Money Ideas

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▶ MUTUAL FUND INVESTING

Why goals-based investing matters

The concept of "goals-based investing" has been appearing in the media, and it's often touted as something new. Perhaps it's new to some mutual fund investors, especially anyone who invests on their own, but those with an advisor already follow the principles of goals-based investing.

Investing that's not goals-based typically measures success by comparing a portfolio's performance to benchmarks or market returns. Performance still matters with goals-based investing, but success is determined by achieving a goal.

The process

You identify your goals and specify your individual investment objectives. Each goal has a mutual fund asset allocation based on its time horizon and your risk tolerance. Progress is monitored periodically so you can stay on track toward achieving each investment goal. Note that it's not only investment performance that's monitored but also changes in any goal that may affect your financial objective.

Here's an example of why meeting a goal matters more than market performance. Say an investor approaching retirement is following the strategy of building a reserve of fixed-income mutual funds to help support their initial years of retirement. This individual has no need to compare how their reserve fares against market ups or downs. Their goal is to keep their planned retirement date even if the markets tumble.

Benefits of goals-based investing

Goals-based investing offers several benefits, both financial and psychological. The goals are more attainable because each one has its own investment strategy and is monitored along the way. You're less likely to react to short-term market fluctuations, being tempted to either sell or buy, because you're focused on the longer term. Also, when markets are volatile or falling, you're less likely to worry – knowing that your long-term investment objectives have been set to account for periods of market volatility over time.

Whenever you want to track how your mutual fund investments are aligned with your goals, please get in touch. ◀

How to use your TFSA in retirement

Just as a Tax-Free Savings Account (TFSA) meets a variety of needs during your working years, it can be equally versatile during retirement.

Providing tax-free income

Drawing income without paying tax is already a win, but tax-free income also lends itself to various retirement income strategies.

Perhaps there are years when a mutual fund investor needs more retirement income, and they're at the upper threshold of a tax bracket. Drawing income from taxable sources would result in paying more tax on that amount, but they could withdraw TFSA funds without climbing to the next bracket.

Say that someone wants to defer their Canada Pension Plan (CPP)/Québec Pension Plan (QPP) and Old Age Security (OAS) benefits to age 70 to gain a larger benefit amount in the long run. The retiree can withdraw tax-free TFSA funds to help cover their cost of living during the years before they take their government benefits.

Some retirees might be in a position where their taxable income amount would result in a clawback of OAS benefits. They can avoid or minimize the clawback by making TFSA withdrawals, as these funds aren't included as income for tax purposes.

Continuing to invest

If you earn income during retirement from part-time work, a business, consulting or a rental property, you can continue to invest in mutual funds in your TFSA – up to your contribution limit.

Some retirees have years when their minimum required Registered Retirement Income Fund (RRIF) withdrawal leaves them with more income than they need. By contributing a portion of that withdrawal to their TFSA, the amount can grow tax-free.

Another way to grow a TFSA is by gradually transferring mutual fund investments from a non-registered account. The non-registered assets are taxable whether they're sold or transferred in-kind, but they would be subject to tax in the future anyway. With this strategy, you pay any tax owing now and benefit from future tax-free growth and withdrawals.

Leaving assets to heirs

Part of estate planning is managing or accounting for the tax payable on estate assets, but with TFSAs, planning for taxation is not an issue.

If you want to leave your TFSA's mutual fund assets to your spouse, you can name them as a successor holder or beneficiary. Usually, successor holder is the better choice because your spouse simply takes over the existing TFSA – it's a simple transaction. If a spouse is named beneficiary, there are rules to follow, a form to submit and potential tax consequences.

If you leave TFSA assets to a child or another heir, you designate them as a beneficiary, and they'll receive the proceeds tax-free.

A TFSA can also be used to help offset tax payable on estate assets by naming the estate as beneficiary. Also, if you wish to donate your TFSA's mutual fund assets to a charity, the donation tax credit can be used to help offset an estate's tax liability.

Note that in Québec, a beneficiary or successor holder can only be named on the TFSA form for insurance investment products, such as guaranteed investment funds or segregated funds. Otherwise, the TFSA beneficiary is to be named in the will. ◂

Meeting health-care needs

As our longevity increases, so does the possibility of losing our independence and requiring long-term care. Private care can be extremely costly, whether you stay at a health-care residence or at home.

One way to safeguard against this financial risk is to purchase long-term care insurance. Note that several insurers have left the long-term care insurance marketplace, and today only a couple of national providers offer this coverage as a stand-alone product. However, it remains a solution worth considering.

Another option is to self-insure – accumulating funds over time to cover potential health-care costs. A Tax-Free Savings Account (TFSA) can be an ideal investment vehicle – your mutual fund investments grow tax-free and withdrawals are tax-free.

Should you require long-term care at any point in your retirement years, you'll have funds available to help meet the costs. If you're fortunate, staying relatively healthy and remaining independent, your TFSA funds can become assets for your heirs. ◂

Finding a balance between spending and saving

When it comes to spending versus saving, there is no exact balance that's right for everyone. Each of us has our own money personality, perhaps one we're born with, acquired by following – or rejecting – our parents' habits, or developed on our own over the years.

Two danger zones

While there's no exact balance, there are two potential danger zones. If someone is primarily a spender, they risk missing out on their long-term savings goals or taking on too much debt by living beyond their means. Someone who's a diehard saver may suffer a different kind of missing out – saving for the future at the expense of enjoying life now.

Anyone close to either danger zone needs to recognize and acknowledge their situation. Awareness is key. You can always change your habits to arrive at a balance to provide for the future while living for today.

Finding the balance for couples

Anyone might think that a spender and saver living under the same roof spells trouble. But such a couple has the potential to find a healthy balance between spending and saving. It just requires understanding, communication and compromise.

Interestingly, two spouses who are both savers or both spenders could have the greater challenge. Although their money personalities match, the savers need to make sure they won't one day regret missing out on life's pleasures. The spenders must be watchful that they don't sacrifice their lifestyle in retirement for the lifestyle they enjoy now.

When we can help

Sometimes you may face a situation where you wonder whether spending a large sum will affect your financial situation. Will a long trip to Europe mean you need to start budgeting? Will purchasing a vacation property force you to retire later? You can contact us when these situations arise. We can help you determine whether spending now will affect your current financial life or long-term goals. ◂

Looking at the lure of money market funds

With money market funds recently posting annual returns upward of 4%, many mutual fund investors wonder whether they should choose these funds for part of their portfolio.

Factors to consider

First, you can't look at the current return in isolation. You must deduct the inflation rate from a money market fund's return to determine its real rate of return.

Second, you must consider the investment vehicle's tax treatment. If a money market fund is in a Tax-Free Savings Account (TFSA) or First Home Savings Account (FHSA), no tax on investment returns is payable. But anywhere else, tax on money market fund earnings is payable at your marginal rate because money market returns are interest income.

Shorter-term savings

When money market funds earn higher returns, you have a new opportunity to save for a vacation, wedding, home improvements or any other short-term goal. Money market funds can also be valuable when you move to safety as a time horizon shortens, such as the last years of a Registered Education Savings Plan (RESP).

Long-term investing

Investing in money market funds for long-term investing is a case of "it depends."

Say an individual invests in a money market fund with money they normally would have invested in the equity and bond markets. What happens if interest rates are falling a number of months down the road? That means a money market fund's rate of return also falls, and this individual no longer wants to be invested in this low-earning fund. They want to resume investing in bonds and equities. But bonds do well when rates go down, and the investor has been missing out. If the stock market has also risen in the meantime, the individual must buy back in at higher prices. The potential risk is choosing short-term gains over long-term growth.

However, many long-term investors – especially conservative investors – may feel quite comfortable including money market investments as part of their fixed-income allocation when they can take advantage of higher returns.

Ultimately, whether or not to use a money market fund for long-term investing depends on each investor's needs and risk tolerance, so it's a decision to make with your advisor. ◂

Safeguard your mutual fund assets with a trusted contact person

Just over two years ago, the Canadian Securities Administrators (CSA) introduced the concept of a “trusted contact person,” which has now been adopted across the country. A mutual fund investor may give their advisor the name of a family member, close friend or trustworthy professional. The CSA recommends choosing a different person than the individual you appointed for your power of attorney or mandate. Suppose the advisor is ever concerned that the investor is becoming less able to make sound financial decisions or may be vulnerable to fraud or financial exploitation. In that case, the advisor can contact the trusted person to address these concerns.

If you haven’t yet named someone or wish to replace your trusted contact person, please feel free to contact us. Keep in mind that this measure was not only introduced to protect seniors who may be developing dementia. Younger individuals can suffer cognitive impairment from an illness or injury, and people of any age can be exploited financially. ◀

Dedicating savings for a specific need or want

Anyone saving for their child’s education costs or their own retirement typically makes regular contributions to mutual funds in a registered plan. But what if you’re saving for a trip to Europe or a kitchen renovation? Or a larger goal, such as the down payment on a vacation property or the cost of potential long-term care?

One method is to establish a savings fund dedicated to meeting a specific goal. You identify the need or want, choose when you want to reach it and determine its cost – your financial goal. Then you calculate how much to contribute each pay period or month. A Tax-Free Savings Account (TFSA) is an ideal savings vehicle for a dedicated savings fund, although mutual funds in a non-registered account may suit some situations.

Using a dedicated savings fund offers several benefits over haphazard savings. Psychologically, you’ll feel confident that you’re on the path to achieving a financial goal. Financially, you’ll avoid using a credit card or line of credit and paying interest, and you won’t be tempted to tap mutual fund investments from your retirement savings or emergency fund. ◀

Investing a large lump sum

If you’re about to invest a significant lump sum in mutual funds, you may wonder whether you’re better off investing the entire sum at once or investing smaller amounts over time.

It’s actually a widely debated topic in the investment world with no one answer that’s right for everyone.

A key factor is how markets perform in the near term, once you invest. If markets generally climb, then you typically come out ahead by investing the entire amount at once – you bought at a good price and your mutual fund investment increases in value. But if markets generally fall after you invest, investing periodically can win out because you’re buying into the market at lower prices, standing to benefit when the market recovers.

Fortunately, it’s not a decision you must make alone. We’ll work with you to determine whether a lump sum investment or periodic investments – or a combination – suits you best. It’s a decision based on several factors, including your risk tolerance, investment objective, mutual fund asset allocation and time horizon. ◀

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