to its equity holders and will continue to evaluate its financial position regularly and expects to resume distributions at the appropriate time". **Thanks to an input from independent analyst Diane Urquhart.**

“ ..As yet, the F-class [low cost] option has not really taken off. RBC’s Vance [Brenda –current Chair of IFIC**] says less than 10 % of funds sold in Canada are F-class *compared with more than 90% sold on a “bundled” basis”.*** Source: M. Ryval*, The debate over fund fees,* 2007 CANADIAN Investment Guide, pgs36 –38. And why is that? The reason is that advisers are scared to disclose their fees and charge them separately in a fee-only account. Another reason, individual DIY investor’s cannot buy F-class funds- the industry forces them to be purchased through an adviser who’ll tack on his own fees whether you need, want or accept advice.

Royal Bank of Canada subsidiary RBC Dain Rauscher Inc, Brokers Settle NASD Mutual-Fund Case

Royal Bank of Canada subsidiary RBC Dain Rauscher Inc and 3 other brokerages agreed to refund $43.8 million in fees to settle NASD claims that they overcharged thousands of clients when selling mutual funds. Royal Bank of Canada subsidiary RBC Dain Rauscher Inc. ($6.8 million), Morgan Stanley DW Inc. ($10.4 million), Edward D. Jones & Co. LP ($25 million), and Royal Alliance Associates Inc. ($1.6 million) imposed upfront sales fees for mutual fund shares even though the funds themselves had stopped charging the fees, according to a Dec. 13 statement by NASD. NASD found that each firm failed to have systems reasonably designed to ensure that customers received NAV pricing* when appropriate. As a result, certain investors purchased Class A shares and incurred front-end sales charges that they should not have paid, or purchased other mutual fund share classes that subjected them to higher fees and the potential of contingent deferred, or back-end, sales charges. The brokerages “deprived their customers of substantial discounts on mutual-fund purchases," James Shorris, NASD's head of enforcement, said in the statement. O. Bilodeau. , http://www.bloomberg.com/apps/news?pid=20601082&sid=axtNEqMEkNHc&refer=canada and NASD News Release
http://www.nasd.com/PressRoom/NewsReleases/2006NewsReleases/NASDW_018080
* *Net Asset Value Transfers: Look Before You Leap Into Another Mutual Fund*.

Fund Factoid: The largest U.S. fund is the US$ 63 billion Fidelity Contra Fund with an MER of 0.93 %. Canada’s largest fund is the $11.8 billion Investors Dividend Fund with a price tag of 2.75 %. Source: M. Ryval*, The debate over fund fees,* 2007 CANADIAN Investment Guide, pgs36 –38

“Re: Are you Happy with fund fees? ”
Jonathan Chevreau, October 3. [National Post]
This survey just released by the Investment Funds Institute of Canada claims that most mutual fund owners are “comfortable” with the high fees many of that Institute’s members charge their clients. As John D. DeGoey is quoted in Jonathan Chevreau’s column on the subject, that is “piffle” and a very very weak excuse by IFIC to justify the excessive charges by many of its member fund managers. The defense offered by Robert Frances for the gouging fees charged by some IFIC members has to be the lamest I have ever heard. The current industry practice of referring investors to the not- so- simplified “simplified prospectus” to learn how much their management charges are is meaningless

and borders on dishonesty by fund managers. It is about the same as my fund manager writing me in Latin and telling me there is a Latin- to- English dictionary at my local library. Until fund managers are required, by regulation or by client insistence, to spell out in dollars and cents their management charges in every quarterly statement, that gouging of investors will continue.
Cyril W. Fleming, Mississauga Ontario"
Source: LETTERS, National Post, Oct. 7, 2006 pg FP15

Q: How many performance measurement experts does it take to change a light bulb?
A: 43 - one to change the bulb and 42 to change the start and end dates.

"The 12b-1 fee is supposedly for sales and marketing costs, but it primarily functions as a trailing commission for the advisor who brokered the initial purchase ... It's the gift that keeps on taking." -U.S. Fund industry observer Chuck Jaffe
Source:http://www.fool.com/news/commentary/2006/commentary06121321.htm?ref=foolwatch

Discretionary account: An account for which the holder gives his/her broker or someone else the authority to buy and sell securities, either absolutely or subject to certain restrictions. also called controlled account or managed account. Source: www.investorwords.com

"We experienced poor returns this year because stock prices fell."
-Extract from a 2001 Fund Annual report

Watch those *average* fund compound return numbers

"Many funds boast strong annual compound growth rates over periods of from one to 10 years. We have no doubt these figures are accurate. If you had invested in a fund exactly five years ago, and had all year dividends reinvested, you would have received the five-year compound rate of return shown in the press or advertised by the fund. The problem arises when you didn't invest exactly five years ago. A simple five-year average can be made up of vastly deferring sets of shorter-term results. As an example, if a fund gained 10% each year for 5 years, its annual compound growth rate would obviously be 10%. But if a fund gained 50% in 1 year and 1.8% each of the next 4 years, it, too, when accurately report the five-year annual return of 10%. A fund with gains of 50%, 10% and 10% plus losses of 9% and 2% over 5 years will also have a 5-year annual growth rate of 10%. That's why many investors can't reconcile published results and their own experience. That five-year, or 10-year, track record could be the result of steady, if unexciting returns, or highly erratic gains and losses.". Source: Canadian Mutual Fund Adviser, Dec. 19, 2006. [That's why it's recommended that investors look at year- by-year returns and the Standard deviation to get a feel for the volatility of the fund.]

Sidebar on PPN's and structured products

"… A basic equity portfolio has certain return, risk and income characteristics. By comparison, a Principal protected note cuts off some of the return from owning stocks in

exchange for eliminating the risk of losing money. …. These [structured] products, and a gazillion others all make trade-offs between those three variables…. There are consequences to all of this. In addition to raising the client's cost of investing, all of this dial- turning also serves to change the person or team making the added- value decisions. In the basic equity mutual fund, a professional stock picker is making the decisions. With the addition of every new feature however, the stock pickers impact on product returns is diminished…. Structured and managed products are designed to make life simpler for the investor, but I think the opposite is true. In my opinion there is a greater likelihood that the buyers will fail to get what they needed, what they wanted and/or what they thought they were getting…". T. Bradley, *If these investment vehicles were ice cream, I'd take vanilla*, Globe and Mail, Dec. 15, 2006

http://www.portfolio4less.com/ The site states that the genesis of portfolio4less.com came from a firsthand understanding of what's wrong with the Canadian mutual fund and brokerage industries. It's an attempt, they claim, to provide a fresh alternative to high priced brokers and questionable advice. According to the firm, the recommendations are based on the principles of Modern Portfolio Theory, not on market timing, or speculation. They appear to have access to a wide range of fund managers and no proprietary securities or funds. Portfolios [Our portfolios], they suggest, are created based purely on unbiased research. Portfolio4less.com asserts that it is not tied to a bank or any fundco, and therefore has no reason to suggest one reinvestment over another other than pure performance. The firm provided the following chart for pre-tax returns to Nov. 31, 2006:

The chart illustrates the performance of the mutual fund portfolios provided through portfolio4less.com. They claim that all benchmarks have been **out performed** with **less** risk.

Comparison to Benchmarks	**1-year**	**2-year total gain**
Benchmark 1 [1]	5.38%	13.93%
Conservative	5.39%	14.42%
Balanced	9.21%	21.93%
Benchmark 2 [2]	10.81%	26.03%
Income Growth	13.38%	26.68%
Moderate Growth	14.73%	28.75%
Benchmark 3 [3]	17.36%	36.68%
Growth	19.55%	37.20%
Aggressive Growth	22.63%	41.72%

1) Benchmark for conservative and balanced portfolios-ishares TSX60-20%, ishares S&P 500- 10%, and ishares Short Bond Index Fund-70%.

2) Benchmark for income growth and moderate growth portfolios-ishares TSX60-50%, ishares S&P 500-10% and ishares Short Bond Index Fund-40%.

3) Benchmark for growth and aggressive growth portfolio-ishares TSX60-70%, ishares S&P 500-20% and ishares MCSI EAFE-10%.

" It seems the fund companies are not open to offering these low cost funds [F-class] outside fee –based accounts"

- Bruce Seago, COO, E*Trade Canada

Source: H. Anderson, " F-Class fund sales plan loses turf war ", National Post, April 20, 2004 pg FP11 [On-line brokers such as E*Trade do not offer advice so there is no argument for them to receive trailer fees. They had offered to give up trailers for nominal transaction fees. Advisers rebelled and scared off AIMTrimark and Elliott & Page who had been prepared to be part of the investor-friendly E*Trade initiative]

" ..The fund governance issue is a recent rare exception in which investors did get more involved with the rulemaking process. In 2006, regulators adopted new rules requiring investment funds to establish independent bodies to review potential conflicts of interest. These rules were a long time coming - having gone through many revisions over several years before taking effect this past summer - partly because this was one of the rare occasions at which retail investors made themselves heard on a regulatory policy issue. As a result of investors' input, the final rule probably provides better investor protection than it would have otherwise. If the regulators had heard from only the industry, the rule may have been abandoned altogether, due to complaints that it's too expensive for fund sponsors to set up these governance bodies. Or regulators could have delivered a watered-down rule that offered little real protection for investors…". James Langton, *Working for investors*, CANADIAN Investment Guide 2007 pgs 92-95

"..In a recent study conducted by Desjardins and published in the Investment Executive's Special Supplement November 2005, almost 60% of surveyed Canadians believe they have limited or no knowledge about retirement savings or investments. The general consensus of the survey of advisors conducted by PureLogix Corp. in October of 2005 suggested a much lower number. According to advisors, perhaps less than 10% of investors have a clear picture of the risks they are exposed to". http://purelogix.blogspot.com/2005/10/advisors-acknowledge-investors-cannot.html *Advisors Acknowledge Investors Cannot Fairly Evaluate Risk*, October 31, 2005 [This contrasts sharply with the findings of the Sept. 2006, IFIC Investor survey wherein fund investors were comfortable with advice, fees and returns]

Using a broker to buy index-based mutual funds could prove hazardous to your wealth.

That was the conclusion of a recent U.S. Zero Alpha Group sponsored study of S&P 500 index funds by Ed O'Neal [assistant professor at Babcock Graduate School of Management at Wake Forest University in Winston-Salem, N.C.] and Mercer Bullard [CEO, Fund Democracy] - funds that merely mimic the Standard & Poor's 500-stock index. These "plain vanilla" index funds are essentially commodities-the variation in performance among such funds depends almost entirely on the MER each fund charges. Those fees can vary dramatically, from a low of 0.07 % to a high of 1.45 %. Clearly, the lower the MER, the higher the return to investors. Kick backs (elegantly called trailer commissions or fees by fundcos) are a Big reason MER's are so high.

Investors who bought funds that don't charge fees to pay the salespeople who market them paid an average of $2.15 in fund operating expenses annually for each $1,000 held in the funds. Those who bought through a broker ended up in index funds with average annual operating expenses of $7.04 per $1,000 - more than 3 times as much - and paid the broker an additional $1.56 a year per $1,000 invested. Classic Pay more, get less.

The differences may seem small, but the resulting disparities in portfolio size mount over time. The broker-bought index fund would cost $29,560 more at the end of 20 years for someone socking away $500 a month, assuming a 10 % annual return before fees. After 30 years, the investor in the low-cost fund would have $1,080,845, vs. $942,511 if he/she invested in the unduly higher-cost index fund. That's a $138,334 difference and demonstrates how abusive conflicted advice can be. Of course, for regular mutfunds the differences could be even larger. Unfortunately, it's not easy to detect if you're dealing with a fiduciary, a professional adviser or a fund salesman (with limited duty of care). Source: K. Kristof, Study *turns glare on brokers' advice,* The Star Ledger, Dec. 13, 2006 The ZAG study study *The Costs of Using a Broker to Select Mutual Funds,* is available for free download at
http://www.funddemocracy.com/Chronological%20Document%20List.htm

Does flawed income trust accounting have a rival in the LCBO?

We've often criticized the income trust industry for flawed and misleading accounting, disclosure and terminology. Now we think we've found a strong competitor in the Disclosures of the LCBO, the Ontario monopoly charged with dispensing alcoholic beverages to thirsty Ontarions. The LCBO Annual report usually tries to convey that the monopoly is doing great. If you examine the Deloitte report [below] you'll find that more than 50% of the so-called "profit" is just a monopoly tax, that its labour costs are out of whack, it has an excessive # of employees and that its up-market vintages sections are loss leaders. The Deloitte report can be found by clicking LCBO 2005 Operational Review - Deloitte & Touche LLP (PDF 5MB) or downloading from
http://www.solidwastemag.com/PostedDocuments/documents.asp

ETF's not always tax –efficient

ETF's are by their nature tax-efficient but sometimes events conspire to knock that idea on its head. Such is the case in Canada in 2006 with the hollowing out of our economy. Acquisitions and mergers have taken their toll on the S&P/TSX Composite index this year and this has impacted the Barclay's fund that mimics it. TSX-listed XIU lost the likes of Inco, Falconbridge and ATI and will distribute $1.800 in capital gains distributions. Capped indexes like XIT [$0.6599] of course must deal with volatile RIM. XMD distributions will distribute $3.6629 while XGD will distribute $7.0499 in capital gains distributions due to fund rebalancing. Some investors may be shocked to receive sizeable T-3 slips for 2006. Source: http://www.ishares.ca/news/press_releases.do
Barclays Canada manages over $66 billion in Canadian assets and in other assets for Canadian clients, including over $13 billion in the TSX-listed iShares Funds.

Sentry Select Diversified Income Trust throws up some surprises

TSX: STD.un's MRFP and financial statements are eye openers:

1. The **MER has risen** to 2.17 % from 1.94 % on a near $200 million increase in AUM-an ominous sign
2. The Turnover ratio was 63.09 % [2005-58.4 %] while the TER surprisingly hovered around 0.19%-during the 9 month period to Sept. 30th the fund **doubled** its brokerage commissions to $2, 078,754 (2005-$1, 067, 896) **without explanation.**
3. Based on market value, the trust returned 12.8 % for the 9 mos. ending Sept. 30, 2006 **down from 20.2 % for 2005** and **42.5 % in 2004.**
4. As a Subsequent Event Note [the Flaherty bombshell], the fund reports that as of Nov. 16, 2006 the **units traded at a 12.3 % discount** to NAV and traded at $4.48 vs. $ 5.63 at Sept. 30th.
5. The trust claims it is positioned well since it has the ability to, **but has not to date,** invest in hi-yield equities and bonds in addition to the threatened income trust sector.
6. REIT's, which mostly escaped the new tax regime, constituted 4 of the top 10 holdings and is in at 2X market weight. The top holding was the **Canadian Oil Sands Trust at 4.60 % which was adversely affected by new tax rules and declining energy prices.**

All in all, this actively –managed portfolio, dominated by income trusts, will be in for more than cosmetic surgery over the next 2 or 3 years. Keep an eye on portfolio turnover and associated expenses, more fee increases and an investment strategy change (and your account location [registered vs. non-registered]).

Turnover stat misleads

The Portfolio Turnover rate is published in the MRFP. So what is it exactly? Turnover is the percent of a fund's assets that get traded during the year, right? Wrong! To calculate turnover, fundcos take the lesser of purchases and sales and divide by assets. That means the turnover statistic is really understating fund trading activity. Moreover, if there's a big difference between purchase and sales, it can vastly understate trading. Say a fund gets huge inflows and the manager simply buys more of the stocks she/he likes most at the moment and lets less-promising stocks dwindle in proportion rather than actually sell the stocks. In such a case, turnover would be zero [0.00%] because the manager didn't sell anything, but clearly there was some trading. Fixing this issue to provide more clarity for tax and cost –sensitive investors would be a piece of cake for regulators -just require that purchases and sales be added together and then divided by assets.

"Investors must keep in mind that there's a difference between a good company and a good stock. After all, you can buy a good car but pay too much for it "- Richard Thaler, Upside, July 6, 1999

<u>“ New” IDA getting to the root cause?</u>

The Investment Dealers Association of Canada has fined *Credifinance Securities Ltd***.** $50,000 for failing to co-operate with an IDA investigation. The IDA panel found the brokerage firm failed to co-operate with two requests for documents, but that its conduct was "reasonable" with respect to 13 other requests. **<u>The case was the first time the IDA took action against a company, rather than an individual, for failing to co-operate</u>.** The IDA also assessed $15,000 in costs. Credifinance lawyers denied the allegations, saying the firm "substantially complied" with numerous requests for documents despite arbitrary or unreasonable deadlines. They also complained the IDA improperly referred to suspicious client accounts in its original notice in the case. The IDA panel concluded the references "caused unjustified harm" and "were in the nature of a penalty." The panel said it took that damage into account when deciding on the penalty in the case. Source: J. McFarland, *IDA fines Credifinance for failure to cooperate*, Globe and Mail, Dec. 19, 2006 pg B7

IFIC loses a Director: Karen Fisher, the president and CEO of Scotia Securities Inc., has departed from the **Bank of Nova Scotia.** Consequently, she has also left her post as a Director of the Investment Funds Institute of Canada. Ms. Fisher has overseen the bank's mutual fund operations since 2000. Scotia funds rarely attracted media attention or much investor dollars to extract fees from. No doubt the Scotia funds will have objectives changed, be merged into oblivion, have their names changed, incur manager changes or otherwise modified to extract more business. Investors could see a lot of churn as all this plays out. Be aware. You may not want to be part of this restructuring with its attendant risks, cost penalties, tax implications and potential portfolio impairment.

<u>Here come the trust fund name changes-fund marketeers on the ball</u>

On Halloween night, the federal finance Minister announced plans to begin taxing income trusts in 2010. A recent poll of trust-sector managers by accounting giant Deloitte & Touche predicts the number of publicly-traded trusts will fall to 100 or fewer from the current 256 by 2011. As a result, on Dec. 8, **CIBC Asset Management** was first out of the gate, deleting the ***trust*** word ***in*** the name of 2 of its Renaissance funds. The $546.2-million Renaissance Canadian Income Trust Fund will now be known as the Renaissance Canadian Monthly Income Fund, and will be reopened to new investors. The fund’s investment objective, which supposedly has not changed, is to generate a high level of cash flow by investing primarily in income- producing securities including income trusts, preferred shares, common shares and bonds. In addition, the $334.8-million Renaissance Canadian Income Trust Fund II has been renamed Renaissance Diversified Income Fund. Notwithstanding the name change, CIBC claims the investment objectives of the 2 funds - generating a high level of cash flow by investing primarily in income-producing securities - remain basically unchanged. As always, be alert to renamings –expect the fund’s **“yield”** to drop as income trusts, as an asset class, wither away. Source: http://www.cibcassetmanagement.com/News-Events/2006/news_20061208.asp

<u>Advisors have serious obligations to investors</u>

Gowlings lawyer Ellen Bessner aptly reminds us that advisors are charged with the obligation to know their clients. In a Dec. 18 National Post article she points out that this obligation does not begin and end with the completion of the NAAF/KYC form or insurance application. Advisors must do much more than simply complete forms and make tickmarks. They must look beyond the questions set out in the form and understand what lies beyond basic, and often incomplete responses [and questions]. Recently, OBSI is apparently giving this aspect more weight as investor advocates and regulators put the spotlight on restitution for incompetent, flawed or conflicted advice.

If an advisor asks a client what her time horizon is and the client says she hopes not to touch the money for "a long time," the advisor cannot simply check a box indicating the client's time horizon exceeds 5 years. One year later, when the client calls the advisor to inform him she intends to buy a house and needs to liquidate, the advisor will have to break the news – far too often for the very first time - that she will be burdened with onerous DSC or other early redemption fees and penalties.

A professional advisor collecting such core client information would probe further. If the client was happy in her apartment and didn't expect to move for "some period," the advisor should attempt to quantify this. As we have seen far too often in disputes, failure to obtain a client's essential facts sufficiently well to support each answer on the form with concrete information leads to trouble for advisors and losses/stress for investors. Unsuitable investments is among the largest causes of investor dissatisfaction. Source: E. Bessner, *It's not like selling a new suit: Financial advisors have a special duty of care for clients*, National Post, Dec. 18, 2006 [we think IPS's really help avoid many problems by delineating the investment strategy]

Investor complaint handling finally now on front burner

On Dec. 20, 2006 a Notice [MR0441] describing how firms should be handling investor complaints was issued by the Investment Dealers Association of Canada to its members. The IDA promises Rule changes to improve investor complaint handling. The Notice explains that the IDA committed to (a) issue the Notice setting out its expectations, (b) revise its complaint handling rules to impose complaint handling timelines and (c) to clarify the standards for handling investor complaints, as a result of the Investor Town Hall event sponsored by the OSC in May, 2005. Following the Town Hall, the IDA, OBSI and the MFDA struck a joint committee to address priority issues for small investors. Investor participation was however not publicly solicited. One of the joint committee's priority issues is the handling of disputes / complaints. Members may, but are not obligated to, consider posting information on their complaint handling procedures on their websites. We will be comparing proposed processes to ISO 10002 and other standards but expect a fair degree of congruence.

- IDA Notice

http://ida.knotia.ca/Knowledge/View/Document.cfm?kType=445&linkType=ftch&dbID=200625346&documentID=442¶graphID=2#para_2

Things they don't tell you about RRSP's

There are a number of pitfalls in RSP investing:

1. When you take the money out it will be taxed at your marginal rate. Many planner models unduly assume a lower tax rate at retirement which may not be the case. Further, there is a point where compounding within an RRSP but paying 100% tax upon withdrawal vs. paying 50% tax on capital gains outside an RRSP makes the RRSP disadvantageous.
2. If you buy low-cost U.S. listed ETF's or U.S. dollar denominated funds and trade them, you will find that currency conversions will impair returns. For whatever reasons, Canadian brokers continue to insist that all securities and cash be in Loonies. They of course earn hefty, generally undisclosed, fees each time a currency needs to be converted.
3. Minimum required annual withdrawals from a RRIF could increase income to the point of "claw-back" of government benefit programs. Take a read of *New Poverty Traps: Means Testing and Modest Income Seniors* http://www.cdhowe.org/pdf/backgrounder_65.pdf R. Shillington, April 2003
4. Dividends within an RRSP miss out on the Canadian dividend tax -credit.
5. Interest on RRSP loans is not tax-deductible
6. Capital losses cannot be carried backwards or forwards. Losses result in a 100% impairment as they cannot be offset against capital gains.
7. Certain fees, sales loads, early redemption penalties and other charges are not tax deductible.
8. Upon conversion to a RRIF, government legislation dictates the timing and minimum amounts of minimum annual withdrawals in a manner that may be disadvantageous to the plan holder.

Additionally, if the capital gains tax is eliminated or modified, the benefits of an RSP may become questionable. Ask your advisor, if you have one, about these points and how they apply to your situation before contributing to an RRSP.

Chuck Jaffe Annual Lump of Coal Awards

And an award goes to**.. *Directors for the 27 [U.S.] mutual fund companies working with Bisys Fund Services***
Category: Getting too many kicks
Bisys provides back-room operations for more than two-dozen small fund families, and revealed this year that it had been paying kickbacks to some of those funds in order to get and keep the accounts. That money came directly from shareholders, in the form of heightened expense ratios. The boards of funds doing business with Bisys owed it to shareholders to investigate, and then to tell shareholders in a special letter what they found and what it means to investors. Just one of Bisys' customers bothered to tell the most important people -- the shareholders -- what was going on. Source: http://www.marketwatch.com/News/Story/Story.aspx?guid=%7B3ED39348%2D24F4%2D4EB7%2DB993%2D9722764F1A10%7D&siteid=mktw&dist=nwtfunds

“Our funds’ performance is getting better and better but not fast enough to prevent it from going from bad to worse” –anonymous

Fidelity [U.S.] to offer redress over trader “ improper behaviour”

More than 2 years ago, the National Association of Securities Dealers and the SEC began investigations into the acceptance by Fidelity equity traders of outsized gifts, gratuities and entertainment from brokers with whom Fidelity Investments did business in 2002 to late 2004.This inappropriate behaviour was taking place even as Spitzer and the SEC was investing the U.S. fund industry for late trading-now that’s Chutzpah. Fidelity Investments cooperated with the Independent Trustees' investigation and concurred with the conclusion reached by the Trustees that “in spite of the absence of proof that the Funds experienced diminished execution quality as a result of traders' receipt of improper TEGG [travel, entertainment, gifts and gratuities], the conduct at issue was serious, is worthy of redress “. Fidelity agreed to make a one-time payment of US$42 million plus interest to the mutual funds. Click below for a recitation of all the going-on and especially the rare apology of a Fundco executive for wrongdoing.

TO OUR CUSTOMERS

- Independent Trustees' Report on Travel, Entertainment, Gifts and Gratuities
- Letter from Chairman Edward C. Johnson 3d
- Fidelity Statement

This should provide motivation and support for IRC’s in Canada on what is right and what is wrong in resolving a conflict-of-interest.

IDA complaint data points to need for changes in the Limitations Act

The Investment Dealers Association of Canada recently published investor complaint handling data showing that for the period from Oct. 15, 2002 to Nov. 30, 2006:

- a full 22% of outstanding customer complaints are more than 9 months old, and
- 8%, or about 1 in 12, of outstanding customer complaints are more than 12 months old.

As for complaints that have been “resolved”, for the same time period, **15% of investor complaints were not resolved within 6 months or less**; and, **5% of customer complaints were still unresolved even after 12 months** or about 3 months longer to give birth to a child. Oddly, an investor complaint is considered resolved by the IDA if it has been received and reviewed by the firm and the firm has merely communicated their decision about the complaint to the investor. It is considered unresolved if it is still under review by the firm, in some form of dispute resolution (arbitration, litigation) or awaiting investor response. An investor considers a complaint unresolved if he/she is unsatisfied

with the result or no response has been received. When you consider that most investors, especially seniors, take some time to even recognize an issue, take some time to organize their thoughts and still longer to get the courage to ultimately complain, it's pretty clear that 2 years is a wholly inadequate statute of limitations period. Source www.ida.ca Complaint Handling

Deutsche Bank coughs up US $208 million for market timing abuses

Deutsche Bank will pay US$208 million to conclude state and federal investigations into the timing of trading in mutual fund accounts, marking the 21st settlement by outgoing New York Attorney General Eliot Spitzer in his three-year-long mutual funds investigation. Mr. Spitzer claimed that the Frankfurt, Germany-based bank's asset management division allowed market timing in its mutual funds, and that the broker dealer division helped in the assault on investor accounts. Market timing activity within the DB family of mutual funds included improper trading at the Scudder and Kemper families of mutual funds. As is usual in these cases, the bank did not admit or deny the charges. Investors will receive US$102 million and US$20 million will go to civil penalties, reports said, and the bank has to decrease its fees by $86 million to investors over 5 years (DB must hire a full-time senior officer to ensure that fees charged by the funds will be negotiated at arm's length and will be reasonable). A similar case is expected to be settled soon with the Illinois attorney general's office for $4 million .R. Froymovich, *Deutsche settles with Spitzer for US $208M,* Investment News, Dec. 21, 2006 [the OSC cut short its prosecution of mutual funds in Canada arguing that the 5 cases dealt with sent a message to the industry –investor advocates were less than delighted with this unjustified curtailment of justice]
http://www.oag.state.ny.us/press/2006/dec/dec21b_06.html

email from a reader: Ken: I would assume that for funds that are actively churned, I mean traded, the brokerage fees would be much higher. Also, would there not also be the possibility for abuse in that one could question how the brokerage fees are determined. Perhaps, in return for some other benefits, e.g.: access to new issues, a fund might pay a higher than normal trade fee. Since the focus of attention is strictly on MERs, then this is a way to hold down what is visible but to incur the expenses where the cost is largely unseen. That is why I just do not understand why it is not a requirement that all of the costs be publicly shown and not just a part of them. Any idea how this can be changed so that there is full disclosure? J. Doe , Toronto ON

RESPONSE: The Trading Expense ratio is now disclosed [in the MRFP] by the fundcos, representing the fraction of fund assets spent on brokerage commissions. By adding the MER to the MER a good idea of fund expenses can be had. Unfortunately, most retail investors don't make this connection and on-line sites, like globefund.com, don't provide TER info. As to wrongdoing, there is of course ample opportunity to use trading clout to extract benefits for the fundco. Soft dollar transactions are one example; receiving "rebates" is another. That's why fund governance is high on investor advocates priority lists.

What are your *real* fund returns ?

"..In June [2006], Morningstar [US] began publishing ***investor returns*** for all the funds it covers. The more familiar total return figures - the ones you see in marketing literature - reflect the changes in the value of a fund's portfolio (including reinvested dividends) over a specific period say three or five years. These are valuable statistics for gauging relative performance. But *investor return* numbers take into account a fund's inflows and outflows, providing a fuller picture of how investors really fared. Say that fund has a monster year, with 100% return, and money floods in during December tripling the fund's size. Then the next year the fund loses 20%. Over two years the fund would be up a stellar 60%, but the majority of shareholders would have lost money and the fund would have a negative investor return. A fund's investor return can exceed its total return if more investor's bought in on the upswing. For more on *investor returns* see www.global.MorningStar.com/investorreturn.

The dollar- weighted return can be useful in picking the right funds. Morningstar's analysis of investor return data shows that investors tend to do worse in volatile, high-risk funds than in cautious, steady ones. Dramatic dips can frighten us into selling prematurely. The dollar- weighted returns of the most volatile high-risk funds as a group were just 62% of their total returns over the most recent 10 years measured by Morningstar. By comparison, investor returns for the least volatile funds almost matched their total returns…". Source: Y. Rosenberg, *Funds that Mint Money*, FORTUNE, Dec. 25, 2006 pgs 69-76 [investor return info. is not yet available in Canada]

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Information contained herein is obtained from sources believed to be reliable, but the accuracy is not guaranteed. The material does not constitute a recommendation to buy, hold or sell. The purpose of this Document and others in the series is to educate investors by bringing together personal finance information from a variety of sources. It is not intended to provide legal, investment, accounting or tax advice and should not be relied upon in that regard. If legal or investment advice or other professional assistance is needed, the services of a competent professional should be obtained.