

INVESTMENTSOLUTIONS

In an environment of low GIC rates and market volatility, investors continue to search for investments offering higher yields and lower volatility. Fortunately, income fund options provide a solution along with the potential for capital appreciation.

Income-generating funds typically invest in high yield bonds, preferred shares, income trusts, dividend-paying common shares, or a combination of these investments. As the chart below illustrates, diversification among these asset classes with low correlation to each other is critical for keeping volatility low and ensuring a stable income distribution.

Diversified income funds invest in a mix of these asset classes. For example, Franklin Templeton's Diversified Income Portfolio invests in all these asset classes and has an annual income yields of over 4%. CI Signature High Income has a heavier weight in income trusts and an annual yield in excess of 6%.



Income investments represent a solution for investors who want to achieve higher yields

Dividend funds such as Bissett Dividend Income and Mackenzie Maxxum Dividend Growth focus on dividend-paying common shares. Both funds have slightly lower income yields than the diversified income funds mentioned above but may offer greater capital appreciation given their focus on equities.

Investing for Income ←

Another income option returns a portion of the investor's original capital within their monthly income stream. This structure defers some of the taxes payable on income distributions in non-registered accounts. Franklin Templeton and Mackenzie both offer return of capital structures called "T-Series" and target an annual income yield of 8% for unit holders.

Income investments represent a solution for investors who want to achieve higher yields than those offered by ordinary bonds or GICs, and those who prefer less volatility than many equity investments provide. Speak to your Rice Financial advisor today about using these income solutions to enhance your income stream. •

Asset Class	Preferred Shares	High Yield Bonds	Income Trusts	Dividend-paying Common Shares
Preferred Shares	1.00	0.00	0.34	0.07
High Yield Bonds	0.00	1.00	-0.04	0.29
Income Trusts	0.34	-0.04	1.00	0.44
Dividend-paying Common Shares	0.07	0.29	0.44	1.00

A low correlation (value closer to zero) suggests little relationship between two investments. Such a pairing would typically provide lower volatility in a portfolio as would investments with a negative correlation. * Source: Guardian Mutual Funds - Monthly returns from January 1998 to June 2003

Managing your portfolio for tax efficiency

After ensuring the asset allocation and diversification in your portfolio is consistent with your risk tolerance and objectives, another important consideration for making the most of your investment returns is tax efficiency.

First, it is necessary to understand how different investments are taxed.

Conservative investments such as bond funds, guaranteed investment certificates (GICs), and money market funds usually produce interest - 100% of which is taxable at your marginal tax rate. Dividend-paying investments such as dividend funds are tax-preferred and therefore taxed at a lower rate. Finally, equity funds - which offer the potential for capital gains - are the most tax preferred in that only half of capital gains are taxable at your marginal tax rate.

Next, you must understand how different accounts are taxed.

Since open, non-registered or cash accounts do not offer tax sheltering, income from these investments is taxed according to the type of income generated, as discussed in the previous paragraph.

Registered accounts such as retirement savings plans (RSPs), locked-in retirement accounts (LIRAs), retirement income funds (RIFs), and locked-in retirement income funds (LRIFs) allow your investments to grow tax free until withdrawn from the account, at which time they become fully taxable at your marginal rate.

Now, you can determine a strategy

Given this knowledge, it makes sense to hold tax-preferred investments outside your registered account and interest-bearing investments within your tax-sheltered account.

Following this strategy, the interest generated by your GICs, bond funds, and other interest-paying investments would be tax-sheltered until withdrawn, while your dividend or capital gains-producing investments would benefit from their tax-preferred nature in your non-registered account.

One additional benefit to holding capital gains-producing investments in non-registered accounts is that you may elect to trigger and retain a capital loss in order to offset future capital gains and the resulting taxes. Capital losses cannot be used in this manner within registered accounts.

A possible exception to this strategy would be the use of interest-paying investments for emergency funds or capital purchases. In these cases, the need for safety of capital and liquidity is more important than planning for tax efficiency. That said, some tax-preferred options now exist to fill this void as well.

Speak to your Rice Financial advisor today to ensure your account is being managed for optimal tax efficiency, in order to maximize your investment returns.

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Mackenzie

