A&Q Update

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Mortgage Renegotiation – When is it worthwhile?

With historically low interest rates, many home-owners question whether breaking an existing mortgage to renegotiate at a lower rate is worthwhile. Each case must be examined individually to see if this strategy makes financial sense. Generally, the greater the interest rate difference and the longer the remaining term of the mortgage, the more likely the move will make sense.

In breaking the current mortgage a penalty will apply. Usually this is a specified number of months interest plus a discharge fee. This amount will typically be added to the principal amount of the new mortgage. If the new interest rate is sufficiently lower and the remaining term of the original mortgage is long enough, the amount added to the principal as a result of the penalty will be more than offset by the reduced interest cost.

If you would like assistance in considering your situation, please give our office a call. Our planning software makes this analysis very straightforward.

Inside this issue:

Registered Plan Contribution Notes

Spousal RRSPs

The three year spousal attribution rule includes the year in which the contribution is made and the following two years. Contributing early will give you more flexibility when you start to draw an income from your spousal plan.

Members of the Teachers Pension Plan

The plan will be issuing a Past Service Pension Adjustment to all members in 2003. This adjustment must be made to compensate for plan improvements which will benefit members in future.

Past Service Pension Adjustments reduce the amount of RRSP contribution room available to the pension plan member. It is therefore advisable that anyone intending to contribute to their RRSP over the next few years should make an effort to make that contribution for the 2001 or 2002 tax years.

After the adjustment is made, available contribution room will be reduced by $5,095. Amounts deposited to the RRSP in the year previous to the Past Service Pension Adjustments are not effected, therefore, contributing prior to 2003 will allow you to shelter more money in your RRSP.

RRSP Loans

In some cases it makes sense to borrow money in order to make your RRSP contribution. With the current low interest rate environment this strategy becomes even more attractive. RRSP loans are available through our office from a number of sources.

RESP Contributions

A maximum contribution of $4,000.00 per child is allowed each calendar year. In any given year the Canada Education Savings Grant program contributes an additional amount equal to 20% of the first $2,000 of your contribution. If you have unused grant available from previous years, grant will also be allotted for the amount contributed over $2,000.

Worthwhile stops on the information highway...

www.tax.ca

A wealth of information on all types of taxation in Canada.

A Word of Thanks!

Thanks to all who attended our annual Christmas client appreciation event. It was nice to see so many clients at the wine & cheese gathering at the office, and as always, the Choral Christmas Celebration at the Centre in the Square was excellent. Stay tuned for future client events!

Labour Sponsored Investment Funds Revisited

We have discussed Labour Sponsored Funds (LSIFs) in previous newsletters, and indeed many of you hold these funds in your portfolio. At this time of year when people are focused on their income tax situations, it seems appropriate to review this type of investment and take a look at the performance of some of these funds.

Simply put, LSIFs supply venture capital for small companies. Both federal and provincial governments encourage investment in these companies because they are one of the primary sources of new jobs for Canadians. In order to do this, both the federal and provincial governments offer tax credits to investors who invest in LSIFs. In Ontario, most LSIF purchases generate a 30% tax credit (15% from each of the two levels of government). This is over and above the tax benefit resulting from the RRSP contribution if the fund is held in a registered account.

The end result is that the after-tax cost of an investment in an LSIF is quite low, particularly for investors in a higher tax bracket. An investment of up to $5,000 per year is eligible for the tax credits.

It is very important to understand two points concerning LSIFs. Firstly, investment in one of these funds is an 8 year commitment. If the funds are redeemed before the end of this 8 year period, the tax credits must be repaid to the government.

Secondly, LSIFs can be quite volatile. Most of these funds invest in relatively few companies when compared to most mutual funds, and the majority of the holdings are small companies in the early stages of development. Both factors increase the overall risk level of the funds. This particular asset class should comprise only a portion of your investment portfolio.

LSIF Rates of Return Ending December 31, 2001

Labour Sponsored Fund Name	1 Yr	2 Yr	3 Yr	5 Yr
Working Opportunity Balanced	-11.5	5.15	18.51	12.41
Dynamic Venture Opportunities	-9.8	0.38	26.11	11.4
VenGrowth I Investment Fund Inc.	-25.5	-1.87	5.1	8.31
Canadian Sci. & Tech. Growth	-6.6	11.93	7.98	5.27
B.E.S.T. Discoveries	-27.1	-6.98	5.24	2.31
Covington Fund I	-22.0	-10.63	-1.37	0.76
Canadian Medical Discoveries	-12.3	4.73	3.27	0.15
Working Ventures Canadian	-38.2	-17.71	-7.63	-4.4
Triax Growth	-43.9	-33.25	-10.88	-6.31
StrategicNova Venture Gwth Fund Inc	-28.7	-3.75	9.81	-
Working Opportunity Growth	-17.9	-	-	-
VenGrowth II Investment Fund Inc.	-0.2	-	-	-
Covington Fund II	0.8	0.4	-	-

Having stated these caveats, how have LSIFs actually been performing? 2001 was a year of declining profits for many companies, large and small. This is certainly reflected in the valuation of many LSIFs. This particularly bad year has skewed the long term numbers substantially. Despite this, many funds have managed to at least preserve the original capital invested, and some indeed have produced respectable returns for investors.

This table illustrates a selection of LSIFs listed in order of their five year return numbers. Vengrowth II and Covingon II are funds we are currently recommending for the venture capital portion of client portfolios. As always, you should read the simplified prospectus carefully before investing. Please contact us if you would like further information.

Systematic Monthly Purchases: Simple But Very Effective

All RRSP investors with contribution room should make monthly contributions to their plans. The theory behind systematic regular investing is not rocket science, yet it makes a significant difference in the results you achieve with your retirement savings.

Firstly, in terms of budgeting, most people find it much easier to make a smaller investment each month rather than coming up with a large lump sum just before the RRSP contribution deadline. Contributions can be further topped up at year end if circumstances allow.

Secondly, the amounts invested earlier in the year benefit more from the compounding effect of investing. The growth of the money is also sheltered for a longer period of time.

Thirdly, and most importantly, when investing systematically in vehicles with fluctuating values like mutual funds, you benefit from 'dollar cost averaging'. When you buy a fixed dollar amount at regular intervals, you buy more units when the price is low and fewer units when the price is high. This significantly reduces your average price per unit through periods of market volatility. In essence, you automatically time the market. Dollar cost averaging can greatly improve the internal rates of return achieved by your investments.

These simple principles also apply to investment in non-registered accounts. Regardless of the type of account, the systematic purchase approach helps investors to remain disciplined. Many families find that regular investing makes long term saving more painless.

The Life Annuity Strategy: Earning a Guaranteed After-Tax Return Superior to GICs

Many retirees like the idea of guaranteed sources of income in retirement. Unfortunately, guaranteed income from your non-registered investment assets usually comes at the expense of your investment returns. For example, GIC (Guaranteed Investment Certificate) rates are currently very low. When income taxes and inflation are taken into account, the real rate of return may indeed be negative.

One alternative strategy involves the use of a life annuity. This product is purchased from an insurance company and provides a level or increasing payment monthly, quarterly, semi-annually or annually. The payment continues for the life of the individual or, in the case of a joint life annuity, for the life of the last surviving member of a couple. A guaranteed income period is also available.

The amount of income generated by the annuity is dependent on the amount initially invested, the age of the annuitant (s), and whether it is a single or joint life product. As long as the owner of the annuity is also the one who is to receive the income, the annuity is considered to be *prescribed.* This means that there is a level portion which is taxable each year. This tax deferral is considerably more favourable than the taxation of a non-prescribed annuity which reports more taxable interest in earlier years.

One concern for many investors is the possibility that the annuitant could die in the early stages of the annuity, resulting in the loss of a large portion of the initial investment, and leaving nothing to pass on to the next generation. The best way to deal with this problem is to purchase an insurance policy with a pay-out equivalent to the portion the investors want to ensure will go to their family. Insurance death benefits are tax free, making this alternative quite attractive.

The following illustration has been provided to us by Standard Life. An after-tax comparison is made between a GIC earning 5% per year and the life insured annuity strategy. The following assumptions apply:

- Investor Profile – Male 65 and Female 65, both Non-Smokers
- Marginal Income Tax Rate of 46%
- Annual life annuity with no guarantee period
- Non-registered investment with a prescribed status
- $250,000 Standard Life Perspecta Universal Life Policy (joint last-to-die)

Long Term GIC Investment

Amount Invested	$250,000		
Assumed Annual Investment Rate	5%		
Gross Yearly Earnings	$ 12,500		
Taxable Annual Portion	$ 12,500		
Tax Payable	$ 5,750		
Net Annual After Tax Payout		$ 6,750	

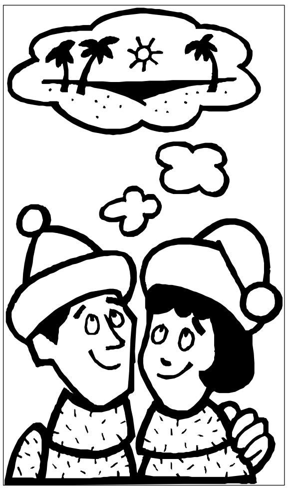
Life Insured Annuity

Amount Invested	$250,000		
Annual Income for Life	$ 17,649		
Taxable Annual Portion	$ 6,550		
Tax Payable	$ 3,013		
Annual After Tax Payout	$ 14,466		
Amount Insured	$250,000		
Life Insurance Annual Premium	$ 3,723		
Net Annual After Tax Payout		$ 10,743	
Equivalent Annual Pre-Tax Rate			**7.96%**
Difference		$ 3,993	
			59.16%

Even after the yearly cost of the insurance policy is taken into consideration, the after-tax income provided by the annuity strategy is almost 60% higher. As a point of comparison, it would be like earning 7.96% on their GIC instead of 5%. For investors looking for guaranteed regular income, this is clearly an alternative worth considering.

There are several important factors to keep in mind when evaluating this strategy.

- If interest rates rise substantially, the strategy becomes less attractive.
- Investment flexibility is lost with the purchase of the annuity.
- The feasibility of the plan depends on the investors health. In other words, the investor must be insurable at a reasonable cost.



Armstrong & Quaile

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"Providing Sound Financial Direction"

John Armstrong is a Certified Financial Planner. Financial planning and financial planning education are his key areas of interest and expertise.

Achieving balance in our lives is critical; a balance between work and family, a balance between living for today and planning for the future. Because we all have competing goals, striving for balance influences many decisions in our day-to-day lives. One thing is certain, the juggling act we do requires a long-term view. Sometimes we need to take a step back to put things into perspective.

It may sound cliché, but having a plan in place goes a long way in helping to achieve both our long and short-term goals. Simply put, planning assistance is the service we provide. We are committed to helping you find that long-term view for the good of today and tomorrow.

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On the Lighter Side – Church Bulletin Bloopers

The following gems were drawn from Ecunet, the US based Internet service for churches and reprinted in the United Church Observer:

- "Pastor is on vacation. Massages can be given to the church secretary."
- "Thursday night – potluck supper. Prayer and medication to follow."
- "At the evening service tonight, the sermon topic will be 'What is Hell?' Come early and listen to the choir practice."
- "Eight new choir robes are currently needed, due to the addition of several new members and to the deterioration of some older ones."
- "The associate minister unveiled the church's new tithing campaign slogan last Sunday: 'I upped my pledge – up yours.'"

Special thanks to client Art Weiler for bringing these to our attention!

Product Feature – What is a Balanced Fund Anyway?

I once heard a fund company representative describe a balanced fund as "an equity fund equipped with air bags". The air bags in this case are the fund's bond holdings.

A balanced fund holds a combination of stocks (equities) and bonds. The approximate percentage of each is usually specified in the fund's written objective. Most balanced funds hold somewhere in the neighbourhood of 30% in bonds. The fund manager can adjust this percentage to reflect changing conditions in the financial markets, but there is normally a minimum bond content percentage stated in the fund's simplified prospectus.

Because bond values historically go up when stock prices go down and vice versa, mixing the two asset classes in one fund tends to smooth the performance of the fund. In other words, balanced funds are typically less volatile than an straight equity fund in the short term. For this reason I would suggest that another analogy might be "an equity fund with heavy duty shock absorbers".

Mixing asset classes in one fund is a strategy used by pension fund managers. For this reason balanced funds are sometimes referred to as 'pension style funds'.

It is possible to achieve some of the same benefits by combining straight bond funds and straight equity funds in a portfolio. The added value of a good balanced fund, however, is that the fund manager uses his discretion to make ongoing asset class adjustments based on current market conditions.

Both Canadian and International balanced funds are available, making it possible to diversify by geographical region while using these funds. Most balanced funds are considered to have a moderate level of risk, falling somewhere between bond funds and equity funds, with bond funds being the least risky of the three.