



'Hang in there' on trusts

Battered sector has room to recover

But never forget need to stay diversified

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Investors have had a few weeks to recover from the fright of the federal government's Halloween-surprise decision to tax income trusts. And some investment experts say the best thing that could have happened to an investor was a case of overwhelming, paralyzing fear.

"Hang in there," suggests David Bruce, a financial adviser and portfolio manager with ScotiaMcLeod. Trusts have bounced back, he points out, since the "overdone" reaction on the first day of trading after Ottawa announced the decision.

He believes the trust sector will recover, recouping more of its built-in premium for the preferential tax status trusts will continue to enjoy for four years under the government's plan.

The "emotional" selling binge on Nov. 1, which sent the TSX's income trust component plunging 12 per cent, came largely from individual investors who had banked heavily on income trusts, Bruce says.

"Retail investors panicking and professional investors buying. You could almost feel the professional investor's hand in the retail investor's pocket. It happens every time," he says sadly.

It's a common misconception that investors should look to replace the 12 per cent return of income trusts, he adds. From 1926 to 2005, the Standard & Poor's 500 index has returned only a 10.4 per cent average annual return. Expecting to do better than the stock market, and thinking such an investment would carry no more risk than holding traditional equities, simply makes no sense.

For investors who were paying attention, Bruce says, signs out of Ottawa and reports in the business media suggested well ahead of time that the income trust party might be coming to an end.

Income trusts quickly built up a myth and mystique that in many cases was not warranted, says Randy Reynolds, a mutual funds representative at Winnipeg's Griffiths Reynolds Stalker. Many investors viewed trusts as supercharged bonds, neglecting to take into account the reality that bonds are debt rather than equity.

In fact, "many income trusts are really just glorified small-cap stocks that pay out their earnings rather than re-investing them in the business," Reynolds said in a recent article. "They're as potentially volatile as any other small-cap stock and the distributions they pay are not and never were guaranteed."

Active mining stocks

A look at some bellwether mining stocks.

COMPANY	SYMBOL
Alcan	AL
Barrick Gold	ABX
Cameco	CCO
Falconbridge	FL
Goldcorp	G
Inco	N
Noranda	NRD
Placer Dome	PDG
Teck Cominco	TCK.B
Wheaton River	WRM

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Reynolds' advice, like that of many other professionals, is to look at income trust holdings with reason rather than emotion. Check whether a trust is backed up by a solid business or real estate and what the potential is for capital growth, as well as how much the income distribution is.

Those most hurt by the curtailment of the income trust bull run have been some seniors and other investors who loaded up on trusts in violation of a fundamental investing principle — diversification.

Trusts are just one asset class in the Canadian stock market, in a larger equity world where Canada makes up only about 3 per cent of international equities. Loading up on trusts — or any other asset class, for that matter — was asking for trouble.

"I was never a really big fan of them," says Joe Robb, a financial planner with Ensurco Insurance Group of Markham. He says his clients did not experience much pain from the trust meltdown because he did not actively promote trust funds.

He says many investors hurt in the trust debacle are now seeking security in the "traditional blue-chip funds," particularly financial funds holding banks and insurance companies.

The superiority of dividend-paying stocks and funds has become the new prevailing wisdom on Bay Street, a fancy that Scotia McLeod's Bruce takes issue with.

"For somebody to say that dividends lead to superior returns in equities ... it is just not right," he says. "It is not supported by the academic literature."

Bruce's message of diversification, patience and avoidance of investment fads is not the answer many want to hear in this time of quick fixes, but you can't fault him on his results. He estimates his clients' portfolios dropped only about half of a per cent in the immediate aftermath of the trust turmoil.

Meanwhile, senior investors got some good news along with the trust shock.

The income-tested age credit is going up \$1,000, and spouses will be able to split pension income between them to pay less tax in total.

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