Aren't You a**maze**d?

Nov 2006

Tidbits to help you through the financial labyrinth of life

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1, Baby Boomers retiring—some planning considerations

We are in the early phase of a period when the baby boomer generation retires. This period will take a few decades for society at large, but the transition will span into several years for most individuals as well; it will rarely be a one-time event.

In broad financial terms, we can talk about the attention of baby-boomers switching from wealth accumulation toward wealth preservation and asset utilization. No wonder therefore that the special characteristics of retirement income planning get increasingly more attention these days from both the financial product manufacturers and the various service providers. There is a lot of innovation happening in both products, and services and tools.

Very few people can honestly claim to be an expert at planning the optimal utilization of accumulated wealth in retirement, because the emphasis traditionally tended to be on the 'sexier' asset-accumulation strategies, tactics, and products. Even for those few, there is a lot to learn. There is a different demographics: significantly longer life-span, and often the presence of even the parents of the new retirees. Then there is a new lifestyle and value system that the boomer generation brings: usually more active, hedonistic, and risk taking than previous retiree generations. These are, of course, broad generalizations; still, these circumstances have probably

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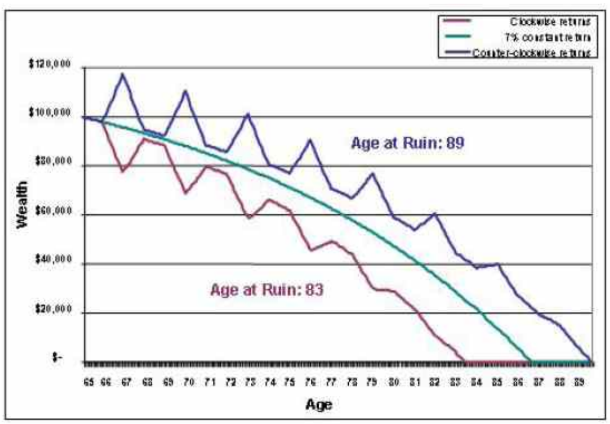
strengthened the tendencies toward more sophisticated understanding , concepts, products, and tools. Some of these are:

- Recognizing the importance of specific earning patterns, beyond the importance of slight differences in volatility and long term average returns.
- Probabilistic calculation of how long an asset base can be used for drawing income from.
- Tax-efficient utilization of retirement assets via special asset-types or, e.g., the ability to identify situations when the 'use non-registered money first and registered money last' rule of thumb is invalid.
- New kinds of insurance products and applications that can make health-risk management, income generation and estate-planning more efficient.
- Flexible planning, allowing the calculation of meaningful, individualized scenarios, to see the consequences and requirements of a wide range of possible futures.
- Fine-tuning of asset-utilization in ways that maximize the use of tax deductions and tax credits, and minimize social security payment claw backs.



Demonstration by Prof. Milevsky, of York U., of how much effect just a slight difference in the sequence of the same annual returns may have on the sustainability of a retirement income flow. (how fast money runs out calculation)

Surveys after surveys reveal that many Canadians start saving for retirement rather late, and a high percentage of even those who are aware of the importance of planning fail to actually implement either the action of planning itself, or its outcomes. The detailed findings of one of these recent surveys can be found at (the lower right corner of) the www.dsf-dfs.com/en-CA/ web page.

In a sense, these findings are not very surprising, or at least they are in harmony with an international survey (article by Tonn, Hemrick and Conrad, in Futures, Sept 2006) that sought to learn about people's perception of the future in general. It found that, on average, people don't think ahead more than 10-15 years; they think more about the present. On the other hand, they tend to worry more about the future. Interestingly, males were found to think more and worry less about the future, and in general, there was a strong correlation between thinking about the future, clearly imagining the future, and being optimistic about the future. As the researchers conclude, the 'results suggest that visioning and scenario writing, tools to help people think and imagine the future, may be able to help people become more positive about the future and lead people to be **more proactive** about the future'. [emphasis added]

There is also some evidence for what I'd call an 'ostrich-self-defense' type of illusion. The researchers found it 'interesting that the respondents believe they have more control over their destinies than humankind does when in fact the behavior of even chaotic systems is more predictable at a large scale than is any of the parts or agents that compose the system.' Toward the end of the article, the authors raise another issue that is relevant for personal financial planning, including retirement planning. They think it's disconcerting that almost one-half of respondents believed that humankind will become extinct within 500-1000 years. They think 'if one does not believe that humankind has a future, then one might be less inclined to support the efforts to protect the future for future generations … A belief in extinction also calls into question the meaning of our lives and contributions.' If our achievements are doomed to die with us, what ought we be doing now? These questions are worthwhile to ask at both individual and broader societal levels.
Interestingly, there is an ongoing follow-up to this research in which I suggest you participate. There is a link to the anonymous survey from my asset-aid.com/future-survey.html page. Anybody can complete the survey in about 20 minutes, and—I think—it would benefit not only the researchers but also the respondents, ... the latter via instigating useful questions about our own life. Isn't the chance for getting good answers much better if we ask the right questions?

In a similar vein, I suggest you visit the Personal Futures Network website (personalfutures.net) of Verne Wheelwright, Ph.D., where you can get a unique, useful, and enjoyable approach to thinking (and acting!) about your future. He offers a stimulating and useful workbook for those who ask. The essence of his approach—what is, in effect, the translation of strategic planning principles, concepts, methods and tools to the level of individuals' lives—is nicely summarized in his article published in the May 2006 issue of the Futurist magazine.

It is important to recognize that futurists are not fortune-tellers. Planning, scenario writing, and strategic foresight are some of the basic ingredients of what they're doing instead. Anybody can learn a lot from Edward Cornish's 'Futuring: The Exploration of the Future' book, about which you can see details (or even order it) at https://www.wfs.org/futuring.htm .

2, Hedge funds: friends or foe?

In addition to formulating dreams, and forging commitments for achieving visions, to a large extent, thinking about the future means contemplating risks. When we see dangers looming, sometimes we build fences, defensive boundaries or hedges, at least figuratively. In other words, we are hedging. We can do it in various spheres of life, including the financial one. It's good to remind ourselves of this original meaning of the word when we think about hedge funds. People often treat them as inappropriate for ordinary investors, mainly because they remember headlines about hedge fund belly-ups, crises and scandals. In fact, there are many kinds of hedge funds; the main common feature of them being that they are more sophisticated than other kinds (the more traditional type) of mutual funds.

I'd say, while mutual funds are hand weapons (clubs, knifes, box-cutters) of war, hedge funds are the firearms (revolvers, guns, rifles, cannons) in the same field. (Sorry for the militaristic metaphor.) Hedge funds are more powerful, and they require better understanding and more careful treatment by their users than more mundane types of investments. They, in general, do deliver their mandate of increasing returns while lowering volatility; on the other hand, I'm not convinced yet about their overall, summary effect on capital markets.

While many of the underlying elaborate financial techniques may enhance market efficiency, some others may endanger the whole system. There are debates, there are biases pro and con, but this area is certainly worth further studying, … and I'm going to do that. Meanwhile, one cannot deny the very respectable track record and tremendous growth of the hedge fund business in the last few decades.
Also, as Prof. Cohen from Harvard and others convincingly presented at the recent World Hedge Funds Summit, it's just a matter of slicing and analysis to be able to look at ordinary mutual funds as a veiled combination of index funds and hedge funds. Every mutual fund has an embedded hedge fund in it, and there are methods and software being developed that soon will serve us to do this 'financial genomics', to improve risk-return characteristics, while lowering costs at the same time.
The crux of the matter for investors is to find fund managers who can select winning assets. It's important to know where to look for them, and how to recognize, evaluate, and monitor them. For the great majority of investors, the beneficial choice is to invest part of their portfolio in one of the fund-of-funds, available today for investors with any size of assets. This way, diversification within the hedge fund universe can be achieved, … and diversification is perhaps the key word (or at least one of the few ones) in the area of risks and money matters.

As for clear evidence that hedge funds performed well in the last 10-20 years, I borrowed a few slides from the presentation by Miklos Nagy, of Quadrexx, and author of the book 'Hedge Funds for Canadians'.

The performance and risks of hedge funds and the growth in the industry since 1990

Global Hedge Fund Net Returns*

1987 - 2005

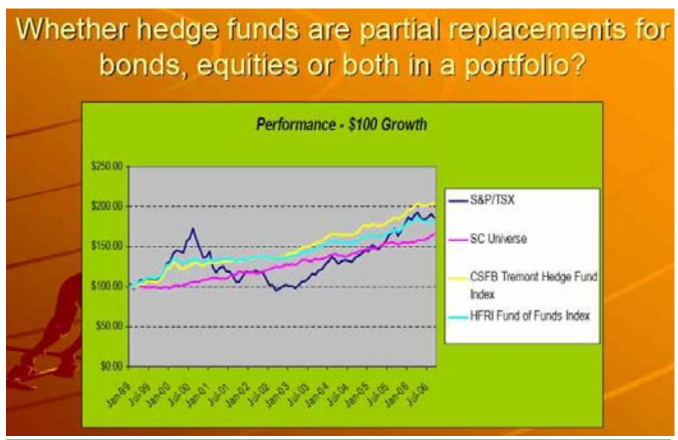
Style/Strategy	Annual Return	Standard Deviation	Sharpe Ratio
Hennessee Hedge Fund index	13.70%	9.52%	1.02
S&P 500	11.60%	17.06%	0.45
Lehman Brothers Aggregate Bond Index	7.52%	5.32%	0.66

* Source: Hennessee Group

The performance and risks of hedge funds and the growth in the industry since 1990

January, 1995 to March, 2000 BULL MARKET	VAN Global Hedge Fund Index	MSCI World Index
Annualized Return:	20.21%	19.86%
Annualized Standard Deviation:	8.51%	13.34%
Sharpe Ratio (4%):	1.90	1.19

April, 2000 to March, 2005 DIFFICULT MARKET	VAN Global Hedge Fund Index	MSCI World Index
Annualized Return:	6.29%	-5.91%
Annualized Standard Deviation:	5.87%	13.68%
Sharpe Ratio (4%):	0.39	-0.72



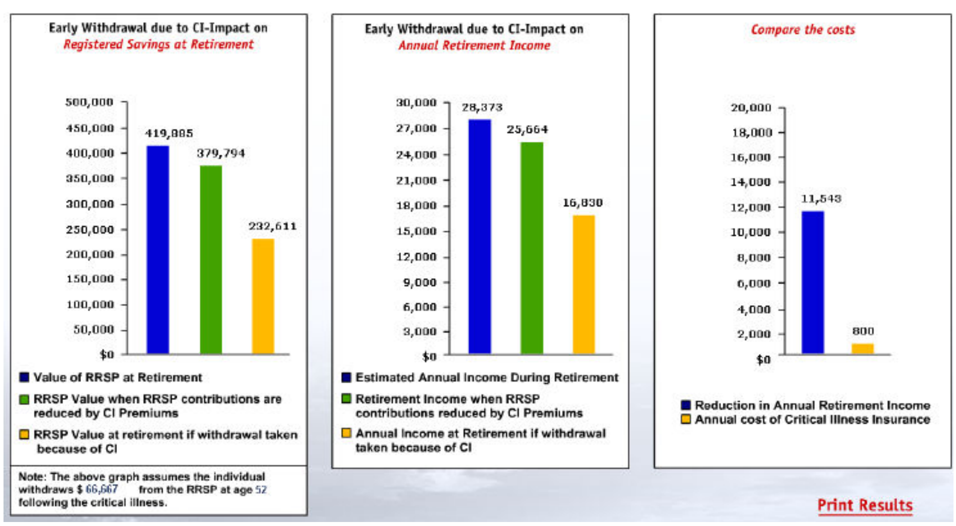
In case the miniature size makes you wonder what is in these charts: they clearly show that both in bull and bear markets, hedge funds achieved better returns, with lower volatility—key aspects of any investment—than either equities or bonds. In other words, they provided a smoother and steeper ride to investors than the other asset-classes. It's also important that they don't correlate strongly with other asset classes. This makes them excellent ingredient in a diversified portfolio.

One more aspect to mention: Both Bank of Canada and Ontario Securities Commission representatives at the Hedge Funds Summit acknowledged that the hedge fund industry in Canada is well regulated, and plays a positive role. The often-heard criticism and ensuing fear regarding the unregulated, behind the scenes activity of hedge funds seems to be much more of a real issue in the US. The fact is that the Senate Committee in Ottawa on Banking, Trade and Commerce is studying the hedge fund sector (visit http://tinyurl.com/y3t4fk for details)

3, New health-risk hedging tools

In April, one of my neighbours got brain cancer, and two weeks ago one of my friends suffered a heart attack. Both are recovering now, and none of them had critical illness insurance. None of them expected it to happen. One declined when I suggested critical illness protection a few years ago, and with the other I made the mistake of never suggesting it. Canada is the last country in the world where a critical illness insurance contract can be bought with fully guaranteed future premiums, … and this uniqueness may disappear sooner than we'd expect.

To see the likelihood at various ages of being a potential candidate for a critical illness insurance benefit, and for a sample calculation of how the financial consequences of a critical illness may impact retirement funds and future income, please visit http://asset-aid.com/CI-impact.html. Here is the summary chart from that sample scenario illustration:



Impact on retirement funds and retirement income of extra costs of a critical illness vs cost of a critical illness insurance policy. Based on one of many reasonable sets of assumptions. Meaning of chart cannot be fully understood without carefully studying all the assumptions applied.

While there are more than two dozen life-threatening conditions covered by some CI policies, by far the most frequent triggering event of CI claims is the diagnosis of cancer. Unfortunately, children also are affected more and more by cancer. In Canada, cancer under age 19 is diagnosed about 1,300 times a year. The number of deaths in this age group is around 230 per year. While the general tendency of improving survival rates holds in this age group as well, it's important to know that future health prospects of cancer survivors are much worse than that of their peers who were not affected by cancer and the harsh radiation and chemotherapy treatments. A large scale recent study found that survivors of childhood cancer were eight times as likely as their siblings to have severe or life-threatening chronic health conditions later.

While the opportunity to buy critical illness insurance for children has been around for a few years, this year it got a big boost. Now, parents or grandparents can buy such life-long protection (with special childhood-related conditions also covered) for their /grand/children where the premiums paid can be refunded later at the policy owner's discretion, and where the payment period can last for 20 years only. To me, the idea of giving up a paid-up policy in 20 years (or a partially paid-up one earlier) for the return of premiums doesn't appear to be attractive because it might be not just more expensive but perhaps even impossible to get it again later. However, there might be situations (let's say a financial emergency unrelated to a critical illness) when the policy owner still wants or needs the cash. Flexibility, the opportunity to adjust to changing circumstances is always a strength.

Flexibility is probably the most important feature of another new insurance product: a long-term care insurance policy, that uniquely allows to spend the monthly benefit amount on what the insured (most likely a senior) and/or their family deem most important. There is no submission of receipts to be reimbursed, no limitation on who would provide the care of any kind (that is family members are not excluded). In addition, this policy too can be paid up in 20 years, just like the children's critical illness policy described above.

Like with preparation for retirement, and contemplation of the future, there is a lot of self-cheating going around regarding the health risks we face. The 2006 Report Card on Health by the Heart and Stroke foundation (www.heartandstroke.ca) revealed that baby boomers 'could be the first generation to turn back the clock and experience a decline in quality of life.' This survey found that while Boomers are concerned about their health and the ability of the healthcare system to serve them, they are still reluctant to accept responsibility for their own health.

Mainly because of unhealthy lifestyle (physical inactivity, obesity, stress, sleep deprivation) and environmental factors, it's not just the Boomers who can expect a decline in life quality from previous generations. There are predictions that today's children may expect a shorter lifespan than their parents or grandparents. Trends of increasing longevity have certainly been reversed in many countries, and we in the richest countries have no reason to think that it cannot happen here as well. The right individual response to these challenges includes many facets, the financial one included.

4, Data, information, knowledge, understanding, learning, thinking, character, motivation, personality —— wisdom as an integrative concept

The fact that it's not 'business as usual' on Earth is getting wider and wider acceptance. Hopefully, we as a species are not doomed yet, but we are surely not far from the no-return point either. Even if the 'doom' scenario comes true, it doesn't necessarily mean total annihilation. In other words, our choices do matter a lot, … more than ever before. As an individual, it's easy to feel helpless under the circumstances. On the other hand, humanity is the sum of us as individuals, and our individual choices effect both our own fate within the unfolding human history, and—via the multiplying effect if we communicate, cooperate with others—how that history itself will unfold.

What does it take from humanity, or us as individuals to match the challenges we face? More and more thinkers realize that we need 'a new enlightenment', a 'paradigm shift', a 'new civilization', a 'new consciousness', etc. Increasingly more people find the old concept of wisdom as the key to survival and progress. The literature of wisdom is booming, it's discussed within various disciplines, and it's more than a fad. I consider it as compass in both my personal and professional life.

Isn't wisdom for the exceptionally bright, experienced, insightful, and virtuous only, and shouldn't we—the great majority, mundane earthlings—just shut up regarding wisdom? Can we define at all what we are mumbling about? Yes and no. Many great scholars, artists and various leaders have tried to define the concept, still there is not one that would satisfy everybody. However, there is some convergence, a lot of overlaps, and not many contradictions or arguments among the various approaches. Here is a short one, from Tom Lombardo (based on his presentation on the WorldFuture 2006 conference):
"Wisdom can be defined as the capacity to grasp the big picture of life, of what is important and meaningful, and guided by compassion and virtue, the ability to apply this understanding to enhance the well being of life, both for oneself and others." As can be seen, wisdom has cognitive, motivational, ethical, and personality dimensions. It is something we each, not just the highly educated or the old, can strive for and make progress toward, e.g., though self-reflection and learning are important ingredients of it, it is not a solitary pursuit.

Wisdom is related to optimism, … as well as to the ability to deal with complexity and contradictions; to the synthesis of past and future, to be curious, practical, and responsible.

Eric Fromm pinpointed an interesting commonality of the apparent opposites of optimism and pessimism, namely, alienation, and being more as observers than actors of life. As he wrote, "while … pessimism functions largely to protect the pessimists from any inner demand to do something, by projecting the idea that *nothing can be done*, the optimists defend themselves against the same inner demand by persuading themselves that everything is moving in the right direction anyway, so *nothing needs to be done*".

I think, the wise and responsible approach, the one that can bring real contentment and sometimes even meaningful happiness, is a conscious, planned life that goes beyond worrying about the pennies. In many cases, it's not much more than a bit of courage to expand planning beyond narrow self-preservation. With that courage, we can get engaged, involved, committed , and live a fuller life than when we take spectator-like stances along the pessimism-optimism dimension.

5, A few specific worthwhile investment opportunities

High yield savings: If you have an investment saving s account or other similar investments that pays less than 4% interest annually, I have some good news for you. I have some mixed news as well: You have only a few weeks to 'lock-in' a 4% guaranteed return investment in some insurance products (segregated funds, tax-sheltered universal life policies) because the company that offers this uniquely high rate will most likely soon align the rate with other offerings currently available on the market.

Private foundations: You may have heard about the advantages and special conditions of establishing private foundations. Traditionally, it was for the very wealthy. Now, with an innovation from Mackenzie Financial, anybody can start a foundation with an initial gift of only $25,000. It's a simple, convenient, fast, smart innovation. Still beyond the opportunity for most, true. However, if you are one of those who can do it, please check out the details (http://tinyurl.com/u8oes), and / or ask me to help with the implementation if you like.

SRI and charity: If you are a socially responsible investor who can afford a low or zero percentage return on your investment, then you should get acquainted with the concept of micro credits. The reason is that you can participate in this wonderful form of helping those who need it the most, either in Canada, or internationally. To learn more, please visit www.oikocredit.org/sa/fca/doc.phtml .

6, Additional sources of information and learning

Seminars:

Life, Money & Illusion Toronto Workshop from 2 to 5 pm, on Nov 25. Location: OISE, 252 Bloor W.
Offered by Mike Nickerson, based on his new book with the same title. See www.flora.org/sustain/LMI/Welcome.html

Select financial life planning concepts, strategies, principles, tools, and products - mainly for baby boomers and seniors
Location: Hwy 401 & McCowan Rd.; from 10:30 to 12 noon, on Dec 2
Offered by myself, as an introduction to a 5 part seminar series. If interested, please RSVP by Nov 28. Also, if this time / location is inconvenient for you but otherwise you'd be interested in attending my financial seminars, please tell me.

Books I recommend:

Buying Time: trading your savings for *income and lifestyle* in your prime retirement years, by Daryl Diamond
- a very good one

Smoke and Mirrors: Financial Myths That Will Ruin Your Retirement Dreams; by David Trahair
- I think a controversial, biased, somewhat unfair & self-serving book; … still also lots of good content there as well

Wealth Logic: Wisdom for improving your personal finances ; Insurance Logic: Risk management strategies for Canadians ; Money Logic: Financial strategies for the smart investor; all by Moshe A. Milevsky
- excellent books, easy to digest, .. I'd argue with only a few small aspects/statements in them. A major deficiency of omission though, even in the 2nd edition of the Insurance Logic is the total neglect of talking about long-term care insurance. Interestingly, would Prof. Milevsky hold an insurance sales licence, one day one of his clients could simply sue him if he/she'd suffer a disadvantage because he/she had not been informed and advised by him about the availability of this type of protection. I think it's just one more example that nobody an no source is perfect. Many very good personal finance articles by Milevsky are available on-line at www.ifid.ca , useful especially if you have no access to his books.

The Omnivore's Dilemma: A natural history of four meals, by Michael Pollan; - Do you think it has nothing to do with life planning? Read it first!

Cancer-Gate: How to win the losing cancer war, by Samuel S. Epstein
Quite shocking book, a meticulously detailed account of the betrayal by the American 'cancer-establishment' of the public interest. Excerpts from the summary description on the back page of the book: 'Despite decades of false assurances, we are losing the winnable war against cancer. ... institutions have spent tens of billions of taxpayer and charity dollars, largely promoting ineffective drugs for terminal disease, while virtually ignoring strategies for preventing cancer, other than quitting smoking. As a result, cancer rates have escalated to epidemic proportions, now striking nearly one in two men and more than one in three women. … silence even extends to frank suppression of information. … Cancer-Gate tells you, the reader, how to fight back by arming yourself with the information you need to protect your family from everyday carcinogens, and how to become an activist in the war against cancer." Visit preventcancer.com for more.

The Upside of Down: Catastrophy, creativity, and the renewal of civilization, by Thomas Homer-Dixon
- Brand new; devote some time to exploring the very rich www.theupsideofdown,com site.

Recent select studies, reports, and forums on the web for people interested in the 'big picture':
(It's easy to find them via Google searches)

State of the Future 2006 & *World Health Report 2006*
Human Development Report 2006
Stern Report - new & high-impact cost/benefit analysis of immediate vs delayed climate-change measures
American Energy: The renewable path to energy security
WorldFuture 2006 (many congress presentations on-line)
U.S. National Report on Population and the Environment
AAAS Atlas of Population & Environment
Canada 2020—CBC & Dominion Institute
www.canada2020.ca - visions of Canada; add your own
The Wisdom Page (www.cop.com) - C. Macdonald's books and a huge collection of other good readings there.
Report of the Commissioner of the Environment and Sustainable Development to the House of Commons - www.oag.bvg-gc.ca - good to know it, though it's not nice
The Demographic Time Bomb: Mitigating the effects of demographic change in Canada - Report of the Standing Senate Committee on Banking, Trade and Commerce - http://tinyurl.com/yyzovt

Intended topics for next newsletters:
improvisation (as opposed to planning); tumbling on happiness; good work, good business; small business considerations; income trusts, PPNs, tax efficiencies; SRI news; costs, trust, DIY investing;

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