Money Ideas

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WEALTH PLANNING

How is your financial wellness?

Financial wellness is not a measure of a person's wealth. It's about the ways that financial aspects in our life either support or undermine our well-being. Stress over financial issues can affect Canadians of all income levels and age groups.

Measuring financial wellness

A person in a healthy state of financial wellness feels secure about meeting their current financial obligations and is confident their mutual fund investment program is on track to meet their long-term financial goals. They're able to enjoy life and not worry about discretionary spending; for example, they can take a vacation without losing sleep over its cost.

That's the ideal. But just about everyone experiences financial anxiety at one time or another. Sometimes it's caused by external factors, perhaps the markets or inflation. Other times the reason is personal, such as dealing with job loss or significant unexpected expenses.

Why it matters

The Financial Consumer Agency of Canada identifies three pillars of good health. The first two may be obvious – physical and mental health; the third is financial wellness. According to this government agency, stressors in our financial life can negatively impact our physical health, mental health, personal relationships and performance at work. Conditions potentially arising from financial stress include anxiety, depression, sleep disorders and high blood pressure, among many others.

How we can help

From the financial wellness standpoint, mutual fund investors with an advisor have an advantage over those without one. You can contact us whenever you feel anxious about a financial issue. Our help may involve providing market information, discussing specifics of your mutual fund investments, negotiating a life change, ensuring you're on track to meet your retirement savings goal or any other type of assistance. Whatever the issue, we're here to help allay your worries and take care of your financial well-being.

Are you ghosting your RRSP?

When it comes to managing their Registered Retirement Savings Plan (RRSP), it's easy for many investors to fall into a routine. Make your contributions to mutual funds. Claim the tax deduction. Repeat.

But there may be a problem if you only follow this routine, then ignore your RRSP. You could miss out on ways to make the most of your plan. Here are some strategies to consider.

When a spousal RRSP saves you tax

Ever since retirees became able to split up to 50% of their eligible pension income with their spouse, the usefulness of a spousal RRSP came into question. A spousal RRSP can still offer tax advantages in three situations, provided one spouse is in a lower tax bracket.

You retire before age 65. Splitting eligible pension income is only an option when you're 65 or older. However, if you retire before 65, you can draw retirement income from mutual funds in your spousal RRSP, with those dollars taxed in the hands of the lower-income spouse.

You wish to split more than 50%. In some situations where the higher-income spouse has employment, rental or business income, the couple may wish to split more than 50% of their pension income. They can achieve this by making withdrawals from a spousal RRSP or spousal Registered Retirement Income Fund (RRIF).

You earn income past age 71. You must close your RRSP at 71, but if you earn income and have a younger spouse, you can contribute to mutual funds in a spousal RRSP until the end of the year your spouse turns 71.

Your RRSP refund can boost retirement income

In retirement, your RRSP or RRIF withdrawals will be taxed at your marginal tax rate. But in your working years, you can take your annual RRSP refund or tax savings and invest the funds – dedicated to helping offset the eventual tax on RRSP or RRIF withdrawals. You can invest your tax refund or savings in mutual funds in your Tax-Free Savings Account (TFSA) or a non-registered account.

Claiming your tax deduction in a future year

Normally, you claim your RRSP tax deduction in the year you make the RRSP contribution, but you can claim the deduction in any future year. It can pay to defer the deduction if you expect an increase in your income – a higher marginal tax bracket results in greater tax savings.

Making a tax-smart donation

Any mutual fund investments remaining in an RRSP or RRIF when the plan holder passes away are taxed as income, payable by the estate. But there's a way to offset this tax. You name a charity as the beneficiary of your RRSP or RRIF, and the resulting donation tax credit is used on the final tax return to offset the tax owing on the plan's assets. Note that in Quebec the charity must be designated as an RRSP or RRIF legatee in a will. ◂

Children and RRSPs

Your retirement is usually on your mind when you think of an RRSP, but here are three situations when you may be considering your children or grandchildren.

Creating contribution room. A child with a part-time or summer job doesn't need to file a tax return if they earn less than the basic personal amount, which is $15,000 for 2023. However, if you help them file a return, they'll create RRSP contribution room they can use later.

Gifting funds for an RRSP. A child or grandchild who is starting out may be unable to make RRSP contributions after covering their car loan, rent or mortgage payments and other financial obligations. You could give them cash so they can contribute to mutual funds in their RRSP, for a savings boost and a welcome tax deduction.

Naming a child as beneficiary. If you name a child or grandchild as the beneficiary of your RRSP, plan for the tax liability – your estate, not the beneficiary, pays the tax bill. Note that in Quebec you appoint a legatee in your will to receive RRSP assets. ◂

Introduce your teen to investing

When your child reaches the age of majority, they can open a Tax-Free Savings Account (TFSA) and First Home Savings Account (FHSA). So it's a good idea if you can introduce them to mutual funds and some investment basics.

A helpful guide

To help determine which basics to cover, it's helpful to know what your child should eventually understand as a mutual fund investor. But this is only a guide; it's not expected that a teen will know about all of these topics.

Compound interest. Understanding compound interest will encourage your child to save when they're able to – and invest in mutual funds. Their money makes money, and the original and new money makes even more. You could show them an online compound interest calculator.

Stocks and bonds. It's helpful to know why equity mutual funds are typically used to meet longer-term goals, why fixed-income funds are used to meet shorter-term goals and how they work together in a portfolio.

Asset allocation. When they start investing, your child should know that their proportion of equities and fixed income is based on their financial goal, their risk tolerance and when they'll need the money.

Diversification. You can let your child know that different types of stocks and bonds perform differently at any given time, so it's wise to have a variety of mutual fund investments.

Discussion ideas

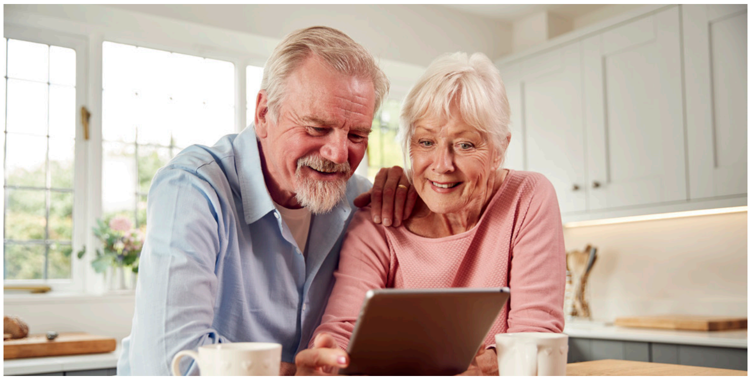
A great lesson is to talk about the mutual fund investments in the child's Registered Education Savings Plan (RESP). Explain why the focus shifted from equities to fixed income over the years.

You could also tell your child that at age 18 or 19 (depending on your province) they can open a TFSA, then explain the account's benefits.

You may want to ask your teen if they've learned about compound interest in school. If not, explain the concept.

These are only a few ideas. You can come up with approaches that suit you and your teen. If you provide an introduction, they won't feel intimidated or overwhelmed when they start to invest. ◂

When to convert your RRSP to a RRIF



The latest you can close your Registered Retirement Savings Plan (RRSP) and transfer the mutual fund investments to a Registered Retirement Income Fund (RRIF) is December 31 of the year you turn 71. There is no minimum age requirement.

When it comes to the timing of converting an RRSP to a RRIF, the first basic guideline is to open a RRIF when you need the funds for retirement income – regardless of your age. The second guideline is to wait until you're 71 if you have other income sources to support your retirement. Waiting gives mutual funds in your RRIF more time to grow tax-deferred and can save you tax while you draw retirement income from sources that are more tax-efficient than RRIF withdrawals.

Factors and strategies

Some retirees can simply follow one of these two general rules, but there are exceptions to the rules – so the timing decision should be made with the guidance of your advisor.

Triggering a tax credit. The pension income tax credit applies to $2,000 of eligible pension income, which includes RRIF withdrawals. You can open a RRIF at age 65 and transfer just enough mutual fund investments from your RRSP to make a $2,000 annual RRIF withdrawal from age 65 to 71.

Delaying government benefits. Do you plan on delaying Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) and Old Age Security (OAS) benefits to age 70? You could open a RRIF – or make RRSP withdrawals – to help provide retirement income in your 60s.

Splitting pension income. You may want to open a RRIF at age 65 to save tax through pension income splitting. Up to 50% of RRIF withdrawals can be allocated to your spouse.

Controlling your minimum RRIF withdrawals. For some retirees, their minimum RRIF withdrawal at age 71 or 72 would push their income to a higher tax bracket. One solution is to transfer some mutual fund investments from their RRSP to a RRIF from age 65 to 71, making annual withdrawals. The result is a smaller RRIF at 71 and a lower minimum withdrawal. ◂

Enjoying the comfort of a cash cushion

A falling market can be a mutual fund buying opportunity, but there are two times in particular when it presents a challenge.

Say that someone is only a couple of years away from retirement, and the stock market plummets. What if they had to postpone their retirement date? Or imagine that someone just recently retired, the market falls drastically, and they're forced to draw retirement income from mutual fund investments that lost value.

There's a strategy to deal with both of these challenges. It's the cash cushion, also called the cash wedge or cash reserve. Several years before retirement, you begin to build a cash cushion that's

typically invested in money market, high-interest savings or short-term bond funds. It's designed to provide income during your initial years of retirement. If markets fall just before or after you retire, you take retirement income from the reserve while you give markets and your portfolio time to recover.

Note that this is only one of the strategies to safeguard against withdrawing retirement income in a down market.

Is the latte factor valid?

The idea behind the latte factor is that you eliminate or cut down on any unnecessary item you regularly purchase, whether it's a specialty coffee or something else. You then invest those savings in mutual funds, and over time you have a significant sum. Whether this concept is valid or not has been much debated.

Latte factor supporters point to the math. For example, say that someone invests just $5 a day in a fund that achieves a 5% annual rate of return. After 30 years, they would accumulate about $125,000.

Critics of this practice question why you would sacrifice one of your life's pleasures when there are other ways to save, such as the pay-yourself-first method where you dedicate a set amount of each paycheque to savings.

What it all comes down to is that how you save is personal. Any saving method or variety of methods is valid, as long as you meet your saving and investment goals.

Beware of following the herd

Whether in politics, the social sphere or the financial world, joining the crowd can make us feel reassured and bring us comfort. But when making mutual fund investment decisions, following the herd can lead to financial loss.

Chasing outperformers. A common herd behaviour is investing in an outperforming mutual fund that has attracted a multitude of investors. The trouble is that you're buying when the investment has become expensive. Also, there's no way of knowing whether one year's winner will be next year's disappointment.

Taking a flight to safety. Another behaviour to avoid is following the crowd who sells their mutual fund investments when markets plummet. In March 2020, when COVID hit and markets fell, mutual funds in Canada recorded over $18 billion in redemptions.[1] Over the following months, many investors missed one of the fastest market recoveries in history.

An advantage of working with an advisor is that we base your investments on your goals, time horizon and risk tolerance – not on what's trending. If you ever do experience fear over a falling market or missing out on a popular fund, let us know.

[1] The Investment Funds Institute of Canada, *IFIC Monthly Investment Fund Statistics – March 2020*, April 22, 2020