THE NEWSLETTER OF
MONEY MANAGEMENT AND
FINANCIAL PLANNING IDEAS

Planning Ahead

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May/June 2015

With summer only weeks away, it's tempting to forget about financial matters and look forward to sunny and warm days and a vacation.

But before the summer days set it, we invite you to get in touch with us for a review of your portfolio, particularly if there have been any changes in your circumstances. It makes sense to ensure everything is in order now so you can kick back and enjoy the summer season.

Also, if you received a tax refund this year, consider how you can put it to use wisely — perhaps by adding it to your RRSP or TFSA, or paying down debt. We can help you find the most appropriate solution.

FOCUS ON RETIREMENT

Retirement planning… or re-planning?

In spite of our best efforts, sometimes life just doesn't follow the expected path. A company reorganizes and an employee who's five years from retirement is now searching for a job. Or a spouse develops a serious medical condition that leads to reduced income before retirement.

Challenges like these have financial consequences that may mean you need to adjust your retirement plans.

Sometimes it's good news

Changes can also come from good news, such as you or your spouse receiving an inheritance.

And not all changes are financial. For example, you may simply change your mind about how you'd like to spend your retirement — from expensive ideas like buying vacation property to more economical ones like settling close to your grandchildren.

You always have choices

If your finances are unexpectedly stretched, you have several options you may want to explore. For example, you might choose to delay your retirement date to accumulate more savings or work part-time before retiring completely.

On the other hand, you might stay with your current target date but modify your planned retirement lifestyle so your savings will go further. If you have enough time between now and retirement, you could save more each year and aim to keep your retirement plans intact.

If re-planning is due to an improved financial situation, you may be able to retire sooner, enrich your retirement lifestyle, or leave a larger legacy for your children.

Whatever changes your retirement plans may require, remember that we're here to help you. ■

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

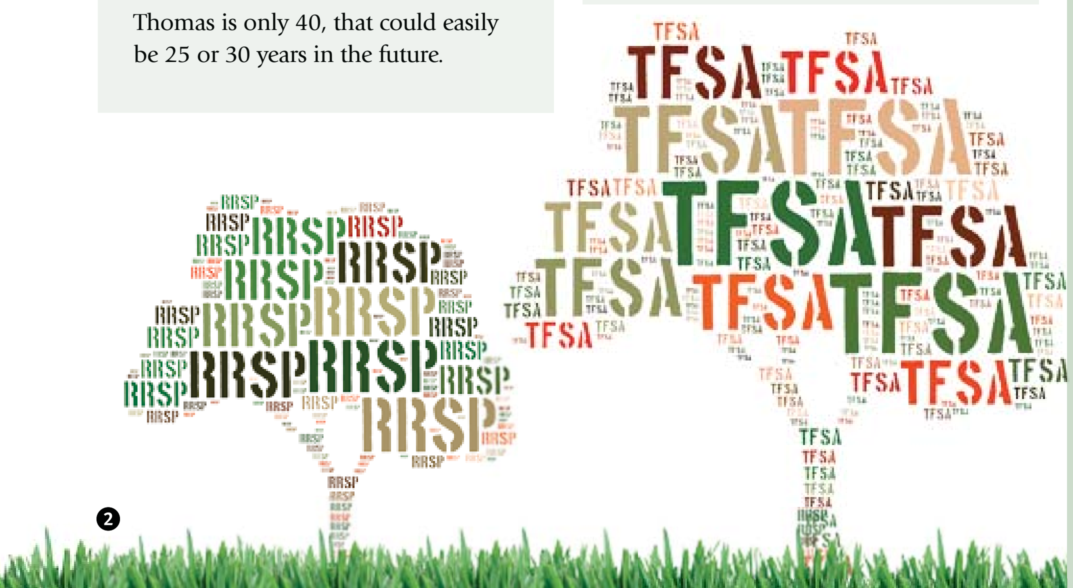
Amir and his non-registered account

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

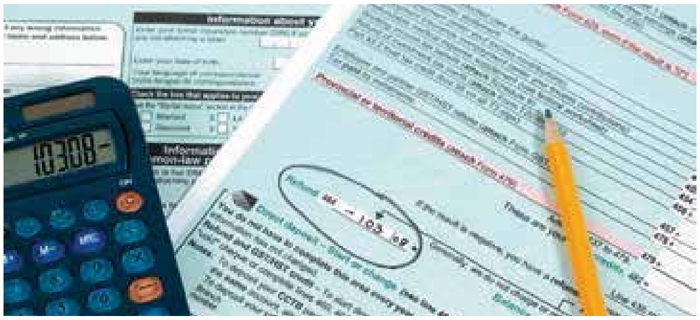
Turn your refund into a tax deduction by applying it to your 2015 Registered Retirement Savings Plan (RRSP) contribution (presuming you have sufficient contribution room available). At a marginal tax rate of 35%, a $2,000 RRSP contribution results in a $700 tax benefit.

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. ■

Keeping your retirement savings in buckets

A key challenge facing retirees and pre-retirees is where to put savings. One strategy you might want to consider is the "bucket approach."

Don't worry — we're not suggesting you pick up some buckets at the hardware store and stash your cash! There's a lot more to it.

The bucket approach addresses a fundamental retirement-saving challenge: If you focus on safe, fixed-income investments, you may have insufficient cash flow to fund all the years of your retirement. But if you go for growth, you may spend your retirement worrying about the markets. That worry could turn into reality if the stock market tumbles.

The bucket approach

To address these challenges, the bucket approach divides your savings into three investment buckets. The first bucket holds safe and secure investments for the short term, the second bucket contains moderate income and growth investments for the medium term, and the third holds growth-oriented equities for the long term.

You draw retirement income from bucket one. Moderate-income-and-growth bucket two replenishes bucket one, and equities-bucket three replenishes bucket two. This flow toward safety makes your portfolio more conservative over time.

With the bucket approach, your retirement lifestyle expenses are covered by low-interest, fixed-income investments. At the same time, equities and higher-yielding bonds in buckets two and three add income and growth to support your lifestyle and help ensure you don't outlive your savings.

What about stock market volatility? No worries there, either. Any underperformance primarily affects only bucket three, which can be given time to recover while the other buckets generate income. With near-term income always covered, the bucket approach lets you invest in equities with peace of mind.

Meeting your unique needs

The bucket method can be customized to suit any risk tolerance, lifestyle choices, nest egg amount, estate planning goals, and personal preferences. One retiree might hold enough savings in bucket one for two years of income, while another may choose four or five years. You might keep bucket one simple, with GICs and money market funds, or add short-term bonds and a life annuity.

Bucket two typically holds higher-yielding but fairly conservative fixed-income investments, like corporate bonds. But more aggressive investors might include global bonds or blue-chip, dividend-paying equities. The same holds true for bucket three — we can choose equities that suit your unique objectives and risk tolerance.

We can also tailor the way buckets one and two are replenished. Steady is best for some people, replenishing buckets on a regular basis, like annually. For others, timing can be based on performance — if equity bucket three makes a run of solid gains, take the profit and add to bucket two.

If the bucket approach sounds like a good idea for you, give us a call to learn more. ■

Creating a tax-smart inheritance

There may come a time, either approaching or during retirement, when you have a certain amount of savings earmarked for your heirs. Ordinarily, these would pass through your will to your intended beneficiaries. But there may be a better way.

When these funds are fixed-income investments in a non-registered account, interest income is fully taxable each year at your marginal tax rate. With a few simple steps, you can move these funds into a tax-sheltered environment, resulting in a larger inheritance for your loved ones.

How it works

The vehicle is a universal life insurance policy, which includes both an insurance and investment component. You make a series of deposits over time, with part of the deposit covering the insurance premium and the rest invested.

You have a wide choice of investments, including fixed-income and guaranteed choices suitable for the inheritance. No tax is paid on investment income within the policy — that's the key benefit of this strategy.

The net result

With this strategy, your heirs receive the proceeds of the insurance policy directly, without delays of estate administration. This includes the balance in the tax-exempt investment component as well as the life insurance portion — so if you purchased a $500,000 policy, that's $500,000 for your loved ones. All proceeds are tax-free. Sound like something that might suit your estate planning needs? Then give us a call to talk about this tax-saving inheritance strategy. ■

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