Money management in tough times

Continued from page 5

a little chippy. Part of buying low is that you actually have to put some money to work when things are looking ugly. It's just insane for a 35-year-old with a long timeframe to lock in money at historically low interest rates, and that's before we even put inflation into the picture."

That isn’t to say there's no renewed interest in deposit products. Peter Ficek notices more awareness from business owners in particular. Ideally, 10% of a business's revenues should be placed in cash because it will improve the business's chances in obtaining bank financing.

Ficek, who specializes in business planning before he looks at personal planning, says when it comes to financing small businesses, banks consider the current debt to equity ratio, the current working capital ratio and the current debt service coverage ratio.

But over the last decade, business owners have tended to use any extra money toward further business investment. "In good times, we seem to forget the basics and in worse times, we seem to go back to the basics," says Ficek, a CFP, business finance consultant and president of the Calgary-based Business Financing Corporation.

When saving 10% regularly, business owners "look better in the eyes of their bank, therefore they're able to be those few businesses that have improved chances of obtaining financing" in a tougher economic climate.

What about new assets?

Waiting for a recovery with current assets is one thing, but what about new money for investing? Julie Leefe finds more of her older clients requesting that these funds go toward GICs. "People aren’t demanding to sell something that went down the last three months of 2008, but if we have some money that’s been freed up, it may go to GICs," says Leefe, a financial planner and investment advisor with National Bank Financial in Winnipeg. "In general, we’re having a discussion about how much more safety they might like going forward. But we’re not seeing a change from medium-risk investments to low risk until we see a little more recovery."

She’s very reluctant to use five-year GICs since the rates are so low. But typically her clients have ladderings in their fixed income portfolios, which means different products mature each year. Some advisors see last year’s events as an opportunity to bring up the guaranteed minimum withdrawal benefit products with clients. When these products first debuted in 2007, Brain originally scoffed at the cost for GMWBs. He’s now changed his mind, especially since some products guarantee income for life. "The right situation is for somebody who is so completely risk averse that they need to have that guarantee," he says. "What this latest environment has revealed is that there are a lot more people in that category that we thought."

Fieberg is reluctant to have his clients pay high fees for guarantees but recognizes there could be a need to protect RRIF, savings or future incomes. He’s currently evaluating four different GMWB products. As he points out: "Advisors make their money in good years and earn their money in bad years and right now, for the last nine months, we should have been earning our money by working very hard. We should be looking at clients individually and thinking of the tax effects and the sensible financial needs they have at the time."

Verbatim from advisors

“My satisfaction level depends on the investment time horizon of the investor: Long = good, short = unsatisfied.”

"Some uncertainty still exists with equities. Fixed income will be a problem when the economy recovers and interest rates rise. This will affect balanced funds, somewhat.”

"I am a believer in buying for the long term. In the past few months, clients have seen their values come back up and those who deposited new money are doing very well. The only clients losing money are the ones who deposited it in money market funds. Most clients are looking at a long-term horizon over the short term.”

“There is more client interest in segregated funds, for sure. But we haven’t changed who we recommend any funds. For certainly there is a lot more client interest in any product that has guarantees tied to them.”

Money market funds (MMFs)—the largest segment of the mutual fund business—are an important part of the Canadian investment landscape. Assets held by MMFs totalled $73.1 billion at the end of May 2009, an increase of 27.4% since May 2007, according to the Investment Funds Institute of Canada.

When compared with the $503.7 billion in total liquid deposits in Canadian banks reported by the Bank of Canada for April 2009, MMFs represent a significant portion of the Canadian economy, although not as important as they are in the U.S., where MMF assets of $4 trillion compare with bank deposits of $8.7 trillion.

In the U.S., MMF sales have been encouraged by the reserve requirements of the Federal Reserve. In order to minimize their mandatory reserve balances (which did not pay interest until very recently), many banks offer “sweep” programs to their depositors, whereby excess funds in checking accounts are automatically used to purchase MMFs on an overnight basis.

In my essay published in the December 2009 edition of AER, A Collateral Proposition, I argued that:

investors have a strong expectation of zero loss from MMF investments;

banks would be forced, due to reputational concerns, to cover credit losses incurred in their MMFs;

therefore, the credit risk of the commercial paper held by bank-sponsored MMFs should be included in their risk-weighted assets for capital ratio calculations.

Concern regarding reputational risk is not simply a reaction to the extreme events of the credit crisis. The implicit guarantee has been tested before: 15 near-failures of MMFs in 1993-94, reserve proposals that applied to credit risk (MMF: MMF:

Concerns regarding reputational risk are:

- MMFs that seek to offer bank-like services, such as maintenance of a stable NAV, should reorganize as special-purpose banks, with all the regulatory and capital implications that bank status implies; and
- other MMFs should not be permitted to use amortized cost pricing of their assets and would therefore carry a fluctuating NAV.

These proposals, endorsed by the Bank of England and currently being reviewed by the President’s Working Group on Financial Services and Markets Commission, required an increase of about $25 billion in NAV. The proposals that apply to credit risk are:

- requiring that all money-market fund advisors establish a “new products” or similar
The future of money market fund regulation

It should be very clear to all sponsor’s role as trustee of the funds and their advisors to follow best practices for determining minimal credit risks; retaining references to credit ratings in SEC rules as an important “floor” on investments; and requiring advisors of money market funds to designate and publicly disclose a minimum of three credit rating agencies that the advisor will monitor, to encourage credit rating agencies to compete for this designation by improving their ratings systems for short-term debt.

The emphasis on credit rating agencies in the ICI’s proposals is simply an abnegation of the sponsor’s role as trustee of the funds. It should be very clear to all participants that the portfolio manager designated by the trustees is solely responsible for determining credit quality. He may take advice from his analytical support team, from the credit rating agencies, or even from a barber if he wants to, but he must not be permitted to delegate a shred of his responsibility for determining the suitability of investments.

Further, any revision of the SEC’s rules must include the aim of providing a legal basis for the harassment of employees affiliated with a failed sponsor. It is the purpose of bank capital requirements to absorb such unexpected losses.

IIROC REOPENS TAUB PROCEEDINGS

Taub, a former stockbroker, stalled enforcement action for more than four years, claiming IIROC has no legal means to pursue him. IIROC vigorously appealed the decision, and won a reversal of the Divisional Court at the Ontario Court of Appeal.

GOLD PRICES WARRANT CAUTION

There are a number of reasons why you should invest in gold, but advisors need to be wary of the meteoric price of the metal, which could be the result of over-hype.

According to a recent report by Windsor-based Dan Hallett & Associates, gold investors need to be aware that much of the demand for gold is being driven by the financial markets rather than substantial shifts in supply and demand.

JAMES HYMAS is president of Hymas Investment Management Inc.

YOU ARE A GTA ADVISOR AND HAVE AT LEAST $30 MILLION IN ASSETS. You know the next few years will be a lot of work, and you are thinking about your options. YOU WOULD LIKE TO BE PAID AT LEAST $400,000 FOR YOUR BOOK. AND YOU NEED TO BE CERTAIN THAT YOUR CLIENTS WILL BE WELL TAKEN CARE OF.

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