Money Ideas

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Many investment practices depend on the individual investor. One article appeals to millennials with a full plate of financial responsibilities. Another informs couples with spouses in different tax brackets about the benefits of a spousal RRSP. Anyone interested in choosing between passive and active investing can learn about each style's potential benefits.

▶ MUTUAL FUND INVESTING

Which is better – active or passive investing?

The debate over whether active investing or passive investing is the better approach has persisted for decades, among investment experts and everyday mutual fund investors.

Active investing typically involves a fund manager and a team of analysts who buy and sell individual securities in pursuit of optimal returns. Their ongoing research and investment decisions are based on a variety of factors, including a company's fundamentals, price fluctuations, and economic and market trends.

When the debate became real

The most common form of passive investing is a fund designed to mirror a major stock market index. For retail investors, this began in 1976, when the Vanguard Group launched the First Index Investment Trust, which tracked the S&P 500 index. Now, 50 years later, mutual fund investors can track any of hundreds of Canadian and global stock or bond indexes.

Each approach has its benefits

Advocates of passive investing emphasize its positive track record. Since markets have historically trended upward over time, you can potentially succeed by tracking an index with a buy-and-hold approach over the long term. You don't take risks on evaluating individual companies or anticipating trends. Also, management fees are lower.

A key reason investors choose the active approach is that it attempts to outperform the market, whereas passive investing is designed to follow the market. The investment team can target promising sectors and individual companies and change portfolio holdings as desired. In a bear market, they can shift positions in an effort to better cope with a challenging environment.

So, there is no definitive winner to the "which is better" question – it's a matter of personal preference. What's important in achieving your long-term financial goals is to stay invested and continue to invest regularly, whether you choose active investing, passive investing or a blend. ◀

Managing a millennial dilemma

Millennials are Canada's largest generation, and many of them face a wealth planning dilemma. They want to start investing for retirement while they are younger to benefit from compound growth, but their current financial obligations make mutual fund investing a challenge.

Say that someone is saving for the down payment on their first home and worries about putting any extra dollars toward long-term goals. Or a couple with a home and a child want to save for retirement, but they're making mortgage and car loan payments, paying insurance premiums, contributing to their child's education, building an emergency fund and saving for a summer vacation.

Developing a plan

You solve the dilemma in three stages. First, you determine the amount you can commit each month or pay period toward your financial savings goals.

Second, list your current goals and categorize them by short-term, medium-term and long-term goals. Include important wants, not just needs. Estimate each goal's total cost, and break down each one into how much to save annually and then monthly.

Third is the balancing act. You want to distribute your available savings toward meeting each objective, ensuring you can meet short-term and medium-term goals with mutual fund investments while staying on track to save for retirement and any other long-term goals. Also, you want to take care of your needs without sacrificing wants that are important to you. This stage usually requires some give and take. In some cases, you may want to look at tracking your expenses and budgeting to increase your amount of available savings.

With our assistance, you can also account for investment growth over time to help you reach each goal.

An evolving strategy

Your plan to meet multiple financial goals will evolve over time. Say you achieve a medium-term goal to renovate your kitchen. You might then dedicate your remaining savings toward one or more of your other existing goals.

Alternatively, a new goal may arise. Perhaps you want to help your child make a down payment on their first home. You might need to save more or make compromises to the amounts you allocate to other goals.

Certain life situations or events might also need to be factored in. For example, the financial challenges of a divorce may lead you to reassess your plan. Or perhaps a significant income increase may enable you to pursue your goals more aggressively.

We can work with you to adjust your plan as life events arise or your goals change. Also, we can regularly review the financial status of your goals to ensure you remain on track. This includes moving toward more conservative mutual funds for a specific goal as you approach the time when you need to access the funds.

More than financial

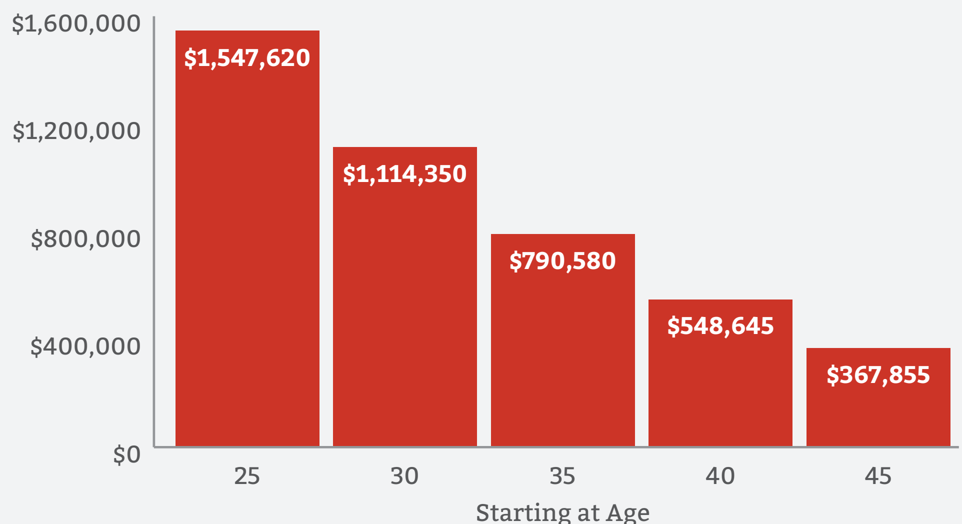
When you're juggling multiple financial goals without a well-planned approach, you can become distressed. Having a strategic plan makes all the difference. Instead of feeling overwhelmed, you can be in control.

Over the years, when updates to your plan are required, you'll be better able to handle the changes, having already experienced the goal-setting and give-and-take process.

The advantage of starting early

RRSP value at age 65 with $10,000 contributed annually at 6%

Based on $10,000 contributed at the end of each year at an annualized interest rate of 6%, with interest compounded annually. This chart is for illustrative purposes only and is not intended to illustrate the performance of any security or portfolio.



Do you need an emergency fund?

Suffering job loss or a loss of income, waiting for disability benefits to begin, or needing a major home repair are just some calamities where an emergency fund can save you financially.

To appreciate the value of an emergency fund, consider how else you would support yourself in the event of a costly, unexpected event.

Avoiding further financial strain

Dipping into your mutual fund retirement savings could set back your long-term goals, especially if you're forced to withdraw funds when the markets are down. Using credit cards or a line of credit means taking on debt at a time of financial hardship. Where an emergency fund helps you solve the situation, these other methods introduce another financial challenge.

Meeting the need

A common guideline is to provide for three to six months of living expenses, typically held in cash-equivalent mutual funds – but the amount varies by need. For example, a self-employed single parent typically needs a larger emergency fund than a couple with both spouses employed.

Building the fund on a budget. Some people recognize the need but haven't built a fund due to other financial demands. In this case, a solution is to start slowly. You can set aside a specified amount each month or pay period and perhaps give your fund a boost when you receive a tax refund or an annual bonus.

At the very least, an emergency plan. Others don't have an emergency fund because they prefer to invest the money in mutual funds instead of tying up a large sum in low-interest savings. While it's true there's an opportunity cost, the fund's purpose is to manage risk, not maximize growth. However, anyone who doesn't want to commit a large sum to low-interest savings should establish an alternative emergency plan they can count on, which may still include a smaller emergency fund.

Having an emergency fund not only provides a safety net to cope financially if an emergency arises but also gives you peace of mind knowing you can handle an unexpected situation or event. ◄

When to review your will

Once you create your will and store it away, it's an easy thing to forget about. However, certain changes in your life or the lives of others may call for a change to your will.

Here are four areas worth monitoring. Also note the common guideline to review your will every three to five years.

Major life changes. A change in your marital status typically means updating your will, whether you recently married, divorced or became widowed. When it's a marriage that creates a blended family, you may use your will and other estate planning measures to take care of your children from a previous marriage.

If a child reaches the age of majority, you may wish to name them as the executor or alternate executor of your will.[1]

Reviewing beneficiaries. You may have reason to add or remove a beneficiary or change the amount of a beneficiary's inheritance. Perhaps you're adding a child, grandchild, niece or nephew, or removing someone who passed away. You change one child's inheritance because you gifted them funds for a down payment on their first home. Or in retirement, you add a charity as a beneficiary.

Change in your financial status. Moderate changes in your financial situation are unlikely to call for updating your will, but a significant change may. For example, you have bought or sold a property or business, or received a large inheritance.

Choice of executor. If it's been quite a few years since you named your executor, it's a good idea to make sure they're still willing and able to assume the duties. You may want to change your choice of executor if they no longer live close to you. Also, if your estate has become more complex, you may wish to name a professional or trust company as your executor.

If you need a new or amended will, consult your legal counsel. ◄

[1] Executor is also known as a liquidator, estate trustee or personal representative, depending on the province.

Does your tax refund feel like free money?

If you consider your tax refund as a gift from the government, you're not alone.

Many Canadians see their tax refund or savings as free money – and money to spend freely. But that refund is your own money that was kept in the government's hands.

Instead of splurging, you may want to determine which part of your financial life needs the most attention. If you have credit card debt, you can use the tax refund to reduce or eliminate ongoing interest charges. Perhaps you want to contribute the amount to mutual funds in a registered account, either saving for your retirement, a first home, your children's education or another financial goal.

Just keep in mind that the refund is your own hard-earned money being returned to you.

You can always contact us for guidance whenever you receive a tax refund, annual bonus or any other cash sum. ◀

Monitoring your credit card transactions

It's easy to let up on regularly checking your credit card purchases, especially if you've never had a problem before.

However, false or fraudulent charges can arise in various ways. A store accidentally charges you twice for a purchase or fails to process a return. Perhaps you signed up for a one-month trial subscription, and now you're getting automatic monthly charges.

Fraud can take many forms. You could be the victim of a data breach, or a phishing email or phone call. A scammer could access your data over public Wi-Fi or steal your credit card information with a skimming device.

At the very least, you should check your monthly credit card statements, or check every week or two if that suits you. Also, you may want to sign up for alerts that many financial institutions offer. You can receive a text, email or app notification each time there's a purchase on your card. ◀

When a spousal RRSP is beneficial

With pension income splitting, the higher-income spouse can allocate up to 50% of their eligible pension income to the lower-income spouse, including Registered Retirement Income Fund (RRIF) payments.

Before the government introduced this provision, a couple used a spousal Registered Retirement Savings Plan (RRSP) to save tax during retirement. The higher-income spouse makes tax-deductible contributions to mutual funds, and withdrawals are taxable to the lower-income spouse. Now, the question is whether a spousal RRSP still provides any benefits not available through pension income splitting.

Here are three situations when a spousal RRSP offers unique advantages.

Retiring before 65. You can only use RRIF income for pension income splitting when the RRIF owner is age 65 or older. However, if you retire before 65, the lower-income spouse can make withdrawals from a spousal RRSP or RRIF, taxable at their lower rate.

Earning income past 71. You must close your RRSP at age 71, but if your spouse is younger and you have earned income, you can contribute to mutual funds in a spousal RRSP until the end of the year in which your spouse turns 71.

Enhancing income splitting. Pension income splitting allows you to split up to 50% of eligible pension income, but when the higher-income spouse has income from other sources, this allocation isn't always enough to equalize each spouse's income. With a spousal RRSP or RRIF, you can withdraw any amount you wish to be taxable to the lower-income spouse. ◀

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