STRATEGY UPDATE

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The Importance of Diversification

by Paul Bourbonniere, CFP®, CLU, CH.F.C.

Risk control is a primary objective in portfolio design,

particularly for those investors with a shorter time horizon or for those who have traditionally used GICs and bonds as a significant component of their portfolios. Low interest rates have forced many to rethink the way they invest. Often the discussion starts with, and unfortunately often stops at, the topic of exposure to stocks or equities. While portfolios with higher equity exposure exhibit more volatility or market risk (which is how 'risk' is often defined), they can have higher expected returns over time.

In our *Worry Free Retirement Experience* process, we can determine the approximate rate of return necessary for you to achieve your retirement financial goals. Unfortunately, the side effect of having a low appetite for risk is that your more conservative portfolio may produce lower returns than are needed to meet your goals. And, lower returns can introduce another risk, the risk of depleting your capital. To put it more simply, it is the risk of running out of money before you run out of "life".

How, then, can we keep risk at a minimum for a given level of stock market exposure?

While finance textbooks describe many methods, we will focus on two low cost, easily achieved techniques. What's interesting is the fact that both tools use diversification.

The first is diversification by security. We often get questions about buying the stock of a company that is in the news headlines. A quick check of the market usually shows hundreds of thousands or even millions of

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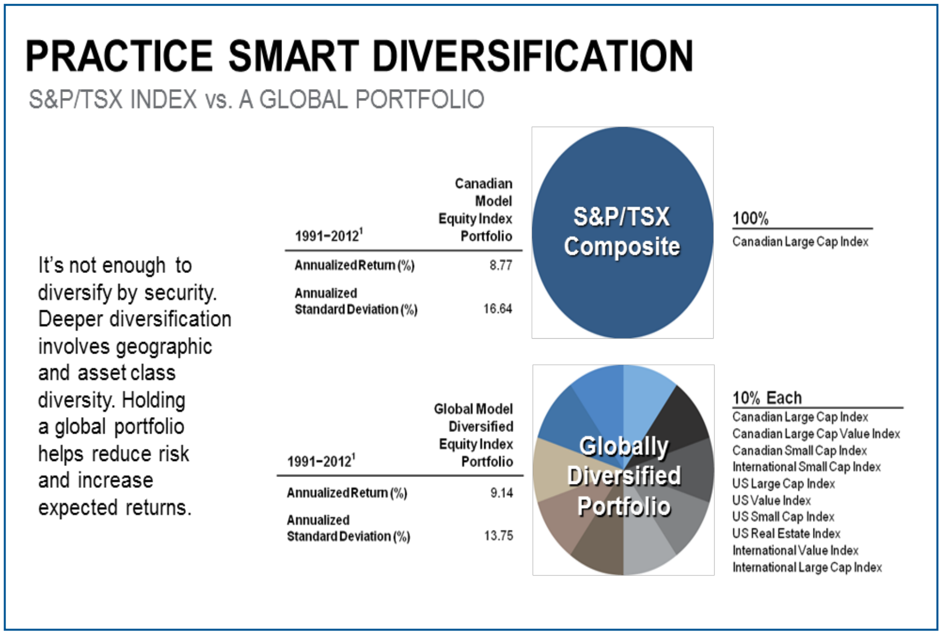

Source: Dimensional Fund Advisors, February 2013

shares traded in the previous few days. What would we, or anybody, know about the company that wasn't already known by those previous buyers and sellers? For every buyer there is a seller, and vice versa. Markets price stocks for future profitability based on current, ever changing information. Rather than picking a few dozen stocks from literally thousands available globally, buying a very broad basket of stocks reduces the chances of the misbehavior of one stock adversely affecting your portfolio.

The other method is diversification by asset class, sometimes known as 'asset allocation'. Traditional asset classes include Canadian equities, US equities, International equities, Canadian bonds, foreign bonds, cash, and alternatives such as gold or real estate. By using a specific asset allocation or mix of asset classes based on your risk tolerance and investment objectives, we create a discipline to 'buy low, sell high' when certain classes do better than others, forcing a rebalancing of the portfolio.

Proper diversification is not choosing only those asset classes you like. In fact, broad diversification ensures exposure to classes we might not otherwise pick. For example, if the whole world agrees that a class looks risky at a particular point in time, then the prices of securities in that class have probably fallen in response.

This year has clearly illustrated the importance of diversification. Based on October 31 data, we have seen returns ranging from the 30% range (US stocks in Canadian dollar terms) to roughly zero (Canadian Bonds). International stocks have significantly outperformed Canadian stocks. And, these are not the results that news headlines would have predicted.

In summary, all investments have some degree of risk. As your Certified Financial Planner® professionals, we at Polson Bourbonniere Financial will help identify and minimize those risks according to your financial objectives. Practice smart diversification. ❖

Planning for Year-End 2013 and 2014

by Derek Polson, CFP®

It's that time of year again. The Fall weather has arrived, and before we know it the New Year is upon us. Resolutions will come, and resolutions will invariably go. But before they do, there are two questions that we all should reflect upon: ***Is my financial "house" in order? And, what should I be planning for in 2014?*** To get you thinking, here's a short list of items to consider acting upon before year-end.

» Tax Loss Selling

Review your non-registered (i.e. non-RRSP/RRIF) investments and consider selling any with accrued losses before year-end. These can be used to offset any capital gains realized in your portfolio in 2013, but you must do so before December 24th for them to qualify for 2013 (or one of the prior 3 years).

» Tax-Free Savings Account (TFSA)

TFSAs allow you to shelter any tax earned on your investments, and will be of increasing importance in the years ahead as you plan for or enter your retirement years. The contribution limit for both 2013 and 2014 is $5,500. And, If you have not yet set up a TFSA, you have $25,500 of available contribution room this year.

Tax Tip – if you have a TFSA and your spouse has yet to open one, you can contribute to your spouse's plan without any negative tax consequences. There is no tax deduction as with a spousal RRSP, but overall, both spouses having TFSAs helps reduce your family's tax bill.

Keep in mind that if you're planning to withdraw money from your TFSA, do so before December 31st because your contribution room is restored in the New Year. (You should not contribute to your TFSA in any calendar year when you've made a withdrawal).

» Age 71 in 2013?

If you had your 71st birthday during 2013, you must convert your RRSP to a Registered Retirement Income Fund (RRIF) and/or annuity, before year-end. Withdrawals can start in 2014, but get the paperwork done in November or early December. As Retirement Income Specialists, we're very well versed in this area, so if you have not already done so, see your Certified Financial Planner® professional at Polson Bourbonniere.

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» RESP Deadline

Dec. 31 is the deadline to make an RESP deposit to get a matching government grant for 2013. For every dollar you deposit to your RESP, the government will add a 20 per cent matching Canada Education Savings Grant (CESG) of up to $500 annually to boost your savings.

» RRSP Deadline

March 3, 2014 is the deadline to make your 2013 RRSP contribution. The maximum contribution for 2013 is $23,820. However the amount you can deduct on your tax filing is based on a percentage of your previous year's earnings and any eligible deduction room carried forward from the previous year. Please check your 2012 Notice of Assessment for your eligible contribution amount.

If you plan to get a head start and want to contribute early for the 2014 tax year. The maximum contribution amount is $24,270. Again, this number will be based on your earned income and will be reported on your 2013 Notice of Assessment.

» Charitable Donations

Thinking about helping out your favourite charity this holiday season? To encourage donations, the federal and provincial governments provide a two-tiered credit system. The total amount of all your donations up to $200 qualifies for a tax credit at the lowest tax rate. The amount over $200 qualifies for a credit at the highest tax rate. When the federal and provincial programs are combined, taxpayers reduce their taxes by about 25% of the total donated up to $200. For the amount over $200, the saving is about 45% (The exact amount varies by province).

Donating appreciated securities, as opposed to cash, has further tax advantages. Your Polson Bourbonniere advisor can provide further details.

Please remember, only Canadian registered charities or other qualified donees may issue official donation receipts that qualify for charitable tax credits. Ask the Charity for its registration number if you are unsure if they will qualify.

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