SIPA Sentinel

January 2012

Small Investor Protection Association - A voice for small investors

GAIL BEBEE PROVIDES EXCELLENT ADVICE TO INVESTORS

The following is a message from Gail Bebee which is worthwhile passing on to all SIPA investors. Keeping in mind that most investors who suffered significant loss were not well diversified and were generally leveraged, Gail's comments are on the money. In these days of volatility and unpredictability diversification is extremely important to help protect your investments from significant loss. For most investors leverage should be avoided. Anyone leveraged last year likely experienced significant loss. Gail's message follows:

"Happy New Year!
I'm sure many of you would like to bid good riddance to the investing year 2011. Before moving on, do take a few moments to review your investing experience over the past year and pinpoint what you learned that will make you a better investor.
Here are five key lessons that 2011 drove home to me.

1. *Diversify, diversify, diversify! 2011 asset class returns were all over the map, once again confirming that putting all your eggs in one basket is risky.*
2. *Bonds may be boring, but they are essential portfolio building blocks. The Canadian Bond Universe Index gained 9.7 % in 2011.*
3. *There is an investing world beyond Canada. In 2011, the S&P/TSX Composite Index lost 11 %. South of the border, the Dow Jones Industrial Average returned 5.6 %.*
4. *Never get sentimental about a stock. RIM was a Canadian tech darling, but those who held the stock throughout 2011 lost 75 %.*
5. *Gold does not always glitter. The price of gold bullion was up about 10%, but at year-end, the precious metal was down 17% from its August high.*

May the investing year 2012 prove a profitable one for you."

LARRY ELFORD CONTINUES TO SPEAK OUT IN LETHBRIDGE ALBERTA

Dave Mabel writes in the Lethbridge Herald about Larry's campaign seeking better investor protection. Larry had a career in the investment industry trying to encourage change from within. Now Larry has produced a video, operates a website at www.investoradvocates.ca, is active on social media, and continues to speak out. The following is Mable's article in the Lethbridge Herald:

"Robbers are taking $60 billion from Canadians every year.
But the police and the politicians are doing nothing to stop them, a Lethbridge audience was warned Thursday.
That estimated $60 billion is as high as the cost of all the nation's other crimes combined, pointed out veteran financial coach Larry Elford. And it's crippling North America's economy.
"This is not a recession," he told the Southern Alberta Council on Public Affairs. "This is a robbery, and you are the victims."
Canada's investment industry has abandoned its "do no harm" code of ethics, he said. But Elford - a Leth-

bridge man who worked 20 years for some of the nation's leading investment houses - said the nation's securities commissions are doing little to penalize unethical sales people.
Meanwhile, he said the RCMP - the only police agency that's empowered to act on a national scale - is given just a token $16 million a year to enforce the laws against "white collar" crime across Canada.
The nation's major banks got far more than that when they asked for a bail-out after the collapse of such American financial icons as Lehman Brothers and CitiBank, he pointed out. Yet some Canadian financial institutions were equally guilty of selling worthless "asset-backed paper" to gullible buyers.
In Lethbridge, Elford said, that put $30 million of the city's tax dollars at risk. So far, he said just $8 million of that amount has been covered - in a deal that admits a $2 million loss.
Worse, he said city officials tried to hide their ill-advised "investment."
"That helps this process to continue."
ATB Financial was even harder hit, he said, and so was the University of Calgary. But nobody would have been at risk if the Alberta Securities Commission had acted in the public's interest.
Instead, he said the ASC allowed the "junk bond" sellers an exemption from the law - one of more than 4,800 similar exemptions it's allowed over recent years.
"Our securities commission acted in violation of the public trust."
But after outlining the issue in letters to Alberta's finance ministers - Iris Evans, Ted Morton and Ron Liepert - Elford said each of them in succession defended the government-legislated ASC and refused further discussion.
White-collar criminals "can buy special permission," and Elford said other provinces' securities bureaucrats are no more protective than Alberta's.
The federal government's proposal to have one national securities commission take over from 13 provincial or territorial ones would have saved Canadians an estimated $10 billion, he said. Government-appointed securities officials are very well paid.
Eliminating provincial fiefdoms could have helped everyday Canadian investors, but the new commission "would have had some of the same people." What's really needed, Elford said, is a national investment protection agency - a proposal the federal Conservatives reject.
On the national level, he reported training manuals when he started in the industry included a code-of-conduct requirement that all transactions be in the client's best interest - not the seller's. But the industry has now dropped its "do no harm" principle, and it's aging widows who are scammed most often.
Like lawyers and doctors, he said the investment sales industry has been granted self-regulatory powers. And provincial commissions provide "kangaroo courts" instead of effective consumer protection.
"The rules are gone. They were stolen from you by bankers, lawyers, regulators and politicians."
No wonder some Canadians have taken to the streets in protest, Elford said. When they point out social ills, we should give them a listen.
Instead, some "Occupy" protesters were thrown in jail, Elford said. But in Canada, he maintained you aren't prosecuted if you "earn" $100 million by selling junk bonds or worthless investments."

IT'S TIME TO LOOK AFTER YOUR INVESTMENTS

Well it's another year and time to think about your investments. At the beginning of January Canadians are entitled to invest another $5,000 in their Tax Free Savings Account (TFSA). These accounts should have been named Tax Free Savings Plan given that you are able to purchase the same investments you would for your Registered Retirement Savings Plan. Some Canadians believed that they were limited to holding only savings accounts and so lost out on any investment gains. I started investing $5,000 each year primarily in common dividend paying shares and Exchange Traded Funds (ETFs). By the start of December 2011 I had invested $15,000 and the market value of those investments was almost $20,000.

However many investors are simply depending on their registered representatives and are not paying sufficient attention to their investments. Everyone should know what they are investing in and how the performance compares to an appropriate benchmark. As we move away from Defined Benefit Pension Plans towards Defined Contribution Pension Plans it becomes even more important for Canadians to become interested in their investments. It is also important that both spouses be involved and be aware of their investments. There are too many cases where one spouse looked after the families investments, but upon their death the family was lost when they did not know what to do. Unfortunately many who were left with sufficient funds for a comfortable life lost their savings when they were sold unsuitable products and often leveraged.
The Canadian Investor Protection Fund (CIPF) carried out some research and the results were presented by the National Post in the following article. It is interesting to note that 19% depend upon their so-called "advisor" to protect their investments and 16% depended on diversification.

Paul Brent wrote an article in the National Post early January "*Investor acumen missed the list".*

Some of his comments follow:

"To update and expand previous research assessing investor awareness about CIPF protection, the Fund recently commissioned a survey of more than 1,000 adult Canadians across the country. The survey contains mostly good and a little bad news about just where investors are today. One of the findings has to do with those dreaded New Year's resolutions. It turns out that a little less than one in five of us make investment or financially focused resolutions."

...

From her post as president of the CIPF, a national organization established and financially supported by the investment industry to ensure client assets are protected in the event of a CIPF member firm bankruptcy, she views New Year's as a time when investors should also consider the safety of their investments.

...

The CIPF survey of Canadians who have investments purchased through a broker or financial advisor found that the largest group of respondents (23%) had assets of more than $250,000 (and 3% had more than $1-million). One in five fell into the $100,000-to-$249,000 range, with the remainder being under $100,000 or not knowing or not answering.

Given the choice of describing themselves as novice, intermediate or advanced investors, the largest segment described themselves as intermediate investors (46%), another 41% tagged themselves as novice and just 13% called themselves advanced investors. More women than men put themselves in the novice camp (50% to 32%) with men more likely to say they are intermediate (51% vs. 40%) or advanced (17% vs. 9%). Those with more financial assets also tended to say that they had more investment knowledge than those with fewer investments.

...

Four-fifths of investors viewed investor protection as important, particularly among women who called it very important (50% compared with 39% of men) and those aged 50-plus compared with those under 30 (51% to 21%).

...

Asked how they protected their investments as investors, the survey respondents made the first line of defense their financial advisor. A total of 19% said putting trust in their advisor was the main way they protected themselves from risk. That answer was followed by protective strategies of diversification (16%), invest conservatively (15%) and monitor investments regularly (14%).

...

Women were more likely than men to say they put their trust in their advisor to protect their investments (22% to 16% for men) and those aged over 50 similarly leaned more heavily on their advisors, with 23% identifying professional help as the most important protection of their investments. Men are more likely to say that diversification is the key way they protect their investments (20% to 12% for women).

Those with incomes $40,000 to $59,000 are more likely to say they trust their advisor (26%). Those with incomes greater than $80,000 are more likely to say they diversify (23%).

LEVERAGING - DOES IT INCREASE YOUR RISK OF SIGNIFICANT LOSS?

For more than a decade we have been hearing from small investors who have disputes with those they trusted with their investments. Lack of suitability is the main reason for all significant loss, but the two factors common in almost all cases are leveraging and lack of diversification. In late January Rob Carrick wrote an article for the Globe and Mail *"Leveraging: Where math and emotion are a bad mix".* The following are some of his comments. The complete article is available on the Glob and Mail website.

"Leveraging is an investment industry term that is best defined as borrowing trouble. Technically, it means taking a loan out to invest in stocks or funds. The more you invest with borrowed money as opposed to your own, the larger the profit you can "leverage." Losses are also magnified, which is why leveraging is a strategy you should avoid."

"Warning: Leveraging proponents, and there are many in the financial industry, can be persuasive. If you're cornered by one, just say your life is exciting enough without watching stocks or funds you bought with borrowed money plunge in value."

"For the investing industry, leveraging is a slam-dunk winning strategy for turning small accounts into big ones that generate more fees and commission. Expect to see lots of hype about RRSP loans now that registered retirement savings plan season is under way. Although not a classic leveraging situation, RRSP loans are still borrowing to invest."

"Just this week, the Ontario Securities Commission issued a note to investors about the risks of leveraged investing. Two key points: Leveraging increases your investing risk; and you're on the hook to pay off your loan even if your investments tank."

"Last fall, the Canadian Foundation for Advancement of Investor Rights (FAIR Canada) sent a letter to provincial securities regulators suggesting there be a presumption that leveraging is unsuitable for retail investors. The onus would then be on the person recommending the leverage to prove it's an appropriate strategy. "We don't think most investors adequately understand the downside risks," said Marian Passmore, associate director at FAIR. "It's easy to get sold [on leveraging] without truly understanding what you're doing.""

"That point is backed up by the experience of Ottawa lawyers John Hollander and Harold Geller, who say leverage matters account for about half of the investor complaint cases they handle. The complaints are usually the same: The client didn't understand how much he or she could lose in a down market. "Over and over, we're hearing clients say 'we did not know,' " Mr. Hollander said. "If one [client] said it, I'd say, okay, that's pretty self-serving. You were told there could be a hit and you didn't want to take it. But they all say it."

Rob's closing comment is: *"Leveraging? Why put yourself through it?"*

NATIONAL REGULATOR - WILL IT HAPPEN?

Finance Minister Flaherty said that the Government cannot proceed with the legislation as it was drafted but the court had found there is both federal and provincial jurisdiction in the securities field, and that he has begun discussions with provinces about a joint approach.

Minister Flaherty said: *"I hope that we can make an arrangement with the provinces to proceed with a Canadian securities regulator … I've had some discussions with some of the ministers responsible for securities regulation. … And some of our officials have also had discussions. So we're trying to see if there's a basis for going forward with the Canadian securities regulator in line with the decision of the Supreme Court of Canada. We'll see. … The reception has been fairly good. There's a recognition that the decision by the court found that there is some federal jurisdiction, and certainly provincial jurisdiction. So now we know it's not 100 percent one way or the other, so we need to talk to each other."*

The Canadian Securities Transition Office (CSTO) is working with the Department of Finance and talking to provinces about how the two levels of government can jointly move forward to establish and empower a Canadian securities regulator. So there is still hope that the investment regulatory regime will be improved.

IS CANADA REALLY THE SCAM CAPITAL OF AMERICA?

It seems there are new disclosures of fraud and wrongdoing almost every day. Many of the scams are no longer news. Many unknowing Canadians are being taken in by internet and telephone scams ... Nigerian letters, stranded friends needing cash, etc. There are also independent fraudsters offering investments to affinity groups and longstanding friends. Then there are the corporate frauds and investment industry manipulations that cost investors dearly. The regulators are failing investors by not having adequate means of restitution. Now the Ombudsman for Banking Services and Investment (OBSI) that provided a means for limited restitution is facing difficulty as industry feels OBSI is too easy on investors. A recent review by the Navigator group suggested that OBSI's processes were fair. SIPA feels that OBSI is not clear about how they stop the clock for limitation periods, they are unable to make objective recommendations without negotiation with industry, and their practice of using "notional accounts" does not recognize that many KYCs are not factual. In many cases the industry revises the KFC to be consistent with the investments held, and there is no requirement for industry to provide clients with a copy of the KYC. In many cases clients have not seen their KYC form until a problem developed and they then found the KFC had wrong information and in some cases their signature was forged. This practice misleads regulators.

The fundamental issue in Canada is that values appear to be changing. Honesty is no longer a prerequisite for high positions, and management and financial reports can be manipulated to misrepresent the true situation. This coupled with the fact that the registered representatives looking after client investments generally do not have a fiduciary duty and do not need to put their clients interests first. That is it seems acceptable for registered representatives to sell products that maximize the return for the registered representative. The lack of fiduciary duty or putting clients' interest first results in many Canadian investors being inappropriately leveraged.

A recent article by Dan Ovsey in the National Post *"Credibility of Canadian CEOs last in group in new survey"* indicates Canadians are beginning to realize this fundamental problem. Dan Ovsey writes: *"Canadians' trust of the corporate world has taken a dramatic downturn in the past year, pushing the credibility of Canadian chief executives to last place among public influencers - below that of government officials and regulators. The overwhelmingly negative perception of CEOs was revealed Thursday in a study commissioned by multinational public relations firm Edelman. The agency's annual Trust Barometer, which surveys the opinions of more than 30,000 people across 25 nations, shows Canadians' trust of CEOs has declined dramatically since last year. In fact, Canadians are twice as likely to trust a peer and almost twice as likely to trust a regular employee over a CEO. "[Canada is] one of few countries we surveyed where CEO trust is the lowest," said Edelman CEO Richard Edelman."*

INVESTING FOR DIVIDENDS? PAYOUT RATIOS ARE IMPORTANT.

Many investors have turned to dividend paying shares. as these often provide a higher return than bonds or GICs and may offer growth opportunity as well. John Heinzel wrote an excellent article in the Globe and Mail on the importance of payout ratios. Some comments from the article follow:
jheinzl@globeandmail.com
I have a question about dividend payout ratios. Some companies have payout ratios of more than 100 per cent, and some as low as 20 per cent. For a company to remain healthy and grow, what's a reasonable payout ratio? - C.P.
The dividend payout ratio is the percentage of a company's earnings paid out in dividends, and it varies widely depending on the industry, stage of growth and other factors. Generally, young and fast-growing companies pay out little - if any - of their profits, because they need the cash to finance expansion and can reinvest the money at high rates of return. Stock market darling Lululemon Athletica Inc., for instance, hasn't paid a penny in dividends.
Similarly, stocks with volatile earnings, such as mining and exploration companies, and technology firms that need cash for research and development, usually pay no dividends or only a token amount.
At the other end of the spectrum are mature companies whose headiest growth days are behind them but which still generate stable, rising profits. Because these companies have more predictable earnings or lower capital needs, they can afford to pay out a chunk of their profits to shareholders. Examples include telecoms, cable companies, pipelines and utilities.
Companies will often set a target range for their payout ratio, which you can sometimes find on the investor relations section of their website. Pipeline operator Enbridge Inc., for example, targets a payout ratio of 60 to 70 per cent of earnings, which provides "a healthy balance between returning income to shareholders and retaining income for re-investment in new opportunities," it says.
It's not unusual for companies to stray outside their payout ratio guidelines, however, if their earnings take a temporary hit. Bank of Montreal's policy is to pay out 45 to 55 per cent of earnings, but when profits sank during the financial crisis the ratio topped 90 per cent.
In extreme cases, the payout ratio can exceed 100 per cent, although such a situation isn't sustainable. Sun Life Financial Inc.'s payout soared to more than 100 per cent in 2008 and 2009, but the company maintained the dividend because it had the cash resources to do so and was counting on profits to rebound and restore the ratio to a more manageable level. Fellow insurer Manulife Financial Corp. chose a different path, however, slashing its dividend in half in 2009.

Generally, the lower the payout ratio, the safer the dividend - and the more room for dividend growth. Grocery retailer Metro Inc. has a conservative payout policy of just 20 per cent of net earnings from the previous year, before extraordinary items. So although the dividend yield is small, at about 1.6 per cent, the company increases the dividend every year like clockwork.
With bond yields at historic lows and more investors looking for cash to fund their retirement years, dividend payout ratios may be set to rise in coming years to meet growing demand for income.
Up until the 1970s, the average payout ratio for U.S. companies was about 50 per cent. But since the 1980s, when investors started emphasizing capital gains instead of dividends, the payout ratio has fallen steadily and now hovers around 30 per cent, according to Daniel Peris, author of The Strategic Dividend Investor.
But the trend may be about to reverse, as companies find it harder to reinvest profits at attractive rates of return and shareholders demand more cash in their pockets.
"The general landscape is one in which corporate payouts to company owners ought to rise," he writes. "More and more baby boomers will be retiring and shifting toward an income focus from their investments. On both the business front and from investors, supply and demand will work in favour of companies returning to more normal dividend payout regimes."

SMALL INVESTORS ARE MOVING TO ETFs

Why are many small investors moving to Exchange Traded Funds (ETFs)?
In Canada mutual fund fees are high and these fees have eroded mutual fund investments so much that many investors have seen their mutual fund investments stagnate.

ETFs are similar to mutual funds in that they offer diversification but have low management fees and there are no deferred sales charges. The fees for buying or selling are similar to fees for buying shares. A commission is paid whenever the ETF investment is bought or sold. For Do It Yourself (DIY) investors this trade commission can be less than $10 per trade.

As more investors move to ETFs, industry is responding by creating new products also called ETFs but with higher fees than traditional ETFs. Still, total assets invested in ETFs in Canada are only 5% of assets invested in mutual funds. We expect that will increase as Canadians become more aware of the advantages of ETFs over mutual funds. Virginia Galt wrote an interesting article published in the Globe and mail which provides information on Claymore and BlackRock ETFs:

Former ETF rivals are now family - The BlackRock-Claymore deal gives investors more choice for exchange-traded funds under one roof

VIRGINIA GALT, Special to The Globe and Mail

Mary Anne Wiley savours the one coffee she allows herself each day and talks about the current buzz that's coursing through her industry: BlackRock's acquisition of exchange traded funds competitor Claymore Canada. The combination of Canada's two largest ETF providers will offer investors a comprehensive suite of products, while giving BlackRock added heft to take on its most formidable competition in the asset management sphere - the mutual fund industry, says Ms. Wiley, managing director of iShares for BlackRock Asset Management Canada Ltd.
As of Dec. 31, BlackRock offered 48 ETFs in Canada, representing $29-billion in assets under management, and Claymore offered 34 ETFs and two closed-end funds representing $6.9-billion in assets. Combined, operating under BlackRock's iShares brand, they will account for 85 per cent of the Canadian ETF market.

"We know there's demand for both product lineups ... Our overarching goal is to make sure that at the end of the day, when the deal closes, clients feel they now have an even more powerful product lineup and service provider with the combined entity. What that's actually going to look like is exactly the work that we are doing now," Ms. Wiley says.
It was Claymore that initiated the deal with BlackRock, after weighing the intentions of several suitors, says Som Seif, who started what became Claymore's Canadian operations.
Toronto-based Claymore was a unit of U.S.-based ETF provider Claymore Group Inc. before being acquired by New York-based Guggenheim Partners LLC in 2009. It was put up for sale last fall, with BlackRock announcing its acquisition of Guggenheim's Canadian Claymore subsidiary for an undisclosed price in January. The deal is expected to close at the end of the first quarter of 2012, subject to regulatory approval.
Although it will ultimately be BlackRock's call, "we don't see any real [fund] closures or changes in mandate on either side, as there isn't really much overlap across the funds," says Mr. Seif, president and chief executive officer of Claymore Canada.
ETFs, which trade on stock exchanges, typically track an index or asset class. Unlike actively managed mutual funds, which strive to beat stock market benchmarks, ETFs, for the most part, are passive investment vehicles designed to replicate the returns of the indexes they track. BlackRock focuses on market-capitalization weighted indexes, while Claymore ETFs take a different approach, tracking indexes based on "fundamental" factors, such as dividends and cash flow.
Claymore has different fixed-income product offerings, "they have non-cap-weighted equity and they have a really attractive commodity lineup," Ms. Wiley says.
Adrian Mastracci, portfolio manager at KCM Wealth Management Inc. in Vancouver, says that, while BlackRock and Claymore take different approaches, there are enough similarities that he is "sure there is going to be some amalgamation" of funds once the deal closes.
"We are not happy to see Claymore go, of course, because we like competition. Competition is good for investors, and it's good for advisers when we have more things to look at. So we are probably going to lose some things [as a result of the acquisition], and we are just going to have to deal with that."
Still, Mr. Mastracci adds, it is a vibrant market and new products will emerge - both from the BlackRock-Claymore combination and their competitors in the ETF field, including establishment players such as Bank of Montreal and Royal Bank of Canada, along with Toronto-based Horizons ETF Management Inc. and new entrant Vanguard Group Inc.
Investor awareness "is very high now," says Ms. Wiley, a University of Western Ontario sociology graduate who landed in the asset management field by happenstance when she was hired to fill in for a maternity leave at State Street Global Advisors. Discovering a passion for the business, Ms. Wiley went on to earn her chartered financial analyst designation and "has never looked back."
ETF assets are now equivalent to about 5 per cent of all mutual fund assets under management in Canada, up from 3.6 per cent three years ago.
With its Claymore acquisition, BlackRock is in a better position to capitalize on the growing appetite for ETFs with a broad range of products that, she says, have "democratized investing" by giving individual investors access to institutional-class investment opportunities for relatively low fees compared with the management expense ratios charged by mutual fund managers.
"The markets are not delivering double-digit returns, nor does anybody expect that's going to happen any time soon, I would think." As a result, investors are paying much closer attention to how much they are shelling out in management fees, she says.

NEW YEARS RESOLUTION - BECOME MORE AWARE OF INVESTMENTS

You need to monitor your investments and compare your results to an appropriate benchmark. Failing to watch your money can result in nasty surprises ... even with the regulated investment industry.