Portfolio advisor

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10 ways to make the most of your wealth in a "tortoise economy"

As an investor, you currently face several challenges, including "tortoise-like" economic growth, low interest rates and volatile stock markets.

In Canada, we're in for a prolonged period of slower economic growth, according to RBC economists – 2% versus 3% in the decades before the financial crisis of 2007-2008.

This in turn leads to more modest expectations for the financial markets.

RBC portfolio strategists believe stock markets are likely to go up over the next five to 10 years, but are unlikely to provide exceptional returns. And with ongoing risks like the European debt crisis, you can expect bumps along the way, like the recent correction.

Meanwhile, interest rates remain low, resulting in virtually zero returns on traditional fixed-income investments like GICs and government bonds once inflation is factored in.

These days, more than ever, you need to be very proactive in finding ways to build and protect your wealth.

In this issue of *Portfolio Advisor,* we look at 10 ways to make the most of your wealth by:

- Focusing on what you can control (such as tax-minimization strategies)
- Getting back to the basics (such as maximizing your RRSP/RRIF)
- Thinking beyond the norm (such as innovative tax-exempt insurance strategies)

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1 Don't put your portfolio on autopilot

It can be tempting to take a wait-and-see approach with your investments during periods of global economic and market uncertainty. Especially in the current low-yield, low return environment, it can seem like there's little to choose between different types of investments. But a closer look shows that there can be meaningful differences.

For example, in global fixed-income markets, the Global Portfolio Advisory Committee at RBC Wealth Management points out that government bonds are currently paying less than the rate of inflation. High-grade corporate bonds pay considerably more and offer better value. High-yield bonds pay even more, but entail much higher risk, especially if the economy were to weaken.

In the global equity markets, you also see key differences. For example, the Global Portfolio Advisory Committee's outlook is currently neutral for Canada and the U.S., but negative for Europe. On an industry sector basis, you also see differences, with the Committee's outlook more positive for the financial sector than the utilities sector in Canada and the U.S., for instance.

In other words, opportunities may be harder to find – but they are still there. By actively adjusting your portfolio's asset mix to reflect changing market conditions, you can take advantage of these opportunities, while at the same time reducing your downside risk.

*For our most recent outlook for global equities, fixed-income, commodities and currencies, please ask us for a copy of the latest **RBC Wealth Management Global Insights** published by the Global Portfolio Advisory Committee.*

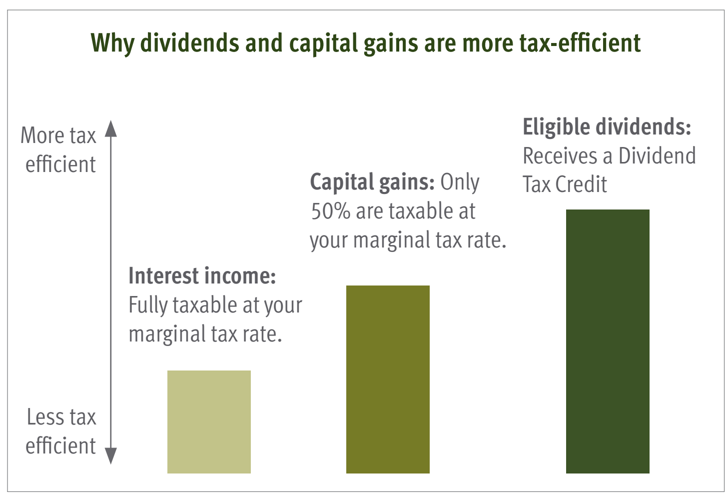
2 Focus on after-tax portfolio returns

In an environment where it's more difficult to earn returns, the saying, "It's not what you make – it's what you keep," just makes sense.

One way you can keep more is by focusing on how your different investments are taxed. Consider the following table, which shows the investment income you keep after tax in a regular investment account, based on your federal income tax bracket.

How much investment income you keep after tax for every $1,000 earned

Taxable income	Interest	Capital gains	Eligible dividends
Up to $42,707	$850	$925	$1,000
$42,708 – $85,414	$780	$890	$904
$85,415 – $132,406	$740	$870	$849
$132,407+	$710	$855	$807
All amounts are approximate.			



3 Allocate your investments tax-efficiently

How you allocate your investments between your registered and non-registered accounts can make a significant difference in the taxes you pay.

Generally, it makes sense to allocate more of your interest-bearing investments, like GICs and bonds, to your registered accounts, such as your Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF). Unlike other types of investment income, interest income earned in a regular non-registered account is fully taxable. But in your registered accounts, it accumulates on a tax-deferred basis.

Bear in mind that taxes are just one consideration in how you allocate your investments between your registered and non-registered accounts. Your risk tolerance and investment objectives are also key factors, and generally should be considered first.

4 Maximize your tax-advantaged retirement plans

Because investments within your RRSP/RRIF grow on a tax-deferred basis, they grow faster than they would outside your RRSP/RRIF. Generally speaking, it makes sense to contribute as much as you can to your RRSP to benefit from this tax-deferred growth (not to mention the tax deductions).

For the same reason, it can also make sense to delay converting your RRSP into a RRIF for as long as possible (the deadline to convert your RRSP is December 31 of the year in which you turn 71). Assuming you can draw income from other sources it can also make sense to withdraw only the legally required minimum amount from your RRIF, in order to continue benefiting from tax-deferred growth.

Quick Tip

If you're a business owner or incorporated professional such as a doctor, dentist, pharmacist or veterinarian, you can also benefit from an Individual Pension Plan (IPP), an enhanced retirement plan that enables you to create a retirement benefit up to $1 million larger than a regular RRSP, and contributions are tax-deductible to your corporation.

5 Maximize your tax-free account

The Tax-Free Savings Account, introduced in 2009, enables you to earn investment income and make withdrawals completely tax-free.

Similar to an RRSP, you can invest in the same sort of investments without paying tax on investment income earned within the plan. Unlike an RRSP, you don't pay tax – ever – on this income. In fact, you can make tax-free withdrawals at any time for any reason, and the amount you withdraw is added back to your available contribution room the following year.

Another key difference is that you gain TFSA contribution room regardless of your earned income. Every Canadian aged 18+ automatically receives $5,000 in contribution room annually (starting from January 1, 2009). That means if you haven't opened your TFSA yet, you can now contribute up to $20,000 to earn tax-free income.

If you are a higher-income earner, it can make sense to gift money that would otherwise be exposed to your higher tax rate to your lower-income adult family members to contribute to their own TFSAs. A family of four adults can shelter up to $80,000 from your higher tax rate in this way.

6 Take advantage of a spousal loan strategy at the historically low rate – before it's too late

Another way to shelter investment income that would otherwise be taxable at your higher tax rate is through a spousal loan. With this strategy, you make an official, properly documented loan to your lower-income spouse. Your spouse then uses the loan to invest – and the investment income is taxed at their lower tax rate.

Your spouse pays you annual interest at a prescribed rate, which is set by the Canada Revenue Agency. Although you have to pay tax on the interest payments, the tax savings on investment income earned by your spouse will more than compensate for this. Furthermore, the CRA-prescribed rate is currently at an historic low of 1%, making this timely strategy especially attractive.

If you want to take advantage of this strategy – and lock in indefinitely at the low 1% prescribed rate – you should act soon soon before the rate goes up.

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7 Invest through an insurance policy to reduce taxes now and for your estate

Insurance isn't just for protecting your family's financial security in case something bad happens. You can also use insurance to make something good happen – specifically, tax-free income and estate benefits.

One way is to invest "surplus" capital you're unlikely to need during your lifetime within a tax-exempt life insurance policy. The investment earnings accumulate on a tax-deferred basis, then eventually go to your heirs tax-free.

You can also invest within a tax-exempt life insurance policy to generate tax-free retirement income. You simply take out tax-free bank loans using assets within the insurance policy as collateral. When your estate is settled, the insurance benefit pays back the loans and any remaining balance goes to your beneficiaries tax-free.

8 Get paid while you wait with dividends

Stocks tend to go up over the long term, but fluctuate in the short term. You can mitigate the impact of these fluctuations by investing in dividend-paying stocks, which help offset any decline in the value of the stock. Effectively, you "get paid to wait" until the stock increases in value.

Stocks that pay dividends tend to be high-quality, blue chip stocks and tend to outperform. A recent RBC Capital Markets study showed that dividend-paying stocks – and in particular dividend-growing stocks – have dramatically outperformed stocks that don't pay dividends over time, when you reinvest the dividends.

In addition, dividends from Canadian corporations also receive a Dividend Tax Credit, making them a very tax-efficient source of investment income.

9 Receive value for your investment dollar

Taxes and inflation aren't the only things that can erode your wealth – fees can also make an important difference. Even an extra 1% or 2% can add up over time.

Firstly, you should be aware of all of your fees. Some investments can have high "hidden" fees, so insist on complete fee transparency.

Next, consider how you can reduce your fees (or costs). One way is to consolidate your investments from multiple, smaller accounts into fewer, larger accounts. With most investment firms, fees are on a sliding scale – the larger your account size, the lower your fee. As a result, you can achieve significant savings by consolidating.

It's also important to consider the value you're receiving for your fees. Ask us for a list of the services we provide as part of your relationship with us.

10 Protect your wealth

Building wealth in today's uncertain economy can be challenging, but you can take steps to protect what you've already built by ensuring you have adequate insurance coverage. There are several types of insurance that can provide protection in ways you may not have considered, both during your lifetime and when your estate is settled.

For example, "living benefits" insurance can protect your financial security if you experience an injury, disability or illness. You can also use life insurance to cost-effectively cover various taxes triggered on death – on anything from remaining RRSP/RRIF balances, to capital gains on recreation properties, jewelry and collectibles.

Please contact us for more information on ways to build and protect wealth in today's economy.

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