Compliments of ExcelPlan Financial

Summer 2016

Financial Planning Guide

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FOCUS ON MUTUAL FUNDS

Cash — too much of a good thing?

According to a widely reported study released by a Canadian investment bank earlier this year, Canadians are sitting on $75 billion in excess savings. That's a lot of money earning interest at today's low rates.

Fund managers even have a name for this phenomenon. They call it "cash drag" — too much cash can literally drag down performance over the long term.

Balance cash with growth

How much cash is too much depends on your specific goals and your time horizon. For example, money you have set aside for household expenses and emergencies is fine in a money market fund, where you can access it quickly.

But the longer you can stay invested, the more time you have to ride out the temporary ups and downs of the market and benefit from the growth potential that equity funds can provide.

Built-in risk management

One of the great things about mutual funds is how they're designed to help mitigate risk. Here's how:

- **Diversification.** Mutual funds offer a world of choice across different market sectors and industries, and every fund contains a diversified mix of professionally selected investments.
- **Regular investing.** With the low minimum purchase amount for many funds, it's easy to invest small amounts on a regular basis. You can even set up a pre-authorized purchase plan and make market fluctuations work for you: You automatically buy more fund units when prices are low and fewer when prices are high. ■

Tuck it in 'buckets'

What are you investing for? Travel? Dream house? Sabbatical? Starting a business? Chances are, there are lots of things you hope to experience, and your mutual funds are there to help. How? By taking a bucket approach.

You see, your mutual fund portfolio isn't just one big bucket of accumulating assets. Rather, it's three (or more) buckets, each with its own timeline, objectives, and appropriate mutual funds, as illustrated below:

Bucket	1. Short-term goals	2. Mid-term goals	3. Long-term goals
Approximate time horizon	Under 5 years	6 to 15 years	More than 15 years
Typical goals	• New car • Family vacation • Home renovations • Parental leave	• Children's post-secondary education • Taking a sabbatical • Purchasing a vacation home	• Retirement
Investment characteristics	• Security • Accessibility • Highest available interest earnings	• Growth and income • Moderate volatility • Tax-efficiency	• Maximum growth potential • Moderate to high volatility • Protection from inflation
Types of funds to consider	**Money market funds** • Invest in short-term, fixed-income securities, such as treasury bills, certificates of deposit, and other highly secure debt issues **Fixed-income funds** • Hold investments that pay a fixed rate of return on a regular basis, such as bonds issued by governments or corporations **Dividend funds** • Invest in companies with a proven history of earning income that is distributed to investors as dividends	**Balanced funds** • Designed to provide a mix of income and growth **Equity funds** • Growth-oriented for capital gains potential • Income-oriented for dividends • Taxed less heavily than interest income (outside of registered plans) **Target date funds** • Automatically rebalanced over time to provide ready access to cash at a specified date, such as child's entry to university **Global equity funds** • Provide diversification, access to opportunities in other markets	**Equity funds** • Broad-based Canadian, U.S., international funds to provide diversification and growth potential **Sector/specialized funds** • Higher potential growth (subject to greater volatility) **Portfolio funds** • Provide a one-decision, diversified, professionally managed portfolio of funds

Whatever your specific goals and time lines are, we can create and monitor a mutual fund portfolio to help you reach them. And while the bucket approach is one way to match specific funds to specific goals, we keep a close watch on all the buckets — to ensure your funds are working effectively together, continue to reflect your investor profile, and are structured to be as tax-efficient as possible. ■

EDUCATION

Sharpen your pencils: post-secondary students and finances

Every September, many university and college students find themselves moving away from home and managing their money independently for the first time. It's an exciting step, but also a time when financial novices can easily get into trouble. As a parent, it is important to help your children develop strong financial skills. Here's how.

Budgeting basics

Work together to jointly establish a school year budget that takes into account their earnings from any summer and part-time employment, scholarships, and government grants or loans. On the spending side, you'll need to account for tuition, textbooks, accommodation, food, transportation and entertainment. Seeing these expenses, in black and white, against the funds available to them may encourage your children to think very carefully about discretionary expenditures.

Credit card smarts

Many financial institutions offer student credit cards with low or no annual fees and low interest rates or finance charges. If this is their first credit card, it's important they learn how to manage it.

Together, you can determine the rules for using the card, such as using it only for groceries, gas and school supplies, and paying it off in full every month.

It's important for young adults to learn how to live within their means and take responsibility for their financial future. Part of that is helping them grasp the concept of their credit record. Just like their academic transcript, it can have a lasting impact on their lives.

There's a lot for students to discover when they first move away. Feeling confident they can manage their own finances gives them a head start. If you need to brush up on your own basic financial skills, like budgeting, in order to teach them to your kids, we can help. ■

EYEOPENER

RESP milestones

Birth

Contribute the maximum of $50,000, and your RESP will grow to more than $150,000 by the time your child is 18, assuming an annual return of 6%. However, you'll get only $500 in CESG.

Age 2

Want to generate the maximum lifetime CESG payment of $7,200? Start now and contribute $2,500 each year until your child turns 17, and you'll have more than $88,000 assuming an annual return of 6%.

Age 10

Haven't started yet? It's not too late. Contribute $5,000 each year for the next seven years and you'll get CESG of $1,000 each year, thanks to the carry-forward of unused grant entitlement.

Age 16 & 17

In order to receive the CESG, RESP contributions must either total at least $2,000 before the end of the year in which the child turned 15 or be at least $100 a year in any of the four years preceding the year the child turned 16.

Age 18

Contributions can be made to an RESP for up to 31 years. The plan can stay in existence for a maximum of 35 years.

FOCUS ON EQUITIES — BALANCE — FOCUS ON SAFETY

With tax-deferred growth and the benefit of the Canada Education Savings Grant (CESG), Registered Education Savings Plans (RESPs) are a great way to save for a child's post-secondary education. The above time line highlights some key dates and deadlines that you won't want to miss in order to make the most of your RESP.

Over time, the investments in your RESP should change from primarily equities and equity funds (to take advantage of long-term growth potential) to fixed income and cash (as you prepare to take the money out). ■

5 mutual fund 'shock absorbers'

Mutual fund investors can be forgiven for feeling like the latest waves of market volatility have been going on for ages. Because the truth is, they have. Fortunately, your portfolio has the benefits of these five built-in shock absorbers.

1. A solid foundation

Your portfolio has been carefully constructed to help you stay on track to your long-term goals through calm and turbulent times alike.

Fixed-income funds, bond funds, conservatively managed balanced funds, and similar holdings help provide income and can provide relatively stable returns. Equity funds, including dividend funds and blue-chip funds, offer steady growth over the long term. These funds typically invest in companies with a long history of steady and increasing returns.

2. Global exposure

International equity funds come in all flavours, providing you with access to growth opportunities in emerging markets and sectors (such as technology) not found here at home. Global funds also enable you to diversify by currency. All of these factors contribute not just to your portfolio's growth prospects, but also to its long-term stability.

3. Discipline

When markets are volatile, investors have a tendency to shy away from growth-oriented mutual funds in favour of income-based funds. It is one of the investment markets' big ironies that this can actually magnify risk. Sure, moving into money market funds might seem like a safe haven during times of market volatility, but persistent low interest rates may make it more difficult to reach your long-term objectives.

When your portfolio's growth component is aligned with your long-term objectives and risk comfort level, you're far less likely to be disturbed by temporary declines. In fact, you might even view them as an opportunity to add select funds at an attractive price.

4. Professional support

Financial research firm DALBAR tracks the gap between actual investment market performance and the returns of American mutual fund investors. For the 30 years ended in 2014, the S&P 500 (a benchmark for American equity markets) posted an annual average return of 11.06%. By comparison, individual equity fund investors averaged just 3.79%.[1]

The major cause of this shortfall? Withdrawing from investments at low points and buying at market highs. With a financial plan and the support of our expertise, you are far less likely to fall into this trap.

5. Regular checkups

Managing volatility is just one of the reasons we recommend regular check-ins. It also gives us the opportunity to discuss what's going on in the markets, review any changes in your personal circumstances, and consider any adjustments that might be appropriate for your portfolio. ■

[1] DALBAR, *Quantitative Analysis of Investment Behavior*, 2014.

Divergence and your mutual funds

In the context of investing, divergence refers to investments that move independently of one another.

It's important because too much correlation can hamper long-term growth potential. If your mutual funds are concentrated in a particular sector or asset class, it can leave you vulnerable to a downturn in that area.

There are numerous ways to apply divergence to investment assets, including:

- **Industry sector.** Because the financial and energy sectors are such a big part of Canada's equity markets, they tend to be a big part of Canadian equity funds. For divergence, we might look to funds that focus on technology or pharmaceuticals, sectors that are affected by different factors than financials and energy.
- **Market capitalization.** A mix of large-cap, mid-cap, and small-cap funds helps to ensure exposure to companies of all sizes, which tend to outperform at different stages of the market cycle.
- **Geography.** Broad-based international equity funds or funds that focus on specific regions offer divergence from the Canadian economy and currency.

If you'd like to know more about how divergence applies to your funds, we'd be happy to go over your portfolio in detail. ■

 ISSN 1205-5840

FundEX INVESTMENTS INC.