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Financial Planning Guide

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FOCUS ON MUTUAL FUNDS

Should you make room for the new tigers?

Move over China and India. Vietnam, Mexico, Brazil, Colombia, and Turkey are jockeying for attention in the emerging markets segment of your mutual fund portfolio.

You can gain exposure to these markets through mutual funds in several categories such as "international," "global" or "overseas," "European," "emerging markets," "Asia Pacific," and "Latin America." Here are five reasons these newly emerging markets show promise:

1. Demographics. The relatively young populations of these emerging markets contribute to a growing, more productive labour force. In Vietnam, for example, 25% of the population is under the age of 14.[1]

2. Increasing per-capita incomes. Within 10 years, Turkey is projected to have more than 11 million households earning in excess of US$30,000 per year.[2] This will boost domestic consumption and demand for imported goods.

3. Infrastructure. Public spending on roads, railways, ports, and airports makes it easier to transport goods and stimulates trade. In Brazil, the government has earmarked $50 billion for improvements to its transportation networks.[3]

4. Improving political stability. Colombia is a case in point; After years of violence, the country is now enjoying more stable, disciplined governance. This is attracting investors, expanding markets for exports, and reducing the costs of doing business.

5. A significant risk/return trade-off. Consider Mexico: In 1994, it was virtually insolvent in the wake of the peso crisis. In December, 2012, Mexico's stock market hit an all-time high.

A prudent overall asset mix can help mitigate the risks of investing in emerging market mutual funds. We can help. ■

1 Central Intelligence Agency, **The World Facebook,** December 2012.
2 Ernst & Young, **Insights**, Autumn 2012.
3 Ernst & Young, **Infrastructure,** 2012.

MUTUAL FUNDS

Small caps, big potential

Some of the largest companies in the world started as risky small-cap investments (Ebay, Wal-Mart, and Microsoft, to name just three). But one may wonder if right this minute, is there a young Steve Jobs out there in his parents' garage, with the potential to create the most valuable company in the world? The answer? Absolutely.

While we can't predict what the next big thing will be, we do know that whatever it is, its genesis will almost certainly be a savvy entrepreneur, a small company, and a big idea.

Who gets to be called small?

Although the numbers aren't cast in stone, the small-cap designation is generally reserved for companies with market capitalization between US$300 million and US$2 billion.

"Market cap" is simply the total value of a company's outstanding shares. The share price itself reflects a variety of factors, including the investors' perceived value of the company's business, its assets, and its intangibles, such as expectations for future potential, management style, and more.

Smaller companies with lower share prices tend to be more nimble than their larger-cap brothers. And that's why these stocks can provide so much upside potential — often greater than the so-called "blue chip" companies. After all, it's somewhat more plausible that a $300 million company could double in size than for a $100 billion company to do so.

Take Google as an example. Its initial public offering (IPO) was priced at $85 in August, 2004. It closed 2012 at $707. If you invested at its inception and held your position until December 2012, you would have achieved an annualized rate of return of almost 29%.

Is this typical? No. But with small caps, just about anything (positive or negative) is possible.

Leave it to the professionals

The big challenge for non-professional investors is grappling with the sheer size of the small-cap universe. The TSX alone lists more than 3,000 companies. And when you consider the number of equities in the global marketplace, you realize that finding the ones worth your time and investment dollars is akin to finding the proverbial needle in the haystack.

To be poised to capitalize on the next Google, small-cap mutual funds may be the place to be. Like dentistry and underwater welding, picking the small cap stocks with the most potential is a job best left to highly trained professionals — in other words, mutual fund managers.

It's their job to know the markets, the climate, and the caveats that drive the growth potential of small-cap stocks. And in their search for those needles, they have teams of people to carry out the research and due diligence (on-site company visits, for example) necessary to gauge a company's intrinsic value and its future prospects.

The mutual fund universe offers a robust selection of small-cap funds from Canada, the U.S., and around the globe. We can help you diversify your small-cap holdings by industry, region, and management style to both minimize risks and maximize potential. Call us to discuss which funds might be best suited to your objectives.

One little company and how it grew

A story in numbers: Apple Corp. started out as a teeny cap, became a small cap, and then became one of the largest caps in the world!

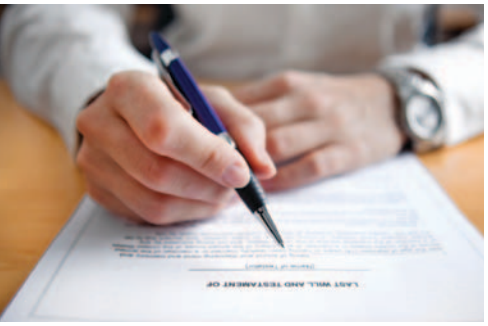
- **Apple was launched as an IPO on December 12, 1980. Its initial price was $22**
- **The stock has split three times since then, so the initial IPO price adjusted for the stock splits is $2.75**
- **In the 12 months ended December 31, 2012, the stock price ranged from $409 to $705**
- **In 2012, Apple became the most valuable publicly-traded company of all time with a market cap in excess of US$620 billion**

ESTATE PLANNING

Choosing beneficiaries means more than just listing names

It's just a space on a form, right? Name your spouse or child as beneficiary and move on to the next line. But designating a beneficiary involves critical choices, important tax implications, and can apply to several financial vehicles.

Beneficiaries can be named on Registered Retirement Savings Plans (RRSPs), Registered Retirement Income Funds (RRIFs), Tax-Free Savings Accounts (TFSAs), life insurance policies, segregated funds, and life annuities. You can designate an individual, corporation, charitable organization, trust, or trustee. (Note that in Quebec, designations for RRSPs, RRIFs, and TFSAs must be made in the will, and naming a trustee for minors doesn't apply).



You can name more than one beneficiary and assign different proportions to each one. Also, it's important to name a contingent beneficiary in case your primary beneficiary passes away before you do.

RRSPs and RRIFs

An ideal choice may be to name your spouse as beneficiary of your RRSP or RRIF, as assets can roll over tax-deferred to your spouse's RRSP or RRIF. Designating a financially dependent child or grandchild also offers tax advantages, which differ according to whether the beneficiary is able or disabled, a minor or adult.

You can name anyone else as beneficiary and that individual will receive 100% of the RRSP or RRIF proceeds. Your estate pays the tax bill.

If you name a charitable organization as beneficiary, the charitable donation tax credit can offset the taxable income from your RRSP or RRIF.

TFSAs

A TFSA has a successor holder and regular beneficiary designations. The first choice is typically to designate your spouse as successor holder — proceeds transfer directly into your spouse's TFSA without affecting contribution room.

Annuities

You can purchase a life annuity with a guaranteed payment option to provide for a named beneficiary. After you pass away, the beneficiary receives a lump-sum payment or regular stream of income payments.

Insurance and segregated funds

Designating your spouse or children as beneficiaries of life insurance or segregated funds is not always the best choice. You may wish to direct the large lump sum to a trust on their behalf in these situations:

- The child is a minor.
- You want the recipient to benefit from investment expertise.
- The recipient will benefit from a trust's tax advantages.
- You're in a blended family and want to ensure fairness among all heirs.

When you find yourself with a beneficiary choice to make, or want to review your current beneficiaries, talk to us first. We'll help ensure you make the best decision for you and your loved ones.

TAX PLANNING

It's all in the family — check out these top credits and deductions

April 30th is just around the corner and so begins the routine of filing personal income tax returns. Trouble is, sometimes following the same old routine means missing out on opportunities to save tax. Here's a collection of family-related credits, deductions and strategies that tax experts identify as often being overlooked.

Eligible dependant credit. This credit gives a tax break equivalent to the spousal credit to a single parent who supports a child or other dependent relative. For 2012, you can claim $10,822 on your federal tax form (provinces and territories offer a similar credit). You can only claim for one child. If there is more than one child and the parents have joint custody, each parent can claim the eligible dependent credit for one child — but if a parent pays child support, he or she can't claim this credit.

Family caregiver amount. Effective for the 2012 tax year, if you have a dependant with a physical or mental impairment, you may be eligible for a (federal) tax credit of up to $300.

Children's fitness and children's art credits. For each child under 16 at the start of 2012, you can claim up to $500 of eligible fitness expenses and up to $500 of expenses in an eligible program of artistic, cultural, recreational, or developmental activities.

Adoption expense tax credit. If you adopted a child under 18 with the adoption period ending in 2012, you can claim a tax credit on eligible adoption expenses of up to $11,440.

Medical expenses credit. Often overlooked is the portion of medical and dental expenses not covered by your benefits plan — expenses for anyone in your family. Premiums paid to a health plan are also eligible expenses.

Child care expenses. Remember that fees for day camp or overnight camp are an eligible child care expense.

Keep these tips in mind this tax season. It's also a good idea to consult a professional tax planner to ensure your tax reporting is accurate and you can keep more of what you earn.

Looking for some extra tax savings?

The ability to defer or eliminate income tax on your investment earnings is among the most powerful incentives for investing within a Registered Retirement Savings Plan (RRSP), Tax-Free Savngs Account (TFSA), or Registered Education Savings Plan (RESP). But did you know that same benefit can be harnessed outside of your registered plans, thanks to corporate class mutual funds?

Sometimes called "capital class mutual funds," these investments are offered by many fund companies. By virtue of the way the funds are structured, they're especially valuable if you have maximized your RRSP, RESP, or TFSA contributions.

The freedom of movement

In a traditional mutual fund, when you want to move from, say, a growth fund to a balanced fund, you have to sell your units, crystallize any gains (or losses), pay the income tax on any gains you realized, and then start from scratch with the new fund.

Corporate class funds are different: You have the freedom to switch in and out of any of the fund company's corporate class offerings without triggering a taxable gain. This frees you to focus on your actual needs and objectives without worrying, for example, about the tax you'll trigger as you start moving out of your equity holdings and into balanced funds.

Of course, should you want to crystallize a gain (or a loss) for tax planning purposes, you can simply redeem those units rather than switching them.

Like traditional mutual funds, corporate class funds come in all flavours so you can diversify by asset class, geography, sector, market capitalization, and investment style.

As your needs or circumstances change, corporate class funds give you the freedom and flexibility to rebalance your portfolio without incurring the tax bite that would normally be triggered when you switch from one fund to another. Keep in mind that if you want to switch funds, we should discuss your evolving needs and decide on switching or rebalancing together.

Tax-efficient fund distributions

Corporate class funds also provide ongoing tax-efficient distributions. This happens because the fund company is able to allocate its gains across its entire family of corporate class funds. As a result, even if you are holding bond or income funds, your distributions may comprise tax-favoured capital gains instead of fully taxed interest income.

One last benefit of corporate class funds is that, unlike your registered accounts, there are no age restrictions on who can hold the funds, nor is there any ceiling on how much you can contribute. Note, however, that management expense ratios are typically higher than those of non-corporate-class funds.

It's important to align your investment decisions with your overall financial planning goals. We can help you balance your portfolio to best reflect all of your objectives. ■

Ready to launch a satellite?

Have you ever thought that there must be something more you can do with your mutual fund investments? You believe your current portfolio is on track, but you want to try something new without a radical move towards risk in your portfolio.

Consider launching a "satellite." The core-plus-satellite strategy supplements your established portfolio with one or more specialized funds. Primarily, the goal is to enhance your overall returns by gaining exposure to a promising market. At the same time, however, adding a satellite may reduce your overall risk through further diversification.

What is a satellite?

Typically, but not always, a satellite is a narrow and focused position. An investor may seek out a small-cap fund or a fund investing in a particular emerging market. Or you might aim to boost fixed income with a U.S. high-yield or global bond fund. Other common choices for satellites include commodities, real estate, precious metal, tech or other sector funds.

Using this strategy

Buy-and-hold investors can use the satellite approach to add a long-term strategic mutual fund position not represented in their core holdings. Or you might add a fund to overweight an existing asset class or sector as a temporary tactical move.

Please talk to us if you're interested in this strategy. Satellite investing should be carried out in accordance with your risk tolerance and target asset allocation. ■

FundEX INVESTMENTS INC