A&Q Update

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What is a Past Service Pension Adjustment?

Each year individuals who are members of a registered pension plan have their RRSP contribution room reduced by an amount called a pension adjustment. This adjustment appears on the Notice of Assessment sent to them each year after their income tax return has been filed. This pension adjustment figure reflects the benefits that they will ultimately receive as a result of being a member of the pension plan.

The adjustment is designed to ensure equity among tax payers. Each individual is only able to shelter a certain amount of money for retirement savings, be it in a Registered Pension Plan, in an RRSP, or in a combination of the two.

A Past Service Pension Adjustment is triggered when improvements are made to a pension plan, thereby increasing the future benefits received by plan members. These adjustments directly reduce the RRSP contribution room available. They are referred to as 'Past Service' because the adjustment applies to benefits the employee has already earned through their employment.

Because these adjustments can reduce the RRSP contribution room so dramatically, it is important to carefully monitor RRSP contributions being made through automatic contribution programs.

Investors who find themselves with little or no

RRSP contribution room will have to look into some 'open' investment options for their additional long-term savings. Fortunately, there are some other excellent strategies outside of registered programs.

Inside this issue:

Worthwhile stops on the information highway...

www.ontarioparks.com

This excellent site provides detailed information on all of Ontario's Provincial Parks. Camping reservation information is also available.

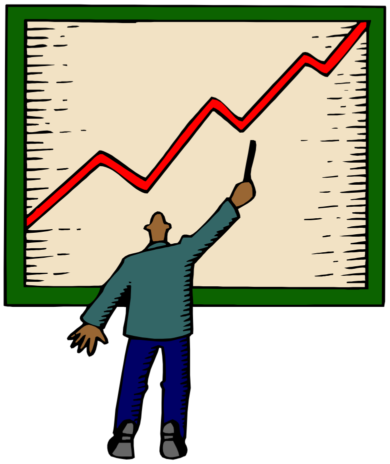
www.fifty-plus.com

The official web site of the Canadian Association of Retired Persons. A good source of information on all kinds of subjects. Geared specifically to folks over 50.

Coming Soon...The Lion King Theatre Event!

At the suggestion of several of our clients, we are organizing a Lion King Customer Appreciation event for spring 2001. This theatre production has received rave reviews and is sold out well in advance. The package will include dinner and luxury coach transportation. Please speak to Sharon at our office if you are interested. We will inform you of the details as they become available.

Pension Plan Surpluses



Surpluses in pension plans are the result of a simple mathematical fact. The benefits promised over time by the pension plan are linear (example: 2% of salary per year of service), while the money inside the pension plan compounds over time.

The Pension Benefits Reform Act of 1987 stipulates the maximum amount any pension may have in surplus. Any surplus amount over these maximums will be taxed away by the federal government. It is therefore imperative that the pension plans reduce the surplus.

Pension managers reduce surpluses by either increasing benefits or reducing contributions. Pension plan surpluses will continue to exist, so stay tuned for more benefit rollouts and contribution reductions. If you would like to contemplate some scenarios in your financial plan to take advantage of the increased benefits, please call.

2000 Federal Budget Notes

The 2000 Federal Budget offered some good news for investors.

Firstly, the Capital Gains inclusion rate has dropped from 75% to 66.6%. This is particularly important to investors who have non-registered investment accounts. The end result is that only 66.6% of any Capital Gain triggered after February 27, 2000 will be considered income in the current tax year. This is also important to people who own assets that have appreciated in value like cottages or recreational properties. The Capital Gain on the sale of your principal residence continues to be exempt from taxation.

A second favourable change relates to the Foreign Content Limit on registered investment plans. For the 2000 Tax Year the allowable foreign content increases from 20% to 25%. After 2000 the limit is set to go to 30%. This will allow the investor to better diversify their investments in terms of world markets. We suggest a review of your portfolio to take advantage of this change. Adjusting automatic monthly contributions to reflect these changes should also be considered.

The Foreign Content Limit for RRSP accounts has increased to 25% for the 2000 Tax Year.

Please note that the middle bracket tax rate has decreased effective July 1, 2000 and that tax bracket thresholds are to increase over the next five years. Full indexation of tax brackets has also been restored to eliminate 'bracket creep'.

If you have any questions as to how these changes impact your situation, please give us a call. We would be happy to review your situation and update your financial plan accordingly.

The A&Q Kitchener Staff – Who are we and what do we do?

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Strategy – Using Other People's Money

We have all borrowed money for a house, a car or to increase our lifestyle spending. Using other people's money is also a tool widely used in business. Most businesses operate on somebody else's money, be it shareholders or lenders. An important fact to remember is that interest paid on money borrowed for business purposes, including investing, is tax deductible.

Leveraging

Simply put, leveraging is borrowing money to make money. This becomes particularly attractive when the interest is tax deductible. Many people use systematic savings plans to contribute to their RRSPs, a key benefit being that the contributions provide a tax deduction. Another way to get a tax deduction is by making systematic interest payments on an investment loan.

At an 8.5% interest rate, borrowing $30,000 to invest costs about $2,550/year or $212.50/month in interest – <u>tax deductible</u>! After saving $1,020 in tax (assuming 40% tax bracket) the true cost is $1,530/year or $127.50/month.

In seven years at a 10% rate of return, the $30,000 borrowed grows to almost $60,000. Over the same time period, the after-tax interest cost to carry the investment loan is only $10,710.

Leveraging allows investors to accumulate non-registered assets while still receiving a tax deduction. Non-registered assets provide significant tax advantages during the withdrawal phase of the plan, because only 66.6% of the capital gain is taxable. Leverage also provides the opportunity to diversify by account type (RRSP vs. non-RRSP).

Conservative Leveraging

The key to leveraged investing is remaining conservative in your approach. Keep the interest payments affordable.

Leveraged portfolios should be well diversified and carefully managed. Many international mutual funds have excellent long term track records with relatively low risk levels. Because no Foreign Content Regulations apply to non-registered investments, investors have the opportunity to diversify globally. This is an important consideration, as historically, rates of return on international equities have been 2-3% higher than that of the Canadian equities. The investments should also be tax efficient, paying few dividends or capital gains.

Risks

Interest rate hikes increase the cash flow needed to carry the loan. Make sure the loan amount is well within your ability to fund the interest expense.

Investment values fluctuate. Leveraged investing magnifies returns, both positive and negative. Time is therefore one of the most important considerations. The investor must be willing to commit to the plan for eight to ten years in order to ride out any market volatility.

More detailed information on leveraged investing is available through our office.

Leveraged investing magnifies returns, both positive and negative. Staying conservative in your approach is critical.

Strategy – Organize Your Spending Plans

When money is being withdrawn from savings plans for retirement income purposes, it often makes sense to spend non-registered money first. Your level of income from other sources in a particular year will be an important factor in deciding where to draw your cash flow from.

Leaving the money inside the RRSP will allow it to grow tax sheltered for as long as possible. Also, when money is withdrawn from the RRSP it becomes taxable income in the year it is withdrawn. In many cases spending non-registered money first will reduce the amount of tax payable in the current year.

Each case should be looked at individually to determine the best strategy for the investor.

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.

Armstrong & Quaile

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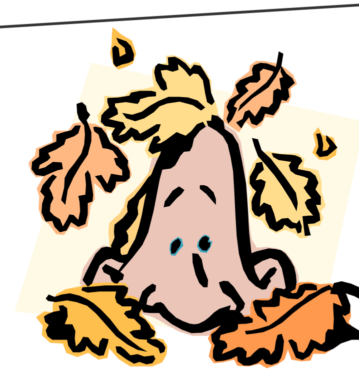

Investment Styles

All mutual fund managers end up at the same point, holding a portfolio of investments they hope will appreciate in value. There are many approaches they take in making selections from the thousands of investment choices available. Each of those approaches, it seems, has a name: top down, value biased, sector rotation, small-cap, growth at a reasonable price.

Those phrases have meaning for seasoned investment professionals, but they don't really help to enlighten individual investors.

Imagine the local curio shop is going out of business and a number of fund managers arrive to look over the merchandise. How would they decide which items were worth buying, and which to leave behind?

Value managers would look for bargains — antiques and other undervalued treasures whose sticker price didn't reflect their true value, compared to either historical norms or other time-tested comparative measures. A Royal Doulton figurine at half the typical value might catch their eye.

Growth fund managers would search for hot properties — the items that have been recently appreciating in quarterly appraisals by other antique buyers.

Top-down managers would start with an overview. What types of antiques were expected to appreciate in the future? And from where? If they thought jewelry was the place to be, and items from Europe were particularly lucrative, they'd narrow their search to European jewelry.

Bottom-up managers would take much the opposite view, looking at each antique on its own merit and trying to appraise exactly how much each item was worth, regardless of where it was made, or what type of item it was.

Small-cap managers would concentrate on knick-knacks, figuring that the big-ticket items were so well-known it would be difficult to find a bargain or advantage. By contrast, smaller and more obscure items could be bought at low prices today and gain greater appreciation later when their inherent appeal was discovered by others.

Sector rotators would study the rhythms of the antique market, how different types of items go in and out of favour. They would know, for example, that the Beanie Baby trend would one day collapse, and people would return to more dependable commodities, like Wedgewood or Lladro figurines. Rotators would try to anticipate that move.

Of course, managers can belong to more than one category. You can have a small-cap value manager. Some managers may look for growth investments but have limitations on how much they're willing to pay.

Which approach is correct most frequently? They all will be right at different times, yet none will be right all the time. That's why style diversification — making sure you have a mix of different styles in your portfolio — is a prudent choice in investing or collectibles.

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