

DUNDEE WealthBuilder

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Through these difficult market conditions, many Canadian investors have become much more eager to learn all they can about money, markets, and investment risk.

Investor education is important. I hope this newsletter and all of the time we spend working one-on-one to discuss your financial goals helps secure your financial confidence.

One of our most important professional concerns is that you feel confident and committed to your long-term objectives, and know that your strategy suits you perfectly. That's why it is always gratifying to hear your questions whenever you seek advice or reassurance.

If there's any financial or investment decision you have questions about, please call so we can take the time to explore possible options or provide you with more information.

Diversify your portfolio with fixed-income funds

These funds help offset equity volatility

For many investors, the extreme volatility of equity markets in the past year has helped draw closer attention to the role of fixed-income investments.

Fixed-income holdings, such as secure, highly rated bonds issued by governments or blue-chip corporations, help provide diversification and risk control in a balanced portfolio. Generally, the more secure the bond, the lower its interest payment.

One way to get wide exposure to fixed-income investments for specific goals is to use mutual funds. Fixed-income funds are professionally managed and categorized by the types of bonds they invest in.

- **Short-term funds.** Short-term bond funds may hold government and/or corporate bonds with average terms of up to five years.

- **Longer-term bond funds.** Mid-term funds tend to have durations running from three to 10 years. Long-term bond funds are more aggressive and can lead to larger gains, but with more volatility.

- **High-yield funds.** High-yield bond funds have more risk exposure. These funds focus on higher-risk corporate

bonds from companies with medium to speculative credit ratings.

- **Foreign funds.** Foreign bond funds hold bonds in foreign currencies — often from Canadian issuers. For example, the Canadian federal government might issue a bond denominated in U.S. dollars, so its value will reflect U.S. interest-rate moves.

Professional advice can determine your ideal asset mix and how to achieve it. ■



MUTUAL FUNDS

Make the most of dividend funds



Dividend mutual funds can offer you an advantageous tax treatment, a regular income stream, the possibility for capital gains, and relatively low exposure to risk. And with today's low interest rates, the income they can provide may be especially attractive.

Here's what you need to know to get the best performance from your dividend fund investments.

Invest tax-efficiently. Because they qualify for the Dividend Tax Credit, dividends from

Canadian corporations attract a lower tax rate.

But this preferential tax treatment applies only to non-registered investments. Inside an RRSP or RRIF, all income is free of tax until it's withdrawn from the plan, when it will be fully taxed. Any dividends earned inside the new Tax-Free Savings Account (TFSA), on the other hand, will never be taxed.





For this reason, many Canadians prefer to hold fully taxable investments within their registered plans, while keeping tax-

advantaged investments, like dividend funds, outside of their registered portfolio.

Income or growth? Some dividend funds put an emphasis on capital gains. Other funds have a high ratio of interest-bearing securities, which attract a higher tax rate. Either or both kinds may be an appropriate choice for you, depending on your objectives.

Look at frequency of distribution. Professional expertise can help you make sure a fund invests in securities that meet your need for monthly or quarterly payments. ■

Investing for income? Your options at a glance

			
Investment	Type of income	Taxation (outside registered plans or Tax-Free Savings Account)	Special considerations
Fixed-rate GICs	Interest	Fully taxed	Principal generally locked in until maturity. Rates at renewal may be higher/lower
Government or corporate bonds	Interest	Fully taxed	May be sold early at capital gain/loss
Preferred and common stock	Dividends	Canadian dividends qualify for dividend tax credit	May be sold at capital gain/loss
Mutual fund systematic withdrawal plans	Interest, dividends, capital gains, return of capital	Return of capital tax-free; Canadian dividends qualify for dividend tax credit; interest fully taxable; capital gains taxed on only 50% of value	Unit value fluctuates. Market downturns can deplete capital early; strong returns can replenish account
Income trusts and real estate investment trusts	Business earnings, rental income	Tax-advantaged distributions, depending on profits of underlying business	Not guaranteed; income depends on profitability of underlying business. Trades like a stock
Annuity	Interest, return of capital	Interest income fully taxed; tax-efficient, if prescribed annuity; return of capital tax-free	Provides income for fixed term or for life. Inflation indexing may be available, but can be costly
Reverse mortgage	Capital	Effectively tax-free	Like selling your home piece by piece while still living there. Complex contract and high cost; legal advice a must

Consumer trends and the frugal boomer

As the baby boom generation ages, its influence and sheer numbers pose significant investment opportunities for those able to figure out its next move.

The year 2008 marked a crossroads, when spending on consumer-related items by the average North American boomer household was expected to cease rising and gradually begin to fall back.

Boomers aren't likely to keep spending

The pace of decline is expected to accelerate. Recessions have typically had a lowering, though short-lived, effect on consumer spending. But the current economic downturn is likely to have a much bigger impact than in past cycles.

Indeed, the significant declines in consumer wealth that occurred during 2008, owing to both house and equity prices, may aggravate the trend to reduced consumption in the next few years, as boomers rebuild retirement nest eggs.

Consumer spending accounts for some 70% of the economy. As it shrinks, this longer-term pattern is apt to unfold:

- Deceleration of real economic growth and reduced inflationary pressure;
- Lower returns on investment, since both average return on investment and interest rate levels are determined by the sum of growth and inflation; and
- Higher savings rates, as boomers boost their nest eggs. Savings will likely climb more to make up for lower investment returns, further subtracting from consumer spending and growth.

In Canada, the critical spending shift is expected to begin in 2009 or 2010, which may partly explain why changes in the Canadian economy have lagged behind the U.S. economy by 18 to 24 months.

Investors adjust to new reality

There are several implications for investors in North America and abroad.

First, if you are planning to raise the weighting of longer-term government bonds in your portfolio, it may be advantageous to do so early to lock in yields before they trend even lower.



Second, equity portfolios may be increasingly geared to countries with the best longer-term growth potential. Within the G-7, that's still the U.S. More promising are Asian nations with considerable development potential. In-between are the hybrids: companies headquartered in the industrialized world with strong business ties to Asia.

In Canada, commodities should rebound, but likely had not touched bottom yet by the end of 2008, at time of writing.

For any investor, today's key question is whether the investment of choice is reasonably priced. ■

*William Tharp, Senior Economist
Dundee Group of Companies*

A CLOSER LOOK AT...

Capital losses and how to profit from them

No investor likes to lose money, but there's a positive side to losses on investments held outside tax-sheltered registered plans — they can be used to reduce your taxable capital gains.

A capital loss occurs when you sell a stock, mutual fund, or other capital investment for less than what you paid for it (including fees). Half of the actual capital loss is taken into consideration for tax purposes.

Suppose you pay \$5,000 for shares of XYZ and sell them for \$4,000. Your \$1,000 actual loss results in a capital loss of \$500 for tax purposes. (We've ignored the effects of brokerage fees to simplify the example.)

The \$500 capital loss must be used to offset any capital gains earned in the same year. Unused losses can be applied to gains as far back as three years. Or, you can apply them against capital gains in any future year.

You can't, however, trigger the loss for tax purposes and immediately repurchase the investment. "Superficial loss" rules create a 60-day zone, 30 days before the sale and 30 days after. If you buy identical property during that time, you lose the capital loss tax break. The loss will also be denied if you try to trigger it by transferring an investment that's in a loss position into a registered plan. ■

Don't dismiss the potential of global investing

While no major world economy has escaped the effects of a global economic downturn, having a stake in foreign markets remains a hallmark of a well-diversified portfolio.

How can you enjoy the higher potential returns of foreign markets and minimize your exposure to risk? The answer is diversification. Investing a portion of your portfolio in a judicious mix of non-Canadian equity and income funds can help to improve your overall longer-term returns.

Foreign opportunities

The equities market in Canada is small by global standards, and largely concentrated in the energy and materials sectors. To gain access to other economic sectors — and their growth potential — it's essential to diversify into non-Canadian stocks.

Aggressive or conservative?

More experienced investors, and those comfortable with greater risks, may want to consider devoting a small portion of their portfolio to emerging markets. When values in these markets are at bargain-basement levels, the potential for profit is high.

Many investors, especially those nearing retirement age, may prefer a more conservative course for foreign markets. Professional advice can help you find a suitable fund match. ■

Are you ready to invest in specialty funds?

Based on one-year returns to November 30, 2008, compiled by Globefund, the top-performing fund in Canada was a specialty fund that focused on alternative energy. The worst performer over that period? Another specialty fund, this one focusing on energy.

These facts spell out the fundamental challenge of investing in specialty funds — they can be extremely volatile.

Targeting new leaders

The past few years have seen an explosion of specialty funds on the market. Many target specific areas or sectors of the market. Specialty funds may focus on areas that hold promise, such as health care, technology, and alternative energy. By investing in one area, specialty funds try to capitalize on the underlying industry's potential rate of growth.

But before you invest, be sure to understand the potential downside.

- **Volatility.** Often specialty funds invest in newer and smaller companies. In some cases, these companies lack the stability of more established companies and can be more susceptible to changes in the marketplace. This translates into greater-than-normal price fluctuations. A specialty fund could just as easily lose 40% as gain 40%.

- **Increased risk.** Because these funds invest in sometimes narrow segments

of the market, they are vulnerable to economic changes in that sector. Other, more broadly based funds can diversify and spread their portfolios over several sectors, thereby reducing their risk.

Long-term focus

Because of the risk and volatility levels, specialty funds are best viewed as long-term investments. Over the short term, they may move up and down faster than you're comfortable with. But over the long term, you should see an overall positive trend.

Investing for the long term also means not panicking when the funds dip down. You don't want to sell your investments at the wrong time, and lock in losses.

The volatility of specialty funds also makes them ideal candidates for systematic, monthly purchases. When prices are down, you can add significantly to your holdings, which works to your benefit when prices go up.

Finding your balance

Holding one or more specialty funds in your portfolio can be a good way to capitalize on the growth potential of different market segments. But their volatility means they're not appropriate to make up the entire equity portion of your portfolio.

Professional advice can help you consider specialty funds in the broader context of your portfolio. ■

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