Insights

SUMMER 2011 STRATEGIES FOR YOUR FINANCIAL SUCCESS

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Dividends can cushion your portfolio in volatile markets

High-quality, dividend-paying equities can moderate the effects of market volatility on your portfolio in uncertain times.

Investing in dividend-paying companies means that, for the most part, you are choosing high-quality investments. That's because dividends are a portion of profits, so a company must be conservatively managed to consistently turn a profit and ensure regular payouts.

In addition, dividend stocks are often found in sectors of the market — such as financials, consumer staples, health care, and utilities — where revenue generation is consistent even during unsettled economic conditions.

Dividends themselves act as a cushion because they generate income even in a market downturn. Also, dividend stocks tend to hold their value better in down markets, largely because their payouts make them less likely to be sold.

Dividend investments meet a variety of needs and goals. They can be useful for investors who are:

Seeking stability. When markets are uncertain, dividend investments suit investors who wish to give their portfolios increased stability.

Approaching retirement. Individuals investing more conservatively before retirement, but who still want growth investments, can participate in equity markets with reduced risk. ScotiaMcLeod's Portfolio Advisory Group rates dividend-paying equities as medium risk because equities do place your principal investment at risk.

Looking for tax-efficiency. In nonregistered accounts, eligible dividend income is taxed more favourably than interest income.

Generating retirement income. During retirement, dividend investments may provide higher after-tax yield than fixed-income investments.

Please contact us if you are interested in adding or introducing dividend investments to your portfolio. ■

During summer, you might find you have a little extra spare time which is ideal to get financial affairs in order.

Some points to think about include making the most of your retirement savings, paying down debt, protecting your family with enough insurance coverage, and investing strategically.

We can help you with all of these matters, and more. Please call us today so we can meet to review your financial strategy — and you can get back to enjoying the summer.

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Are ETFs right for your portfolio?

The world's first exchange-traded fund (ETF) was created in Canada in 1990, when the Toronto Stock Exchange produced the Toronto Index Participation Fund. Today, the TSX lists more than 160 ETFs, and they continue to gain in popularity among some investors. From December 2008 until the end of February 2011, assets in Canadian ETFs more than doubled, with total assets under management surpassing $41 billion.

One of the reasons for this significant increase in popularity is that ETFs allow investors to diversify their investments into areas of the market to which they otherwise would have limited or no access.

What are ETFs?

ETFs provide investors with participation in the returns of a commodity or an index of stocks. They are similar to mutual funds in that they hold a basket of investments. However, unlike mutual funds, they trade on an exchange and do not rely on an individual manager to provide investment returns. Instead, returns are correlated to the performance of the index or commodity.

Investors can choose among ETFs that cover domestic and international

equity markets, fixed-income indices, and indices offering exposure to specific sectors, as well as commodity ETFs, which invest in commodity futures markets (see table below). You can, for example, hold one ETF that tracks the S&P/TSX 60 Index, one that tracks the price of silver, and another that enables you to invest in health care.

Are they cheaper than mutual funds?

Cost is often cited as a benefit of investing in ETFs; however, this is not always cut and dried. Actively managed mutual funds have a portfolio manager that selects which securities to purchase and sell on an ongoing basis. Traditional ETFs are passive investments — they track an index, commodity, or other underlying securities without the need of an individual manager. These tend to have lower operating costs, which means that the management expense ratios (MERs) for ETFs are generally lower than those of mutual funds. However, unlike mutual funds, ETFs have additional costs in terms of commissions and exchange fees. Also, lack of liquidity for some ETFs may result in large bid/ask spreads.

Overall, which investment vehicle has lower costs? It depends on the actual investment and the way you invest. Some index mutual funds, for example, have lower MERs than actively managed ETFs. In some cases, the difference may be negligible or non-existent.

Increase portfolio diversification

As previously mentioned, individuals can use ETFs to diversify their investments into areas of the market that are either very difficult or impossible to access, based on amount of investment or availability — for example, shares listed on the exchanges of emerging market economies such as India or China. ETFs can also be useful for more proactive tactical investing, where investors may choose a specific sector or commodity — such as gold, oil, or cotton — representing favourable value or growth potential.

Many investors who choose ETFs use them to complement mutual fund holdings as part of a diversified portfolio that may also include individual stocks and bonds. Mutual funds and ETFs each have unique features and benefits. Mutual funds, for example, offer more choice in actively managed funds, and their lack of transaction costs when buying or selling can be attractive to investors making frequent contributions to retirement savings.

If you are wondering whether you should include ETFs in your Registered Retirement Savings Plan (RRSP) or non-registered account, talk to us. We can help you determine if ETFs suit your personal investment style and goals. ■

ETFs cover a wide range of investments

ETFs can be useful as core holdings that track major indices or as satellite positions for niche investments in a portfolio.

Investment Style	Asset Class	Commodities	Region
Value	Canadian equity	Natural gas	Canada
Growth	U.S. equity	Oil	U.S.
Core	Global equity	Gold	Europe
Passive or active	Dividend	Silver	Asia/Pacific
Leveraged or inverse	Preferred shares	Base metals	Japan
Bullish or bearish	Currencies	Grains	Brazil
	Fixed income	Agriculture	Russia
Capitalization		Diversified	India
Large cap			China
Mid cap			Emerging markets
Small cap			Global choices

5 ways to split income with your spouse — and pay less tax

Diverting income to a lower-income spouse can effectively reduce a couple's combined tax bill. However, it's important to be aware of the "attribution rules" contained in the Income Tax Act. These rules deny certain types of income-splitting techniques. For example, if you transfer property to your spouse, any income from the property will be attributed back to you, the transferring spouse, and must be reported on your tax return. However, there are perfectly legitimate ways to split income with your spouse without attracting attribution. Perhaps one or more ways may apply to your situation.

1 Pension income splitting

When you are 65 or over, you can split up to one-half of eligible pension income with your lower-income spouse. Eligible income includes payments from a:

- Registered Retirement Income Fund (RRIF);
- Life Income Fund (LIF) or Locked-in Retirement Income Fund (LRIF);
- Registered pension plan; or
- Lifetime annuity.

When you are under 65, only lifetime annuity payments from a registered pension plan are eligible for income splitting.

2 Spousal RRSPs

The above pension income-splitting rules were introduced in 2007, causing many Canadians to wonder whether spousal Registered Retirement Savings Plans (RRSPs) were worth keeping or starting. In fact, there are still situations where spousal RRSPs are beneficial.

For example, if you retire before 65, you can still split income using a spousal RRSP, as withdrawals can be made at any time. Just be aware of the three-year attribution rule. If your spouse makes a withdrawal from the spousal RRSP within three calendar years of your last contribution, the withdrawal is treated as income on your tax return.

Also, if you wish to split more than the one-half of pension income allowed under pension income-splitting rules, a spousal RRSP gives you that opportunity.

3 Spousal loans

In this strategy, the higher-income spouse lends an amount to the lower-income spouse to invest in a non-registered account. The government sets a prescribed rate for such loans, which is currently 1% — the lowest rate it has ever been. Tax on investment income is paid at the marginal rate of the lower-income spouse.

Just be sure that interest on the loan is paid within 30 days after each year end, or the arrangement will be considered invalid. Also, before implementing this strategy, it's prudent to seek independent family law advice.

4 Lower-income spouse invests

This strategy results in the couple's investment income being taxed at the marginal rate of the lower-income spouse. All that's required is for both spouses to be earning income, and for each spouse to have a separate bank account.

Quite simply, the higher-income spouse pays the household bills and expenses, enabling the lower-income spouse to invest his or her own funds in a non-registered account.

5 Spouse as employee

If you are a business owner or self-employed, you can reduce your taxation by hiring your spouse. The job must be legitimate and you must pay a reasonable salary. You are paying your spouse with taxable income, but it is now in the form of salary that will be taxed at your spouse's lower marginal rate. Also, since salary is a deductible business expense, you reduce the income tax your business pays.

Please contact us and seek professional tax advice if you think you may benefit from any of these income-splitting strategies. ■

Incorporating your personal values into your investment decisions

As a consumer, you may not wish to purchase a pair of shoes made by child labour or a weed killer that may contain potential toxins. That same sentiment can apply to your investments.

Socially responsible investing (SRI) is a growing trend. According to Canada's Social Investment Organization, there is more than $609 billion in SRI assets in Canada, including retail and institutional investments.

What qualifies as SRI?

Socially responsible investing is the use of social, environmental, and governance considerations in the selection of companies in which to invest.

Core strategies for SRI focus on positive and negative screening — choosing companies that make positive contributions to society or the environment and excluding companies whose products or practices have a negative social or environmental impact. Assessing a company's performance is commonly based on these areas:

- Product safety and quality;
- Human rights record, labour relations, and respect for workforce diversity;
- Corporate governance and codes of conduct;
- Community involvement and charitable contributions; and
- Environmental practices and reporting.

Investment performance

Academic studies in Canada and worldwide have compared the performance of socially responsible investments with conventional investments. Usually the findings show little or no difference over the long term, a result verified by comparing indices.

For example, the Jantzi Social Index is modelled on the S&P/TSX 60, but selects 60 Canadian companies according to environmental, social, and governance criteria. Since its inception on January 1, 2000, through March 31, 2011, the Jantzi Social Index has an annualized return of 6.78%, while the S&P/TSX 60 returned 6.67%.

Where to invest

In 1986, there was one SRI fund in all of Canada. Today, investors who wish to include socially responsible investments in their portfolios can select from 94 retail mutual funds and retail venture funds, a variety of segregated funds, and an exchange-traded fund. SRI funds cover all major asset classes and include balanced funds, global or international equity funds, and an index fund.

Of course, you can also invest in individual stocks. Many public companies publish an annual Corporate Social Responsibility Report, which you can use to assess their environmental and social performance. ■

4 reasons your child should file a tax return

Do you have a child who has a summer job this year or who will be working part-time during the school year?

Even if your child doesn't earn enough income to pay income tax, there are still benefits to filing a tax return — so you may want to let your child know about the following reasons.

1. Tax refund

If income tax is withheld from your child's paycheque, let your child know that he or she can file a return to get a refund of the deducted amount.

2. RRSP contribution room

By filing a tax return now, your child will build RRSP contribution room that can be used in the future. Also, by filing a return your child will receive a notice of assessment showing TFSA contribution room, provided he or she is over 18.

3. GST/HST credit

If your child is over 18, he or she can file a tax return to qualify for the GST/HST credit. Students may qualify for this quarterly payment even if they have no income to report.

4. Tax credits

By filing a return, your child can carry forward the unused portion of tuition fees, education, and textbook amounts for tax credits to be used the following year. Or the amounts can be transferred to an eligible family member — including you — to claim on his or her tax return. ■