Financial Planning Guide

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FOCUS ON INVESTING

Travel first class with blue chips

If you're like many Canadian investors, your portfolio includes holdings in Canadian blue chips — those large, nationally recognized, financially sound companies that have been around for generations. As a core investment, blue chips are an established way to pursue solid returns over the long term. Canada's blue-chip investment choices, however, do have their limitations. There's a particularly narrow focus on the financial services, energy, and materials sectors.

Expand your horizons

Adding U.S. and global blue chips allows you to fully diversify into other investment sectors, such as information technology, consumer staples, telecom, and healthcare. Even U.S. blue chips alone may enhance your portfolio. While giving you exposure to the U.S. marketplace, many companies also have international operations and serve the global market.

Adding global blue chips, however, does bring another dimension. Many of the world's most successful corporations are headquartered in locales such as Switzerland, Germany, Japan, Australia, and the United Kingdom.

What suits your style?

Blue chips can play a key role in any investor's portfolio. If you're a conservative investor, you might choose domestic blue chips as a lower-risk core equity holding and add U.S. and global blue chips to gain international exposure in a relatively secure way. If you're a more aggressive investor, you might use blue-chip investments to help manage volatility within a high-growth-oriented portfolio.

Talk to us if you want to explore blue chips. We'll assess your current holdings and look at new opportunities that suit your investment objectives. ■

Asset location: Sometimes it's personal

It's common to hear about asset allocation, but asset location, not so much. Yet asset location is very important — it's all about determining the most suitable investment vehicle for each mutual fund you hold.

To start, you're generally best off taking full advantage of the tax breaks the government gives you by contributing your maximum allowable amounts to your Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA). But when you have both registered and non-registered accounts, a number of factors come into play that can influence which types of investments go where.

Usually we base asset location on what's most favourable from the tax perspective, in order to maximize after-tax returns. But it's also important to take into account your personal investment objective and time horizon, which can change things.

Here are three scenarios using the exact same investment, but with three different asset location outcomes.

SCENARIO 1

Thomas and his RRSP

Thomas, 40, is building his retirement nest egg and invests $5,000 in a Canadian short-term bond fund as part of his fixed-income portfolio. He holds this investment in his RRSP. Thomas is following the tax-smart asset location guideline to hold fixed income in an RRSP and equities in a non-registered account.

In a non-registered account, interest income is taxed most heavily, at the same rate as employment income. Equities are more favourably taxed, with tax payable on 50% of capital gains, and only when realized. Canadian dividend-paying funds also receive favourable tax treatment, thanks to the dividend tax credit.

So Thomas holds more lightly taxed equity and Canadian dividend funds in his non-registered account, since he'd lose their tax advantages in his RRSP. And he keeps more heavily taxed fixed-income funds in his RRSP, where they can grow on a tax-deferred basis until withdrawal. Since Thomas is only 40, that could easily be 25 or 30 years in the future.

SCENARIO 2

Veronika and her TFSA

Veronika is saving up for a family trip to Europe. She puts $5,000 into a Canadian short-term bond fund that she holds in her TFSA. Her TFSA is ideal for this purpose — the money can grow tax-free, she can withdraw it tax-free, and she can replenish the funds starting the year after the withdrawal.

The funds you hold in a TFSA are dictated by your investment objective and, of course, your available contribution room. In Veronika's case, her low-risk choice suits saving for a trip. Low-risk funds would also be appropriate for an emergency fund.

TFSAs aren't just for short-term goals, however. In fact, when the goal is long term, it suits many investors to choose funds with the highest potential returns for their TFSA. The higher the returns, the greater the tax would have been if earned outside a TFSA.

SCENARIO 3

Amir and his non-registered account

Amir is four years away from retirement. He makes a large fixed-income investment in his non-registered account, including $5,000 in a Canadian short-term bond fund. It's part of a plan Amir and his advisor put together to protect against the risk of a market downturn in these critical upcoming years. He invests in short-term bonds because they had positive returns during the 2008 market crisis, though he recognizes that past performance may not indicate future results.

The overall plan revolves around funding the initial years of Amir's retirement. He's going to begin drawing retirement income from his non-registered account, so that's where he is now placing this lower-risk investment.

Locating your mutual funds are especially helpful in managing asset location. Investments can be assigned to an RRSP, TFSA, or non-registered account with only a few decisions. In addition, fund companies provide tax slips identifying distributions by type of income, which helps in making tax-related asset location decisions.

We're here to help ensure your funds are in the vehicles that meet your personal investment objectives while taking advantage of potential tax benefits. ■

INVESTING STRATEGY

Tax refund? Oh, the choices

Expecting a tax refund? If you apply it strategically, you can stretch that money — even triggering tax deductions, savings, and grants. Here are six ways to make the most of your money.

1. Pay down debt

Use your refund to pay down debt on a credit card, and you'll effectively gain an after-tax rate of return equal to the interest rate. At a 20% interest rate, that's a 20% return.

2. Contribute to your RRSP

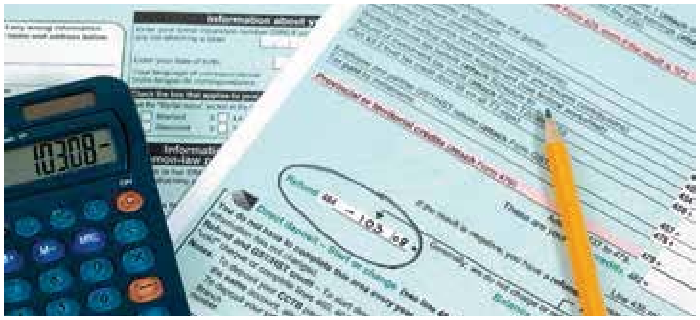
Turn your refund into a tax deduction by applying it to your 2015 Registered Retirement Savings Plan (RRSP) contribution (presuming you have sufficient contribution room available). At a marginal tax rate of 35%, a $2,000 RRSP contribution results in a $700 tax benefit.

3. Contribute to an RESP

If you have children, you may be using a Registered Education Savings Plan (RESP) to set money aside for their future post-secondary education. Depositing your refund may enable you to get "free money" from the federal government, in the form of the Canada Education Savings Grant (CESG). The CESG adds 20% to the first $2,500 contributed to an RESP annually.

4. Contribute to your TFSA

Contribute your income tax refund to your Tax-Free Savings Account (TFSA) and it will grow tax-free. A one-time contribution of $2,000 earning 5% compounded annually will generate more than $550 in five years.



5. Add to your non-registered investment account

Invest in equities and Canadian dividend securities in a non-registered account, and the investment income generated will be more favourably taxed than interest income.

6. Make a charitable donation

When you donate your tax refund to charity, not only will you be doing a good deed, but you'll qualify for a charitable donation tax credit. The federal credit is 15% on the first $200 donated and 29% on contributions above $200. In addition, if you haven't claimed the credit in the past five years, you may be eligible for the First-Time Donor's Super Credit, for an additional 25% on the first $1,000 donated.

Want to talk over your available choices? We can help you turn your tax refund into a long-term gain. ■

Source: Canada Revenue Agency (Cra.gc.ca)

TAX PLANNING

Sometimes, splitting with your spouse is a good thing

The new Family Tax Cut has put income-splitting in the news. Available for 2014 tax filing, the Family Tax Cut provides a non-refundable tax credit of up to $2,000 for eligible couples with minor children based on the net reduction of federal tax that would be realized if up to $50,000 of the higher-earning spouse's taxable income was transferred to the lower-income spouse.

But there are also some not-so-new income-splitting strategies that might enable you and your spouse to save tax.

Tax-smart investing. A lower-income spouse who contributes to family expenses often has little or no money left to invest. But if the higher-income spouse pays all the bills and household expenses, it may free up the earning of the lower-income spouse for investing. In a non-registered account, the resulting investment income will be taxed at the lower-income spouse's lower rate.

Spousal loans. The higher-income spouse can lend money to the lower-income spouse to invest. As in the previous strategy, the resulting investment income will be more favourably taxed. Note that the loan must charge interest at a rate that is at least equivalent to the

government's prescribed rate, which is currently just 1%. The interest must be paid no later than 30 days after the end of the year and reported as income by the spouse who made the loan.

TFSA times two. The higher-income spouse can contribute to his or her own Tax-Free Savings Account (TFSA) and give his or her spouse the funds to contribute to a TFSA as well, resulting in more money in a tax-sheltered environment.

Spousal RRSP. If you and your spouse will be in different tax brackets during retirement, you can open a spousal Registered Retirement Savings Plan (RRSP) now for a tax advantage in retirement. Pension-income-splitting allows you to split up to 50% of eligible pension income, but with a spousal RRSP you can split more than 50% of retirement income.

Remember that tax strategies can be complex, so before implementing any of the above, we recommend that you consult with your professional tax advisor. ■

INVESTMENT PLANNING

Take diversification to the next level

When we speak of diversification, it usually refers to holding all three main asset classes: cash, fixed income, and equities. But diversifying within each category is equally important. In this article, we're going to talk about diversifying fixed-income investments.

Different fixed income categories will lead the market year to year. For example, over the past five years, the average annual rate of return for Canadian short-term bonds was while the rate of return for U.S. high-yield bonds was 10.69%.[2]

By diversifying, you'll be more likely to hold the current leaders. At the same time, outperforming bond categories can offset poor performance of other bond types, decreasing risk and smoothing returns.

Many ways to diversify

Effective diversification involves choosing investments with different characteristics. Here's a look at the main categories of fixed-income securities and what distinguishes each.

Domestic government bonds: *High security; lower income.* Government of Canada and provincial bonds are recognized as the safest type, with principal and interest payments backed by the government.

Corporate bonds: *Slightly lower security, slightly higher income.* These bonds offer higher yields than government bonds because they're not backed by the government but corporate bonds labelled "investment grade" by ratings agencies are generally considered to be low risk.

High-yield bonds: *Higher potential income, less security.* Issued by corporations, these bonds are rated below investment grade. Since there is a greater risk of default they offer higher yields.

Floating-rate bonds: *Protection from interest-rate fluctuations.* Most bonds have fixed interest rates, but with floating-rate bonds, the rate floats up or down in tandem with market rates, offering protection from rising rates.

Global bonds: *Geographic diversification.* Global bond performance is affected by rising or falling interest rates, inflation, market conditions, the business cycle, and political climate — all factors that vary across regions and countries. Diversifying across countries can enhance potential returns and reduce overall risk.

Emerging-market bonds: *Highest potential income, higher risk.* Emerging markets include nations in Africa, Eastern Europe, Latin America, the Middle East, and Asia. With economies developing and not always stable, emerging market bond yields are typically higher than those of other global bonds, reflecting higher risk.

Finding the mix that's right for you

Each investor achieves fixed income diversification differently. Whether you are looking for an all-in-one investment or to combine individual securities, we can help you explore the opportunities. ■

1 Based on FTSE TMX Canada Short Term Bond Index, five-year period ending December 31, 2014
2 Based on Barclays Capital U.S. High Yield Very Liquid Index CAD Hedged, five-year period ending December 31, 2014

INVESTING STRATEGY

Key guidelines on 'when to fold 'em'

Just like breaking up is hard to do, so is deciding to part ways with a security from your portfolio. Here are some guidelines on when you may want to initiate the "sell" conversation with us.

1. When the investment is under-performing. Any investment can have its ups and downs, so underperformance must be evaluated very carefully. In fact, a fundamentally sound investment that's lost value can represent a buying opportunity. However, if performance has lagged well behind that of similar investments over an extended period, it may be time to cut your losses and end the relationship.

2. To take profits. Selling an investment that's posted solid gains can be a good way to lock in gains and rebalance your portfolio.

3. When the investment has changed. Over time, an investment can change in numerous ways. Perhaps the company or mutual fund is under new management, or maybe the sector has lost favour or competitors are eating into market share. Change doesn't necessarily mean sell, but the question should be asked: Would you invest in this security today?

4. When your objectives change. Any change in your life circumstances is cause for a portfolio review. If you're approaching retirement, for example, it may be time to sell off higher-risk securities and invest in lower-risk holdings. But any life change, such as going through a divorce or receiving an inheritance, may call for a change in asset allocation.

Wondering whether you should sell? We're always here to evaluate an investment or help with the financial side of a life situation. ■

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