# CastleMoore News

Buy, Hold... *and* Know When to Sell™

## RISKY BUSINESS

**By Ken Norquay, CMT, Partner**

Baby boomers got dream-creamed in the 2008/9 stock market crash. Their blue chip stocks dropped 45% on average – the juniors dropped even more. These are the same investors whose Wealthy Barber's Buy and Hold approach drove the stock markets up, up and away in the 1990s. Their long range financial plans called for compounding returns of 7% or 8% so they could retire rich, like Warren Buffet. The 1990s mutual funds craze lulled a whole generation of investors into the dream of getting rich in the stock market. But the 2008/9 nightmare changed all that.

Losses of 30%, 50% or more meant baby boomers would no longer retire rich if they only made 7% or 8% a year until retirement. At that rate, it would take years to just make back what they had lost. To make those 1990s dreams come true, they would need to make more money faster. They would need to take more risk.

### Investors became traders.

Since the low in March of 2009, the TSX 60 index has recovered about 85% of the 2008/9 loss. The two year recovery since then (March 2009 to March 2011) has been relatively easy for traders. These Renaissance traders have, by and large, done fine. And those die-hard buyers and holders who just kept on holding have done okay too. If the stock market keeps on going up, they could break even this year. Our concern is that these neophyte traders don't understand how risky trading is.

Consider the past year's action. This is a chart of the Exchange Traded Fund (ETF) representing America's 500 biggest blue chip stocks. It covers the two years from the 2009 low to March 2011.

Notice the sharp drop in January 2010. Then the market recovered into April. Then it dropped sharply into June and recovered until now.Chartists refer to this as a broadening formation: the up and down swings get bigger and bigger each time. Their theory is that the wider and wider swings are caused by speculators nervously leaving the market at the first sign of trouble, then charging back in – then leaving again, then charging in again. The fear of loss and greed for quick profits becomes progressively


greater with each swing up and down. Charting theory is telling us that the US blue chip stock market is full of speculators hoping to make their stock market dreams come true by betting on QE2. It's fine to trade for fast profits: but make sure you wake up when the alarm clock goes off.

Check this chart: it compares two Canadian ETFs. One represents Canada's 60 largest TSX companies; the other represents Canadian small cap stocks. Do you see how dramatically the small cap stocks have outperformed the large cap?


Speculators tend to buy juniors, big investors (pension funds and mutual funds) tend to buy blue chip stocks. The dramatic out performance of junior stocks (especially from July 2010 to now) confirms that many small speculators are in the markets now, pursuing their dreams of quick profits in the stock market.

In my investing book, Beyond the Bull, I ask investors to observe the action of others in the investment world, so we can improve our performance. In that vein, we observe that (a) the stock market is going up and we can make money by participating, and (b) both Canadian and US stock markets are showing signs of excessive speculation. CastleMoore's interpretation of these observations is: we want to be invested in the stock markets and we want to sell at the first sign of trouble. Our motto is still: Buy, Hold and Know When to Sell.

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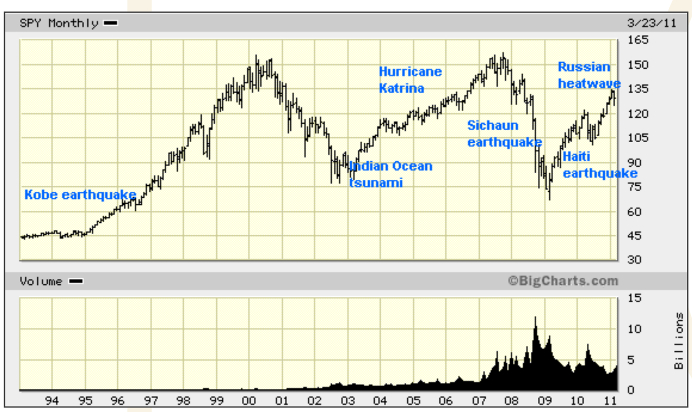
# NATURAL DISASTERS AND THE INVESTMENT IMPACT

**By Robert 'Hap' Sneddon, FCSI, President**

One of the tough parts of absorbing the impact of natural disasters as a money manager is that you eventually, by instinct, consider how it may impact your clients. After you live in the details of the human elements like most, glued to your TV, newspaper, radio, internet, etc, your mind eventually wanders to what protective decisions you may or may not have to make based on the event. That's the reality of things.

After conducting interviews with the Globe & Mail (March 15) and Dow Jones, Smart Money magazine (upcoming April issue) on the subject I thought it might surprise our readers to know what the historical record actually is of the impacts of natural disasters on portfolios or investments in general. The short answer is not much.




This chart of the S&P shows that there is little correlation between natural disasters and the markets. Things revert to what they were doing just prior to the event.

If we look at the major natural disasters over the last 20 years they are:

| Event | Year | Lives Lost |
|---|---|---|
| Kobe Earthquake | 1995 | 6,434 |
| Indian Ocean Tsunami | 2004 | 230,412 |
| Hurricane Katrina | 2005 | 1,836 |
| Sichaun Earthquake | 2008 | 86,000 |
| Russian Heath Wave | 2010 | 50,000 |
| Haitian Earthquake | 2010 | 222,570 |

In every instance there was an initial market reaction, but within weeks or even days the trend that was in effect prior to the event reasserted itself. What is striking to me in doing more research after the interviews is recounting the number of souls who left us. Grasping the sheer scope of the level of death is often lost in the media coverage. We are regularly directed to the physical damage, a few "human interest" vignettes, and of course the impact to us at safe in our homes. But when you look again at the numbers today for the Haitian earthquake or Indian Ocean tsunami these were colossal tragedies.

Now, if the Fukishima reactors do have a serious breach I believe we will get a second wave of market reaction – a double dip reaction so to speak, now that markets have moved higher post event, including Japan's 17% move off the lows. But as bad as it could be, history shows us things snap back.

History shows we humans are wildly resilient, really life is in general. History too shows us that while it is instinctual to think of pulling in your oars during a natural disaster, if we focussed on what help we could offer to those in need, small as our individual contributions maybe, we will be worrying about the right things. Our portfolios will be okay.

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# THE CHART PAGES

## GOLD BULLION


Gold has completed the correction we brought to readers attention in January. This 3 year chart of gold bullion recently broke out to new highs, a positive technical development. With the USD falling at present, gold has undertaken a "reserve currency" status, like the Euro, Yen or Swiss Franc. We held a modest position since December, and added to it in February. Today we hold bullion for clients in both a US dollar and a CDN dollar hedged position. We will be adding more to the hedged position soon.

## CHINESE STOCKS


This 3 year chart of the Shanghai stock market shows it is close to beginning a new bull phase. China, the NASDAQ and copper are the trifecta that called the bottom in the global stock markets two years ago. The Chinese stock market has not participated in the upside to the extent that we've seen in North American or European markets since September. The correction in Chinese stocks which began in November will be over on a close above 3,100. If the global growth theme is to have legs, China needs to break out and confirm the action of Western markets since November.

## LOONIE


The Loonie has recently broken above resistance at $1.02 USD. The next price target is $1.10 USD. Canadian investors sending capital abroad must first make 7-8% to break even if it's priced in the greenback. Of note is the lower three panels which show that the indicators have never really become over-sold. The biggest monthly corrections over the last couple of years have only averaged 5%. Our dollar has too morphed into a reserve currency through the actions of international investors.

## US DOLLAR


The US dollar index as measured against a basket of global has fallen and broken short term support since our last publication (break of blue trend line). With many currencies rising, something has to give. Currencies are all inter-related, marked to each other on a one-on-one basis, but their global position is only revealed against a broad measuring tool as we show here. The next stop for the greenback is 70 on this index (which generally corresponds with a $1.10). That being said, a longer term chart would show that the USD broke a downtrend in 2008 buy stopping in the low 70's (far left off the chart) from 130 in late 2002. It appears we are headed there again in what will look like a large basing pattern.

# THE CHART PAGES

## CANADIAN EQUITIES


The TSX is still in correction mode in the near term. Recently the longer term and very reliable 125 week moving average has turned up. While we do hold a broad index basket position for most clients, we are concentrating within our FOCUS and TWO-WAY PORTFOLIOS in the energy, technology, materials, industrials, and healthcare sectors. We anticipate redeploying cash in the next few weeks during this corrective phase.

## US EQUITIES


This shorter term chart of the S&P shows the resistance that we cautioned readers about in January. The market peaked in the third week of February and is still in correction mode today. A retest of the lows in early March around 1250 is possible and even a probe lower to the1200 level is as well. This correction is much like the one we had in November though the current one is a little larger and longer as shown by the 2 blue strokes. We have and intend to have minimal un-hedged US positions in the near future. Like the Shanghai it's more an indicator than an investment.

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# CHALLENGES AND CONSIDERATIONS FOR 2011 – A FOLLOW UP

**By Thomas Kleinschmidt**

**Hope's place in your investment strategy is the 500 Level bleachers, not on the field.**

I need to repeat the first paragraph from my last article: *"Don't think that since the TSX is almost back at where it was 2 years ago your retirement is 'back on track' as now is the time to worry about losses and put an action plan in place to deal with the next slumping."*. We as investors need a plan in place to prevent large-scale losses.

And there's nothing like a nice 800 point market pullback to make the point, eh? During that period how did you respond? Did you jump out? Did you hold on? Did you peer down positions and reallocate assets? Were you able to remain objective and weigh both sides of the coin? Or did your brain selectively screen the information in the news/tv/web for proof that you were doing the right thing?

I recommend that investors focus on a few strategies, rather than on the news. Why? Simply put we cannot predict and should not react to every rustle in the grass. First, strategies are above these daily events. Second, as generals in a financial battle our job is to focus on the overall movement of our dollars to accomplish the current objective. Our goal is to attain the objective with the least number of dollars. Typically, we have dollars committed in a number of smaller battles in the much larger timeframe of our investing horizon. Said differently, investors typically maintain a few pools of capital in different asset classes and/or management methodologies during our investment lifetimes, moving these pools around as our financial circumstances change.

Now, most folks have a good idea about our financial circumstances in the long term, but what about those externalities that can come out of nowhere to bite us? As we walk through the financial jungle we have to be on our guard at all times, so having a number of strategies to deal with the time that the rustle in the grass is really a tiger about to eat us is a really good idea.

Right now we are walking on such a trail… half way up from the valley of the shadows and half way up the mountain of fear. The rustle in the grass most likely is a stalking tiger. Most investors are nervous, some are oblivious; some are quick and some are slow. But all are on the menu (FYI, running away or playing dead does not work with tigers).

## A New North American Growth Portfolio

Investors who wish to dedicate a portion of their portfolios to stocks and have them managed in a discretionary manner can consider this new portfolio.

Based on a blend of technical analysis and Strategic Analysis Corp.'s Structural Valuation Analysis® (SVA®) the North American Growth Portfolio seeks to invest in stocks that are out-performing the indexes in the S&P/TSX Composite, DOW 30, S&P500 and NASDAQ100, and DOW Transports. No longer do investors have to wait-and-hope, enduring stock market sell-offs, and setting their retirement and financial goals back years and years time and time again. And when the equity markets dictate large cash positions these will be managed according. Contact me directly for more information (905) 847-2713 or thomas@castlemoore.com

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# GUEST COLUMNIST

**TAX ALERT is a commentary on topics of current interest – usually topics relating to recent changes in tax law, new CRA administrative practices or current interpretations arising from tax cases. Professional advice should be obtained before acting on any of this information.** ed.5/10

# TAXPAYER RELIEF, REFUNDS AND AMENDED TAX ELECTIONS

**By Ed Arbuckle,**
**CA, FCA, TEP**

In 2007, Canada Revenue Agency (CRA) issued a comprehensive Information Circular IC 07-1 to let taxpayers know when and how they can ask for relief from the normal collection, re-filing or refund provisions of the Income Tax Act. Knowledge of these rules can be extremely helpful to taxpayers who owe or potentially owe significant amounts of money to CRA or are looking to get refunds that they are otherwise statute barred from receiving. The Circular deals with four main areas:

- Request for taxpayer relief – cancellation or waiver of interest and penalty charges
- Filing a voluntary disclosure to eliminate penalties on unreported income
- Obtaining refunds beyond the three year limit normally allowed
- Filing, amending or withdrawing special tax elections beyond permitted time limits

The Minister does not have to grant relief in any of the above areas and each request will be reviewed by CRA and decided on its own merit. If CRA denies an adjustment, they will also provide the taxpayer with an explanation of the reasons for their decision. A second appeal to the local tax office is then possible.

## Time Allowed for Application

The Minister may grant relief for any tax year that ended within 10 years before the calendar year in which the taxpayer's request is filed. Therefore, a taxpayer has 10 years from the end of the calendar year in which the tax year ended to make a request to the CRA for relief. This 10 year limitation period rolls forward every January 1. Relief from interest charges relating to tax matters that arose more than ten years ago will not be allowed. Cancellation of interest refers to the elimination of interest already accrued whereas a waiver of interest refers to cancellation of future interest charges.

## Request for Taxpayer Relief

In determining whether to waive or cancel interest charges, CRA will consider a number of factors:

- Whether the taxpayer has a history of compliance
- Whether the taxpayer knowingly allowed a balance to exist on which interest has accrued
- Whether the taxpayer has exercised reasonable care and has not been negligent or careless in filing tax returns
- Whether the taxpayer has acted quickly to remedy any delays or omissions.

Taxpayer relief for interest (and less often penalties) may be warranted in three situations outlined by CRA as follows:

- Extraordinary circumstances
- Natural or man-made disaster
- Death / accident / serious illness / emotional or mental distress
- Civil disturbance
- ***CRA actions***
  - CRA error
  - CRA delay

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- ***Inability to pay***

  • Financial hardship / inability to pay

The request for relief is normally applied for using form RC4288E accompanied by a detailed supporting submission and backed up by appropriate documentation. A taxpayer can make this application based on any one or more than one of the three situations.

Extraordinary circumstances apply for reasons beyond the taxpayer's control. For example, the inability to file a tax return because of serious illness, accident or serious emotional or mental stress all qualify. Actions caused by CRA would include such things as processing delays, or undue delays in resolving an objection or appeal or completing an audit. Errors in materials available to the public from CRA or incorrect information provided to a taxpayer also qualify as a CRA action that cause interest to be payable.

The inability of a taxpayer to pay or financial hardship can involve several different situations. The Circular lists the following examples:

- Where a collection has been suspended due to an inability to pay
- Where a taxpayer can show that the inability to pay requires an extended payment arrangement
- When payment of accumulated interest would cause a prolonged inability to provide the basic needs of life such as food, medical assistance, transportation, shelter etc.

## Voluntary Disclosure

As most people know, CRA operates a Voluntary Disclosure program that allows taxpayers to come forward and correct inaccurate information already filed with CRA or omitted. In such cases, taxpayers will have to pay the taxes owing plus arrears of interest but CRA will waive penalties and prosecution that might otherwise occur. CRA may also provide some relief on a case by case basis on interest arrears after the taxpayer has made the voluntary disclosure.

A Voluntary Disclosure is only valid where it has been made before a CRA review or other investigation is under way which would include a simple request by CRA to file a tax return. Information Circular IC00-1R2 deals with Voluntary Disclosure in detail and this area will not be further dealt with in this article.

Taxpayers should understand that CRA has extraordinary powers to track down information that will disclose unreported income. For example, most of Canada's tax treaties with other countries provide for an exchange of information between tax authorities and this process is being used more frequently.

## Obtaining Refunds

The normal time to make a claim for a tax refund is three years from the date of the Notice of Assessment for the year or three years from the end of the year if a return was not filed. Often, taxpayers are unaware of this three year limitation and consequently refunds may not normally be available if notices of objection or returns have been filed more than three years late. However, the Income Tax Act does grant the Minister discretionary authority to accept such late requests if they are made within the10 year period. Individuals can make such a request if they were not aware that they missed claiming a deduction or a refundable or non-refundable tax credit was not applied for on the original return.

Refund claims are often overlooked simply because a taxpayer has no tax payable and therefore does not file a tax return. Refundable tax credits such as the child tax credit or GST credit are payable to the taxpayer even with no tax payable so a return should always be filed. Non-refundable credits such as the disability tax are also often overlooked. Ten years of disability tax credits not applied for amount to over $10,000.

In the case of corporations, there can be unclaimed balances due to taxpayers in accounts that CRA has closed because of inactivity. Christian Belanger has written a comprehensive booklet about this in a Guide for a Detailed Review of Tax Accounts of Canadian Companies. It can be found at **www.instalment-account.com.**

## Filing, Amending or Withdrawing Special Tax Elections

The Income Tax Act often allows taxpayers to make special elections to obtain an alternate tax treatment from the norm. For example, an election to defer income could make a transaction tax free until years later. The Income Tax Act gives the Minister discretion to extend the statutory time for filing such elections or permit elections to be amended or revoked. These requests must still be made within the 10 year time period.

If a late filing election is accepted, a late filing penalty is imposed. Therefore, taxpayers need to consider if the benefit of the late filed election exceeds the cost of the penalty and gives them a positive result. In many instances that will be the case.

CRA lists a number of situations in which late, amended or revoked elections are permitted:

- There have been tax consequences not intended by the taxpayer and the taxpayer took reasonable steps to comply with the law
- The request arises from circumstances beyond the taxpayers control
- The taxpayer acted on incorrect information given by CRA

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- The request results from a mechanical error by the taxpayer
- The taxpayer can show that they were not aware of the election provision even if they took a reasonable amount of care to comply with the law and took remedial action as quickly as possible

Circular IC 07-1 provides an extensive list of specific elections that can be filed late. There are too many to list here and advice should be sought if you think you missed an election. Some of the obvious ones are as follows:

- An election to capitalize interest cost instead of deducting it
- An election to defer the income or capital gain when a replacement property is acquired for a property that was stolen, expropriated, destroyed or a former business property
- An election to designate a property as a principal residence because there has been a change of use to an income producing property
- An election to have a bad debt deemed to be disposed in the year and reacquired to permit a capital loss deduction
- An election to have the tax free roll over rules not apply on the transfer of assets to a spouse
- An election to have the tax free rollover reserves on the transfer of property to spouse or common law partner not apply
- An election to allow the taxpayer to have a taxable dividend from a Canadian corporation by a spouse or common law partner included in the taxpayer's income
- An election that allows a private corporation to have a taxable dividend treated as a tax free capital dividend
- An election to have an excess capital dividend treated as a taxable dividend

Space does not allow a detailed discussion of the above but be assured that any one of the elections could be beneficial to you in the right circumstances. Tax filings are best done with pre planning but tax savings can also be there by filing or re-filing or withdrawing a late election.

## Summary

The Circular certainly allows a taxpayer to reduce interest and penalties and obtain tax refunds retroactively but the procedures can be a bit of a cage match. The odds aren't quite as bad as playing blackjack at the casino but still can be a bit like a root canal procedure. First get advice to see if you can benefit. If you can't get help and are confused whether or not you qualify, do the paperwork to the best of your ability, quote circular IC 07-14 as your authority, file your amendment and hope for the best. CRA is usually quite helpful as long as they get your request on time. This article first appeared in Canadian MoneySaver magazine.

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