

From: Kevin Malone
Date: July 25, 2007 1:30:32 PM EDT (CA)
To: <falconaire@sympatico.ca>
Subject: SM on CC discussion list

Hi, enjoyed reading your stuff on the Canadian Capitalist discussion board, I just posted a long message about my own experience, I was hoping you could check it out and correct any errors I made in describing it. It is very sad to me that so many people will not open their eyes to the benefits.

Kevin

Kevin Malone // Jul 25, 2007 at 1:20 pm

Wow, it was quite a task reading through all of the comments. I sense a lot of resistance from those who (like me) were raised on the almost religious belief that the “right thing to do” is invest in RRSPs. As someone who is just a few months from paying off in full a mortgage on a \$750,000 home (purchase price, not current value), I have tried helping friends of mine understand it, but with little success, even when I show them that (in some cases) that we’ve led remarkably similar lives in terms of our income and expenses (including home) and yet their financial situation is unquestionably horribly inferior to where I (and my wife) are at. They do not argue that, but they resist, using most of the same arguments that I see here. For some it is fear, and for others they just don’t want to deal with the idea that maybe what they have been doing was not as brilliant as they thought it was, that is, an ego thing. Which I understand, I’ve been there when it comes to investing and I am still far from even an amateur expert. But despite that, I am doing better than virtually anyone I know, even people who bring in a lot more income.

I am not a financial or investment expert, which means those who want to resist will easily find a way to continue doing that, since I am not going to be able to come back with fancy sounding rebuttals, but heck, if even one person listens to what I have to say and ends up where I am today - a middle class guy with a middle class job but a rich man’s house (where I live anyway, maybe not in Toronto!) and a bright financial future

then it's worth it

It's kind of unfortunate that the entire thing has become known as the Smith Manoeuvre when it should have been called "Investing More Intelligently" or something less goofy and suspicious sounding. And the book of course is appallingly badly written. There are people in this forum who could do a better job of it judging by what I have read.

Anyway, my "SM" was boring, boring, boring and very very very effective.

Here's how it worked according to my Joe Sixpack level of understanding.

I was doing what a lot of people do - paying off my mortgage as best I could but at the same time maxing my RRSP, because it was my heartfelt fight to the death belief that maxing my RRSP was the most important thing I could do. I made a lot of the usual investing mistakes that young people make within my RRSP and eventually settled into a more sensible (for me) strategy of buying and holding "quality" with some boring ETFs thrown in as well. Some of these investments were generating Canadian dividends (or I should say dividends that are counted as Canadian), which of course were staying in the RRSP. Fine. Good.

Then a few things started to occur to me.

The tax treatment of Canadian dividends is really great...some smarter person will provide the exact figure, but basically you end up keeping something like 80 cents (probably more) on the dollar depending on your income/tax situation. Verrrry niiiiiiiiiiiice.

But I wasn't getting any of those benefits because my investments are in the RRSP, which means that whenever I would take them out, at retirement or otherwise, everything in there would be treated the same - taxed at my marginal tax rate of the time, and with government and possibly private pension to consider, it would certainly be in the area of 20% or maybe more. Not so great. I realized I had been operating with the goofy thought process that when I pulled the money out at the end I wouldn't need to worry about being

taxed on it. Laugh if you like, but I've encountered all sorts of people that haven't thought about that.

So I started thinking that my dividend bearing investments in particular might be better held outside of an RRSP. This led to some other thoughts as well.

To skip ahead, after lots of reading and discussions with my wife, we met with an experienced SM advisor and got hooked up with a guy within our existing charter bank and started developing an SM strategy. As I said, kind of boring, but very neat if you will.

It would have been 8 years to pay off our mortgage doing what we were doing at the time we started our SM. Our mortgage was our only debt and we were making payments much higher than the average couple (according to our bank guy).

We will now be paying off our mortgage in 4 years. I wish I had it here with me, but do the math on 4 years of mortgage payments on a \$750,000 home and well needless to see it is a lot of money! If only we had started this sooner.

How do you cut your mortgage time in half (that seems to be the normal SM experience by the way?). Well, it's kind of easy. You attack the mortgage like it is a war...you keep paying as much as you can towards it from your regular source of income (work) but you borrow the maximum available equity from your home (which gets increased with every mortgage payment you make - have to find a bank/banker willing to do that for you) and with that borrowed money you purchase income-yielding investments. With that income you pay off the interest on the loan with part of it, and with the rest of it you direct it to the mortgage.

So, you are now making your mortgage payment from your employment income, and additionally you are directing the income (minus the interest payments) from your investments (which you purchased with your home equity) to the mortgage.

And that's not all...those payments you are making on the interest (using income from

the investments you purchased with borrowed money) come back to you from the government every year! All of it. Guess what you do with that money? That's right, pay off even more of the mortgage! So there's your three-pronged attack...standard payments, investment income payments, and government tax refund, all attacking the mortgage. The mortgage doesn't have a chance...!

The benefits of this clobber the value of the RRSP tax deduction that seems to keep people hooked like junkies on a pipe.

The investments used to accomplish this for us were incredibly boring income-yielding mutual funds with a very limited goal - to net 8% a year. We averaged more like 12% but the plan was based on 8%, so we are finished up in a bit less than the 4 years we had anticipated.

In what is rapidly becoming a matter of weeks, we are going to own our \$750,000 (which is now worth about \$1 million) outright and have a mortgage-burning party. Our investments will likely continue to deliver about 10% annual income (a few dips and valleys are fine, with the nature of these investments it would take WWII for a long term problem) which on a \$560,000+ portfolio is obviously a huge amount of money...

Once the mortgage is paid off, we'll simply direct that income to purchasing additional investments (and buying stuff too!) further increasing our investment income.

Think about it...people are hoping their RRSP is going to be enough to live off in retirement, and here I own my home and I already have enough investment income to live off...I could seriously considering retirement if I wanted to, but I like my job

If it really bothers you to have an interest-free debt that gives you tens of thousands of dollars a year, you can obviously start paying it off when your mortgage is done. But not thanks...I'll take the free money and keep taking it, from here to eternity.

Well, I hope people here will at least appreciate that I tried, sorry if it is not very technical.

I urge you to look into it. A lot of you here are obviously advanced enough in this area that you would not even need an SM advisor to do it, you'd just need a bank/banker willing to do a readvancable mortgage and go the extra mile with the various accounts that are required to make this all legal for the tax man. Our guy has done this with many people and it has been no trouble at all for us, so getting the right bank/banker to deal with is obviously a key, and although we too probably could have managed without an SM advisor, we would not have found our banker without him, so for that alone it was worthwhile.

OK, that's that. If something sounds screwy just ask me and I will try to answer, but be nice, I am just trying to help. All I know is my situation seems tremendously better than other people with my level of income and that you can't argue with the results, even if I am not good at explaining how I got here.

Kevin