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Financial Planning Guide

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FOCUS ON MUTUAL FUNDS

Is your fund portfolio like *Dancing with the Stars* or *Arrested Development*?

In 1888, George Eastman invented a push-button camera and the film to go with it. Eastman Kodak took off, and for the next 100 years or so, the company dominated its field. In 1930, it was added to the Dow Jones Industrial Average as one of the 30 core stocks reflecting the fortunes of the broader US economy.

And get this: Kodak invented the digital camera in 1976. But it had such a stranglehold on the film market (at that time, 90% of all film sold in the U.S. was Kodak), the company simply couldn't envision a world without film and didn't pursue the digital wave. Ah, hindsight!

Doing a slow pan across the last 20 years or so, Kodak was delisted from the Dow, saw its share price drop from $90 to 76¢, and, in January of last year, filed for bankruptcy protection (at which point, its stock fell to a wound-salting 36¢).[1]

What's the moral here? That even the most successful and innovative companies can become obsolete.

For mutual fund investors, this means considering another layer of diversification. So not just diversifying by asset class and geography, but ensuring that you have exposure to technology funds. Technology is to our investment world what the railroads were to George Eastman's: fundamental building block of the economy. Tech funds can deliver unparalleled diversification and the robust potential of a sector that is quite literally dancing with the stars.

Call us if you'd like to explore the technology sector for your mutual fund portfolio. ■

[1] http://www.kodak.com

MUTUAL FUNDS

3 ways to reward your conscience — and your capital

The stereotype that "green" or socially responsible investors are do-gooders sacrificing returns for the sake of their conscience has been firmly laid to rest. What's more, SRI funds have emerged as strong performers across every major fund category. (See chart: "Socially and financially responsible.")

So what is socially responsible investing and does it make sense for your portfolio? Here's a quick backgrounder.

Environmental, social, governance

In the early days, SRI generally meant avoiding companies that produced tobacco, firearms, and alcohol. During the days of apartheid in South Africa, public awareness of SRI broadened and gained traction as individual and institutional investors divested out of businesses with ties to the country and its regime.

Today, there are no specific rules about what constitutes a socially responsible investment, but most mutual funds apply an ESG screening protocol. ESG is a kind of blueprint for assessing a company's commitment to its environmental impact, social responsibility, and corporate governance (hence ESG).

Environmental factors could include such things as a company's disposal of emissions and waste, its dependence on diminishing resources, and its impact on climate change.

The social prong weighs the company's employee diversity, aboriginal relations, and consumer and animal protection.

Corporate governance is the newcomer of the trio and seeks to gauge things like employee relations, executive compensation, and shareholder relationships. It is becoming widely accepted that responsibility in these areas will not only make a company more socially responsible, but will also help maximize profits.

ESG screens can also be used to exclude companies with poor practices or in controversial industries such as weaponry or genetically modified foods.

Of course, SRI fund managers also apply rigorous financial analyses to choose securities that have both strong ethics and good growth potential.

50 shades of green

Quantifying intangibles, like whether a company is philanthropic enough, is significantly different from the more traditional yardsticks, like price-to-earnings ratios. And because these criteria are more abstract, it's not surprising that each fund company has its own proprietary way of measuring and ranking them.

Another important point here is that SRI funds don't just apply ESG screens to traditional "green" industries like renewable energy or organic farming. ESG tenets are used to assess corporations across every market sector.

For example, a mining company could could still be part of an SRI mutual fund if it conducts its business in a way that meets or exceeds ESG standards.

The degree of ESG compliance required depends on the fund company and its specific objectives. Some companies demand more than others. But it's fair to say that SRI fund managers have had a hand in influencing business practices across many industries as these firms strive to accommodate and attract institutional investors.

To see if these funds merit a place in your portfolio, please contact our office. ■

Socially and financially responsible

This chart shows the performance of SRI mutual funds against overall industry averages (to March 31, 2013). While many SRI funds are young and don't yet have longer-term track records, the trend is compelling. Of course, past performance alone is never a reason to invest for the future. But this can give you an idea of how responsible investing can go hand in hand with profitable investing.

	Average annual compound return		
Fund Category	**1 year**	**3 years**	**5 years**
Canadian Equity Funds			
SRI	7.66	4.44	1.67
Non-SRI	6.22	3.38	.47
Canadian Fixed Income			
SRI	2.78	5.15	5.27
Non-SRI	3.66	4.86	4.50
Canadian Small/Mid Cap Equity			
SRI	16.14	12.33	5.42
Non-SRI	1.34	3.75	2.09
US Equity			
SRI	14.23	9.76	4.00
Non-SRI	10.41	8.38	1.99

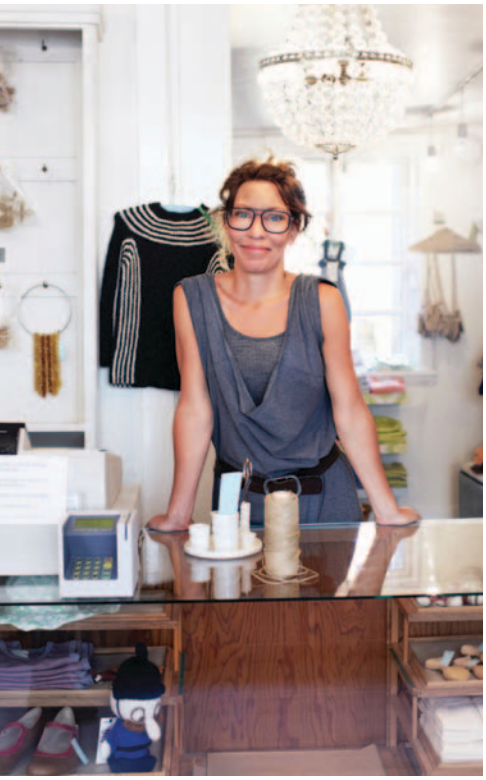
Source: Social Investment Organization, *Socially Responsible Funds Perform Strongly.*

SMALL BUSINESS

Small business owners take note: Capital gains exemption going up in 2014

If you have been mulling the opportunity to crystalize a capital gain from shares of a small business, farm, or fishing property, there's good news.

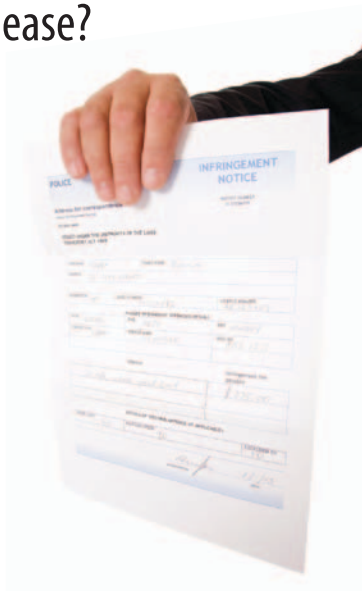
Thanks to the federal government's spring budget, the lifetime capital gains exemption on these assets is going up to $800,000 from $750,000. And even if you have exhausted the existing limit, you will still be eligible for the additional $50,000 starting in 2014. This sets up a strategic planning opportunity that could save you more than $12,000 in taxes.



As you might expect, the rules are complex and require some advance planning. So if you own (or think you own) these kinds of shares, please call our office. We would be pleased to help you get the most from this exemption. ■

MANAGING CREDIT

Dad, could you sign this please?



It's fall, and time for the annual migration of kids flocking back to school. Not coincidentally, it's also the season for young adults to apply for loans and credit cards. If you are thinking about co-signing a loan or credit card application, here are a few caveats.

When you co-sign a loan, you are effectively becoming a joint borrower. That makes you equally responsible for repaying the debt. If you are comfortable with this, our advice is to start with a small loan and a short repayment schedule.

Credit cards are a little different. Some issuers require no co-signer. Others won't let you co-sign but will let you add your child as a secondary card holder on your own account, in which case you are equally responsible for their debts. And still others don't issue traditional credit cards to students at all.

If you share your account, you'll be able to monitor your student's spending on your own monthly statements. If you co-sign, you have the option of receiving a copy of your student's monthly statements. It's probably a good idea to opt in for this, as it will help you to keep track of the balances and make sure your own credit rating is not being compromised. ■

MONEY MANAGEMENT

Watch those fees!

What happens if you have a banking package that includes, say, 15 free transactions, and you go over? Or if your balance drops below the minimum threshold? You could find yourself facing unexpected (and hefty) fees.

If it happens more than once, the bank may upgrade you to a more expensive package that includes more transactions, as a courtesy — which may or may not be what you want.

You can avoid this by reviewing your actual banking needs. How many transactions do you usually have per month? Is it worth carrying a hefty balance to avoid a few dollars in transaction fees? Do you make withdrawals from other banks' ATMs, get U.S. money orders or certified cheques, need a safety deposit box? These services are often included in the higher-priced account packages. If they're features you use, it might be worth it.

And lastly, always check your statement! If you get bumped into a higher-tier package that you don't want, call your branch and let them know. ■

Acquisitions and mergers and mutual funds, oh my!

Mergers and acquisitions are a regular occurrence in the financial marketplace, often leading to bigger and better opportunities for investors. The same can hold true for mutual funds.

According to the Investment Funds Institute of Canada, there are some 1,155 mutual funds in Canada with more than $500 billion in assets.[1] With so many funds, it's not unusual for fund companies to buy other companies and for individual funds to be amalgamated within a fund family.

What happens if you hold units in a fund that gets merged? The answer will depend on why the funds merged and whether your objectives, or the fund's objectives, have changed.

Funds rolled into funds

Mutual funds are consolidated for a variety of reasons.

In a large fund company with a very large portfolio of funds, managers are often keen to combine similar funds as a way to reduce costs, harness economies of scale, and lower management expense ratios (MERs). Another common reason is underperforming funds being removed from the lineup — most easily achieved by rolling them into one of the company's similar but better performing funds.

Sometimes one fund company is bought out by another, resulting in substantial portfolio overlap and inevitable consolidation.

Another trend is for funds with a very narrow investment scope to be amalgamated into funds with a broader mandate. For example, a highly specialized mergers and acquisitions fund might be integrated into a more broadly focused North American equity fund.

It's even possible for a fund to be liquidated rather than merged, in which case, all of its assets are sold and the proceeds distributed to the unitholders.

Tax implications

Depending on how the funds are merged, there may be tax consequences. For example, if newly merged funds have a lot of overlap, the manager might sell off duplicated assets. Any profits from those sales could result in taxable distributions (and potentially significant tax consequences) to the fund's investors. Likewise, capital losses have their own potential tax implications. Funds that are liquidated will also obviously trigger tax consequences depending on the type of income that's distributed.

Outside of the tax issues, it's also possible that the investment strategy of the newly merged fund will change. In this situation, we need to consider whether the fund still makes sense in your overall portfolio. For example, a fund with a mandate to hold 25% of its assets in foreign equities could merge with a fund that seeks to hold only 10%. Will it still meet your needs?

Rest assured, fund companies are required to get approval from their shareholders and boards of directors before any assets are sold or letterhead is revised. You will receive advance notice, typically by mail. Should you receive a notification like this, please do not hesitate to contact our office. ■

1 Investment Funds Institute of Canada. Figures as of March 2013.

Too much cash?

Is it even possible to have too much cash? The short answer is yes, if that money is languishing in your investment account (or your bank account, for that matter).

Cash and cash equivalents (money market funds, cash-equivalent funds, and T-Bill funds) in your portfolio serve some important purposes: They give you the capital to take advantage of investment opportunities. They provide a source of liquid assets in case of emergencies. And they can offer a measure of stability if the rest of your holdings are in flux.

That said, cash is not an investment, per se. If you have a small cash position as a way of capitalizing on potential investment opportunities, you're probably in good shape. But if you're expecting money market funds to contribute to your fixed-income earnings, things are less rosy.

Interest rates and investment returns on cash and its equivalents are hovering very close to zero. Sure, inflation is low, but it's still there, gnawing away at your purchasing power. In the last three years it has added 6% to the cost of a typical basket of goods and services.[1] Meanwhile, interest rates on 3-year GICs over that same time period averaged 1.29%.[2]

If you're sitting on too much cash, you're not just short-changing your investment objectives, you're compromising your future goals. We can help you find the balance of cash, income and growth that's right for you. ■

1 Bank of Canada inflation calculator
2 Bank of Canada inflation calculator

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