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Financial Planning Guide

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FOCUS ON MUTUAL FUNDS

The deadline approaches

March 3, 2014, is an important date for mutual fund investors. That is the deadline to contribute to your Registered Retirement Savings Plan (RRSP) and claim the deduction on your 2013 return. It's also a great time to take a new look at how to fully leverage the tax advantages that this important vehicle provides.

Mutual funds, which provide broad diversification, convenience, and professional money management, are an ideal RRSP investment. And with a gradually improving economy, strong job growth, and firming equities prices, hopefully you'll be able to contribute more this year.

Are you missing out?

Sadly, only 63% of Canadians contributed or planned to contribute to their Registered Retirement Saving Plans in 2012, according to a survey conducted by a major Canadian financial institution.[1] And while that's a healthy increase from the 38% who planned to contribute the year before, it still suggests that a large number of Canadians are not taking full advantage of this valuable vehicle.

Conflicting financial priorities stemming from the weak economy, such as everyday expenditures and paying down debt, were cited as key reasons for the shortfall, and for the fact that the average contribution fell by $1,100.[1]

Beat the deadline

Don't miss out on this key opportunity to optimize your mutual fund investments. If you haven't yet contributed your maximum for 2013, contact us immediately.

In addition to topping up your RRSP for 2013, we can set up a contribution plan for 2014 and revisit your RRSP investment strategy to make sure it continues to reflect your investor profile. ■

1 Survey conducted by market research firm Pollara on behalf of BMO, February 2012.

Are equity funds a good inflation hedge?

The U.S. Federal Reserve has been following an ultra-low interest rate policy since the 2008 financial crisis. Many fear that the resulting cheap credit could lead to rising prices down the road — in other words, inflation.

Warning younger Canadian savers about inflation these days is hard, because few have witnessed its pernicious effects as price increases dilute hard-earned buying power. These effects can be significant, especially for seniors living on fixed incomes. For example, inflation of just 3% a year would cut the purchasing power of a senior's annuity payments by close to half (46%) over two decades.

Outpacing inflation

Historically, gold has long been considered an effective inflation hedge. However, equity mutual funds may fill a similar role.

Jeremy Siegel, a professor at the Wharton School and author of *Stocks for the Long Run*, notes that the businesses that mutual funds invest in are "claims on real assets, such as land and plant and equipment, which appreciate in value as overall prices increase."[1]

Although there can be significant short-term fluctuations, Siegel says over 30-year periods "the return on stocks after inflation is virtually unaffected by the inflation rate."[1]

Picking individual equity winners in the inflation hedging game is hard, because price increases can be volatile; some industries are more vulnerable than others. Statistics Canada even keeps two measures of inflation to account for this disparity. The Consumer Price Index (CPI) targets a broad basket of goods, but the core CPI excludes food and energy prices, which tend to be more variable.

How mutual funds can help

The upshot is that investors who want an effective inflation hedge may be better off investing in a professionally managed mutual fund, rather than trying to figure out which individual companies will outperform.

One especially effective option is to invest in an international mutual fund that has heavy allocations in countries with a history of stable money. That way, if inflation rises in Canada, you stand to be compensated, as this would cause the Canadian dollar to fall and your foreign-currency fund units would then be worth more when converted back into local funds.

Equity mutual funds offer significant advantages over bond funds in an inflationary environment, because the earnings of the companies that they invest in will rise in such an environment; however, the interest that previously issued bonds pay will not.

Inflation risk may be rising

In late 2013, the urgency of considering possible inflation hedges increased, with the announcement that Janet Yellen will be taking over as the U.S. Federal Reserve chairman in early 2014. She is thought to place priority on job creation over keeping inflation low, which could significantly heighten inflation risks.[2]

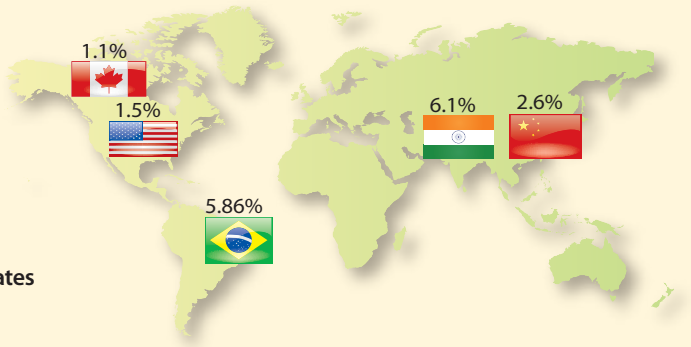
As if that were not enough, inflation pressures from China are showing signs of spreading into Western economies. Low Chinese wages have long been a key factor in keeping prices low for many of the goods that Canadians import, ranging from textiles, to toys and iPhones. However, Chinese wages have been rising[3] and the effects risk spilling over into Canada.

In short, savers need to think ahead. While phrases such as "the risk of inflation," may seem tame, they need to be taken seriously. Talk to us about how to position your portfolio to hedge against possible inflation down the road. ■

1 Jeremy Siegel, "Stocks: The best Inflation Hedge," Kiplinger.com, June 9, 2011.
2 "Janet Yellen will stick to her predecessor's expansionary policies," *The Economist*, Oct. 12, 2013.
3 "Manpower CEO Joerres Says Wage Inflation May Aid China Economy," *Bloomberg News*, Sept. 12, 2013.

Could inflation spread here?

In a global economy, there is a danger that inflation could spread to North America from countries where it is higher. This chart provides a snapshot of current inflation rates around the world.*



* Monthly inflation, Nov. 1, 2013. Source: WallStreetDaily.com, trading economics

RETIREMENT PLANNING

Expecting significant retirement income? A TFSA may be better than an RRSP

Many Canadians face a tough choice at the start of each year, regarding whether to contribute to their Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA). Both popular tax-planning tools have advantages. Which is better for you depends on a variety of factors. Your projected retirement income provides a good clue.

If your projected marginal tax rate will be lower after you retire than what it is now, an RRSP may be the better option. That's because the tax deductions you get when you contribute to an RRSP are likely to be larger than the tax you pay later, when you withdraw the funds.

However, some Canadians will actually have higher incomes when they retire. For example, some retiring employees have taken to "double dipping," after they leave their first careers. This involves collecting a pension but continuing to provide work as private contractors in their old fields of expertise. (A retired teacher continuing to take on substitute teaching mandates would be an example.) In such cases, their marginal tax rates when they retire could be higher than when they were working. For them, a TFSA may be a better option. ■

EDUCATION PLANNING

Why you may want your kids to leave home broke

Most Canadians would shudder at the prospect of sending their kids out into the world with no financial assets. However, some kids often do worse — many are forced to leave home not just broke, but owing money as well.

The average student debt load after graduating from a four-year undergrad program now sits at around $27,000.[1] This provides a strong indication that parents are having a hard time helping their kids pay their education expenses.

Worse, those costs are rising. Canadian full-time students in undergraduate programs paid 3.3% more on average in tuition fees for the 2013/2014 academic year this fall than they did a year earlier. That follows a 4.2% increase in 2012/2013.[2]

Getting a head start on those increases is crucial. A first step should involve consulting us, to make sure you are investing enough in your kids' Registered Education Savings Plans (RESPs) or an alternative dedicated account. They will be far better off if they leave home merely broke — as opposed to in debt. ■

1 The Canadian Federation of Students.
2 Statistics Canada, *The Daily*, Sept. 12, 2013.

EDUCATION PLANNING

Canadians working longer to finance kids' education

Many parents are responsible and well intentioned and, as a result, have invested significant sums in their kids' Registered Education Savings Plans (RESPs). However, according to a recent survey by a major Canadian financial institution, 60% of Canadian parents with children under the age of 25 are putting their own retirement goals on the back burner, to help pay for a child's schooling. Fully a third of parents surveyed even took on debt to help fund their kids' education.[1]

There are several reasons that parents are forced to put themselves into this uncomfortable position. These include a tough job market, rising education costs, and increasing pressures on students to take on additional studies, such as advanced degrees. However, the most important reason is that many parents wait too long before starting to put money aside.

Make sure that does not happen to you. Talk to us about balancing your savings for your children's education and your own future. ■

1 CIBC poll, conducted by Leger Marketing, June 2013.

Are resource funds worth a look?

Mutual funds that invest heavily in commodity-rich sectors such as forestry, mining, and energy, have been underperforming. The average performance for the natural resources equity fund group was -11.3% in 2012.[1] That means that now may be a good time to take a look at resource funds.

While weakness in any investment sector should raise eyebrows, value investors start sniffing when assets are cheap. With recent underperformance, resource funds may represent an attractive opportunity.

A resource-rich country

Because of the heavy weighting of commodities in the Canadian economy, many domestic mutual funds have some exposure to resource-investment opportunities in the sector. These include Western Canada's oil sands, the Saskatchewan-based potash industry, uranium deposits, gold and base metals producers, forestry, and many others.

Some focused investors favour funds that target only natural resources companies. Others drill down even further, investing only in specific resource industries, such as precious metals.

Despite the current environment of modest economic growth, Canada's resources remain in high demand throughout the world. In fact, as the global economy gradually gets fully back on its feet following a tough post-recession environment, demand should increase even further.

Fuelling growth

Emerging markets, whose economies are far more dependent on manufacturing production than developed nations, are particularly large consumers of Canadian raw materials. For example, despite recent slowdowns, fast-growing countries such as the "BRICs" (Brazil, Russia, India, and China), continue to generate significant demand for wood, base metals, and particularly, energy. In fact, a recently released report from the International Monetary Fund (IMF) notes that the resource-heavy Canadian economy is unlikely to be affected by projected short-term sluggishness in some emerging markets.[2]

Because picking individual winners in this highly volatile sector is tricky, mutual funds remain an ideal vehicle through which to invest in resource stocks. Uncertain geopolitical factors, demand trends, and even natural disasters drastically change the outlook for companies in the gold, natural gas, and even nuclear fuel industries — some for the better, others for the worse. Investing in a pool of opportunities provides investors with a far safer way to benefit from upside potential.

If you'd like to explore the potential of resource-based mutual funds for your portfolio, please contact us. We can help you choose funds that align with your risk tolerance, investment time horizon, and growth objectives, and that complement your current fund holdings.

1 Globefund, "15-Year Mutual Fund Review," Dec. 13, 2012 edition.
2 International Monetary Fund, *World Economic Outlook*, Oct 2013.

Could your funds use more Canadian exposure?

For the past five years, U.S. equity markets have generally outperformed Canadian markets. For example, for the five-year period ended Oct. 31, 2013, and the first 10 months of 2013 (to Oct. 31, 2013), the Canadian benchmark S&P/TSX Composite Index posted gains of 6.44% and 7.27%, respectively. Over the same periods, the S&P 500 Index rose 12.7% and 23.5%.[1]

As a result, if you hold both U.S. and Canadian equity funds, the former may have grown to represent a greater percentage of your portfolio than is optimal for your investor profile. This may be a good time for us to consider rebalancing.

Two ways to rebalance

There are two possible ways to bring your U.S.–Canada balance back to where it belongs. Trimming U.S. equities and investing more in Canada is one possibility. However, doing so could have tax consequences if your holdings are in a non-registered account.

An alternative is to rebalance your positions gradually, using regular contributions of cash to invest in the underweight portion of your portfolio.

Stay in touch

Changing markets can easily throw a once-balanced mutual fund portfolio out of whack. Remember to check in with us regularly to make sure your fund portfolio is in balance and on track. ■

1 S&P Dow Jones Indices.

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