

Financial Planning Guide



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FOCUS ON INVESTING



With interest rates rising, does an RRSP loan make sense?

Interest rates are rising, making credit more expensive. Should this deter you from borrowing to contribute to your Registered Retirement Savings Plan (RRSP)?

In most cases, borrowing to contribute is still a valid strategy. Loans are still very affordable by historical standards, and RRSP loans are often available at special rates.

Long-term benefit, short-term cost

For example, suppose you borrow \$5,000 at 6%, to contribute to your RRSP. If that \$5,000 generates a modest investment return of just 5% compounded annually, it will increase the value of your RRSP by \$8,144 after 10 years. After 25 years, the increase is almost \$17,000.

What's the cost? If you pay the loan back over 12 months, your total interest cost will be just \$163.99.

If you can pay the loan back sooner, your interest costs will be even less. One

of the most effective ways to do this is to put the tax savings created by the RRSP contribution towards repaying the debt. Many financial institutions offer repayment schedules at this time of year that allow sufficient time to report the contribution for 2004 and realize the tax savings before you have to start making payments on the loan.

Professional advice can help you determine the optimal amount to borrow, and possibly uncover contribution sources that you have overlooked.

Go hunting

For example, perhaps you have bank deposits or Canada Savings Bonds in a personal account that can be easily transferred to your RRSP to pump up your contribution — and your tax benefit. Another possible source: any year-end bonus or profit-sharing you receive from your employer. ■

PENSIONS

Leaving your job? You may not have to lock in your pension

If you have a small locked-in Registered Retirement Savings Plan (RRSP) or Locked-in Retirement Account (LIRA), you may be able to “unlock” it, and roll over the contents to a regular RRSP. Several provinces allow the rollover for low balances (the eligibility limit varies). The small value rules cover existing plans as well as new transfer values. If you have a low-value locked-in plan, ask if the governing province has such a rule and if your plan is within the limit. Note that the unlock is not yet available for federally regulated pension money. ■



INSURANCE

Quitting smoking this year? The payoff could be big!

The health benefits of quitting smoking are well known — but not as many people know that breaking the habit can substantially reduce their life insurance premiums. A 40-year-old man in average health who doesn't smoke might pay half as much for term life insurance as a 40-year-old male smoker. If you quit smoking last year, or plan to quit this year, ask how your policy defines “non-smoker” and when your premiums can be reviewed. ■



TRAVEL

Travel warning for condo owners

One of the appeals of condo living is that you need only lock your door when going away. Well, not really. If you're taking an extended trip, tell the condo office how to reach you in case there's a problem. Believe it or not, an Ontario woman almost lost her home because a new management company took over while she was gone and could not access her bank account for pre-authorized maintenance fee payments. Her condo, like many, automatically puts a lien on a unit when fees are unpaid for more than 90 days. ■



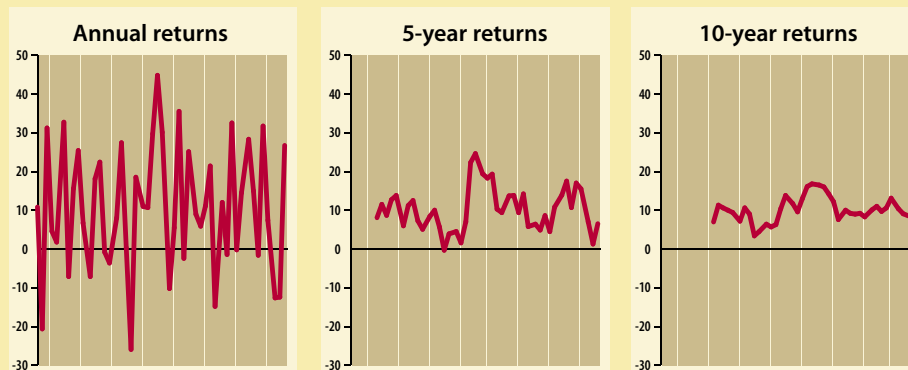
EYEOPENER

graphic evidence of how investing works

Take the long view on volatility

THE STOCK MARKET can seem incredibly volatile if you look only at its performance from one year to the next. But performance smoothes out over time if you look at the compound growth.

The three charts below are all based on historical Canadian stock market returns (represented by the S&P/TSX Composite Index) from 1956 through 2003. As you can see, the annual returns are quite variable, while the rolling returns over five years are much less volatile. Rolling 10-year returns are less volatile still. Understanding this can help equity investors keep their sights set on the long term. ■



ESTATE PLANNING

Protect your RRSP legacy

Here's one more reason to have a valid beneficiary designation for your Registered Retirement Savings Plan (RRSP). Previously, insurance company RRSPs were generally the only ones that were creditor-proof. But in 2004 the Ontario Court of Appeal ruled that non-insurance RRSPs are also creditor-proof at death if paid to a named beneficiary. The decision might also affect Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, and Newfoundland and Labrador, which have similar succession legislation, but not Quebec, which is not under “common law.” Note that this applies only at death; insurance RRSPs also offer creditor-proofing while the plan holder is alive. ■

O Canada! 4 reasons to like your homegrown funds

Not so very long ago, the 30% foreign-content restriction for Registered Retirement Savings Plans (RRSPs) was seen as a distinct hindrance to potential performance. Canadian stocks and mutual funds always seemed to lag other major markets.

More recently, though, Canada has been a winning place to invest, and signs point to ongoing gains in 2005. Here are four key reasons why Canadian equity funds are an excellent choice as part of a diversified portfolio.

1. Currency strength. The great Canadian turnaround story starts with our dollar. It has been soaring, and some economists even believe it could reach US\$0.85 this year thanks to strong economic fundamentals and surplus federal budgets.

Why does this matter? Foreign equity funds got a big performance boost as our dollar suffered a prolonged slump in foreign exchange trading during the 1970s and '80s. That was because the stocks they held were valued in foreign currencies that were rising against our own. A foreign company's shares could have been flat in trading on its home stock market but still show a gain here when the foreign share price was converted to Canadian currency.

Now, it's the other way around. The rising loonie has made it hard for foreign funds to shine because their returns reflect the impact of converting their holdings to Canadian dollars. There was a superb example of this in 2003. U.S. stocks, as measured by the S&P 500 Index, gained 26.4% — when valued in greenbacks. But the return for Canadian investors was just 5.3% once the S&P returns were expressed in Canadian dollars.

2. Demand for commodities. The Canadian stock market also lagged other markets in the past because foreign investors saw us mainly as commodities producers, and commodities were out of favour.

Now, commodities are in big demand, thanks to concerns about energy supply and also to supersonic growth in China, India, and several other countries. Energy stocks make up about one-fifth of the Toronto Stock Exchange and are a core holding in many Canadian equity funds.

3. Economic growth. Canadian factories have been running at their highest

levels in a decade, and our growth gap with the U.S. vanished last year. This year, Canada is expected to be an economic growth leader among the major industrialized nations that make up the G-7.

Interestingly, economists expect us to post strong growth without suffering the rapid inflation that often accompanies it. They point out that the Bank of Canada has made

it clear it's committed to keeping inflation under control. Also, we depend heavily on imports and the strong loonie makes them cheaper to buy.

4. Global scope. Finally, remember that when you buy a Canadian equity fund, in many cases you are buying at least some exposure to global investment opportunities. Canadian mutual funds get the same 30% RRSP foreign-content limit that individual investors do, and many managers use that to access sectors that are not well represented here. More to the point, most major Canadian resource and manufacturing companies operate on a global scale.

Canadian mutual funds represent important investing opportunities. Professional advice can help you ensure that your Canadian holdings are sufficiently diversified and positioned to help you meet your long-term investing goals. ■



What's inside a Canadian fund?

WHEN IS A mutual fund Canadian? It's what's inside that counts. To get a better understanding, here are the major categories of 100% RRSP-eligible Canadian mutual funds. The criteria are based on classifications by the Canadian Investment Funds Standards Committee (www.cifsc.com), whose category assignments normally reflect a fund's holdings over at least three years. ■

Canadian Bond

At least 70% of the portfolio must be in Canadian dollar-denominated bonds, debentures, and short-term notes. The portfolio's average term-to-maturity must be greater than three years.

Canadian Dividend

At least 50% of total assets and 75% of non-cash assets must be dividend-paying shares of Canadian corporations, convertible into the securities of Canadian corporations, or royalty and income trusts (restricted to 25% of the portfolio).

Canadian Small Cap

A minimum of 50% of total assets and 75% of non-cash assets must be invested in Canadian equities. The portfolio's average weighted market capitalization must also fall below a certain percentage of the total market capitalization of the S&P/TSX Composite Index.

Canadian Equity

At least 50% of the fund's total assets and 95% of non-cash assets must be in exchange-listed Canadian equities.

Canadian Balanced

The equity component must be 30%–70% of the fund's portfolio with fixed income and cash comprising the rest.

Canadian Tactical Asset Allocation

Must be at least 70% in one or a combination of Canadian fixed income, Canadian equities, or Canadian cash and equivalents. Asset weightings are not restricted or are less stringent than for balanced funds.

Canadian Income Trust

A minimum of 40% of the total assets must be invested in income trusts, and at least 75% of non-cash assets in income trusts (including REITs) or other income-producing securities such as dividend-paying common or preferred shares, bonds, mortgages, or other fixed-income instruments.

What's the best way to finance a major purchase?

Planning to borrow money for a major purchase this year, perhaps to buy a car or boat or to renovate your home? Here's a look at the main sources of financing you're likely to consider, along with the pros and cons of each.

Line of credit

If you own a home and have sufficient equity, a home equity line of credit can be a convenient and affordable way to borrow. You can borrow as much as you need, whenever you want, up to a preapproved credit limit. You can make repayments at any time without penalty. These secured loans tend to be among the cheapest available; they are often priced at "prime."

Be aware, however, that the rates are variable, so your cost could rise over time. Set-up may also involve legal and appraisal fees, so it's best if you can establish your line of credit at the same time you arrange your mortgage, or when you renew it, especially if you change lenders.

Term loans

With a term loan, you borrow a certain amount at a fixed rate for a predetermined period.

Term loans are less flexible than lines of credit, but your cost is totally predictable. The loan rate might even be cheaper than the variable line of credit, depending on market conditions. As with a line of credit, you can usually pay down the loan at any time without penalty — but confirm that with the lender.

Vendor loans

Many car, boat, furniture, and appliance dealers offer zero-percent financing. If you think you'll be able to repay the loan in full when you have to, this can be a good option. But be sure to read the fine print very carefully. How long does the concessionary rate run? Is there a penalty if you repay the full amount at the end of the term? If you can't repay all of it, what will the interest rate be on the outstanding balance?

Remember, too, that the cost of the financing may be built into the price of the item. Be sure to shop around. You might find it more economical in the long run to negotiate a lower price from a different vendor, and arrange your own financing.

Insurance loan

If you have a whole life or universal life insurance policy with built-up cash value, you may want to consider a policy loan. If the policy was issued many years ago, you might find that the loan rate is very low.

Policy loans require professional advice, since there are limits on what you can borrow without creating tax complications and reducing your coverage. Note that insurance cash value can also be used to secure a bank loan or line of credit if you can't, or don't want to, tie up home equity. ■

5 great ways to pay less tax

START THE YEAR off on the right foot by taking steps now to reduce your tax bill when filing your 2005 return. Here are five suggestions.

1. Make an RRSP contribution. You get a tax deduction and the earnings compound tax-free until withdrawal.

2. Make sure non-registered investments are tax-effective. Outside your RRSP or RRIF, capital gains generally carry less tax than Canadian dividends, which carry less tax than interest.

3. Pool the family's medical bills. It's easier to qualify for the Medical Tax Credit if the lower-income spouse reports all expenses. Your claim can cover any 12-month period ending in 2005. Remember that premiums for out-of-Canada medical insurance and other private medical coverage are eligible expenses.

4. Pay your kids or spouse a salary. If you're self-employed, you can split income by paying family members reasonable wages to work for you. The personal credit alone shelters almost \$8,000 from income tax.

5. Give yourself a raise. Owners of an incorporated business need to plan a year in advance in order to take advantage of rising RRSP contribution limits. The maximum contribution is \$16,500 for 2005 and \$18,000 for 2006. To contribute the maximum, you would need earned income of \$91,667 in 2004 and \$100,000 in 2005. (Remember, RRSP contribution limits are based on the previous year's earned income.) ■

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