

Financial Planning Guide



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Small savings can add up to big investments

Many people want to invest more money, but they can't find the cash to do it. Perhaps they're not looking in the right places. Consider these sources of "hidden" savings:

Stuff you don't use

What do you spend on fitness club and other memberships you rarely use, or on premium TV channels you hardly watch? They might eat up \$50 a month — \$600 a year!

CPP/QPP contributions

Do your payroll deductions for Canada/Quebec Pension Plan contributions end in mid-summer? Invest the amounts no longer deducted. You've been doing without them up to this point in the year anyway.

Insurance

Consider raising your deductibles on

home and car insurance to \$1,000 or \$2,000. Do you think you would ever file a claim for less? Remember: Investing money saved on premiums creates a "self-insurance" fund.

Lottery tickets

The average household spends \$310 yearly on "games of chance," says Statistics Canada. Why not buy half as many tickets and invest the rest?

Windfalls

Try the "20-80" rule for unexpected cash, such as a bonus at work or an inheritance. Treat yourself with 20% and put 80% to work for you.

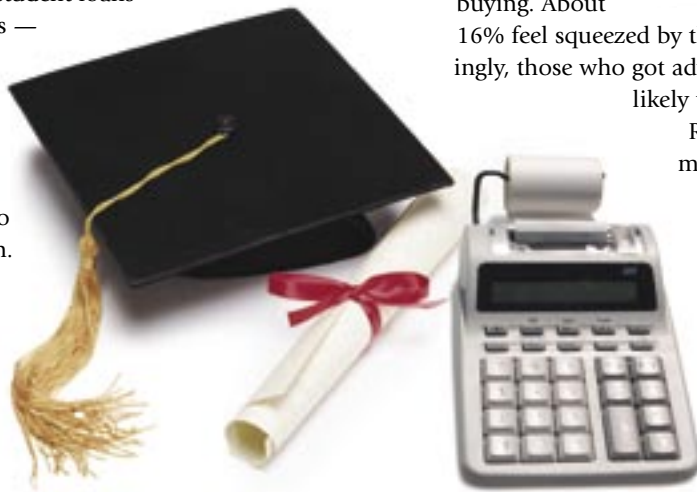
A few dollars saved here and there can quickly add up to \$1,000 or more a year — put to work, that's enough to make a significant difference to your long-term investment growth. ■

TAX PLANNING

Tax breaks on “official” student loans only

Interest on a student loan generates a tax credit only if the loan is under the Canada Student Loans Act or similar provincial legislation. Be careful: Financial institutions also offer student loans outside these programs — with no tax break.

One business student learned this the hard way after using a low-rate student line of credit to pay off his official loan. Tax authorities denied him credit on \$4,340 of interest. He challenged that in court (*Vilenski v. The Queen*, 2004), but lost. ■



FINANCIAL PLANNING

Plan for your mortgage

A recent poll of more than 1,000 people in Canada's five largest cities found that about 75% of first-time house hunters did not seek professional financial advice before buying. About

16% feel squeezed by their household bills. Not surprisingly, those who got advice first were also those who were much more likely to say they feel comfortable.



Remember that, with financial advice, you can make sure that you get the right mortgage to fit your financial plan. ■

INSURANCE PLANNING

Do you have enough disability coverage?

The group disability insurance plans that many employers sponsor are designed for the average salaried worker. As a result, there is often a coverage gap for higher-paid managers and professionals. Many plans cap monthly benefits at \$5,000.

Sales representatives and others receiving variable compensation may also be under-insured. Benefits typically don't reflect bonuses, commissions, profit sharing or stock options — even though these payments can be a significant part of the paycheck.

If you earn more than \$100,000 a year or receive significant non-salary compensation, look closely at your disability coverage. You may want to augment any employer-sponsored coverage with an individual policy. ■



FINANCIAL CLASSROOM

your guide to the basics and how to benefit

Prime rate

The “prime rate” matters a lot if you're about to borrow money or if you have a loan with a variable interest rate that is tied to prime.

What it is

The prime rate is the base for the rates your financial institution charges on its various types of loans. It's what a lender charges on its least risky loans. For example, a line of credit secured by home equity might be priced at prime, while an unsecured line of credit could cost prime plus several percentage points.

How it works

Some people believe the Bank of Canada sets the prime rate, but, in fact, it only sets the Bank rate — that is, the rate that the Bank of Canada charges when it lends money to institutional lenders. These lenders, in turn, set their own prime rates. Banks and lenders may even grant loans below prime rate — for example, special Registered Retirement Savings Plan investment loans in January and February.

Why it matters

Rates on new and variable rate loans, including mortgages and lines of credit, rise and fall with prime. The higher the prime rate, the more it costs you to borrow.

Diversify your mutual funds for investing success

Most investors are aware that diversification is a key element in investment success. That's one reason mutual funds are so attractive. Each mutual fund pools the resources of many investors to purchase a diversified portfolio of holdings — many more than any individual investor could afford.

Mutual fund investors can add another layer of diversification by making sure their portfolio includes several funds with different objectives or management styles. Here are some strategies to keep in mind when contemplating your own diversified portfolio of mutual funds.

1. Start with your objectives. You cannot build a solid portfolio if you don't first prepare the foundation. This means taking a frank look at how long you are prepared to hold your funds, how realistic your performance expectations are, and how you'll react when your funds hit a bit of turbulence.

Remember, the volatile nature of certain mutual funds requires patience and long-term commitment.

2. Choose quality over quantity. Be careful not to overdiversify — that is, spread relatively small dollar amounts among too many funds. Remember, a mutual fund is already a diversified group of investments. Excessive diversification simply dilutes your portfolio's overall growth potential.

Regardless of how much money you have,



few investors will ever need more than eight or 10 different funds. If you're just getting started, you may want to consider investing in a good balanced fund until you've built up your savings.

3. Diversify by asset class. Different elements of the economy respond differently to changing economic conditions. In other words, what's good for bonds may not be as good for equities. To ensure your portfolio is responsive no matter what the economy is doing, you may want to include as part of your holdings money market funds (cash-equivalent securities), bond or mortgage funds (income), and equity funds (stocks).

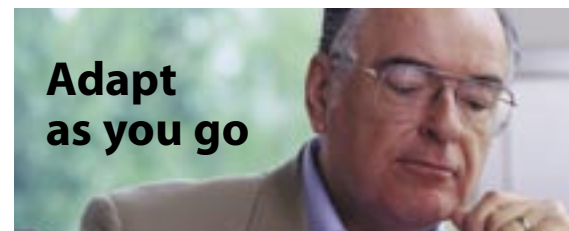
The proportion of each asset class you hold will vary depending on your objectives and current market conditions. So, you'll want to review your allocations every year or two.

4. Diversify by geography. International diversification can shield your portfolio from undue volatility in any one region — including Canada. Besides, there are simply too many compelling investments around the world not to take advantage of them.

Your options range from funds that invest exclusively in the world's major economies to those that specialize in the dynamic emerging markets.

5. Diversify by management style. Not all mutual funds are managed the same way. "Value" managers, for instance, look for bargain stocks that are trading for less than they are worth. "Growth" managers focus on the potential of a stock's price to go up and how fast it will do so.

6. Take advantage of professional advice. Professional guidance can help you sift through your options to find mutual funds that are appropriate for you. ■



Adapt as you go

EACH INVESTOR SHOULD have an asset mix to suit his or her financial goals and risk tolerance. That mix will probably stay constant through your peak earning years (your 30s, 40s, and early 50s).

As you approach retirement, however, the purpose of your investments changes quite dramatically. Not only is your investment time horizon shorter, but you may no longer have regular employment income. The emphasis shifts from long-term growth and capital accumulation to income and liquidity.

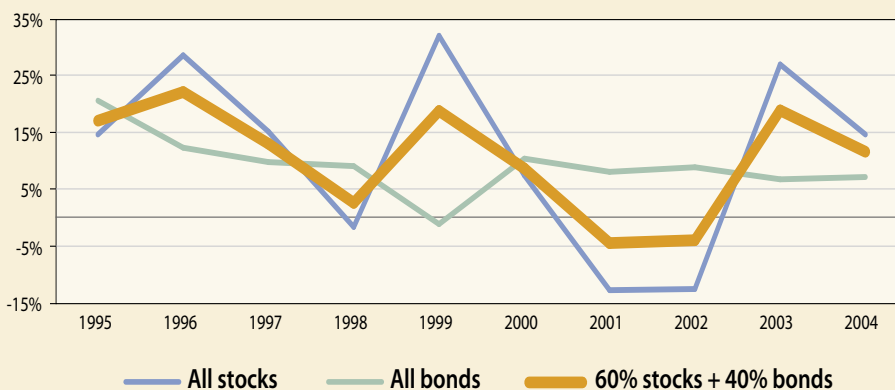
Whether your risk tolerance is high, moderate, or low, it's important to adapt the asset mix in your portfolio to suit your changing objectives. For instance, an investor who's about to retire might reduce his portfolio's weighting in growth-oriented assets.

You might also want to adjust the assets themselves — for example, by switching to more conservative equity funds that will provide blue-chip growth and minimal volatility.

Professional advice can help you find the mix of investments that will meet your income needs, provide inflation protection, and preserve your capital. ■

The best of both worlds

An all-stock portfolio can be very volatile, while an all-bond portfolio will likely produce low returns. But a portfolio comprised of 60% stocks and 40% bonds should, over time, produce solid returns with less fluctuation.



Source: Morningstar Canada; S&P/TSX Composite, BIGAR Broad Market Composite

A living will is a key part of your estate plan

Medical technology has advanced to the point where the terminally ill and gravely injured can be sustained for months, or even years. But not everyone would opt for such heroic measures — if they had the choice.

To indicate they have made that choice, and made some difficult health-care decisions ahead of time, Canadians are increasingly using “living wills” to set parameters for their own personal care.

What is a living will?

A living will is separate from your regular will. Your regular will deals only with the distribution of your property after death and issues such as providing a guardian for your children. A living will deals with personal care and health care for someone who becomes incapacitated.

All provinces recognize the concept of a living will, but they don't all use the same terminology. Some provinces use terms such as “advanced health-care directive” or “power of attorney for personal care.”

Regardless of what it's called, a living will allows you to identify specific procedures that you will or will not accept. Or, it can provide more general directions, such as refusing any “heroic measures.” A living will can also reiterate the decision that appears on your organ- or body-donor card.

Legislation does not dictate the contents of a living will, but certain standards must be met for the document to be valid. For example, several jurisdictions won't let you refuse to be administered food, water,

and painkillers. And all require you to be mentally competent when the document is signed — and with a witness who attests to that. This is important since, when the time comes, family members might question your state of mind back when the instructions were given. You must be at least 18 to sign a living will. Parents can sign on behalf of minor children.

The CBC News Website has a basic cross-Canada summary of how living wills are handled, with links to provincial Websites. Go to cbc.ca/news/background/wills.

Have you named a decision maker?

In your living will, you can also name a “health-care proxy” — a trusted person to be responsible for carrying out your wishes. Some provinces require this. Ideally, this decision maker should live in your area since he or she could be involved with your care for months.

Make sure your family members know about your living will and health-care proxy declaration. Give them copies and explain your thinking so that there's no doubt. Similarly, give copies to your doctor, lawyer, and minister or other cleric. You may even want to keep a card in your wallet or purse indicating that you have a living will and health-care proxy.

Some provinces offer fill-in-the-blank forms. But consider getting professional advice to ensure your instructions are clearly expressed and enforceable. And, as with a regular will, review these papers periodically to make sure they still reflect your wishes. ■

Make the most of fringe benefits at work

WHEN THEY HEAR the term “compensation,” most employees think only of their salary or rate of commission. But employer-sponsored benefits can contribute a lot to a compensation package — some of it tax-free.

For example, there's no tax if your employer pays all or part of your private health insurance — except in Quebec. The boss can pay for a home computer and educational courses aimed at helping you in your job. Would you rather have a tax-free \$2,000 computer or a taxable \$2,000 bonus?

Stress management and language training are tax-free. So are wellness and retirement counselling. There's no tax on employer-paid dues to job-related professional associations. Add to the list discounts on products and services, wedding and holiday presents, and a \$10,000 death benefit on top of your insurance.

Even when they're not tax-free, fringe benefits are still a good deal because all you have to pay is the tax. Suppose your kids get company-sponsored day care that would normally cost \$1,000 a month. If you're in the 40% bracket, you pay just \$400.

Or maybe your employer will pay for your spouse or child to join you on a business trip. That amounts to travel at less than half-price.

Check with your employer to find out what specific benefits are available and how you can best use them. ■

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