MONEYSTRAT® SECURITIES INC.
January/February 2014

MONEYFILE
FINANCIAL STRATEGIES
INVESTMENTS • TAX • INSURANCE • WILLS • ESTATES

*David Brodigan*

*Geordon Ferguson*

*Margôt Adam*

*Paul Mancuso*

FOCUS ON INVESTING

# A third of Canadians are missing out on RRSP benefits

**Only 63% of Canadians contributed or planned to contribute to their Registered Retirement Saving Plans (RRSPs) in 2012, according to a survey conducted by a major Canadian financial institution. And while that's a healthy increase from the 38% who planned to contribute the year before, it still suggests that a large number of Canadians are not taking full advantage of this valuable vehicle.**

Conflicting financial priorities stemming from the weak economy, such as everyday expenditures and paying down debt, were cited as key reasons for the shortfall, and for the fact that the average contribution fell by $1,100.

## Good news

The good news is that a gradually improving economy, strong job growth, and firming equity prices may make it easier for you to refocus on your financial future this year.

RRSPs remain an excellent way to defer taxes and build up a pool of assets for retirement. Topping up contributions is especially important for baby boomers (the first of whom turned 65 in 2010), who are now increasingly under the gun to get their finances in order before they retire. The years they have remaining in which to build up their RRSPs are running out.

## Beat the deadline

If you haven't yet contributed your maximum for 2013, contact us immediately. The deadline to contribute and claim the deduction for 2013 is March 3, 2014.

In addition to topping up your RRSP for 2013, we can set up a contribution plan for 2014 and revisit your RRSP investment strategy to make sure it continues to reflect your investor profile. ■

[1] Survey conducted by market research firm Pollara on behalf of BMO, February 2012.


# Are equity funds a good inflation hedge?

**The U.S. Federal Reserve has been following an ultra-low interest rate policy since the 2008 financial crisis. Many fear that the resulting cheap credit could lead to rising prices down the road — in other words, inflation.**

Warning younger Canadian savers about inflation these days is hard, because few have witnessed its pernicious effects as price increases dilute hard-earned buying power. These effects can be significant, especially for seniors living on fixed incomes. For example, inflation of just 3% a year would cut the purchasing power of a senior's annuity payments by close to half (46%) over two decades.

## Outpacing inflation

Historically, gold has long been considered an effective inflation hedge. However, equity mutual funds may fill a similar role.

Jeremy Siegel, a professor at the Wharton School and author of *Stocks for the Long Run*, notes that the businesses that mutual funds invest in are "claims on real assets, such as land and plant and equipment, which appreciate in value as overall prices increase."[1]

Although there can be significant short-term fluctuations, Siegel says over 30-year periods "the return on stocks after inflation is virtually unaffected by the inflation rate."[1]

Picking individual equity winners in the inflation hedging game is hard, because price increases can be volatile; some industries are more vulnerable than others. Statistics Canada even keeps two measures of inflation to account for this disparity. The Consumer Price Index (CPI) targets a broad basket of goods, but the core CPI excludes food and energy prices, which tend to be more variable.

## How mutual funds can help

The upshot is that investors who want an effective inflation hedge may be better off investing in a professionally managed mutual fund, rather than trying to figure out which individual companies will outperform.

One especially effective option is to invest in an international mutual fund that has heavy allocations in countries with a history of stable money. That way, if inflation rises in Canada, you stand to be compensated, as this would cause the Canadian dollar to fall and your foreign-currency fund units would then be worth more when converted back into local funds.

Equity mutual funds offer significant advantages over bond funds in an inflationary environment, because the earnings of the companies that they invest in will rise in such an environment; however, the interest that previously issued bonds pay will not.

## Inflation risk may be rising

In late 2013, the urgency of considering possible inflation hedges increased, with the announcement that Janet Yellen will be taking over as the U.S. Federal Reserve chairman in early 2014. She is thought to place priority on job creation over keeping inflation low, which could significantly heighten inflation risks.[2]

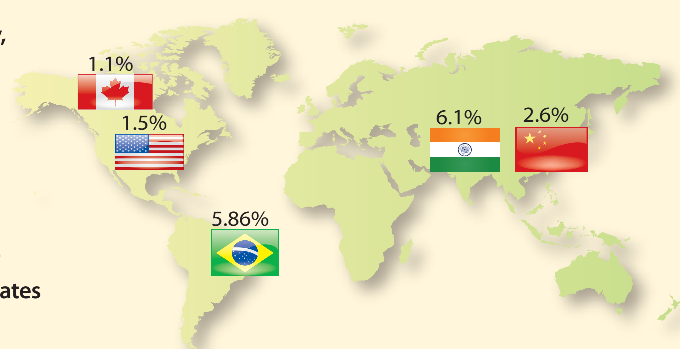
As if that were not enough, inflation pressures from China are showing signs of spreading into Western economies. Low Chinese wages have long been a key factor in keeping prices low for many of the goods that Canadians import, ranging from textiles, to toys and iPhones. However, Chinese wages have been rising[3] and the effects risk spilling over into Canada.

In short, savers need to think ahead. While phrases such as "the risk of inflation," may seem tame, they need to be taken seriously. Talk to us about how to position your portfolio to hedge against possible inflation down the road. ■

1 Jeremy Siegel, "Stocks: The best Inflation Hedge," Kiplinger.com, June 9, 2011.
2 "Janet Yellen will stick to her predecessor's expansionary policies," *The Economist*, Oct. 12, 2013.
3 "Manpower CEO Joerres Says Wage Inflation May Aid China Economy," *Bloomberg News*, Sept. 12, 2013.

## Could inflation spread here?

**In a global economy, there is a danger that inflation could spread to North America from countries where it is higher. This chart provides a snapshot of current inflation rates around the world.***




* Monthly inflation, Nov. 1, 2013. Source: WallStreetDaily.com, trading economics

**RETIREMENT PLANNING**

## Expecting significant retirement income? A TFSA may be better than an RRSP

Many Canadians face a tough choice at the start of each year, regarding whether to contribute to their Registered Retirement Savings Plan (RRSP) or Tax-Free Savings Account (TFSA). Both popular tax-planning tools have advantages. Which is better for you depends on a variety of factors. Your projected retirement income provides a good clue.

If your projected marginal tax rate will be lower after you retire than what it is now, an RRSP may be the better option. That's because the tax deductions you get when you contribute to an RRSP are likely to be larger than the tax you pay later, when you withdraw the funds.

However, some Canadians will actually have higher incomes when they retire. For example, some retiring employees have taken to "double dipping," after they leave their first careers. This involves collecting a pension but continuing to provide work as private contractors in their old fields of expertise. (A retired teacher continuing to take on substitute teaching mandates would be an example.) In such cases, their marginal tax rates when they retire could be higher than when they were working. For them, a TFSA may be a better option. ■

**EDUCATION PLANNING**

## Why you may want your kids to leave home broke

Most Canadians would shudder at the prospect of sending their kids out into the world with no financial assets. However, some kids often do worse — many are forced to leave home not just broke, but owing money as well.

The average student debt load after graduating from a four-year undergrad program now sits at around $27,000.[1] This provides a strong indication that parents are having a hard time helping their kids pay their education expenses.

Worse, those costs are rising. Canadian full-time students in undergraduate programs paid 3.3% more on average in tuition fees for the 2013/2014 academic year this fall than they did a year earlier. That follows a 4.2% increase in 2012/2013.[2]

Getting a head start on those increases is crucial. A first step should involve consulting us, to make sure you are investing enough in your kids' Registered Education Savings Plans (RESPs) or an alternative dedicated account. They will be far better off if they leave home merely broke — as opposed to in debt. ■

1 The Canadian Federation of Students.
2 Statistics Canada, *The Daily*, Sept. 12, 2013.

**EDUCATION PLANNING**

## Canadians working longer to finance kids' education

Many parents are responsible and well intentioned and, as a result, have invested significant sums in their kids' Registered Education Savings Plans (RESPs). However, according to a recent survey by a major Canadian financial institution, 60% of Canadian parents with children under the age of 25 are putting their own retirement goals on the back burner, to help pay for a child's schooling. Fully a third of parents surveyed even took on debt to help fund their kids' education.[1]

There are several reasons that parents are forced to put themselves into this uncomfortable position. These include a tough job market, rising education costs, and increasing pressures on students to take on additional studies, such as advanced degrees. However, the most important reason is that many parents wait too long before starting to put money aside.

Make sure that does not happen to you. Talk to us about balancing your savings for your children's education and your own future. ■

1 CIBC poll, conducted by Leger Marketing, June 2013.

# What to do when markets hit new highs

**Stocks have been rising in value fairly steadily since the 2008 recession. Many investors have thus been wondering whether they should take some profits.**

Those who are in it for the long haul may want to think twice. While registering gains may make you feel good, excessively trading assets is generally not the most effective investing strategy.

## The temptation to sell

Let's admit it — when investment holdings increase in value (the S&P 500 hit a record high in late 2013[1]), it's tempting to book profits. However, the short-term pleasure you get may have a downside. For one, sales of equities outside of registered plans could spark tax consequences. Any increase in the value of the securities since purchase may trigger a taxable capital gain.

Furthermore, the most effective investment strategies are longer-term in nature and rely on a proper balance between asset classes. These strategies are founded on the dictum that you can make more money through "time in the market, as opposed to market timing."

## Beware market timing

When seasoned investors sell a particular stock or mutual fund, they know they need to replace it with another or shift those assets to fixed-income investments.

Attempts to "time" the market, however, can be costly. Market timers try to sell off equities at or near market highs, move into fixed income, and then re-enter the market when equity prices have dropped, in order to profit from the next upswing.

It's generally not considered a viable strategy. History shows that upsurges in equity prices and mutual fund valuations happen suddenly. Those who shift too often risk missing out on key upwards movements.

## Few good parking spots

The other problem facing investors who want to take profits when markets hit new highs is to figure out where to "park" the proceeds. Right now, returns on major fixed-income instruments are generally unattractive, because interest rates are so low. Furthermore, the Bank of Canada has been signaling that its policy interest rate, which is currently at 1%, is likely to remain low for the foreseeable future.[2]

That does not mean you shouldn't hold any fixed-income assets — quite the contrary. Maintaining a balanced portfolio is crucial. It just means that there are few compelling reasons to shift funds from the equities portion of your portfolio right now — unless you are underweight in fixed-income holdings.

If you feel that stock valuations are getting frothy and are temped to book profits, talk things over with us. Remember, we are always available to act as your "sounding board." We can review your portfolio, calculate gains to date, explore the income tax implications of taking profits, and look at where you might reinvest gains if you do decide that it's time to sell. ■

1 CNN Money, October 17, 2013.
2 Bank of Canada press release, October 20, 2013.



# Time to rebalance Canadian and U.S. exposures?

**In recent years, the benchmark U.S. S&P 500 Equity Index has frequently outperformed the S&P/TSX.**

**For example, in 2012 and the first nine months of 2013 (to September 30, 2013), the Canadian benchmark S&P/TSX Composite Index rose 4.0% and 2.84%, respectively. Over the same periods, the S&P 500 index rose 13.41% and 17.91% (in local currency terms, excluding dividends).**

**This unequal performance between the U.S. and Canada may mean that you are over- or under-invested in one of these markets and your portfolio needs to be rebalanced.**

**Trimming U.S. equities and investing more in Canada, to account for the differing performances, is one possibility. However, doing so could have tax consequences if your holdings are in a non-registered account.**

**A better option may be to re-balance your positions gradually. Disciplined savers contribute regularly to their investment accounts on an annual, quarterly, or even monthly basis.**

**There are, of course, no hard-and-fast rules. We can provide sound guidance regarding your particular circumstances.** ■

1 Addenda charts (addenda-capital.com).

This newsletter has been written (unless otherwise indicated) and produced by Ariad Communications. MoneyFile provides information on financial planning strategies which include mutual fund investing, insurance, tax, financial and estate planning. The Moneystrat group of companies provide services in each area through the following companies: Moneystrat Securities Inc. – Mutual funds investing and financial planning, Moneystrat Financial Services Inc. – tax planning, Moneystrat Insurance Management Inc. – insurance. Vol. 27, No.5  ISSN 1205-5840