INVESTING

Canadian Income Trusts
TRICK OR TREAT?

BY RON BROUNES

For Canadian companies and income oriented investors, Halloween 2006 proved to be far more trick than treat. Furthermore, Finance Minister Jim Flaherty emerged as that rude neighbor who chooses to dim the porch lights and not give out any goodies to the candy craving children. (Has anyone considered "toilet papering" Mr. Flaherty's house?)

For years, investors throughout Canada, the United States, and elsewhere participated in Canadian Income Trusts, most often for the tax-efficient status they enjoyed. The trust structure allowed the issuing businesses or flow-through entities (FTE) to distribute their operating income to unit-holders and avoid paying traditional corporate taxes in the process.

Most often used as a vehicle by companies with income producing properties like real estate, oil wells, or public utilities, the income trusts ultimately became popular with diverse businesses in retail, hospitality, and even basic materials as well.

Mr. Flaherty and his politicos soon recognized the trend for Canadian companies to convert to this popular structure, and began to calculate the potential loss in tax revenues to the government. They grew concerned with what they perceived to be a "growing trend toward corporate tax avoidance." After a lengthy debate of the pros and cons over several years, on October 31, 2006, he announced a proposal designed to "restore balance and fairness to Canada's tax system, to ensure our economy continues to grow and prosper and to bring Canada in line with other jurisdictions." In other words, Canadian Income Trusts will lose their corporate tax-exempt status.

As written, newly formed income trusts will be subject to corporate taxes immediately, while existing entities would be "grandfathered" for a few years with a transitional grace period until 2011. The new Canadian legislation will not apply to REITs (Real Estate Investment Trusts) which will continue to operate under the old tax-exempt rules.

A History Lesson

The trust structure became popular for individuals interested in investing in income producing assets that offered both attractive cash flow streams as well as the potential for capital appreciation. Historically, businesses with reliable cash flows from real estate, commodities, and other natural resources gravitated to such structures and were able to bypass corporate taxes as long as they made distributions of their profits to their investors known as unit-holders. The trusts typically make cash flow distributions on a monthly or quarterly basis.

Savvy investors took advantage of these tax-efficient opportunities and often were able to participate in diverse portfolios of related income producing properties. While the trusts avoided the burden of double taxation faced by most corporations, Canadians were taxed on the distributions at their personal rates and foreign investors (such as those in the U.S.) were subject to a 15% Canadian withholding tax.

The trust concept really took off when the dot.com IPO bubble burst in the early 2000's and the lull in new transactions caused investment banks to lose a significant source of fee revenue. Soon, they began exploring other opportunities to boost their bottom lines. Similarly, with global interest rates declining to historically low levels, many investors sought out attractive income streams to replace the limited cash flow offered by the stable fixed income markets. The trusts represented beneficial opportunities for both the bankers and the investors. Quickly, Canadian corporations began converting to the trust structure and took advantage of the tax savings that could be passed along to the unit-holders. Bankers saw their fee revenue increase as the conversions replaced the dot.com IPOs that had gone by way of the dinosaur. Investors were rewarded with excellent income-oriented returns from the trust distributions and also maintained some upside capital appreciation potential.

Yellow Pages Group became Yellow Pages Income Fund in what represented the first significant income trust conversion and raised over $1 billion (Canadian dollars) in the process. In fact, in 2002 almost 80% of all dollars invested through Canadian IPOs found a home in these income trusts. Oil and gas and real estate were no longer the primary participating industries; that same year, over 60% of new trust deals were outside of these traditional markets. In 2006 alone, conversions totaled over $70 billion (Canadian) and the estimated market cap for trusts on the Toronto Stock Exchange exceeded $200 billion (Canadian). In fact, these transactions became so popular with investors that the mere mention of a potential conversion often served to lift the share price by 10% to 20% virtually overnight (though the hype didn't quite reach dot.com proportions).

Certain Risks Abound

While income trusts gained in popularity during those years, they were not without their risks. Many advisors touted the income potential of these investments and often shared the strong track records of double digit yields returned to the unit-holders. However, unlike traditional fixed income securities, these trusts are actually equity investments whose cash flows were determined by the operations of the underlying companies and not based on a predetermined coupon. Many of the early trusts were tied to commodities, which can be quite volatile and incur dramatic price fluctuations. Energy and other natural resources trusts, for example, can be impacted by a variety of factors that are out of the control of company management: weather, natural disasters, OPEC, geopolitical developments, basic laws of supply and demand. Therefore, unit-holders that became accustomed to the substantial cash flow streams and high returns when the underlying commodity prices are rising, must live with the consequences of down markets as well.

Additionally, many of these energy income trusts (often referred to as Energy Royalty Trusts) were structured to own and operate producing oil wells and related properties. In most cases, they comprised a fixed number of income producing assets. When the wells are in production, the unit-holders reap the benefits of an attractive income source. Ultimately however, the underlying resources begin to deplete and the production levels cannot be maintained without significant new investments in other wells (which may or may not prove to be as successful). Since many of the newly structured trusts have moved beyond the energy sector, the negative ramifications of depletion have become less of an issue for those unit-holders. While companies in mature businesses may realize slower growth rates through the years, strong fundamentals can contribute to ongoing profitability and attractive distributions to investors. These trusts function similarly to mature corporations that maintain a healthy periodic dividend payment with the potential for long-term capital appreciation. And yet, the trusts did not face the burden of double taxation.

Until Now (or, at least 2011)

In reality, the proposed tax changes did not come without warning. Beginning in 2004, Canadian officials tried on two other occasions to move forward with a similar proposal, but were unsuccessful. For years, politicos recognized the growing trend of companies converting to trust structures for no other true business reason than to avoid paying corporate taxes. While energy, real estate, and other natural resources companies had long been the most likely (and logical) entities to engage in such structures, the governmental officials took particular note when other types of businesses soon followed suit.

Numerous studies have been commissioned through the years that attempted to estimate the lost revenues incurred by the government as a result of the growth of income trusts. While no true consensus has been reached, a study by Canadian economist Jack Mintz placed the total negative affect at about $700 million (Canadian) for 2006. He increased those calculations to include the intended conversions of two significant telecommunication companies, Telus and BCE that were announced just prior to the Halloween proposal. Taking these two large companies into consideration, Mintz revised his estimates for federal revenue lost to $1.1 billion (Canadian) for 2006. While other studies may show differing results, the significance of these numbers (and the trend toward conversions of these major players) certainly contributed to the ultimate decision by Flaherty to move forward when he did.

On the other hand, some economists actually believe that the projected revenue shortfall should be far less of an issue than politicians claim. They feel that the income trust structure contributes to solid economic growth in the country as investors have more disposable income to spend on traditional goods and services, thus benefiting the economy as a whole. Such a philosophy is somewhat consistent with "supply side economics," a concept preached by Ronald Reagan and many of his fiscally conservative disciples.

The Immediate Aftermath

Despite the long standing rumors associated with such a move, investors did not take too kindly to the Flaherty proposal and reacted with great haste (and even some initial panic). The S&P/TSX Capped Income Trust Index, the benchmark Canadian Income Trust index, plunged by over 15% in the two days that followed the announcement and remained almost 10% lower by the end of the year. The S&P/TSX Capped Energy Trust declined by about 12% during those subsequent two months as well. Because, REITs were not affected by this new proposed legislation, the S&P/TSX REIT Index actually gained market value during that short time frame as unit-holders sought out opportunities within the remaining tax-efficient investments among the trust structures.

Once investors had a chance to reevaluate (and perhaps took into account the four year transition period), the primary trust

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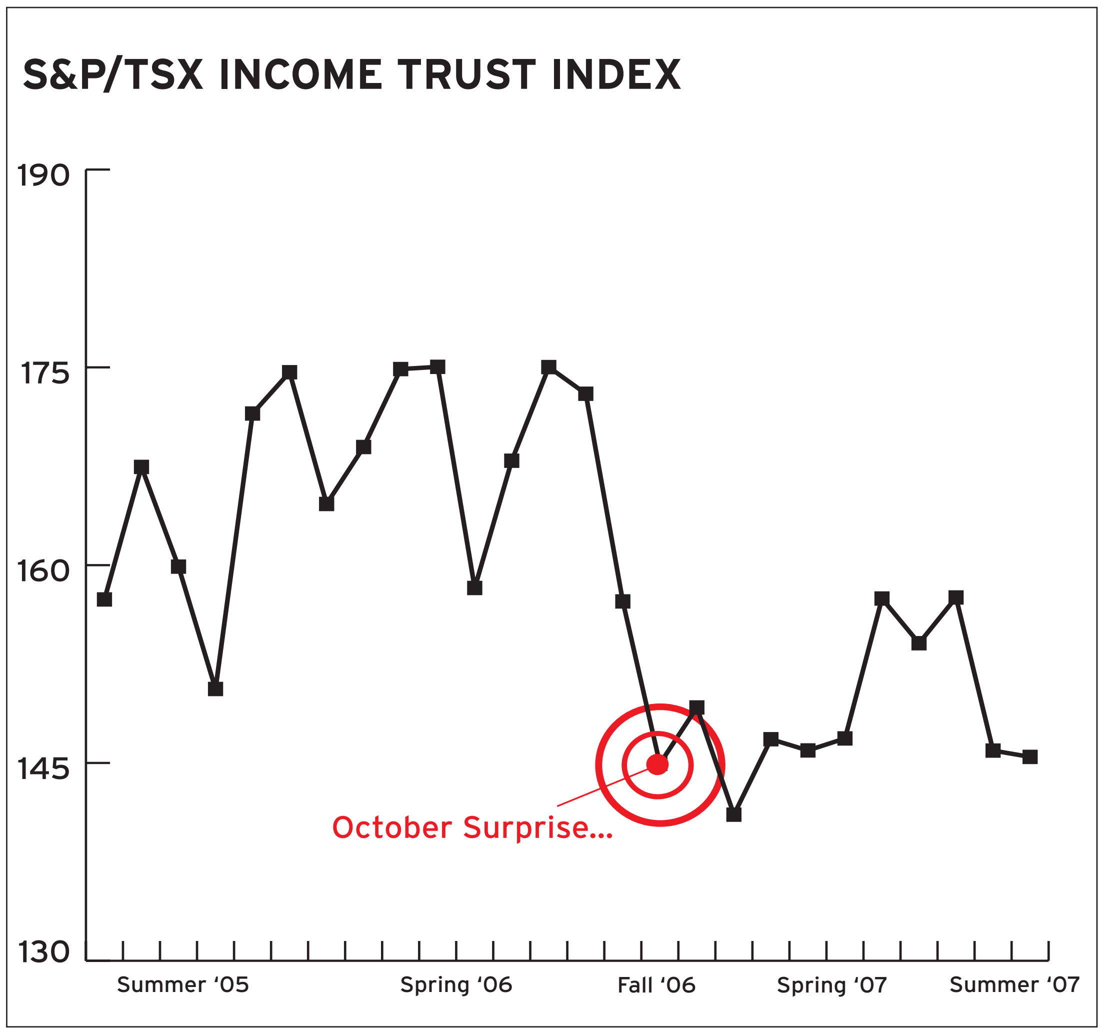
	NAME	SYMBOL	INDUSTRY	REVENUE	MARKET CAP	OUTSTANDING	PRICE (9/11/7)	DIVIDEND	YIELD	WEBSITE
1	Priszm Income Fund	QSR.UN	Retail	503.38M	180.74M	25,000,001	6	0.1067	21.3%	www.priszm.com
2	Peak Energy Service Trust	PES.UN	Oil & Gas	127.67M	101.10M	37,000,001	3.82	0.06	18.8%	www.peak-energy.com
3	Enterra Energy Fund	ENT.UN	Oil & Gas	244.41M	317.95M	61,000,001	3.88	0.06	18.6%	www.enterraenergy.com
4	Connors' Bros Income Fund	CBF.UN	Packaged Foods	938.23M	404.18M	50,000,001	8.17	0.1125	16.5%	www.connors.ca
5	Harvest Energy Trust	HTE.UN	Oil & Gas	1388.2B	3.38B	143,000,001	27.78	0.38	16.4%	www.harvestenergy.ca
6	NAL Oil & Gas Trust	NAE.UN	Oil & Gas	310.75M	950.61M	79,000,000	11.9	0.16	16.1%	www.nal.ca
7	Paramount Energy Trust	PMT.UN	Oil & Gas	394.67M	867M	107,000,001	7.58	0.1	15.8%	www.paramountenergy.com
8	Chemtrade Logistics Income Fund	CHE.UN	Commodities	552.13M	269.34M	33,000,001	8.16	0.1	14.7%	www.chemtradelogistics.com
9	SFK Pulp Fun2	SFK.UN	Paper Products	312.37M	442.20M	105,000,000	4.22	0.05	14.2%	www.sfk.ca
10	PrimeWest Energy Trust	PWI.UN	Oil & Gas	624M	1.88B	91,000,000	21.92	0.25	13.7%	www.primewestenergy.com
11	Crescent Point Energy Trust	CPG.UN	Oil & Gas	321.01M	1.78B	101,000,001	18.92	0.21	13.3%	www.crescentpointenergy.com
12	Contrans Income Fund	CSS.UN	Railways	455.25M	265.07M	29,000,000	9.56	0.1042	13.1%	www.contrans.ca
13	Freehold Royalty Trust	FRU.UN	Oil & Gas	139.24M	708.15M	49,000,000	14.1	0.15	12.8%	www.freeholdtrust.com
14	Provident Energy Trust	PVE.UN	Oil & Gas	2,187.25B	2.90B	242,000,001	12.15	0.12	11.9%	www.providentenergy.com
15	Sun Gro Horticulture Income Fund	GRO.UN	Forest Products	197.31M	168.92M	22,000,000	7.62	0.075	11.8%	www.sungro.com
16	Newalta Income Fund	NAL.UN	Services	441.04M	797.67M	40,000,001	19.41	0.185	11.4%	www.newalta.com
17	Enerplus Resources Fund	ERF.UN	Oil & Gas	1301.4B	5.57B	129,000,000	45.14	0.42	11.2%	www.enerplus.com
18	Noranda Income Fund	NIF.UN	Mining	1055.07B	475.81M	50,000,000	9.84	0.085	10.4%	www.norandaincomefund.com
19	Livingston International Income Fund	LIV.UN	Financial Services	322.18M	447.68M	27,000,000	16.67	0.142	10.2%	www.livingstonintl.com
20	Rogers Sugar Income	RSI.UN	Packaged Foods	532.74M	386.71M	87,000,001	4.31	0.0367	10.2%	www.rogerssugar.com
21	Focus Energy Trust	FET.UN	Oil & Gas	234.7M	1.22B	69,000,001	17.14	0.14	9.8%	www.focusenergytrust.com
22	IInnVest Real Estate Investment Trust	INN.UN	Real Estate	389.67M	654.36M	56,000,000	11.58	0.09375	9.7%	www.innvestreit.com
23	Peyto Energy Trust	PEY.UN	Oil & Gas	350.56M	1.77B	105,000,001	17.3	0.14	9.7%	www.peyto.com
24	Enbridge Income Fund	ENF.UN	Gas Utilities	254M	364.60M	34,000,001	10.33	0.08	9.3%	www.enbridgeincomefund.com
25	Royal LePage Franchise	RSF.UN	Real Estate	29.66M	173.04M	130,000,000	13	0.1	9.2%	www.royallepage.ca
26	Inter Pipeline Fund	IPL.UN	Gas Utilities	1011.04B	1.86B	203,000,000	9.16	0.07	9.2%	www.interpipelinefund.com
27	Fort Chicago Energy Partners	FCE.UN	Gas Utilities	563.11M	1.37B	131,000,000	10.36	0.0775	9.0%	www.fortchicago.com
28	Home Equity Income Trust	HEQ. UN	Financial Services	43.73M	169.58	13,000,001	12.24	0.09	8.8%	www.homeq.ca
29	The Consumers' Waterheater Income Fund	CWI.UN	Utilities	156.70M	762.67M	49,000,001	14.67	0.1075	8.8%	www.consumerswaterheaters.com
30	IPC US Real Estate Investment Fund	IUR.UN	Real Estate	169.67M	449.39M	44,000,001	9.59	0.069	8.6%	www.ipcus.com
31	Northland Power Income Fund	NPI.UN	Electric Utilities	164.79M	792.50M	62,000,000	12.51	0.09	8.6%	www.npifund.com
32	Pembina Pipeline Income Fund	PIF.UN	Gas Utilities	335.82M	2.20B	131,000,001	17.22	0.12	8.4%	www.pembina.com
33	Energy Savings Income Fund	SIF.UN	Gas Utilities	1212.31B	1.45B	98,000,000	14.87	0.10083	8.1%	www.esif.ca
34	Innergex Power Income Fund	IEF.UN	Utilities	41.15M	303.56M	24,000,001	12.1	0.080417	8.0%	www.innergex.com
35	Westshore Terminal Income Trust	WTE.UN	Marine	161.55M	996.44M	74,000,000	13.2	0.086	7.8%	www.westshore.com
36	Parkland Income Fund	PKI.UN	Oil & Gas	1,199.87B	809.56M	48,000,000	16.84	0.0967	6.9%	www.parkland.ca
37	CML Healthcare Income Fund	CLC.UN	Services	288.89M	1.34B	86,000,000	15.73	0.08625	6.6%	www.cmlhealthcare.com
38	Sleep Country Canada Income Fund	Z.UN	Home Furnishings	324.09M	303.38M	14,000,000	21.6	0.1167	6.5%	www.sleepcountry.ca
39	Great Lakes Hydro Income Fund	GLH.UN	Electric Utilities	177.11M	938.97M	48,000,000	19.29	0.1	6.2%	www.greatlakeshydro.com
40	Northern Property REIT	NPR.UN	Real Estate	84.01M	454.61M	20,000,000	22.55	0.115	6.1%	www.npreit.com
41	Riocan Real Estate Investment	REI.UN	Real Estate	646.41M	4.64B	209,000,000	22	0.11	6.0%	www.riocan.com
42	Gateway Casinos Income Fund	GCI.UN	Hotels/Resorts	133.34M	782.01M	32,000,000	25.05	0.125	6.0%	www.gatewaycasinosincomefund.com
43	Dundee Real Estate	D.UN	Real Estate	291.44M	1.67B	42,000,000	36.75	0.183	6.0%	www.dundeereit.com
44	Cominar Real Estate Investment Trust	CUF.UN	Real Estate	131.69M	961.96M	44,000,001	21.9	0.105	5.8%	www.cominar.com
45	CCS Income Trust	CCR.UN	Oil & Gas	1673.82B	2.31B	52,000,000	45.26	0.175	4.6%	www.ccsincometrust.com
46	Labrador Iron Ore Royalty Income Fund	LIF.UN	Steel	83.23M	983.36M	32,000,000	37.5	0.116	3.7%	www.labradorironore.com

indexes began to regain some of their lost value. On a year-to-date basis (through June 15, 2007), the Capped Income Trust had increased by about six percent, with the Capped Energy Trust lagging a bit with a four percent gain. U.S. investors in Canadian income trusts may have actually fared somewhat better as they have benefited from the strength in the Canadian dollar which recently stood at a 30-year high vs. the U.S. currency.

So What's Next?

During the next four years, some trusts may simply choose to convert (or, in some cases, convert back) to Canadian public corporation and take advantage of effective strategic planning and the current available deductions to offer as high a return to their shareholders as possible. Others may look to the U.S. markets and determine if the tax laws abroad may create new opportunities for them and their investors. Master Limited Partnerships are often considered the most similar business structure to the income trust. Some entities may examine such a conversion as the available tax treatment may allow their investors to continue receiving comparable distributions and potential returns. As always, additional costs and administrative complexities will be involved in any type of conversion (particularly one that includes a new country of domicile). So, effective cost/benefit analysis would be imperative.



On a side note, the MLPs endured a similar structural transition as a result of U.S. tax law changes in 1986. At that time, U.S. REITs and MLPs backed by natural resources were exempt from the new legislation. Today, many income trust investors remain hopeful that similar modifications will occur in the current Canadian proposal, thus allowing a substantial number of energy (and other commodity) related trusts to continue to receive the favorable tax treatment.

A New Trend?

In mid-May 2007, Northstar Healthcare, Inc., a Houston, Texas based medical service company, became the largest IPO in Canada this year. The $170 million offering was considered a hybrid investment vehicle as it offered the capital appreciation of an equity security with the attractive yield potential of fixed income paid in the form of a high dividend. The company was priced to yield over nine percent, a rate that is higher than many current Canadian Income Trusts are paying.

Northstar management chose the Canadian exchange because they believed that the country's investors would be seeking alternative income sources given the recent changes in the tax status of the income trust. They also recognized that Canadian investors have few opportunities to participate in medical services companies as the country maintains a socialized health care system. Further, avoiding the costs and complexities associated with the Sarbanes-Oxley regulation in the U.S. may have entered into the decision-making process as well.

INCOME TRUSTS:

ONE ADVISOR'S POINT OF VIEW

By Kevin Malone

Our firm's primary experiences with Canadian Incomes Trusts dates back to 2004, though we had been involved on a much smaller scale for a few years prior. About three years ago, we developed an investment strategy around a "high and growing" dividend equity portfolio that was targeted to our RIA clients. At the time, we believed that investors should reduce their exposure to the fixed income markets as bonds may struggle for the next five years or so, a view that has proven correct thus far.

While we explored investing in certain alternative products to keep the integrity of the volatility of the portfolio intact, we were concerned that such securities wouldn't provide the income or cash flow stream desired by our clients. We chose to earn the income through equity asset classes and Canadian Royalty Trust became one key allocation of this income oriented portfolio. In some cases, trusts made up 15% to 20% of the entire high and growing dividend portfolio. Our clients welcomed the attractive yields and some wanted us to devise entire portfolios comprised of income trusts and MLPs. Today, we have reduced our overall allocation to these securities to between 5% and 10%, though they still remain an important income producing asset class for us.

While many investors were quite displeased, the recent tax changes proposed by the Finance Minister last October were certainly understandable. After RBC (Royal Bank of Canada) announced its intent to convert to an income trust structure, the Canadian government essentially said "enough!!!" After all, RBC had about as much right to call itself a Royalty Trust as I do (or my company does) and such a conversion would mean far less tax revenue received by the federal government. Canadian Royalty Trusts were initially established to encourage the development of the natural resources of Canada, a concept that made all the sense in the world at the time. Well, the tax benefits received by these entities led to significant abuses as companies in totally non-related industries attempted to take advantage. RBC is a perfect example of this abuse.

Another key factor helped lead to the decision to change the tax status. If one looks at the future growth potential of Canada, natural resources will undoubtedly be a major contributor. The country is rich with resources and more are being discovered all the time. The tax law may have made more sense when oil prices were low and there was little exploration. However, with energy prices climbing through the roof, activity is plentiful and new resources continue to be found. Exploration companies do not need tax incentives these days. The sheer supply and demand have become incentive enough. While the law certainly served its purpose, it made practical sense to revise it for now.

For investors with short memories, the current Canadian situation reminds many of the US tax consequences surrounding the old MLP (Master Limited Partnership) laws. Similar abuses occurred years ago as the laws were not well written and companies such as Alliance Capital Management took advantage of loopholes within poorly scribed language and moved to become MLPs. Today, the laws are very clean and only companies engaged in distributing/maintaining natural resources and also the maintenance of rental properties can participate. Those that fit the criteria can still receive the tax benefit. In Canada, where natural resources are more plentiful, the incentives for Royalty Trusts no longer seem needed.

Though the year 2011 is a long time away, I don't expect to see any major changes in the way the new regs have been proposed. I also believe that many trusts will continue to operate under the same structure and will not convert to MLPs or others in an attempt to receive the tax benefits. Royalty Trusts will continue to operate as royalty trusts, but will be paying taxes on the Federal level; thus, the value of the companies will be lower than before.

Already today, the prices of these publicly traded trusts are reflecting these changes. The related markets tumbled in the days that immediately followed, though have bounced back a tad in the months since the initial "shock." In some cases, the worst may already be over and many of these trusts continue to provide attractive yields. Natural resources are highly priced and that factor contributes to the nice returns more than any tax benefit. We still own them and will continue to analyze those markets now and in the future as we seek income and cash flow in our high and growing dividend portfolios.

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In any case, analysts expect other U.S-based companies to explore similar opportunities to take advantage of the growing demand for high income-oriented investments by Canadian investors.

Stay Tuned

The 2011 deadline essentially allows the managements of the current Canadian income trusts, a grace period to evaluate the most effective and efficient structures moving forward. Bear in mind, many crucial details remain to be worked out and changes occur within the economic and political landscape each day. Studies continue to be evaluated indicating differing perspectives of the ramifications of such a move on the country's potential revenue stream, as well as the entire Canadian economy. Additionally, discussions are ongoing about the fairness of the tax plans for the various investor types: Canadian taxable individuals vs. Canadian tax-deferred investors (within retirement plans) vs. foreign investors.

In the meantime, trust investors continue to take advantage of the current tax benefits and are waiting to see how things play out over the next four years (while thinking up new "tricks" to play on Flaherty next Halloween). ■

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HALLOWEEN MASSACRE

By Curtis L. Lyman, Jr.

Following the U.S. equity market declines in 2001, which were accompanied by historically low interest rates, many of my more income-oriented clients began searching for investment vehicles that would produce yields higher than traditional bonds. Resource-oriented shares in U.S.-based Master Limited Partnerships (MLPs) and Canadian Royalty Trusts (CANROY) appeared to be attractive. Both investment vehicles are natural resource related. The main difference, however, is that MLP's are indirectly tied to the price of commodities and the CANROY's provide an almost pure play in the price of oil, coal, and natural gas. The investments in both vehicles served clients well providing advantageous tax treatment of "income" as well as capital gains.

Canadian Finance Minister Jim Flaherty's "Halloween Massacre" came without warning and was in apparent contravention of campaign promises made by the Conservative Party Candidates which led up to their victory earlier in 2005. Unfortunately, the events were not too dissimilar from past events in this country where, when faced with potential loss of corporate revenues, tax laws are drastically altered to protect such revenues.

Current-day MLPs were themselves created as an exception to tax law changes in the U.S. when some DJIA corporations threatened to convert to master limited partnership structures in order to avoid corporate taxation. (Who knows where GM might be today if they'd been permitted to do this….) One need recall only a few years ago when large corporations like the infamous Tyco were moving their corporate domiciles offshore to Bermuda in order to avoid domestic corporate taxation. The response of the U.S. government was to change the tax laws, effectively penalizing those companies that found shelter from taxes outside the U.S. As investors, when we consider "risks" we must also consider "legislative risk."

It remains to be seen whether the tax law changes proposed by Flaherty will pass Canadian legislative scrutiny and, if they do, what impact such legislation may have on CANROY share prices both in the near/intermediate term and following full proposed implementation in 2011 when the favored tax status under pending legislation would go away. As well, when we analyze the investment opportunity, we often remind our clients not to let the "tax tail wag the dog." I believe that this may be good advice in this instance.

CANROYs must be distinguished from other Canadian pooled investment vehicles like REITs, Stock Market Sectorial Trusts, and Specialty Trusts. CANROYs are those pooled investment trusts that are oil and gas companies who, by virtue of their special tax structure, pay out the bulk of their earnings, before taxation, in monthly dividends. However, what should be recognized, is that investment in the CANROYs is an almost pure and direct investment in the commodity price of oil, gas and coal. For American investors, there is also the currency exchange consideration. As the value of the "Buck" has declined against the "Loonie," U.S. investors in the CANROYs have enjoyed some healthy capital gains based on currency exchange.

Looking forward, we are of the opinion that subject to some higher than historic volatility in share prices, CANROYs present a unique investment opportunity for clients seeking total returns, if they are willing to assume commodity risk, currency risk, and legislative risk. If one posits that the domestic price of oil, gas, and coal are in part related to the weakness of the Buck and that there is nothing on the horizon to slow the decline in the value of the USD, it may be likely that oil, gas, and coal prices will continue to increase. There has appeared to be very strong elasticity in oil and gas prices here in the U.S., as demonstrated by strong demand for these commodities in spite of significant price increases. It appears unlikely that the price of the commodities represented by the CANROYs is going to collapse in the foreseeable future.

Similarly, while there may be a rebound in the value of the USD in the near term, there is nothing on the horizon that gives one any significant reason to believe that the secular decline of the USD value will cease. Our country's budget deficit remains out of control and our current account deficit continues to grow as Bucks chase cheap labor and consumer goods imported from afar. Finally, the legislative risk is now well-known and I believe, factored in to the share price of the CANROYs. What is not factored in is the possibility that the legislation proposed by the Conservative Government might be modified to the benefit of existing CANROYs. Remember that thousands of Canadians saw significant percentages of their retirement savings wiped out last October and they are not happy about it. Flaherty and his government poked a stick into the Canadian and U.S. investors' beehive and I would opine that they have been stung soundly, as have members of the Canadian Parliament. Modification or a defeat of the taxation proposal could be an outcome which is not factored into the CANROY price. Yield-oriented investors, in my experience, tend to focus on the dividend yield, often investing without further investigation as to the risks of the underlying instrument.

In the case of the CANROYs, I suspect that until last October, few contemplated the effect of legislative risk. Many CANROYs are well managed, provide a good flow of information as to their proved reserves, and have strong operating histories. Investors seeking yield should consider them as a high yielding alternative but must also factor in the risks of a change in commodity prices, currency risks, and legislative risk. ■

Curtis L. Lyman, Jr. is an independent investment advisor who manages an advisory practice in Palm Beach Gardens, Florida doing business as US Fiduciary where he serves as Senior Managing Director. His firm provides asset management and wealth management services for wealthy individuals and their families, foundations, and other business entities. Presently, he manages about $200,000,000 and approximately 1% of clients' portfolios are invested in Canadian Royalty Trusts (CANROYs), as part of a larger income oriented allocation that employs MLPs and CANROYs.