



Downside defence ... at a cost; Product offers equities plus shield from losses

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A fully financed, leveraged stock market program with downside protection is making waves in Canada a decade after a similar product launched as a massive hit in Australia.

Macquarie Equity Plus lets Canadian investors borrow \$100,000 or more to buy various combinations of the top 60 Canadian blue-chip stocks or exchange-traded funds. Investors collect all dividends, write off the interest and benefit from any capital gains, but don't absorb any losses.

The Australian version, Macquarie Geared Equities Investment Plus, has sold billions of dollars' worth and spawned many imitators from banking rivals.

About half of Macquarie's 150 financial advisors have been trained to sell the product, one of whom is Chris Cottier, technical editor for some of the Dummies financial guides in Canada.

Launched quietly in June, the program has "generated immediate and widespread interest from the moment we launched it internally," says Aaron Boles, a spokesman for Toronto-based Macquarie Private Wealth (formerly Blackmont Capital).

Mr. Boles says that is "largely because nobody has seen anything like this in Canada before."

The underlying concepts are not in themselves new: Buying stocks with leverage or offering downside protection. What's different is how they've been put together.

Investors borrow for fixed terms between one and five years or select a variable interest-rate option. The catch is that to get the downside protection, they will pay hefty rates of interest, ranging from 12% to 18% over three to five years, depending on terms chosen and stocks selected. That extra-high interest rate buys what is, in effect, insurance against losses.

And for those in the top tax bracket, true servicing costs may be less after factoring in dividend income, dividend tax credits and after deducting interest expenses.

Macquarie says a tax opinion from a major Bay St. law firm confirmed "the financing costs of EquityPlus do carry the tax efficiencies they were intended to."

Boles is vague on how Macquarie builds the downside protection. Asked if it involves put options, he responds: "There's a hedging program under the hood. It obviously works because we wouldn't have brought it to Canada if it didn't." He adds it works similarly to Australia's, since securities laws in the two countries are not dissimilar.

To illustrate the downside protection, Boles cites a hypothetical example of an investor buying

100,000 shares of a stock selling for \$1 a share. If they fall to 25¢ when the loan period is over, this client doesn't owe \$100,000, she owes only the \$25,000 they are now worth (plus accumulated interest).

But if a high-flying stock such as Potash Corp. of Saskatchewan Inc. soared in the interim, profits are "yours to keep. Walk away. We take the hit," Boles says.

Investors can buy into a maximum of six stocks, although by choosing ETFs they can get indirect access to the whole Canadian market or specialized sectors of it. The maximum number of picks rises to eight for financing above \$250,000, and to 10 stocks when investing above \$500,000.

It's not for everyone, but Boles says it may appeal to certain groups. For example, young professionals who don't yet have a chunk of money to invest but have strong regular cash flow may find this a way to build up equity in the market.

Potential investors should read a 154-page information folder to acquaint themselves with possible risks (interest rates, default, death, etc.) and consult an advisor about securities chosen. Early exits are not recommended and may result in adverse tax consequences. There is a "limited trading" feature, and investors should take a buy-and-hold approach.

Tax specialist Graham Williams, a partner with the Toronto-based accounting firm of Stern Cohen LP, says at the stated range of interest rates, assuming dividend yields of 2% to 4% after tax, the annual cost would be 4% to 8% to carry such an investment.

Of course, this assumes all loan interest is fully tax-deductible. If not, the numbers are less rosy.

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