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# Financial Insight

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Every new year begins with anticipation of what the next 12 months may bring.

There's absolutely no substitute for good planning and preparation to shape what lies ahead.

What you save now for retirement can sweeten your outlook for the future, plus give you an immediate tax break for your RRSP contribution. Let's get together to make the most of these savings this year.

FOCUS ON INVESTING

# RRSP or TFSA or both? Let goals drive your strategy

**As of January 1, you can now invest $5,000 annually into a Tax-Free Savings Account (TFSA). At the same time, you may be considering how much to put into your RRSP. If you can't max out contributions to both, review your savings strategy.**

### What's the difference?

You contribute to an RRSP with pre-tax dollars, while TFSA savings come out of after-tax income. Both have annual limits and allow you to carry forward unused contribution room.

Both enjoy tax-sheltered growth, but you will be taxed on withdrawals from an RRSP. All TFSA withdrawals are tax-free — you keep every cent.

### Each has its benefits

With higher contribution limits — $21,000 in 2009 — your RRSP is ideal for retirement savings, especially if you reinvest your tax savings. RRSPs promote long-term savings because withdrawals are taxed and can't be returned to the plan, with a few exceptions that let you borrow from a plan to buy a home or go to school.

In contrast, you may take money out of a TFSA and recontribute it later, and there is no upper age limit for contributing, as with RRSPs. TFSA withdrawals don't count as income, so won't affect benefits like Old Age Security.

### Both can work together

An RRSP-TFSA split may be useful if you have pension benefits that reduce RRSP contribution room, or to save more for retirement. You might use a TFSA to save for short-term needs or emergencies. You can use both to split income with your spouse. We can review your goals to set a suitable strategy. ■

MUTUAL FUNDS

# Invest like a marathoner: save your emotions for the finish line

**An old saying holds that investing is a marathon, not a sprint. And just like marathon runners, long-term investors can experience the emotional ups and downs of running long distances — from euphoria when they're ahead to discouragement if they slip behind or stumble. Managing those feelings is the key to endurance and crossing the finish line.**

We assess the suitability of mutual funds and other investments in your portfolio based on how consistent their performance is over the long term, and how well a fund's characteristics suit your investment timeline, goals, and risk tolerance. To do this, we look for professional mutual fund managers who manage risk in many ways, such as through diversification of assets and holding true to their mandate and management style through changing market conditions.

### Keep your perspective

This past year has been a particularly challenging one for investors all over the world, given the wild swings in the markets. Financial professionals stress the importance of maintaining a long-term perspective in making investment decisions — whatever the market conditions. As the illustration below shows, markets can rebound dramatically after a period of losses, producing a respectable average compound annual return for those who stayed invested.

This suggests that performance of any one mutual fund or asset class in any one year matters far less than the performance of your entire portfolio over many years.

### Diversified portfolios gain over time

A balanced approach is used for many investment plans. For long-term investors, a goal may be to build an "all-weather" portfolio that does well when the sun shines, yet is positioned to withstand damage from the occasional storm.

Historically, such mutual fund portfolios have delivered superior returns over time. For example, the Morningstar Canada balanced global index of mutual funds — 60% in equities and 40% in fixed income — made money in 18 of the 22 years from its inception in 1985 through 2007. Annual returns ranged from a loss of 6.5% to an eye-popping gain of 43.8%. The 22-year average compound annual return was 9.4%.

### Emotions can mislead you

What's been dubbed "the cycle of market emotions" is an investor's worst enemy because it can prompt irrational behaviour to sell investments at a low point. As markets climb, the cycle starts with optimism followed by excitement, thrill, and euphoria as prices soar — prompting people to buy at the top. As markets decline, the cycle responds with anxiety, denial, fear, and panic. Near the bottom, discouragement may drive people to sell low. Eventually, as markets start to recover, the cycle begins anew, with hope and relief on the way up.

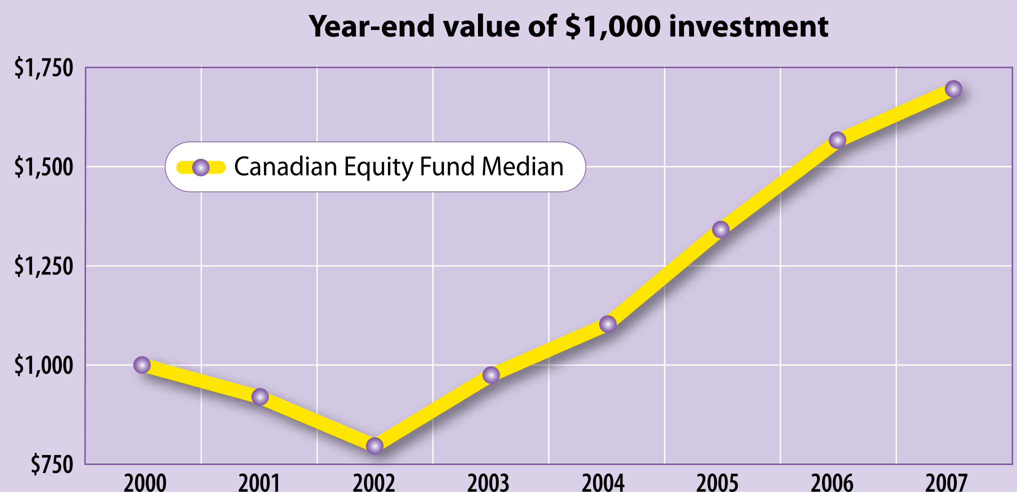
Where do you now stand in this cycle?

### Your timeline matters the most

Market fluctuations are inevitable, but you can still win in volatile markets with the right strategy and a portfolio of mutual funds or investments chosen for their long-term potential. Professional guidance can help keep your investment strategy properly aligned with your long-term goals. ■

## Winning years can overcome losing ones

**JUST BECAUSE EQUITY mutual funds or other investments decline in any given year doesn't mean they can't bounce back in value in subsequent years. In fact, successful long-term investors take advantage of the market's tendency to rebound over time. This illustrates how a $1,000 investment in 2000 would have lost nearly 25% of its value in 2001-2002, based on median returns of Canadian equity mutual funds charted by Morningstar Canada. Selling at that time would have locked in that loss, but holding on would have brought average compound annual returns of 16.3% over the next five years.**



**RETIREMENT PLANNING**

## Advice from today's retirees: start saving early!

Retired Canadians polled in a recent national survey offered important words of advice to those still working. On finances, more than half (54%) of retirees said they recommend you start saving early. Four in 10 fear they didn't save enough themselves. On the lifestyle front, almost 60% recommend you take time to really think about what you want to do as a retiree. More than half said it is important to develop a balanced life now — and not to wait until you stop work. More than six in 10 did not work with a professional to plan their retirement, while only 15% said they're completely living their retirement dream. Professional advice can be an important factor in getting what you want out of retirement. ■

**REGISTERED SAVINGS**

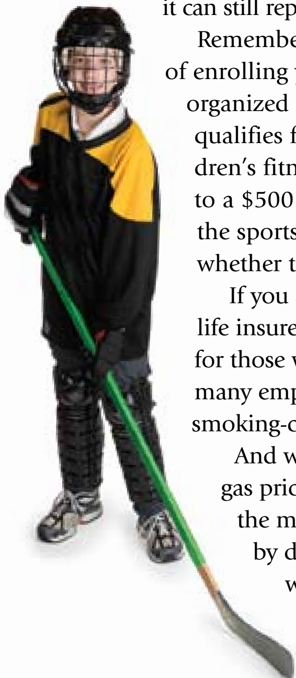
## Retirement savings get more protection

In the past, small-business owners and other entrepreneurs may have been uncertain what protection their retirement savings would have in the event of bankruptcy, and rules were inconsistent from province to province. Recent amendments to bankruptcy legislation introduced by the federal government now protects all RRSPs and RRIFs from seizure by creditors, so long as the contributions were made at least 12 months before bankruptcy. The newly implemented legislation does not apply to non-registered investment accounts. In the past, only certain investments, such as certain segregated funds and locked-in plans, were protected from creditors. ■

**MONEY AND LIFESTYLE**

## Shed your expenses while getting fit

Like many people, you may have marked the start of the year with an effort to get fit and maintain your health. Consider how this can also improve your finances. For instance, many employers subsidize fitness club memberships, yoga classes, healthy-heart programs, and similar activities. The subsidy is a taxable benefit that has to be reported, but it can still represent savings to you.



Remember, too, that the cost of enrolling your child in an organized sports activity likely qualifies for the federal children's fitness tax credit, up to a $500 maximum — ask the sports organization whether this applies.

If you smoke, consider that life insurers cut premium rates for those who give it up, while many employers subsidize smoking-cessation programs.

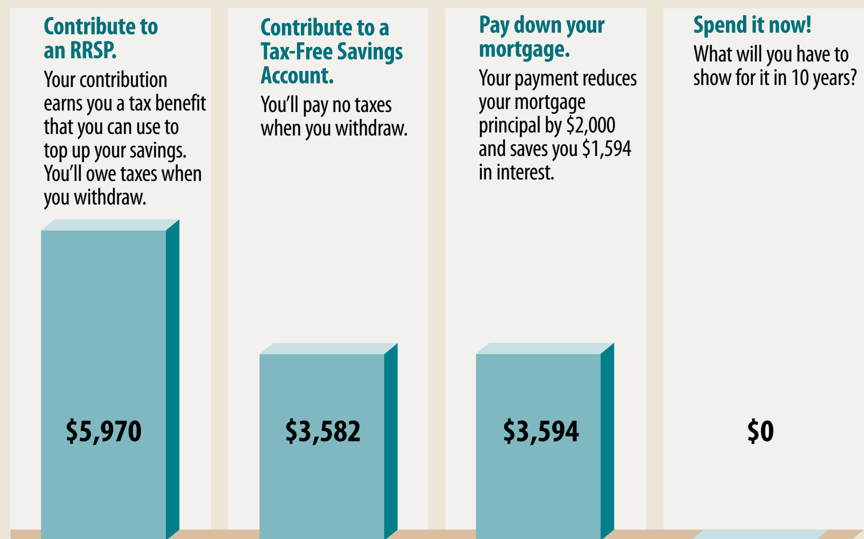
And with today's high gas prices, think of all the money you'd save by driving less and walking more. ■

**EYEOPENER**

*graphic evidence of how investing works*

## Save it, spend it, or pay off debt?

**So, what would you do if you came into some extra cash? Before you splurge, consider what you might be giving up — think of this as the "cost" of financial opportunities lost. Suppose you got a bonus of $2,000, after tax. This chart shows where you might stand after 10 years if you put that money to work instead of spending it.**




These scenarios are for illustration only. Assuming a 40% marginal tax rate, your pre-tax bonus would be $3,333 (the amount that would net you $2,000) if deposited directly into your RRSP, compounded annually at 6%; the Tax-Free Savings Account compounds at the same rate. The mortgage scenario is based on a $150,000 mortgage at 6%, amortized over 25 years, with the prepayment made in year 15.

# Take special care to pass on your registered savings

**The money in your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF) can be a big part of your overall net worth, so pay special care to what would happen to these assets in the event of your death.**

Generally, the value of an RRSP or RRIF at the date of death is included in the deceased's income tax return for the year of death. However, there are advantages to designating certain beneficiaries.

### Some beneficiaries keep tax advantage

You can save on estate taxes and roll over funds tax-efficiently to certain people:

• Your RRSP or RRIF may be rolled over into your spouse's registered plan on a tax-deferred basis.

• The proceeds can be given tax-free to financially dependent minor children or grandchildren, and used to purchase an annuity to provide them with income until age 18.

• For dependent children or grandchildren over the age of 18, whose prior year's income was below the basic exemption — $9,600 in 2008 — a gift from your RRSP or RRIF would be taxed in their hands.

• Finally, if you have a dependent child or grandchild of any age who is mentally or physically impaired, you can make a tax-free transfer into his or her RRSP/RRIF or use it to purchase an annuity.

Keep in mind, you can name anyone as a beneficiary; however, the RRSP/RRIF first gets taxed as income to your estate. You might leave it to charity so donation tax credits help offset the tax due.

### Tax savings for your estate

After your death, your tax-advantaged RRSP or RRIF beneficiary may opt to cash out your registered funds and apply them to your estate before rolling over the rest.

This is known as a "refund of premiums" and can be helpful from a tax point of view. Suppose you had substantial tax credits and deductions that offset ordinary income for the year of death. Your spouse could have part of the RRSP cashed and taxed on your final return, for the tax benefit, and roll the rest into his or her plan.

### How to name a beneficiary

You may name a beneficiary in the RRSP/RRIF documents. Alternatively, you could designate a beneficiary in your will. Don't do both. The in-plan designation is easier to change and not subject to automatic revocation by marriage or a new will. Quebec residents must indicate if a spousal beneficiary designation is revocable, and some plans require this designation to be made in a will.

### Dealing with changes

Be sure to change your designation if your marriage breaks up or the beneficiary dies.

And when converting your RRSP to a RRIF, be sure to designate a beneficiary, even if it will be the same recipient. Legally, the RRIF is a new plan.

Professional advice can help you take full advantage of tax-saving strategies and ensure your wishes will be met. ■

FINANCIAL PLANNING

# An annuity is another income option

**MANY RETIREES USE Guaranteed Investment Certificates (GICs) to produce income from savings held outside their RRSPs and RRIFs. In some cases, an investment known as a "prescribed life annuity" can be a GIC alternative that may deliver more spending money.**

### Guarantees regular payments

A prescribed life annuity holds your non-registered savings with a life insurer in exchange for lifelong monthly income to you — or to you and your spouse.

While GIC interest is fully taxed, prescribed annuity payments consist of both taxable interest and tax-free return of capital. The taxable portion is spread evenly over your lifetime payments to deliver tax-efficient cash flow.

### Some drawbacks

Prescribed annuity income cannot be indexed for inflation. And there may be no estate value to an annuity, unless you pay for coverage over a guaranteed period. This is why some people use the extra income to buy life insurance that can take the place of the original capital.

When a GIC matures, you can withdraw any cash you may need for a major expense or other purpose. That's not possible with the annuity, since you can't retrieve it as a lump sum. But the annuity guarantees a set income for life.

Professional guidance can help you find the most tax-effective way to generate income in your retirement. ■

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