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It pays to know what your money is really up to

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The client A 54-year-old divorced single woman, no children. She owns a home with a mortgage. She earns an annual income of $110,000, and has no pension.

The portfolio The client had $300,000 in her RRSP, and $50,000 in non-registered investments. The RRSP was invested in five Canadian equity funds and two U. S. equity funds. Her non-registered account was invested identically to the RRSP, with the addition of a Canadian balanced fund.

The problem "The client thought she had a conservative portfolio," says David Phipps, a certified financial planner for Assante Capital Management Ltd. in Ottawa. "But in fact, she was invested 96% in equities and only 4% in fixed income." That makes her a growth investor and her portfolio dives sharply when the market is in decline. Her holdings weren't tax efficient, either. The client held $50,000 in the non-registered portfolio, while at the same time having non-tax-deductible debt on her line of credit and mortgage. On top of that, "the little bit of fixed income she had was held in a taxable account." The portfolio's equity funds lacked diversification and suffered from duplication of mandates. So, why did she believe her portfolio was low-risk? "Her investment statements did not report the internal rate of return," Mr. Phipps says, "so the client had a hard time monitoring the account's performance."

Thefix Mr. Phippsdetermined that the client would be more comfortable with her assets allocated 60% equity and 40% fixed income, but decided to move the portfolio to 80% equity and 20% fixed, with a plan to move to 60/40 once the markets recover. "This approach balanced the client's desire for less risk with her concern about moving to a lower-risk portfolio at the bottom of the market." His next step was to diversify her equity holdings by asset class, geography, industry sector and security. He sold the mutual funds in the RRSP and invested the proceeds in a managed portfolio offered by SEI Investments Canada. The portfolio was chosen because it re-balances automatically to ensure the asset mix does not drift too far from the client's wishes. "And the Management Expense Ratio (MER) is lower than the MER being paid for individual mutual funds," he adds. In addition, each asset class is allocated amongst several money managers for diversity by investment style.

The advice As for the nonregistered portion of the portfolio, Mr. Phipps asked his client: "If you came into my office today, would you choose to borrow $50,000 and put the money in the stock market?" Because that is exactly what she is doing, he says. "Anyone who has a mortgage and a non-registered portfolio is effectively choosing to borrow to invest. At minimum, they should restructure the debt to make it tax-deductible, but more often then not the client should simply pay off the debt."

The outcome He sold off the $50,000 non-registered portfolio, paid off the line of credit and applied the remaining proceeds against the mortgage. The final move was to arrange quarterly statements, which show the rate of return for the whole account, so she is no longer in the dark about what her money is up to.

THE NEW PORTFOLIO

22% Canadian equity large cap

3% Canadian equity small cap

24% US equity large cap 4% US equity small cap

22% Europe Australasia and Far East (EAFE) equity

5% Emerging markets equity

10% Canadian fixed income

4% Real return bonds

3% Global bonds

3% alternative investments

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