Financial Planning Guide

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FOCUS ON MUTUAL FUNDS

Canada's economy humming along

When the final numbers are tallied for 2017, Canada's economy is expected to lead the G-7 group of industrialized economies[1] and come in second only to Spain among all developed nations. Considering that the Canadian economy was recently a laggard, the speed and magnitude of the economic rebound are remarkable.

Growth is widespread

What's most impressive about the Canadian economy is that growth is coming from a diversified group of sectors.[2] A rebound in oil and gas output is providing a boost, but so are upticks in manufacturing, financial, and wholesale and retail trade. According to one estimate, technology is one of the fastest growing sectors of the Canadian economy.[3]

And despite the lack of clarity about the direction of U.S. economic policies, the Bank of Canada's Business Outlook Survey[4] finds that business sentiment is strong, particularly when it comes to investment and hiring decisions. These are both key indicators for future growth.

Economic vitality

Further supporting an optimistic outlook is the unemployment rate, which dropped to its lowest level in almost a decade in late summer 2017,[5] and a strengthening Canadian dollar.[6]

In light of these bright prospects, this is an ideal time for us to touch base on your Canadian equity fund exposure. There may be new opportunities to explore that align with your investment objectives and risk tolerance — so you can take advantage of the prospects for the growth in our markets. ■

1 International Monetary Fund, World Economic Outlook, July 2017.
2 Bank of Canada, Business Outlook Survey, Summer 2017.
3 Brookfield Institute, The State of Canada's Tech Sector, 2016.
4 Bank of Canada, Business Outlook Survey, Summer 2017.
5 TradingEconomics.com.
6 Forex Market News and Analysis, Daily FX, July 21, 2017.

How rising interest rates affect your investments

After keeping rates at historic lows for the past decade, the Bank of Canada raised interest rates in 2017 and hinted that, with the economy close to full capacity, more rate increases may be in the cards.[1] Rising rates are most obviously felt in higher mortgage rates and borrowing costs, but they can also affect an investment portfolio. Here's what you need to know.

Winners and losers in the rate game

With Canadian economic growth picking up, the consensus is that the Bank of Canada will continue to raise interest rates. Indeed, the Bank suggested that the economy could be running at full capacity by the end of 2017, making the case for additional rate increases in 2018.

There are winners and losers in a rising interest-rate environment. The financials sector may see an uptick because rising rates often point to strength in the economy, and a stronger economy may result in fewer loan defaults, along with higher spreads on what financial companies pay out on savings accounts and what they earn on their government and corporate bonds.

In addition to the financial sector, the industrial, consumer discretionary, and technology sectors of the market typically benefit from rising rates.

Areas of the market that are more sensitive to higher rates — such as telecommunications, utilities, real estate investment trusts, and fixed income — may experience higher volatility.

How mutual funds are affected

How your fund holdings are affected by rising rates depends on a number of additional variables. Here's a rundown, by fund category.

Money market funds. Funds that hold highly secure interest-earning securities are clear winners in a rising-rate environment. If you're parking cash in a money market fund, you'll enjoy higher rates on your savings.

Bond funds. When interest rates rise, the price of previously issued bonds falls. The longer the term of the bond, the more marked the price decline. At the same time, however, newly issued bonds offer higher yields.

The effect on bond funds, however, is more complex, and will vary depending on the types of bonds held and the fund manager's ability to adjust the fund's holdings. Moving to shorter maturities, for example, can help mitigate the effect of rising rates.

Regardless of the effect on the fund's unit price, it's important to remember why you have bond funds in the first place — to provide stability and generate regular income.

Dividend funds. Dividend funds that focus on utility, pipeline, and telecommunications companies may experience greater volatility as those companies will see increases in their borrowing and financing costs in a rising-rate environment. Funds with a significant weighting to financial services companies, on the other hand, may experience less volatility and could even benefit.

Growth funds. The Bank of Canada is raising rates against a backdrop of stronger economic growth, and an improving economy can boost corporate profits — which is one of the biggest factors supporting equity markets. Growth-oriented mutual funds with a higher weighting in industrials, financials, and technology companies usually stand to benefit the most.

Maintain your focus

After such a long stretch of stable or declining rates, it's common for investors to become apprehensive at the first hint of increases. Remember, however, that we chose the funds for your portfolio based on their combined ability to help you reach your long-term goals regardless of interest rate or market ups and downs.

That's why it's important to maintain your current investing regimen. If you invest automatically, for example, continue to do so. If you're concerned that rising rates may affect your personal borrowing cost, talk to us. Effective debt management is an important part of your investment plan and just one of the many components of our service to you. ■

1 Bank of Canada Monetary Policy Report, July 2017.

RETIREMENT PLANNING

Canadians have more than $1 trillion in unused RRSP contribution room

The numbers are staggering. More than 24 million Canadians have unused Registered Retirement Savings Plan (RRSP) contribution room.[1] That works out to more than $40,000 for each tax filer. With a median annual RRSP contribution of just $3,000, it would seem Canadians are missing out on enormous tax-saving opportunities.

It's difficult to understand why. RRSPs provide a number of benefits, including tax-deductible contributions, long-term tax-deferred growth, and diversification opportunities. And unused contribution room represents the potential loss of many years of tax-free compound growth. Adding just $2,000 to your RRSP in January 2018, for example, earning 8% annually, would bump up your savings by almost $11,000 by 2040.

One of the easiest and most convenient ways to ensure you are always taking full advantage of your RRSP is to start — or increase — regular investment contributions. Once formed, these good habits are hard to break. With regular contributions, you're more likely to get closer to your maximum allowed contribution, and your money will begin to grow tax-deferred as soon as it's in your plan.

Automatic plans are easy to set up, and you can choose a withdrawal date and frequency (weekly, bi-weekly, monthly, etc.) that dovetails with your cash flow. If you're not already taking advantage of preauthorized contributions, we can help you get started. ■

1 Statistics Canada, CANSIM Table 111-0040, Registered Retirement Savings Plan (RRSP) room; accessed September 2017.

EYEOPENER

We're not as financially literate as we think we are

A recent survey[2] found that more than three quarters of Canadians (78%) believe they are financially literate: 64% rate their knowledge as "good," while 14% rate it as "excellent." However, tests results conducted as part of the survey tell a different story — six in 10 failed a test measuring basic financial literacy. In terms of demographic groups, 52% of Boomers passed, while only 45% of Gen Xers and 31% of Millennials got a passing grade.

How would you fare?

Test your own financial knowledge with these five questions from the test. Answers are below.

TRUE OR FALSE?	HOW RESPONDENTS FARED
1. A mortgage term refers to the length of time you need to pay off your mortgage.	51% answered incorrectly.
2. You can have multiple TFSA accounts with different banks at the same time.	20% got it wrong; 40% didn't know.
3. Applying for a credit card can negatively affect your credit score.	36% got it wrong; 17% didn't know.
4. A car that is more expensive always costs more to insure than a cheaper car.	50% got it wrong.
5. All banks charge you money to have a chequing account.	50% answered incorrectly or didn't know.

Answers: 1: False. 2: True. 3: True. 4: False. 5: False.

2 May 2017 survey conducted by Ipsos on behalf of LowestRates.ca.

Retirement planning is a lifelong activity

Whether you're 30 years from retirement or three, a diversified, well-managed portfolio of mutual funds can help provide the mix of security, income, and growth you need to reach your retirement goals. But what that portfolio looks like will change over time, as these three scenarios illustrate.

The building years

"Go for growth" is likely to be your investing mantra at this stage of life. Thanks to kids, mortgages, and a propensity for accumulation, these years tend to be typified more by spending than saving. However, time is totally on your side. With a long investment horizon, you can focus on growth-oriented equity mutual funds, knowing that you'll have plenty of time to ride out any temporary market downturns. You'll also benefit the most from compound investment growth.

Whatever else is going on at this busy stage of life, let's look at beefing up your holdings with an optimized cross-section of domestic and international equity funds that have the potential for long-term capital appreciation.

Peak earning years

At this stage in your life, you may be mortgage-free (or close to it) and be earning the highest salary of your career. Your children have left home and are independent. With more income and fewer expenses, these are typically your biggest earning years and (not coincidentally) your biggest tax-paying years.

For most people at this stage, there's still lots of time for the growth potential of equity funds. It goes without saying that this is also the time for us to make doubly sure you're taking full advantage of tax-advantaged accounts, including Registered Retirement Savings Plans (RRSPs) and Tax-Free Savings Accounts (TFSAs).

Pre-retirement years

With retirement on the horizon, this is the stage when you want to start gradually shifting your fund portfolio away from capital appreciation and toward capital preservation and income generation. In the same way that dollar-cost-averaging (buying in small increments on a regular basis over time) is a smart way to acquire mutual funds, it's an equally smart way to transition out of them.

Now may be the time to use this approach to start moving into the funds that will provide your retirement income stream. This doesn't mean selling off all your growth-oriented funds. But by starting well in advance, you can enjoy the luxury of slowly rebalancing. Even if your anticipated retirement is 10 or 12 years away, we can talk about what's next and set up the steps to implement your plans seamlessly.

Whatever life stage you're in, remember that we're here to help. We can help you clarify your short-, medium- and long-term goals and craft a mutual fund portfolio to help you reach your financial objectives. Over time, as your life evolves, we can make sure your portfolio stays aligned to your changing needs and objectives. ■

Exercises to tone your portfolio

Getting in shape is arguably one of the most frequent New Year's resolutions. But it's not just people who can benefit from a New Year's tune-up. Here are three exercises we can use to help ensure your mutual fund portfolio stays in top shape.

Balance

The key to good physical fitness is balance. The same is true for your fiscal fitness. To achieve balance in your mutual fund portfolio, we start by reviewing your goals and the value of your individual funds, which may have changed over the course of the year. For example, if your equity funds have outperformed, they may now represent a larger proportion of your portfolio, which could mean more potential volatility than you are comfortable with.

Reduce

Rest assured, this kind of reducing doesn't involve any hard-to-keep resolutions. Rather, as part of the balancing process we may want to prune back funds that no longer fit your investor profile or crystallize gains from any that have outperformed.

Strengthen

An ideal way to strengthen your portfolio is with pre-authorized contributions. We can then look at how best to deploy this year's contributions. One place to consider is your existing funds. Adding new cash to funds in asset classes that are under-represented in your portfolio is an easy, effective way to get back to your target asset allocation.

Call us soon to set up your New Year's portfolio tune-up. ■

FundEX INVESTMENTS INC.