

Financial Planning Guide



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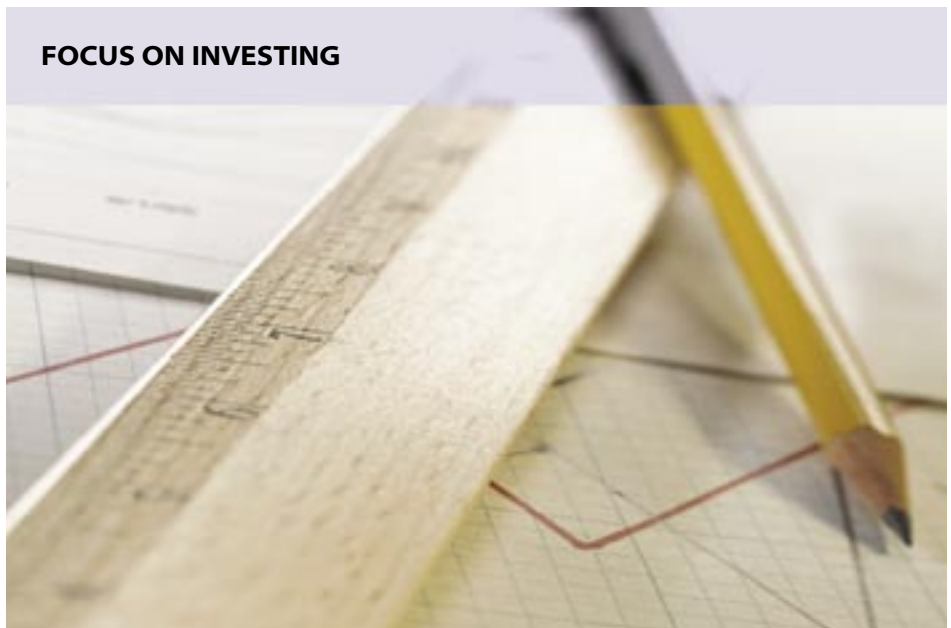


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FOCUS ON INVESTING



Have you got the right retirement plan?

Earlier this year, 59% of the working-age Canadians polled in a national survey said that they felt they were behind in their retirement savings. Yet 79% of all respondents said that they didn't have a retirement plan.

In other words, many people fear they're not saving enough even though they don't know how much they should be saving.

Because of prudent planning, you're likely not one of those people. And one of the best ways to keep your retirement plan on track is to review and update it as we head into 2006. This will give you plenty of time to gather the information you need — before the Registered Retirement Savings Plan rush starts in mid-January.

With a regular review, you can check that your plan accurately reflects the five key elements of a successful retirement strategy:

1. Your target retirement age.
2. Your desired lifestyle. Where would you like to live? Do you expect to work part time; for how long? How important are costly activities such as travel or wintering down south?
3. Your current net worth — assets minus liabilities — and ability to maintain or increase your savings rate.
4. Your eligibility for government and employer pensions.
5. Your risk tolerance — how well you can handle the ups and downs of various types of investments.

Then you can take appropriate action to stay on track. For example, you may need to adjust your contribution levels, fine-tune your asset mix, or rethink your retirement projections.

Professional planning can make all the difference in how you feel about meeting your retirement goals. ■



WHAT YOU NEED TO KNOW ABOUT...



Your RRIF and how it works

A Registered Retirement Income Fund (RRIF) is like a Registered Retirement Savings Plan (RRSP) in reverse. An RRSP accumulates money, which a RRIF gradually turns into taxable retirement income.

Q: When is the best time for me to convert my RRSP into a RRIF?

A: You must convert your RRSP into a RRIF or some other income-producing vehicle by the end of the year in which you turn 69. You can convert earlier, but remember that once you convert you'll have to begin taking minimum withdrawals from the RRIF.

In the final year, it's best not to wait until the last minute. You'll want some time to review your needs, plan your income stream, and complete the paperwork. Before you convert, try to contribute the maximum for the year, including any contributions you were able to carry forward from previous years.

Note: You must sign a new beneficiary designation even if you want to name the same person as was designated in your RRSP.

Q: What different types of investments can a RRIF hold?

A: A RRIF can hold the same investments as an RRSP, including cash, GICs, bonds, stocks, mutual funds, and more. Keep in mind that at least one taxable withdrawal must be made annually.

Q: Do spousal plans to which I've contributed have to be converted as well?

A: Not necessarily. The deadline for converting a spousal RRSP will be based on your spouse's age. In fact, if your spouse is younger than 70 and you still have earned income, you can continue to contribute to a spousal RRSP, and claim a tax deduction for the contribution.

EDUCATION SAVINGS

Plan ahead and meet the RESP deadline

December 31 is the deadline to contribute to a Registered Education Savings Plan (RESP) for the 2005 tax year and to qualify for the annual Canada Education Savings Grant (CESG).

Unused RESP contribution room can be carried forward, along with eligibility for the CESG, but it is limited. The maximum contribution for any one year is \$4,000. If you miss too many years, it soon becomes impossible to take full advantage of the \$42,000 maximum lifetime contribution. ■

TAX FILING TIPS

Group insurance deductions boost tax credits



Does your employer deduct group medical and dental insurance premiums from your pay? If so, get a receipt. Those payments are eligible for the medical expense tax credit, which you may qualify for if your family medical costs for the year exceed 3% of your net income or \$1,844 (whichever is less). Remember, you can claim expenses for any 12-month period that ends in the calendar year. ■

INVESTMENT PLANNING

Can you gain from losses?

In investing circles, the last few weeks of each year constitute "tax-loss selling" season. Tax-loss selling involves selling off investments that have recorded a capital loss in order to offset taxable capital gains. Reviewing your portfolio in early December is a good idea, so that you can identify potential candidates and decide (with professional advice) whether this strategy is appropriate. To count for this tax year, trades must be completed by December 31 — and most take three business days to settle. ■



Explore commodities with funds

Natural resources such as energy, industrial metals, and timber continue to power the Canadian stock market — putting it among the world's better-performing markets. If you hold one or more diversified Canadian equity funds, you've probably benefited to some degree.

According to Morningstar Canada's investment funds database, the average diversified Canadian equity mutual fund is 19.8% invested in energy stocks and 19.5% in "industrial materials," which include building materials and commodities. The average Canadian balanced fund has similar weightings — 20.1% and 15.8%.

Here are some key points to keep in mind as you review your investments.

Choose your fund type. To get even more exposure to this exciting sector, however, you may be thinking of adding funds that focus exclusively on resources. In that case, you can choose from two



approaches: diversified resource funds that invest in various sectors, and specialty funds that target just one area — for example, oil and gas.

Be prepared for volatility. Resources are both volatile and cyclical (see chart). Exploration and extraction are especially risky, complex activities.

Pay attention to fund management. Resource stocks are definitely an area in

which active, professional management pays off. One approach is to look for resource fund managers who have had hands-on experience as engineers or geologists. They have nuts-and-bolts field smarts in addition to the securities analysis background common among professional investment managers.

Diversify. Resource stocks tend to win big and lose big, which means it's important to find a mutual fund that holds a range of companies. You can diversify

further by holding a range of mutual funds that focus on different subsectors or companies of different sizes.

Don't forget the tax breaks. Consider, too, that exploration and extraction companies operating in Canada may get certain tax breaks, which your mutual fund will summarize in the annual statement you receive in time to file your taxes in April. Remember to claim these on your return, as they lower your cost of investing and can enhance returns.

With professional advice, you can find a resource fund or funds to complement your existing portfolio. ■



What's driving the boom?

FOUR YEARS AGO there was little interest in commodities. Most had been in the doldrums for decades, and prices for some were at their lowest levels since the 1930s' depression. Today, in contrast, the prices for oil and gas, base metals, and other raw materials are reaching new highs.

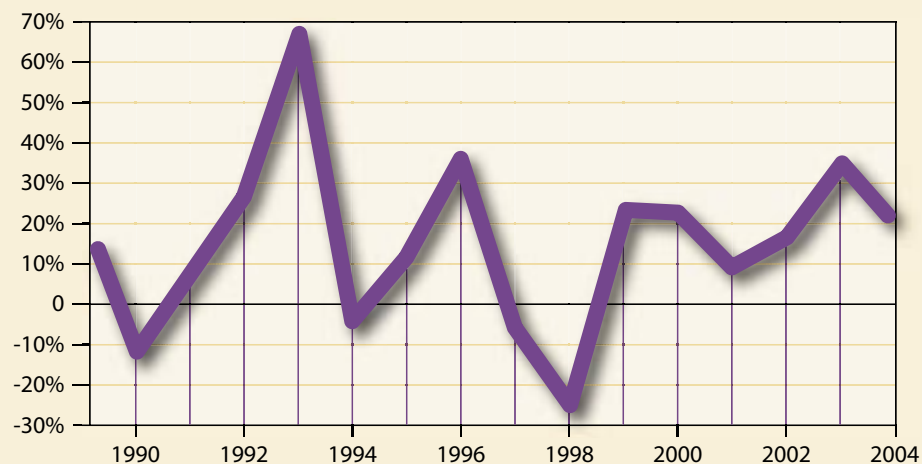
Why the change? In a word: growth. In North America, low interest rates fuelled a housing boom, driving up demand for building materials. Also, in addition to historical demand from North America, Western Europe, and Japan for commodities, China and India have emerged as powerful players.

These two countries account for more than 40% of the world's population and their economies are growing at a blistering pace. We think of them as exporters, but they are also rapidly building their own infrastructure — highways, airports, and housing. Some analysts believe that China and India will consume more base metals over the next 20 years than the U.S. and Canada did in the past 60.

This augurs well for Canadian stock markets. Resource stocks comprise about 40% of the total value of all companies listed on the Toronto Stock Exchange. ■

Commodity ups and downs

THE RESOURCE SECTOR offers high potential returns for investors who can handle the volatility. This graph shows how volatile the annual returns have been, on average, for natural resources mutual funds over the past 15 years.



Manage your credit, invest your savings

Debt is a very powerful tool, and can be helpful or harmful. Used appropriately, it can help you earn a university degree, become a homeowner, or save for a comfortable retirement. But when debt gets out of hand, it can easily grow so large that your debt load winds up dictating lifestyle, career, and retirement decisions.

Here's how to take charge of debt and use your credit wisely.

Take inventory

First, list all of your loans. Note the amount due, interest rate, prepayment penalty, if any, and whether the interest generates a tax deduction or tax credit. Then note the purpose of each loan, so that you can distinguish your "good" debts from your "bad" debts.

Good debt helps you meet your mid- and long-term goals. This would include a home mortgage, a tax-deductible investment or business loan, and a student loan that makes it possible to get a good job. It might also include financing for a big-ticket purchase, such as a car.

Bad debt typically funds short-term lifestyle spending — especially through credit cards. Consider this: By the time you pay off the loan, interest costs can add 30% to the price you paid. Think about all the purchases you've financed. Were they really worth the cost? Have they given you more freedom and flexibility, or less?

Set priorities

Now, formulate a plan for getting rid of the bad debt over time, starting with

the highest-priced loans. Aside from an emergency cushion, do you have Canada Savings Bonds (CSBs) or other low-yield deposits that are easily cashed? Debt repayment can be an excellent use of that money. If you're in the 40% tax bracket, reducing a credit card balance at 16% is akin to earning 26.7% on a fully taxed CSB or Guaranteed Investment Certificate.

If you can't clear all of these loans now, allocate a portion of each paycheque to debt reduction.

Be a smart borrower

When considering a loan, remember to focus on the rate, not the amount. For example, many Canadians are fixated on paying down their mortgages as quickly as possible, yet they also carry costly credit card debt. Remember, your home mortgage is likely to be your cheapest debt.

Indeed, a home equity line of credit can often be the best way to finance a major purchase. Suppose you're considering a new car and you have the choice of a cash-back rebate or 0% financing for two years. It might cost you less overall to tap your line of credit and use the rebate to immediately reduce the loan.

Get advice

If you're having difficulty getting a handle on your debts, professional advice can provide a valuable and objective assessment. Don't be afraid to ask for help in calculating the real, after-tax, cost of a loan, and also tips for optimizing the use of your money. ■

Don't get caught in a cross-border tax trap

CANADA-U.S. cross-border ties are very common. Many Canadians marry Americans. Many Canadian children settle in the U.S. as adults. And many Canadians spend considerable time down south.

Dealing with two tax systems, however, can sometimes give rise to complications. Here are three potential pitfalls that Canadians may unwittingly fall into:

If you marry a U.S. citizen. Many business owners protect their assets by putting everything into the spouse's name. But if the spouse is a U.S. citizen, the full value of those assets may be subject to U.S. estate tax when he or she dies.

If you freeze your estate. It's common for the owner-manager of a successful business to do an "estate freeze" as part of his or her retirement and estate planning. This defers tax on the company's future growth by shifting it to the entrepreneur's children. But the traditional Canadian estate freeze can create a substantial bill for U.S. gift tax if the owner-manager is a U.S. citizen.

If you're insured in the U.S. The third pitfall can affect Canadians with no American citizenship. Suppose you buy a whole life insurance policy in Florida or Arizona, where you own a second home. This U.S. policy does not qualify for the same tax sheltering that Canadian insurance contracts get. Ottawa requires you to report — and pay tax on — each year's growth. ■

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