Money Ideas

Fall 2018

Jean Pagé
Wealth Consultant
Credential Asset Management Inc.
Email: jpage@frontlinecu.com

Lynn Rowsell
Mutual Funds Investment Specialist
Credential Asset Management Inc.
Email: lrowsell@frontlinecu.com

Frontline Credit Union
Credential Asset Management
365 Richmond Rd.
Ottawa, ON K2A 0E7

Telephone: (613) 729-4312
Fax: (613) 729-5075

In the autumn, life seems to speed up as work and family life get busy again. All these plans may remind you of some financial goals as well. Maybe it's investing for the kids' education, a family cottage or an enjoyable retirement. Whatever your goals, we are here to help.

Credential Asset Management

▶ MUTUAL FUND ISSUES

Should all the talk on trade affect your investing?

Trade, tariffs and treaties have dominated the financial news this year – and much of the political news too. Trade disputes between the U.S. and China, the Brexit negotiations between the U.K. and the E.U., and the NAFTA treaty talks all form part of this trend. But should investors be worried about what it means for them and their funds?

Investor sentiment. Sentiment is one of the quickest ways that economic and political changes can affect the markets and asset prices. Uncertainty or pessimism amongst investors can lead them to exit the market, move to "safer" or more defensive asset classes or, move away from a sector or industry that concerns them.

While trade concerns have depressed investor sentiment this year, it's important to note that investor sentiment can be fickle and turn quickly – it is the short-term noise that is best tuned out of a long-term investing view.

Investment plans. When uncertainty is present, many companies may hold off on investing in expansions, new capabilities, or facilities until the future is clearer. This has been widely reported in the U.K., where many firms have indicated that plans have been put on hold until they know the shape of post-Brexit trade agreements.

Structural changes. Changes to the terms of trade between countries and trading blocs can lead to changes in the amount and patterns of economic activity in those areas. The supply chains of some industries may be reconfigured. Some sectors may prosper under new rules; others may struggle.

Structural changes can take years, even decades, to become clear. Investors should be careful about making rash investment decisions based on these long-term, unpredictable changes.

Mutual fund investors should keep in mind that the professional money managers of the funds are watching developments and taking into account the trends that may affect the investments they manage.

A disciplined investment plan, based on your goals and your time horizon, remains the best guide to good investment decision making. Let's talk if you feel that it's time to review your situation. ◀

TIMELINES

As the year winds down, these deadlines approach

The final months of the year contain some important deadlines for mutual fund investors. Here are some things to consider:

Tax-loss selling. You have until late December to sell a fund (or any security) that settles in 2018 – December 15 is the expected last buy or sell date for Canadian securities to settle in calendar year 2018, based on trade date plus two business days.

However, it is recommended to review your non-registered mutual fund portfolio earlier to consider the sale of an investment with accrued losses before the end of the year to offset capital gains realized in the year, or in the three previous taxation years if net capital loss was created in the current year.

RRSP conversion. If you turned or are turning 71 this year, December 27 is the deadline for collapsing your Registered Retirement Savings Plan (RRSP). However, planning for this important financial change should be done well in advance of the December deadline. While many of your mutual funds may continue to serve you well after the conversion, a portfolio review is a good idea.

TFSA withdrawal. Strictly speaking this is not a deadline, but if you're planning a withdrawal from your Tax-Free Savings Account (TFSA), consider making the withdrawal by December 31 instead of waiting until the new year. That way, the amount withdrawn in 2018 will be added back to your available TFSA contribution room on January 1, 2019. Keep in mind, as mentioned above, that if you are selling fund units, you will need to allow time for the trade to settle.

Let's talk about any changes you need to make to your mutual fund portfolio and your finances before year end. ◀

FUND STRATEGIES

Dividend-paying investments may be worth another look

Investing for dividends has appeal for lots of different kinds of investors. Income investors appreciate the predictable flow of income. Conservative investors view dividends as a proxy for well-run, high-quality companies. Hard-nosed investors believe that the imposed discipline of dividend payouts makes for efficient use of capital.

Is a mutual fund that focuses on dividends an appropriate investment for you? Let's take a closer look.

What are dividends? Dividends are a distribution of a company's earnings to shareholders and are usually accrued in one of two forms – cash or stock. Each organization's board of directors determines the actual dividend amount that the firm will pay out. Most cash dividends are paid on a quarterly basis. Meanwhile, stock dividends are generally paid at infrequent intervals.

Solid companies. Companies that pay dividends must have actual earnings and cash flows to fund these cash distributions to shareholders.
A company that pays a dividend has less retained earnings to fund organic or inorganic growth opportunities. This means that the company's management team must be selective with its financial decisions, leading - in theory - to better decisions over the long run.

A long history of steadily rising dividend payments indicates that a company's management is shareholder-friendly.

Dependability. Dividends from strong, established companies can provide steady income. Although quarterly dividend payouts by the fund's holdings are not guaranteed, dividend-paying mutual funds are a good option for a steady income stream.

Tax considerations. You have the potential to pay less tax on your earnings. Outside of registered plans, Canadian dividends qualify for the dividend tax credit. As a result, dividend income is taxed at a lower rate than interest income.

Downside protection. If you're concerned about volatility in the stock market, dividend funds could provide some protection. The dividend softens the effect of any decline in the price of the underlying stocks.

Income or growth? To select the dividend fund that's right for you, we need to start by reviewing your goal for the investment. Is it primarily to provide income? Are you looking for additional growth? Perhaps you need more diversification?

Watch fund names. It's important not just to rely on the fund's name. Many investors are surprised to learn that dividend funds can vary widely in both equity content and risk profile. Indeed, many of these funds are not structured solely to produce income, but rather to focus on growth.

To further complicate things, there are plenty of dividend-style funds out there, holding lots of dividend-producing stocks, but without the word "dividend" in their names.

As with all investment decisions, your specific objectives will help us pinpoint the dividend fund that best suits your objectives. If you'd like to understand how dividend investing is aligned with your goals and explore the opportunities, let's talk. ◀

Canadians staying put after retiring, says poll

We've all heard the friend or colleague bemoaning their lack of retirement savings saying, "My home is my RRSP [Registered Retirement Savings Plan]." A new poll indicates that, for most Canadians actually facing retirement, that's just not true.

The poll by Ipsos, released in July 2018, found that 93% of Canadians aged 65 and over feel it's important to stay in their current home.

According to these homeowners, staying at home during retirement is about maintaining a sense of independence during their retirement years.

Fifty-one per cent say they want to stay close to family, friends or their community, while 40% say emotional attachments and memories mean it's important to remain in their current home.

In contrast, it seems the further you are from actually retiring, the more likely you are to imagine moving out upon doing so. Just 68% of those aged 35 to 44 felt the need to stay in their pre-retirement home.

The poll points to the folly of expecting your home's value to provide for you in retirement. A well-planned mutual fund portfolio as part of your retirement savings plan is one of the best ways to ensure you'll have choices about your home when retirement becomes a reality. ◀

Source: ***Ipsos poll for HomeEquity Bank,*** released July 16, 2018.

For the millennial generation, a little knowledge may be a dangerous thing

Despite the less-than-flattering stereotypes, millennials have a lot going for them: they are the most educated and skilled generation in Canadian history. That should set them up for career and life success.

But there's one area where they don't excel, and that may hold them back. They lack sufficient financial knowledge.

According to a PwC study, 24% of millennials have basic financial literacy, and only 8% have high financial literacy.

Why does it matter? According to a BMO report on millennials and financial literacy, this lack of financial savvy means they risk missing opportunities to make the most of the money they have or will earn.

For instance, they may choose the wrong savings vehicles for their goals, miss out on tax-savings strategies or not understand the importance of diversification in their overall portfolio.

But they have made a start. The BMO report notes that 72% of millennials are saving for a financial goal.

And before the rest of us get too smug, it's worth noting that last year, the Financial Consumer Agency of Canada (FCAC) found that many Canadians still don't understand some basic financial facts.

Seems the need for sound financial advice is as strong as ever. ◀

Sources:
1. ***Millennials & Financial Literacy – The Struggle with Personal Finance,*** pwc, 2015.
2. ***Generation Why? BMO Wealth Management Report,*** Canadian Edition, July 2017.
3. Financial Consumer Agency of Canada. ***Financial Consumers' Rights and Responsibilities – 2016 Final Report,*** conducted by Ipsos, February 2017.

Everyone's a winner, and a loser. The lesson? Diversify

At any given time, or any year, or any phase of the market, one asset class gets all the attention. Tech stocks one year, natural resources the next.

Investors can be tempted to chase after those outperformers, hoping to maximize their returns. Of course, none of us can predict the future or who will be next year's star.

Nothing illustrates this better than the 'periodic table of asset performance' which documents the top performing asset classes over a period of years.

In this example, Canadian Bonds were the top performer in 2011, but a laggard in the years 2016 and 2017. Meanwhile, Emerging Markets had a difficult year in 2011, but shone as the best performer last year.

A well-diversified investor is best placed to always take advantage of the assets having their day in the sun but also have some protection against this year's loser.

2011	2012	2013	2014	2015	2016	2017
9.7%	16.4%	48.1%	23.9%	21.6%	31.9%	28.7%
4.6%	15.3%	41.3%	15.0%	19.5%	21.1%	17.4%
-1.8%	14.0%	35.9%	14.3%	19.5%	17.1%	15.0%
-2.7%	13.8%	31.6%	10.6%	14.6%	8.1%	13.8%
-8.7%	13.4%	13.0%	8.8%	3.5%	7.7%	9.1%
-9.6%	7.2%	4.7%	7.0%	2.4%	4.4%	7.1%
-14.2%	3.6%	4.3%	4.1%	-8.3%	1.7%	4.0%
-16.2%	-0.5%	-1.2%	-2.8%	-16.3%	-2.0%	2.5%

Canadian Bonds
Canadian Equity
Canadian Small Cap
Emerging Markets
Foreign Equity
Global Equity
U.S. Small Cap
U.S. Equity

Sources: Fidelity Management & Research Company, Datastream. Total returns in CDN$. Note: It is not possible to invest directly in an index. Asset class performance represented by: foreign equity: MSCI EAFE Index; global equities: MSCI World index; emerging markets equity: MSCI Emerging Markets Investable Market Index ; U.S. equity: S&P 500 Index; U.S. Small Cap: Russell 2000 Index; Canadian equities: S&P/TSX Composite Index; Canadian small cap: BMO Small Cap Blended Weighted Index (Price Return); Canadian bonds: FTSE TMX Canada Universe Bond Index. As at December 31, 2017.

Four factors that may trigger a fund review in your portfolio

Most mutual funds are designed to be medium or long-term investments and not traded frequently – as you might do with an individual stock holding. But occasionally, an individual fund may outlive its usefulness for your portfolio or your goals. Here are four situations that could dictate a review of a fund in your portfolio.

Your portfolio needs change. Probably the best reason to re-examine your investments is a change in your needs. It may be that you are entering a different phase of your investing life. For instance, you may be nearing retirement when your need for growth may be lower and your need for income increased.

It may also be the case that your understanding of your own risk tolerance has shifted as you have lived through different market conditions or simply to come to understand yourself better. You may have grown more or less tolerant of risk, which may mean that a fund in your portfolio is no longer an appropriate holding.

Sometimes rebalancing may also be a factor. For example, if one asset class has performed well, it may now represent too large a share of your overall portfolio. In selling down units in that asset class to come back into balance, we may decide to exit a fund altogether to keep your portfolio efficient or avoid too many or overlapping funds.

Change in fund manager. When you put your money into a fund, you are putting a certain amount of trust into the fund manager's expertise and knowledge. A change in the manager does not automatically indicate a need for a change – most funds have a team of people inputting into the investment decisions from researchers and analysts to co-managers and investment committees. That being said, individual talent can matter and it's worth watching the performance of the fund under its new management to ensure that it continues to perform well and continues to be managed in a way that is consistent with the role it was originally chosen for.

Change in fund's mandate or style. Each individual fund in your portfolio was chosen to play a specific role in your overall portfolio strategy. This will include not only asset class like equity or fixed income, but also "style" such as value, growth or momentum. It may also include specific elements in its mandate such as market capitalization (small- or large-cap) or specific sectors or geographic regions.

Over time, there can be a "drift" from these elements. On some occasions there may be changes in mandates or styles as a fund company reorganizes its fund line-up. Often, but not always, a change in fund name may signal a change in approach.

Consistent underperformance. All funds will have years where they shine and when they don't. And short-term fluctuations are part of investing. However, significantly poor performance over several years may mean it's time to re-evaluate. If the fund has consistently underperformed its peers and its target benchmark, there may be better options available.

If you have any concerns about a fund in your portfolio, or feel it's time to review your investment goals or strategies, let's talk. ◀

▶ MUTUAL FUNDS

Safety first for these income-focused funds

Whether it's to provide an income stream to meet financial needs or as a counter to the more volatile parts of your portfolio, there's always a need for safe fixed-income or cash-equivalent funds. These fund types can play just such a role.

Money market funds. These may not offer much returns potential in a time of historically low interest rates, but your holdings are extremely secure. Money market funds are generally considered the safest mutual fund investments and also provide liquidity for easy access to funds when other investment opportunities arise.

Mortgage funds. These funds hold Canadian residential and commercial mortgages and are designed to provide a steady stream of income. Traditionally, these funds have invested in high-quality mortgages and have provided low-volatility and good security of capital.

Income funds. These funds focus on providing a steady stream of income, often along with some possibility of capital gains. Some of the best choices for stability include short-term bond funds and government bond funds.

Balanced funds. Because they invest in both stocks and fixed-income investments, holdings in one asset class can offset volatility in another. The result can be steadier performance than that of funds holding just one type.

Some of these funds are unlikely to lose value while others may have the potential to decline during extreme market turbulence. However, those that decline are likely to fare better than funds that focus on more aggressive investments such as growth stocks.

It's important not to go overboard on conservative investments at the expense of growth potential. The balance of security, income, and growth that's right for your risk tolerance and investment goals should drive your choices. Let's talk if you feel that it's time to review your situation. ◀