

## So much for the Halloween surprise

### Income trusts have done rather well since Oct. 31

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A half year after income trusts were supposedly massacred by Jim Flaherty's "Halloween Surprise," most diversified income trust mutual funds are in the black for the six months ended April 30, 2007.

The latest performance data show the average income trust fund gained 4.5% in April alone, reversing much of the bleeding created by the controversial announcement of a 31.5% tax on trust distributions.

Reports of the devastation caused by the Halloween bombshell are "greatly exaggerated, since most trust-heavy mutual funds have either made money or had minimal losses in the six months since the announcement," says Morningstar Canada investment funds editor Rudy Luukko.

Data supplied by Fundata Canada Inc. to [www.financialpost.com](http://www.financialpost.com) shows the average income trust fund had a positive 0.49% return over the past six months. The median is 0.64%. Funds listed by Fundata in this category must hold at least 75% in income trusts.

The three top funds had double-digit performance of 14.3%, 13.8% and 9.9% -- and that's only for half a year.

Three-year returns to April 30, 2007, look even better, with the average income trust fund enjoying a 16.7% average annual compound return. The median return is 17.62% -- meaning half the funds did even better.

Some much better: Sentry Select Focused Growth & Income has a whopping three-year return of 32.1% for the three years ended April 30, 2007. None lost money over three years.

This prompts B.C.-based certified financial planner Fred Kirby to wonder who's complaining. "Investors who have held for three years have done well, so only the latecomers and the financial institutions that were underwriting these things seem to have something to complain about."

Kirby says 18 income trust funds held 80% of the \$10.8-billion of the assets under management in October. They have an asset-weighted loss of 1.3% the past six months but a threeyear, asset-weighted positive return of 17.5%.

Most income trust mutual fund investors may be down "by an insignificant amount" over six months, but those who held for three years "outperformed even the majority of Canadian equity funds," Kirby says.

True, those who sold in the weeks following the Oct. 31 announcement may now regret it (including yours truly). However, those shrewd enough to buy during the November downdraft should be nicely ahead by now.

CANADIAN INCOME TRUSTS	
TOP TEN 6-MONTH	
	% simple rate of return
1. Dynamic Focus+ Small Business Fund	14.31
2. Lawrence Income Fund	13.82
3. Leith Wheeler Income Trust Fund Series B	9.94
4. Saxon High Income Fund	7.46
5. Fidelity Income Trust Fund	5.55
6. Sentry Select Fidac U.S. Mortgage Trust	4.39
7. Bissett Income Trust & Dividend Fund F	4.20
8. Middlefield Equal Sector Income Fund	4.06
9. Bissett Income Trust & Dividend Fund A	3.69
10. Sentry Select MBS ARIF B	3.42
TOP TEN 3-YEAR	
	% avg. annual compound return
1. Sentry Select Focused Growth & Income	32.12

CREDIT: Fundata, Andrew Barr, National Post

CANADIAN INCOME TRUSTS.

Don't bother telling this to the noisy income trust lobby, which is so used to blaming the Tories for their "devastating" losses that the statistics will go over their collective heads.

Former Tory (now Liberal)MP Garth Turner last week began circulating a petition bemoaning the \$25-billion "wiped out" in the retirement accounts of two million Canadians.

The current figure is much less than half of that. Independent consultant Diane Urquhart estimates that as of May 14, only \$9-billion has been lost from a total market cap of \$197.6-billion for 288 income trusts. That's a net change of less than 5% since Oct. 31.

Hardest hit are energy trusts, which have fallen 10.1% to \$78- billion. Business trusts are down 1.7% to \$92.9-billion while REITs (Real Estate Investment Trusts, not affected by the tax) are up 1.5% to \$26.6-billion.

But there is still net negative performance for the income trust market between Oct. 31 and May 15, Urquhart says. Closed-end funds of trusts have performed more poorly than the composite of all the underlying income trusts.

That, Urquhart says, "belies the view that these professional money managers were able to separate the wheat from the chaff in this diverse asset class, where there were so many poorly performing business income trusts."

Urquhart says the number of income trusts in the market is declining so "there is now some survivor bias" in measuring income trust performance.

All losses are unwelcome but can occur in any particular asset class at any given time.

That's why advisors tell investors to hold several asset classes not highly correlated to each other.

The political and sector risks of this asset class were well known at least a year before the Tories took on the file.

Furthermore, not all poor performance can be attributed to the tax change.

Toronto consultant Andrew Teasdale says many trusts were distributing well in excess of their earnings and a good number in excess of their cash flow.

"Much of the fall in the price of some trusts has been due to cuts in distributions, which had nothing to do with changes in taxation, save where this impacted the ability to raise capital to fund these distributions."

Morningstar's Luukko says Ottawa's action was the beginning of the end for trusts in terms of having tax-favoured status versus dividend-paying corporations.

"So it has become all the more important to evaluate trusts on their own business merits, just as you would any other equity."

The Halloween shock has caused investors to review their options for generating cash flow, Luukko says.

"We've been seeing an increase in the number of T-series funds whose distributions consist partly or at times entirely of a return of the investor's own capital."

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- - - Chevreau's blog is at [www.wealthyboomer.ca](http://www.wealthyboomer.ca).

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