SIPA Sentinel

April 2007

SIPA has a mission:

- to aid public awareness of how the investment industry operates;
- to provide guidance to those who have a complaint about investments with a bank, broker, financial advisor, or other seller of financial products;
- and to pursue improvement of industry regulation and enforcement.

Small Investor Protection Association - A voice for the small investor

SIPA Sentinel

The SIPA Sentinel is issued bi-monthly. From time to time we include articles and re-prints that offer opinions on subjects related to investing and regulation. These are meant to help increase investor awareness, and SIPA may not share these opinions.

HOPE FOR INVESTOR PROTECTION

The United States is leading the way for investor protection. SIPA supports the concept that investment advisors have a fiduciary duty whenever advice is given. Financial advisors, brokers and fund salespersons giving advice on which products to buy should have a fiduciary responsibility as they are or should be dealing from a knowledge base that investors do not have. Discount brokers that do not give investment advice do not have a fiduciary duty but do have a duty of care. Industry argues that unless they have discretionary authority they do not have fiduciary duty, and so it becomes an issue for the courts to decide.

In the U.S. the Financial Planning Association challenged a recent Securities and Exchange rule that favoured brokers over financial planners by exempting them from fiduciary responsibility. This was an obvious attempt by the industry to take advantage of investors similar to what Canadians face today. The court ruling has leveled the playing field and supports the concept of fiduciary duty for those who give financial advice. This ruling will be a major benefit for investors and hopefully is a prelude to similar developments in Canada.

WASHINGTON, March 30 /PRNewswire-USNewswire/ -- The Financial Planning Association(R) (FPA(R)) characterized today's decision by a federal appeals court eliminating a controversial Securities and Exchange Commission (SEC) rule as a major victory for consumers.
"Finally, there is hope that the consumer will be able to cut through the thick fog of confusion shrouding their financial adviser," said FPA Chair Daniel B. Moisand, CFP(R). "This ruling means the Securities and Exchange Commission can bring clarity to the financial services marketplace," Moisand added.
The appellate court ruling concludes a lawsuit filed by FPA against the SEC in July 2004. The Association challenged an SEC rule exempting certain broker-dealers from the fiduciary requirements of the Investment Advisers Act of 1940 that was first proposed by the SEC in 1999
FPA President Nicholas A. Nicolette, CFP(R), also issued a statement urging the SEC to forego a request to the Supreme Court to review the decision and to expedite the transition of fee-based accounts to a legal status.
"This rule should have died a quick and merciful death six years ago," Nicolette said. "It would not be the best use of taxpayer dollars to prolong a policy that is contrary to the public interest."

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FPA also urged the SEC to limit an expected transition rule for the estimated $300 billion in fee-based accounts to three months. Nicolette noted that the SEC had extended the effective date of the original rule to nine months, due to the need to adjust to a new regulation.
"In this case, the industry is well aware of existing rules, and can easily make the transition to either commission-based accounts or to convert them to advisory accounts with relative ease," Nicolette added.
FPA's attorneys successfully argued in court that the SEC cannot rewrite the protections Congress adopted in a way that would have allowed brokers to offer the same advisory services as registered investment advisers without requiring brokers to put their client's interests first.

INCOME TRUST AFTERMATH

Now that income trust reality is emerging investors will be seeking new opportunities. They should be aware that the investment industry survives on selling product to investors. The problem most investors face is how to evaluate the products being offered when the industry has proven to be unreliable in providing advice to investors. Bre-X, Nortel, the tech bubble, income trusts, principal protected notes, and mutual funds are only a few of the pitfalls investors have faced. Dr. Al Rosen of Accountability Research Corporation has been writing articles to alert investors about the risks associated with investing because of the lack of meaningful disclosure and the creative accounting that misleads investors. We have featured a number of Dr. Rosen's articles to help make investors aware. The following article was published in Canadian Business.

The Green Trap

Al Rosen
From the April 9, 2007 issue of Canadian Business

In the aftermath of the income trust drubbing, people must be wondering what the next market pitfall will be. When considering such questions, it's helpful to revisit the criteria that have contributed to past market failings.

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In the aftermath of the income trust drubbing, people must be wondering what the next market pitfall will be. When considering such questions, it's helpful to revisit the criteria that have contributed to past market failings.

First, a business needs to appear logical and reasonable on the surface to attract serious investor attention.

Second, people must be willing to ignore a lack of current profitability, in hopes of a tidal wave of future business (the "build it and they will come" mentality).

Third, investors have to believe they can hit a home run by buying early before others have clued in. This can best be described as the ego factor.

With these aspects in mind, I want to warn you of the green trap. That's not a golf term, but rather when investors fall victim to throwing money at environmentally friendly pipe dreams. Green traps are similar to value-trap investments, whereby companies appear undervalued by most investment measures, but never appreciate in price because of fundamental problems.

There are no doubt some legitimate green investments out there. But, there is also a seemingly endless supply of money pits. Back in 1999, Credit Suisse First Boston issued a research report on fuel cell–maker Ballard Power Systems Inc. (TSX: BLD), estimating the B.C. company would sell 448,000 car and truck units by the end of this year. Don't worry if you haven't noticed any zero-emission fuel-cell cars driving around — you're not alone. Had you invested $100 in Ballard at the time of the CSFB report, you would have about $13 today. Had you invested $100 in Ballard 10 years ago (before the tech bubble), you would have about $57 today. The company ended 2006 with its 15th straight year of operating losses as a public company.

I mention Ballard in particular because it was seen at the time as the technological market leader. Today, the company is still viewed as a technological leader, which seems to satisfy an oft-quoted investment criterion of finding companies with sustainable competitive advantages. The problem is that there is no market for fuel-cell vehicles. And with apologies to CFSB, there clearly wasn't going to be a market (as detailed in our own research report for our institutional investor clients back in 1999).

Ballard, however, is far from the only green company struggling today. Hydrogenics Corp. (TSX: HYG), another fuel cell–maker, based in Mississauga, Ont., has seen its shares fall 72% in the past year and recently announced job cuts of 50 full-time equivalent positions.

Many green investments fall short of investor expectations because they end up competing for shrinking pieces of a shrinking pie. For use in train yards, Quebec-based Railpower Technologies Corp. (TSX: P) makes hybrid-powered locomotives that cut greenhouse-gas emissions and diesel fuel use by 40–70%. Unfortunately, the greenest alternative is not the most cost effective one for the railroads. Railpower's stock has dropped 84% in the past year, as market prospects have shrunk and competitors have emerged.

A similar conundrum exists for ATS Automation Tooling Systems Inc. (TSX: ATA). The Ontario company recently pulled the planned IPO of its solar power division, Photowatt Technologies Inc., because too many competitors had recently joined the public markets, and ATS couldn't get the price it thought the division deserved.

Clearly, it's tough to distinguish the good green investments from the bad. One strategy to avoid the traps is to steer clear of early stage companies entirely. While this might hurt in the ego department, it won't necessarily cost you in the wallet. The best time to invest in a technology company (green or otherwise) on a risk-adjusted basis might be after it's already profitable.

Research In Motion Ltd. (TSX: RIM) has doubled in price since last August alone, well after the Ontario company's profitability and industry leadership had been proven. RIM turned profitable in Q2 2003, and has risen more than sixfold since then. So, the next time you're tempted by a green dream investment, try looking at the bottom line instead of the pie in the sky.

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WORTH REPEATING

From time to time we re-publish articles for the benefit of new members and sometimes as a reminder as some things do not change. The following is a shortened version of an article posted on SIPA's Blog (http://smallinvestors.blogspot.com/) Tuesday, November 22, 2005. We feel it is appropriate to remind those who blame the current finance minister for their losses with income trusts that it is not Government that created the problem but the investment industry.

Election Issues & Platforms - Corruption & Wrongdoing

Corruption and wrongdoing are key issues in Canada from which all else flows … The Gomery Commission indicates that greed and corruption permeates our government and that TruthTellers are not protected.

Certainly heath care, education, and security are important, but how much money is robbed from Canadians citizens by white-collar criminals who escape punishment? Adscam represents only hundreds of millions, but the investment industry robbing Canadians represents 100's of billions. We estimate losses due to wrongdoing to be in excess of $1 billion each year and could be in the order of $20 billion per year.

Canadians, particularly seniors and widows, are being robbed of their savings by robber barons who manipulate the public and encourage Canadians to place their trust in an industry that fosters scams like Bre-X, corporate shenanigans like Nortel, Livent, Corel, Eaton's, Air Canada and Stelco that cost Canadians their savings and pensions.

Now there is the income trust debacle. The investment industry has been allowed to prey on the public and sell them products, that are not regulated in a meaningful way, and deceive seniors into thinking these products offer security of capital and a handsome rate of return. These same seniors who did not want to risk their money by buying equities were sold income trusts that have even more risk.

Many of the unsuitable income trusts have dropped in value virtually from the date of issue and had badly deteriorated before Goodale's September statement. This debacle should not have been allowed to happen. Many seniors will lose a major portion of their savings because they were deceived by an industry that is out of control. The following is list of a dozen of the worst. There are many others that will be revealed in the Accountability Research Report due for release Wednesday, November 23, 2005.

Bankrupt:
Heating Oil Partners BANKRUPT

Unit value drop this year (to November 18, 2005) :
Associated Brands 64%
Boyd Group 65%
CanWel Building Materials 65%
Chemtrade Logistics 58%
Connors Brothers 50%

Clean Power 41%
Clearwater Seafoods 59%
Entertainment One 66%
FMF Capital 87%
Menu Foods 77%
Tree Island Wire 47%

Canadians are being robbed of their savings by white collar criminals of the same breed as those who defrauded our Government in the sponsorship scandal. The loot is many billions of dollars each year and this ultimately is paid by the taxpayer.

It is time that Government makes the fight against crime and corruption a priority and mobilizes the Canadian public to help in that fight by introducing legislation that will enable all Canadians in every walk of life to come forward and tell the truth about those who are corrupt and scheme to rob Canadians.

Canadians need a Government that recognizes the extent of corruption in Canada and takes action to combat its spread and restore Canada's reputation to regain the trust of our citizens and the rest of the Global community. Canadians should be protected from robbery and corruption, and be protected when they come forward with the truth.

PONZI – The man who made investment history

Most investors have heard of Carlo Ponzi and his investment schemes that defrauded his customers. There are many schemes today that are not unlike those created by Ponzi. A recent article (March 15, 2007) in the Economist provides food for thought when it asks "Is the financial system a confidence trick?" The following is excerpted from the complete article.

Ponzificating

From The Economist *print edition*

Is the financial system a confidence trick?

CHARLES PONZI was a likeable man. That helped him persuade American investors in 1920 that he could deliver returns of 50% in just 45 days by exploiting a loophole in the pricing of international postal coupons. In a way, he was advertising an early version of an arbitrage fund.
In reality, the loophole could not be practically exploited. So Ponzi exploited his customers instead. He could deliver returns only by taking money from new investors to give to his early backers. But although he died in poverty, the Italian immigrant achieved immortality of a sort: fraudulent moneymaking operations are often known as Ponzi schemes.
In the world of finance, describing something as a Ponzi scheme is a standard form of abuse. This insult has been bandied around a lot of late. Financial-sector profits have grown far faster than GDP over the past 25 years; everyone has become richer by lending money to everyone else. Household debt is running at about 100% of GDP in America and higher still in Britain. Credit derivatives are soaring in value and payment-in-kind notes (which pay interest with more debt, rather than cash) are in vogue. Last month Tim Lee, a strategist at pi Economics, described the whole financial system as "the equivalent of a gigantic Ponzi scheme."

...
Ponzi's original scheme was fraudulent from the start. But even if he had found some exploitable anomaly in the financial system, his rationale was flawed. Because he offered such a high rate of return over such a short period, claims on the "Bank of Ponzi" would quickly have reached ridiculous levels.
So perhaps there are good and bad Ponzi schemes. Good schemes will do more than funnel money from latecomers to early takers, allowing the foremost to prosper at the expense of the hindmost. And they will not allow claims to increase too fast. That was the big mistake of John Law, the pioneer of paper money in early 18th-century France. Law's system eventually collapsed, but he did have the insight that the creation of credit might increase trade, and thus general welfare.
But how to tell when a scheme has gone too far? Hyman Minsky, an American economist, distinguished three kinds of borrowers. Hedged debtors can safely meet all debt payments from their cashflows. Speculative borrowers can meet current interest payments from cashflows but need to "roll over" their debt in order to pay back the principal. And Ponzi borrowers can pay neither interest nor principal from cashflows but rely on rising asset prices to keep going.
...
George Magnus, a strategist at UBS, has just written a research note entitled "Have we arrived at a Minsky moment?" His big worry is of a contraction in credit supply. As lending standards tighten, consumer demand could suffer, possibly prompting a recession in the United States. No one knows when the credit cycle will end, he says. But the pyramid is beginning to look a bit top-heavy.

DECISIONS – Markarian v. CIBC World Markets Inc.

This judgment is significant because the court recognized the behaviour of the bank and ordered an award of punitive damages. It also recognized industry's abusive use of appeal proceedings and ordered immediate payment of $1,500,000 notwithstanding appeal.

Markarian v. CIBC World Markets Inc. (June 14, 2006), 500-05-069668-018 (Sup. Ct. of Q.)

The retired couple Haroutioun and Alice Markarian and their family's holding company had entrusted their assets to Mr. Migirdic, an investment advisor with CIBC World Markets Inc. ("CIBC"). In 1993, Mr. Migirdic had carried out a great number of highly speculative trades for another of its clients, Ms. Rita Luthi, but had omitted to inform her of the resulting losses.
Ms. Luthi, unaware of the fact that her investments had almost vanished, wanted to draw funds from her account. Faced with this problem, Migirdic arranged for the Markarians to guarantee, unbeknownst to them, the overdraft in Ms. Luthi's account. This allowed Migirdic to advance amounts to Ms. Luthi, without having to give her the bad news that he had lost almost all of her investments. In 1994, in order to hide the important overdraft in his own trading account – which he had illegally opened under the name of his uncle and unbeknownst to the latter – Migirdic, through the same fraudulent stratagem, obtained from the Markarians' holding company a guarantee of the trading losses in that account.
CIBC questioned on a few occasions the incongruous character of the guarantee provided by the Markarians in favour of Ms. Luthi's account, but always relied on and never verified the false explanations provided by Migirdic. These explanations were to the effect that he had obtained a written confirmation from the Markarians that they were fully aware of the fact that they had guaranteed the investment losses in Ms. Luthi's account.

In 2001, Migirdic finally admitted his fraudulent actions to CIBC and admitted that the Markarians were unaware of the fact that they had guaranteed the losses in Ms. Luthi's and in his own account. A few days later, CIBC terminated Migirdic and informed the Markarians that it considered the guarantees to be valid. Then it proceeded to withdraw approximately $1,500,000 from the Markarians' accounts, in execution of these guarantees. In reaction, the Markarians filed suit against CIBC to recover these amounts and other damages. CIBC took warranty proceedings against Migirdic.
The Court ordered CIBC to pay the Markarians and their holding company compensatory damages amounting to almost $1,500,000. CIBC was also condemned to pay the Markarians moral damages in the amount of $50,000 each, punitive damages of $1,500,000 and to reimburse them their legal fees for up to $94,500.
Provisional execution of the judgment for an amount of $1,500,000 was ordered, notwithstanding appeal, for fear that CIBC would use appeal proceedings to curb the Markarians' determination.

68% OF CANADIANS CONCERNED ABOUT WHITE COLLAR CRIME

From RCMP website - http://www.rcmp-grc.gc.ca/fio/accountablity_e.htm

In a recent survey (EKOS Survey, Wave 3, 2005-2006), Canadians said economic crime was the most serious problem in Canada at 67%, gang violence rated second at 66%, and gun crime and organized crime both rated third at 54%. Terrorism rated last at 14%.

When asked about what type of crimes Canadians were personally more concerned about, those polled rated economic crime first at 68%, gang violence second at 59%, gun crime third at 51%, property crime forth at 48%. Terrorism rated last at 30%.

A poll conducted in 2002 by the Pollara Group on behalf of the Certified General Accountants Association of Canada found that 59% of Canadians had seen or heard about the Enron scandal in the United States, with 73% of the 59% saying they believed a similar corporate scandal is likely to occur in Canada. The poll also noted that about 45% of Canadians expected government to be responsible for ensuring that the necessary reforms are made.

WATCHING YOUR INVESTMENTS

How do you know whether your investments are performing as they should?

Many years ago the Toronto stock market rose by 29% and my RRSP was up by 17%. To me this seemed good for a conservatively invested account. One evening a friend of mine disclosed that he had done well over the previous five years. He said he was invested all in mutual funds and he had gained 18% over five years. I said that Canada Bonds (at the time) were paying 5% with no risk so why would he risk his money in mutual funds for 3.5% per year?

It is essential that you measure your investments performance against an appropriate benchmark. Your investment should provide a better return than Canada Bonds or else you should keep your money in bonds to preserve your capital. Some experts suggest your investments should include both bonds and equities in a ratio of bond percentage equal your age. Not a bad idea. Investors in mutual or segregated funds should pay particular note.

Exchange Traded Funds or ETFs are similar to other funds in providing diversification but they can be bought and sold like equities and are not subject to the amount of fees as other funds. You pay only brokerage fees and ETFs can be traded through a discount brokerage.

As an example the chart below shows the year end value of the Toronto Stock Exchange (TSX), ETF that tracks the Toronto Stock Exchange (XIU), the ETF that tracks the Toronto Financial Index (XFN) and the Bank of Nova Scotia (BNS).

Date	TSX	increase	XIU	increase	XFN	increase	BNS	increase
20021231	6614		$37.35		$26.75		$26.45	
20031231	8220	24.3%	$45.83	22.7%	$33.30	24.5%	$32.80	24.0%
20041231	9246	12.5%	$51.48	12.3%	$38.87	16.7%	$40.70	24.1%
20051230	11272	21.9%	$63.58	23.5%	$46.75	20.3%	$46.14	13.4%
20061229	12908	14.5%	$74.50	17.2%	$53.88	15.3%	$52.10	12.9%
4 yr total		**95.2%**		**99.5%**		**101.4%**		**97.0%**

Those who hold shares may also benefit from dividends. The Bank of Nova Scotia currently yields about 3%. So, if your investments don t measure up, consider getting a second opinion.

BROKERS HALL OF SHAME – NASD BrokerCheck On Line

SIPA published a Brokers Hall of Shame on our website in 1999. It was an alphabetical list of bad brokers based on information publicly available.

Now in the United States NASD is providing information on brokers on a website. A search mechanism enables you to enter a surname and retrieve all brokers with that surname. NASD BrokerCheck is a free online tool to help investors check the professional background of current and former NASD-registered securities firms and brokers. Canadian investors should visit this website at http://brokercheck.nasd.com as there are links to additional resources and tools

In Canada the regulators provide limited information and their websites are not user friendly when it comes to trying to ferret out information on registrants with a few exceptions. For several years the IDA has collected data on complaints and settlements in the investment industry. Recently some of this information was leaked to the public but the IDA moved quickly to say this information should not be available to the public.

If our regulators are even half serious about affording investor protection, making public the information on the ComSet database would make a good start on a Canadian BrokerCheck.

WHAT ARE INVESTOR ADVOCATES SAYING? Take time to visit their forum at http://www.investoradvocates.ca or use the SIPA website link.