SIPA Sentinel

December 2008

Happy New Year!

SIPA's mission: To aid public awareness of how the investment industry operates, to provide guidance to those with an investment complaint, and to pursue improved investment 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 investment and regulation. These are meant to help increase investor awareness, and SIPA may not share these opinions.

TAX FREE SAVINGS ACCOUNTS (TSFA)

The announcement of the new Tax Free savings Account to take effect in 2009 is the best news for small investors in a long time. The TSFA differs from RRSPs (and RIFs) in several ways. Unlike registered plans, the money deposited is after tax dollars, however when money is withdrawn there is no tax payable. As a result, all of the income earned and capital gains are accumulated tax free. Also if you withdraw money you can replace it at a later date.

There is an initial limit of $5,000 per year but this limit will be increased by inflation. Seniors can contribute and, unlike RIFs, there is no minimum withdrawal required. The TSFA accounts, like RRSPs and RIFs, are individual, but spouses can be designated as a Successor Account Holder. This enables the transfer of the account to the surviving spouse without tax implications. You can hold the same investments in a TSFA that you would in an RRSP or a RIF. All Canadians should consider opening a TSFA.

WORDS OF WISDOM from Claude Lamourex

The Financial Post published "The Wisdom Series" with captains of Canadian industry. On December 31st they interviewed Laude Lamoureux, former president and chief executive of the Ontario Teachers pension Plan, who responded to the interviewer about the argument that government and regulators failed to protect investors by making sure investment products were appropriate: *"Products were over-complicated and people should have stayed out of it. … Why should people who are doing honest, hard work have to bail out people who were taking risks and probably should have known what they were doing? When I look at investments, keeping it simple is probably the thing that most people should do."*

Later he elaborated on his opinion on investments: *"There's nothing wrong with bonds and stocks. That's where most people should be. I'm a big fan of iShares and exchange - traded funds. But now they're selling products that pay double if the index goes up, or* *lose double if it goes down. Why? Because the one in between makes more money. The intermediary is trying to extract more than hi share."*

Investors would do well to heed Lamoureux's advice and avoid the complex structured products promoted by industry and stick with bonds, stocks and ETFs. Seniors who followed the rule of thumb of having a percentage of your investments equal to your age in fixed income will have fared much better than those whose investments were largely equity based. Those invested in equity based funds and were also leveraged will have suffered substantial loss. Let us hope that 2009 will provide some recovery.

LEAVE BULL AND BEAR ETFs TO DAY TRADERS

Al Rosen, Financial Post, Thursday, December 11, 2008

Sometimes you get mauled by the market bear, and sometimes you get gored by the bull. But, with Betapro ETFs, you can easily get run down by both at the same time.

Most investors and advisors who are new to Betapro Bull and Bear ETFs expect to get twice (2x) the exposure to an underlying index or commodity (you can go bullish or bearish). It's reasonable to assume that a fair number of people also end up disappointed in their investment.

Say, for example, you decided to buy the TSX Bear ETF back in mid-October, correctly anticipating more bad economic news. In the month that followed, the index went for a wild ride but ended up down only 3%. Nevertheless, most would expect their Bear ETF to have increased by 6% (2x the index). But here's the problem: It didn't increase by 6%, or even 3%. In fact, it declined by 7%.

Your first suspicion might be that one month is too short a period to gauge the effectiveness of the ETFs. Unfortunately, taking the longer view doesn't help either. Since the inception of the TSX 60 Bull and Bear funds, the index has declined 22%, while the Bear fund has increased just 14% (not the 44% you might expect).

Confused yet? Just wait. Even stranger things have happened in the Bull and Bear Global Gold funds. The underlying index has declined roughly 4%, but both the Bull and the Bear funds are down, a whopping 53% and 81%, respectively.

So, regardless of whether you were bullish or bearish on the direction of global gold stocks this year, you lost money, and by a considerable margin at that. You'd also be a loser either way on the Emerging Markets, Global Mining, TSX Energy, and Gold Bullion funds. It should be clear by now that the Betapro funds are not suitable for the buy-and-hold crowd (even if it's just a month). If the average investor or advisor happened to read the Betapro prospectus before investing (I know, try not to laugh), it might have become apparent around page 47 that they were endeavoring on some very risky investments.

Because it's at that point that you finally run into some plain language and a decent explanation of the risks involved: "the ETF...does not and should not be expected to return 200% of the index over any period of time other than daily." That means you get the return you expected for the first day. But after that, all bets are off. The legal document further explains that "for any given benchmark return, increased volatility will *negatively impact the relative period performance of the ETF." Basically, you can be dead right on the way a certain index will move in the next few weeks, but unless you are sure of the percentage move each day, then returns can suffer, possibly to the point of losing money altogether.*

The Bull and Bear funds are a good tool for day traders or sophisticated institutional investors who use them for daily hedging. Unfortunately, they don't seem to be marketed exclusively to that crowd. While all the requisite legal warnings exist, Betapro attracts wider retail interest in its funds by suggesting that so-called "rebalancing" can mitigate the impact of natural market volatility. The company warns that "to minimize these effects [of volatility], longer term investors should rebalance their HBP ETF holdings periodically." To most people, rebalancing means taking the capital you already have invested and shuffling the allocation of those funds. To Betapro, rebalancing actually means recapitalizing. Under similar circumstances, people often call this throwing good money after bad.

For example, say you own a bull fund, and the underlying index loses 10% on the first day and gains 11.1% on the next (for a net gain of nil). Your 2x leveraged Bull fund would lose 20% and then gain 22.2%, which would leave you short on a net basis (because you actually needed to gain 25% on the second day). So, if you suffer too many big losing days, you will need to pony up extra cash to break even again. The longer your investment horizon, the more inappropriate the funds are for you or your clients. Some Betapro funds have dropped 50% in just days, which means you would have to double-down on your investment in the hopes of moving higher again in the future. It also means that in order to "rebalance" effectively, investors need as much cash sitting idle as they have invested in the funds. And that's not even considering the extra needed to bridge the frequent gap-ups in the opening prices of the funds.

Since inception, only four of 14 Betapro ETFs have delivered on the 2x exposure that most retail investors thought they would get from buying the funds. The alternative to that serious underperformance, is to suffer a huge drag in overall portfolio performance from having so much "rebalancing" capital parked on the sidelines. All in all, retail investors and investment advisors are much better off leaving the Bull and Bear funds to the day traders.

LEADERSHIP AND INTEGRITY IN THE FINANCIAL SERVICES INDUSTY?

The Financial Post published a comment made by Dominic D'alessandro, President and CEO, Manulife Financial regarding leaders and integrity:

“Integrity is the foundation on which everything else depends. Without it, one may still get to the top; but it's almost certain that one's stay there will be neither successful nor long. More than ever, people want leaders they can trust, who stand for something and who can be relied upon to do the right thing.

The irony of discussing leadership and integrity, given the tumultuous developments in global financial markets, is not lost on me. Every day brings new revelations that these *qualities, sadly for everyone, were too often absent in many parts of the financial services industry."*

WHAT WENT WRONG ON WALL STREET?

James Gilles, Professor Emeritus, Schulich School of Business, wrote in the Financial Post on Tuesday, November 25, 2008

"The current meltdown in financial markets is certain to focus attention once again on the perennial question: What is wrong with the current system of corporate governance?"
"In the past quarter-century, a dramatic change in the thinking about the goals of the corporation took place. Rather than existing to earn profits through the production of goods and services, the principal purpose of publicly traded corporations began to be the maximization within the law of the value of their shares on the stock market. Rewards to the directors and management increasingly were determined not by the quality of a company's products or services, but by the performance of company shares.
The acceptance of this concept has been catastrophic, particularly for institutions in the financial sector. With the ever-greater complexity of the financial needs of companies and of individuals, investment banks, while always repeating the mantra of "maximizing shareholder value" began to use, with the advice from scholars in many of the country's leading business schools, "financial engineering" to manufacture all types of various complex financial instruments that have no intrinsic economic value, but which when properly (or improperly) manipulated can generate fees and profits. Their development made the sub prime mortgage lending calamity -- the genesis for the current man-made economic meltdown--possible."

PUSHED INTO POVERTY

Many Canadians dependent upon their savings for retirement may be pushed into poverty this year. Most Canadians are not well informed about investing and tend to rely upon an "Advisor" to look after their investments.

The public has been led to believe that mutual funds and segregated funds offer safety for investment. There is no doubt that the concept of diversification, upon which funds are based, is essentially good, but with the great variety of funds there are some that have a greater risk than normal market risk. Many Canadians have moved their savings from safe income investments such as G.I.C.s, government bonds and Treasury Bills because of low interest rates. In many cases the promised higher returns could not be maintained resulting in the value of the investments deteriorating. Many small investors lost with Principal Protected Notes and other structured products.

This year the precipitous decline in the overall market will impact most investors. Those who held a significant portion of safe income investments will suffer less than those whose investments were totally in equity based investments. Those who borrowed to invest in equity based products will be particularly hard hit. There are fund companies that promote leveraged investment by encouraging or arranging for investors to borrow from banks, mortgage their homes, or take margin loans from the firm.

Many seniors without workplace pensions depend on receiving income from their investments to supplement Government assistance. The rapid decline in the markets this year could rapidly deplete their savings with the end result that the many investors will be pushed into poverty.

TIPS FOR INVESTORS FROM OHIO

The Ohio Department of Commerce's Division of Securities has tips to investors on how to avoid becoming a victim of a "Ponzi" scheme. A "Ponzi" scheme is one in which you are promised high returns on short-term investments and is the number one investment scam being perpetrated against Ohio investors. These tips are applicable to investment generally.

- *Be leery of family and friends singing the praises of a particular securities salesperson or investment.*
- *Be skeptical when promised unusually high or unrealistic returns – especially when other investments are not performing as well.*
- *Take the time to understand what you are purchasing.*
- *Always stay in charge of your money.*
- *Keep detailed notes on conversations relating to your investment accounts.*
- *Carefully review your mailed account statements against your online account.*
- *In addition, before working with an investment professional, investors should call the regulator to ask: Is the brokerage firm, securities salesperson, investment adviser or investment adviser representative licensed? Have any enforcement actions been taken against them? Is the investment product properly registered with the regulator?*

And always remember that it is your money and if it is lost it is not easy, and sometimes impossible, to get it back.

PRINCIPAL PROTECTED NOTES REQUIEM

For some time we have cautioned investors about principal protected notes as well as other structured products. In October Andrew Willis and Tara Perkins produced an article entitled *"Desjardins pulls funds amid market plunge"*. The article states:

"Desjardins Group is winding down hedge fund-linked products, as Canada's largest financial co-operative joins life insurers in dealing with problems in guaranteed investments that have been pounded by the downturn.

Montreal-based Desjardins is shutting down lines of what are known as "principal-protected notes," or PPNs, an extremely popular product with individual investors. The move comes as Manulife Financial and Sun Life Financial take reserves against possible *losses on annuities and other funds that promise customers' capital will always be returned.*

The products that Desjardins killed bought hedge funds to offer the co-op's 5.8 million customers the upside of markets, along with a guarantee they would get back 100 cents on the dollar. Desjardins is closing PPNs called the Perspectives Plus Guaranteed Investment and Alternative Guaranteed Investment, both of which come due over the next five years."

As many investors had already found, the promise of guaranteed capital and good returns sounded too good to be true. The guarantee applies only at maturity and for many there will be no income and they will need to accept a substantial discount if they want their money before maturity.

"Desjardins spokesman André Chapleau said the company is steering clients into other savings products. He added: "The customer is not affected and the capital is guaranteed. We were never able to guarantee the performance."

The current market crisis makes it clear that the regulators have not protected investors when they provided exemptive relief and allowed the industry to create and sell unsuitable products to unsuspecting investors. A significant comment on PPNs illustrates how these practices pervade the industry.

"Market volatility, falling interest rates and negative fund performance have caused many PPNs to experience what's known as a "protection event." Losses past a certain threshold trigger the complete sale of the active asset, in most cases a mutual fund. The remaining funds are then invested in a defensive asset, typically a zero-coupon bond.

A recent industry survey of the Big Six banks by TD Waterhouse found Bank of Montreal leads the pack, as a seller of 69 PPNs that have experienced a protection event. CIBC has done this with 26 products, Royal Bank of Canada has had a protection event on 20 PPNs, Bank of Nova Scotia has had 12 and National Bank 11. No PPN sold by TD Bank has experienced a protection event."

THE $50 BILLION MADOFF PONZI LESSON

An article entitled "What investors can learn from Madoff scandal" by Kathleen Pender, published Sunday, December 21, 2008, included some sound advice for investors:

It's not clear exactly how Madoff allegedly bilked wealthy and supposedly sophisticated investors out of $50 billion in a Ponzi scheme. … But based on what we know so far, here are 10 lessons for investors who work with registered investment advisers:

1. Don't buy what you don't understand.

2. If it sounds too good to be true, it is. Madoff claimed to earn 10 to 12 percent, year after year, with nary a down month. In the real world, such consistent returns are as improbable as doubling or tripling your money in a year.

3. Know where your money is and who is watching over it. . Madoff allegedly faked statements to make it look like his clients owned securities when in fact their money was being used to pay off other investors. If your money is with an adviser, find out where it is held, whether the custodian is affiliated with the adviser and what safeguards are in *place to make sure the adviser can't swipe your money. If you give your adviser discretion to make trades in your account, do not give him or her permission to withdraw funds. And make sure statements are sent directly to you.*

5. Are your assets insured? Most brokerage accounts are insured against fraud or embezzlement (but not against market losses).

6. Diversify. Some Madoff victims had virtually all their assets with his firm, which violates the first rule of investing: Don't put all your eggs in one basket.

7. Beware of affinity groups. Many scam artists recruit clients through religious, ethnic or work groups whose members know and trust each other. Madoff's clients included many wealthy Jewish people and nonprofits in New York and Florida who found him through word of mouth.

8. Understand fees. Sheryl Garrett, head of the Garrett Planning Network, an association of fee-only financial planners, says investors should fully understand how their advisers are compensated. "Strongly consider not giving anyone trading authority or the ability to withdraw their fee from your account. You can write a check for the fee," says Garrett.

9. Don't assume the SEC (Regulator) will protect you. "It's unacceptable that the SEC is not providing the basic level of protection that investors ought to be able to rely on," says Barbara Roper, director of investor protection for the nonprofit Consumer Federation of America. ... Unless things change at the SEC, Roper says, "Good luck. You're on your own. Cross your fingers. And hope for the best."

RRIF WITHDRAWALS

The Minister of Finance tried to provide some relief to RRIF holders by allowing them to reduce their withdrawals by 25% this year. Also the Minister of Finance sent the following open letter to federally regulated financial institutions regarding minimum withdrawal requirements for Registered Retirement Income Funds. I am not aware that any action was taken by provincial regulators.

> *"I am writing to seek your cooperation on an important issue for Canadian seniors, withdrawals from Registered Retirement Income Funds. Many seniors are understandably concerned about the impact of the recent deterioration in market conditions on their financial security and I believe it is important to ensure that they do not face undue obstacles in managing their assets in these challenging times.*
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> *A common misconception is that seniors must sell assets to satisfy RRIF withdrawal requirements, something many may not want to do at this time given the recent decline in value of many assets. The income tax rules permit "in-kind" asset transfers to meet the minimum withdrawal requirements – they do not require the sale of assets.*
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> *It has been brought to my attention that, in certain circumstances, there may be obstacles to in-kind asset transfers within financial institutions. It has also been suggested that some financial institutions may not be advising clients of this option where it does exist.*

To address this issue, I am expecting all financial institutions to accommodate in-kind transfers – at no cost to clients – or offer another solution that achieves the same result. I would ask that you ensure that all clients with RRIFs be made aware that this option exists.

I would like to hear from you by Friday, November 28 to confirm that steps have been taken to ensure that in-kind asset transfers between RRIFs and other accounts are possible at no cost to the client and that RRIF clients will be made aware of this option."

FROM SIPA's MAIL BOX

From time to time SIPA will publish messages received to illustrate the issues faced by Canadians. Names of organizations and individuals are deleted to protect the identity of individuals.

- *"My 90 year old husband has been a client of the … brokerage firm for over 40 years. Two weeks ago I discovered something unbelievable. The broker has had my husband fully invested on margin. Ex. $200,000 portfolio has $100,000 margin. With the market meltdown, the broker has been selling holdings to cover the margin and the result is a disaster. The account is a joint account. Nobody informed me of this. I am devastated. How am I going to cover my husband's growing health care needs? What can I do?"*
- *"I happen to take note of a recent notice to watch the CBC Fifth Estate programme, "Who's guarding your money?", tuned in and was surprised to see Chris Ouslis and his family profiled regarding their investments with Norshield. My husband and I are in a similar situation mostly because we also shared the same advisor through … . In fact, Marcia Ouslis had contacted me in July 2007 and very generously provided me with a list of organizations including yours which she suggested I contact. Unfortunately, it was awkward for us because our ex-advisor continues to have an indirect business relationship to my husband. In any case, I did slowly unravel and dissect our statements by actually documenting it through a Letter of Complaint to both the OSC and OBSI and with their guidance, I did enter a formal complaint in November 2007 against … . By June 2008, I received a phone call from an OSC legal advisor, who informed me that we had missed the legal limitation period (which begins the day one buys an investment). Case closed. The day after the CBC telecast, I received a phone call from OBSI. We have received a letter to be signed and returned to begin their investigation. A coincidence, but perplexed that it's taken a year for them to decide to undertake the work."*

Today's smile: *Do you have any idea how cheap stocks are?*
Wall Street is now being called Wall Mart Street. - Jay Leno