



Express

Planning to retire? Retire with a plan!

At what age would you like to retire? Where would you like to live, and on how much income? Leaving full-time work will likely free up nearly 2,000 hours a year – even more when you factor in commuting. How will you use that newfound time?

Cold, dark winter days make it easy to fantasize about retirement and the freedom to do whatever you want, whenever you want. That can be attainable, but when and to what degree will depend on how well you do your planning. The start of the year is always a good time to check your progress.

Let's review some of the key issues.

- **How much income will you need?** The traditional rule of thumb is 70% of your pre-retirement income, but the actual level will depend on your desired lifestyle. Research by Statistics Canada has found that many people retire comfortably on much less – 50-60% of their full-time income. But, of course, many need more – especially those who intend to do a lot of travel or have expensive hobbies. How well have you been managing your spending? What's the likelihood that you'll be debt-free at and in retirement?
- **What's your life expectancy?** This is greatly affected by your current state of health, lifestyle and the genes inherited from your parents. Canadians are living longer than ever. There's more than a 25% chance that an average 45-year-old man will live past 85. A 45-year-old woman has about a 50% chance of passing 85 and better than a 25% chance of living past 90. Increased longevity and a trend toward early retirement mean many Canadians will spend as long in retirement as they did in their careers. This question can be phrased another way: how long must your desired retirement income run?
- **How important is it to you to leave an estate for your loved ones and/or a charitable bequest?** There are several ways to use life insurance to achieve such estate planning goals – and it's even possible to secure these gifts while generating tax breaks for use now. Your NBF Investment Advisor can explain the ins and outs of using insurance for estate planning. Alternatively, your advisor can structure your retirement income plan to ensure that enough of your savings remain intact for your heirs and favoured organizations.
- **What are reasonable investment returns?** Nobody can make predictions about investment returns with absolute certainty, but we can make reasonable assumptions and then keep revising them. Talk to your Investment Advisor about your comfort level – otherwise known as your "risk tolerance." Your advisor can then see how well your current holdings fit within that zone, offer an opinion on likely returns going forward and provide recommendations if any changes are warranted. Above all, be aware that few, if any, reputable market analysts expect investment returns in the next decade to match those of the booming 1980s and '90s. This points to a need for sound asset allocation, judicious investment selection and ongoing risk management.

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- **What's a reasonable assumption for long-term inflation?** This is one of the most important assumptions in your retirement planning. If inflation averages 3% a year, today's dollar will lose half its value in 23 years. Even at a seemingly low level of 2% – the middle of the government's target range – inflation will halve your purchasing power over 35 years.
- **How much do you wish to rely on government programs?** Together, Old Age Security and the Canada/Quebec Pension Plans were designed to replace no more than 40% of income for an average wage of \$40,000. Maximum payments for 2005 will total just under \$16,000. The federal government, which runs and funds OAS, has said its current design is sustainable as long as Ottawa avoids a return to budget deficits. But the OAS program's size and rapid growth suggest there may be a need for changes at some point. Also consider the outlook for Medicare. Health care is a huge wild card. We all know that Medicare is under stress, and should consider the potential impact on our retirement income of having to pay more health-related expenses out of our own pockets.
- **Do you expect a pension from your employer? If so, how good will it be?** Pension plans vary widely in design, benefits and security. If you haven't already done so, read the members' guide for your plan. And, ask your NBF Investment Advisor to assess your employer-sponsored plan and how it can fit with your own saving and investing. For example, those such as public sector employees who belong to high-quality defined benefit pension plans can arguably be more aggressive with their own investing than those who lack guaranteed, fully indexed pensions. Definitely discuss this with your Investment Advisor if you are in a defined contribution pension plan or group RSP. Those plans are very similar to your own RSP, and your advisor can coordinate the total asset allocation so that your investments all work together, no matter which plan they're in.

- **Do you expect to work during retirement?** Many Canadians do, as discussed in the article on the next page. Part-time, casual or project-based work offers abundant benefits, especially for early retirees.

The questions above are aimed at enabling you and your Investment Advisor to determine how much capital you should have at the start of retirement – in your RSP and regular investment account. Then, based on how much you have now and your risk tolerance, your advisor can develop recommendations on how much you should be setting aside each year, as well as how that money should be invested.

But retirement is about more than money – much more. Here are some “soft” issues to think about.

- **What does leisure mean to you – and to your spouse?** Start a dialogue right now if you haven't done so already. Couples face enormous change when they suddenly find themselves together all the time. That can easily strain the unprepared.
- **How do you measure your success and personal satisfaction?** This can be a huge issue for those who have left high-pressure careers. Business owners and senior executives often have trouble gearing down. Commissioned salespeople and others on incentive pay may also find it challenging to do things just for pleasure.
- **How much can you rehearse?** Try out retirement-related activities now to smooth your transition later. Investigate new hobbies and different kinds of work, such as volunteering, small consulting projects or part-time teaching. Rehearsal is especially useful if you plan a dramatic lifestyle change – for example, moving from the city to a rural area, or leaving Canada for another country. Remember, though, that retirement planning is a dynamic ongoing process, not a one-time project. The plan you have now reflects your dreams, numbers and assumptions as they stand today. Next year's dreams may or may not be the same as this year's, but the numbers and assumptions are bound to be somewhat different. Your NBF Investment Advisor can help devise a reasonable plan, measure its progress and make the inevitable adjustments required to keep both your retirement dreams and investments on track.

The new retirement pastime: a job

Retirement used to be an on-off proposition. One day a person was working, the next day they weren't. Period.

That's changing. More and more, people and the organizations they work for are considering various forms of phased retirement.

The 2001 census found that more than 365,000 Canadians over 65 were still in the workforce. That was up 16% over 10 years, while the total labour force grew just 10%.

A national public opinion poll done in 2004 found that 61% of baby boomers aged 40 or older expected to have some form of phased-in retirement. And a human resources consulting firm reported that one-third of the older workers it surveyed would be willing to delay their planned retirement date if offered a flexible arrangement that allowed them to reduce their hours in stages.

Many retirees work not only for income but to keep socially, mentally and physically active. Still, the financial benefits can be profound.

Boost flexibility and security

Let's say you're 15 years away from your target retirement date. You figure you'll need \$30,000 in today's money to top up your government retirement benefits and employer pension, if any. You want that income stream to run 30 years and be indexed for 3% inflation. Your RSP is now worth \$250,000 and you assume it will average 8% in compound annual growth until retirement, and then 6%. With no other income in retirement planned, you would have to save approximately \$3,900 annually over the next 15 years. That assumes each year's RSP contribution is increased by 3% to offset inflation.

But what if you plan to work part-time during your first five years of retirement? Suppose you figure you can make \$8,000 a year and conservatively assume no wage growth. How much of a difference would that make? First, the target income stream you have to produce from your own money is now \$22,000 for those five years – not \$30,000. Second, this means the \$8,000 difference can remain invested, continuing to generate growth that will keep compounding over time. In this scenario, your annual savings requirement would be \$2,332 – about 40% less than before. But why not continue to save at the \$3,886 level? You could then boost your 30-year \$30,000 income target by \$1,750 a year – a cushion of nearly 6%

that's fully indexed for inflation. Either way, planning for a bit of work in retirement can increase your flexibility and financial security. So, what would it take to earn \$8,000 a year as a working retiree?

Ironically, the movement toward part-time, casual and project-based employment that caused so much chagrin in the 1980s and '90s will make it much easier for retiring boomers to keep working, but at a pace over which they have substantial control. And, those people and their skills will be in high demand; demographers have warned that the Canadian economy faces a major labour shortage starting in about 2010. Indeed, shortages have already hit some fields.

Of course, there's growing interest in self-employment too. The number of businesses run by those over 55 grew by 30% between 2001 and 2004 – four times the growth rate for businesses run by those younger than 55.

Phased-in pensions

Ideally, older workers with pension plans should be able to work fewer days for less money and top up their income by collecting part of their pension early. Unfortunately, federal income tax rules require pensions to be paid in equal instalments and do not allow you to receive payments from a pension plan in which you are still accruing credit. But there is mounting pressure to relax those rules, and authorities in Quebec and Alberta already offer a way around them.

The phased retirement concept developed by Quebec and later adopted by Alberta is for those within 10 years of their pension plan's normal retirement date. If their employer agrees, they can reduce their hours of work and draw annual lump sums from their pension plans to make up the lost income. The federal tax department has approved these deals by stating that the lump sums are essentially the same as cashing in part of the pension entitlement. There are, however, limits on how much a person can take and a new withdrawal application must be filed each year. The Quebec and Alberta provisions are somewhat cumbersome, but have established a benchmark. Coming years will likely bring more change in those two provinces and throughout Canada.

Another boost in the RSP ceiling

People with substantial income get to put an additional \$1,000 into their RSPs, with the top limit pegged at \$15,500 for 2004 and \$16,500 for 2005.

These steps are part of a series of increases set out in the 2003 federal budget. Plans call for the RSP ceiling to top out at \$18,000 for 2006. After that, it will be indexed to growth in the average national wage.

RSP contribution ceilings

Tax year	RSP ceiling*	If earned income in the prior year was at least
2003	\$ 14,500	\$ 80,556
2004	\$ 15,500	\$ 86,111
2005	16,500	91,667
2006	18,000	100,000
2007	Indexed	Indexed

* Assumes no membership in an employer-sponsored pension plan or DPSP.

These changes only affect the RSP ceiling. Your personal RSP contribution room is still based on 18% of earned income for the prior year, plus any unused contribution room from previous years, minus the "pension adjustment" reported by your employer on your T4 tax slip if you belong to a pension plan or deferred profit-sharing plan.

As the table shows, those with at least \$91,667 of earned income in 2004 are allowed to contribute as much as \$16,500 to their RSPs for 2005. Notice that the ceiling planned for 2006 will cover as much as \$100,000 of income earned this year. If you own an incorporated business, you might wish to have your accountant review how much compensation you take as salary and how much as dividends. Salary creates RSP room; dividends don't.

Do you still need foreign content?

The loonie has been soaring in foreign exchange trading, especially against the U.S. dollar. That's good news because imported items will cost us less and so will foreign travel, especially the midwinter getaway that so many Canadians cherish. But the loonie's ascent also makes it harder for foreign investments to deliver the returns we've come to expect.

Foreign stocks, and the mutual funds that hold them, got an extra lift as our dollar suffered a prolonged slump in foreign exchange trading from 1974 to 2002. Those shares could have been flat or even down in trading on home stock markets, but still show a gain here when converted to Canadian currency.

Now, it's the other way around as the loonie heads up. There was a powerful example of this in 2003. U.S. stocks, as measured by the S&P 500 Index, gained 26.4% when valued in greenbacks. But investors here got just 5.3% when the S&P stock values were expressed in Canadian dollars. The accompanying chart shows this and the reverse effect which occurred in 1997-98 when the Canadian dollar fell. Note that the two sets of columns reflect returns on the same investment, the S&P 500 Index. The only difference is the currency in which the returns were reported. The light grey column is for returns valued in U.S. dollars. The dark grey one shows what a Canadian investor got when those returns were converted to Canadian dollars. The black line shows annual changes

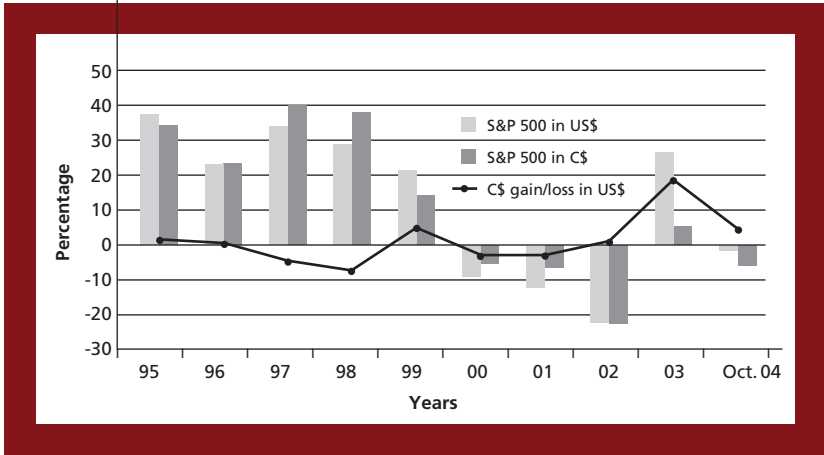
in the exchange rate. See how a falling loonie boosted the Canadian dollar returns while a rising loonie hurt them?

A few mutual funds use derivatives to hedge their exposure to currency fluctuations, but that can be expensive and is far from a sure bet; currency movements are extremely difficult to predict.

Frankly, recent years have been quite frustrating for Canada's global investors. Even before the loonie took off, world markets were struggling in the wake of the big bear market, corporate governance scandals, geopolitical instability and more recently, the oil price shock. In contrast, Canadian stocks have done relatively well. All of a sudden, it seems, our natural resources are in major demand, our factories are running at their highest levels in a decade, yet inflation remains relatively low.

So, does your RSP or RIF still need foreign content? Yes. The reasons why you looked beyond our borders before are just as valid now.

Currency can help or hurt returns



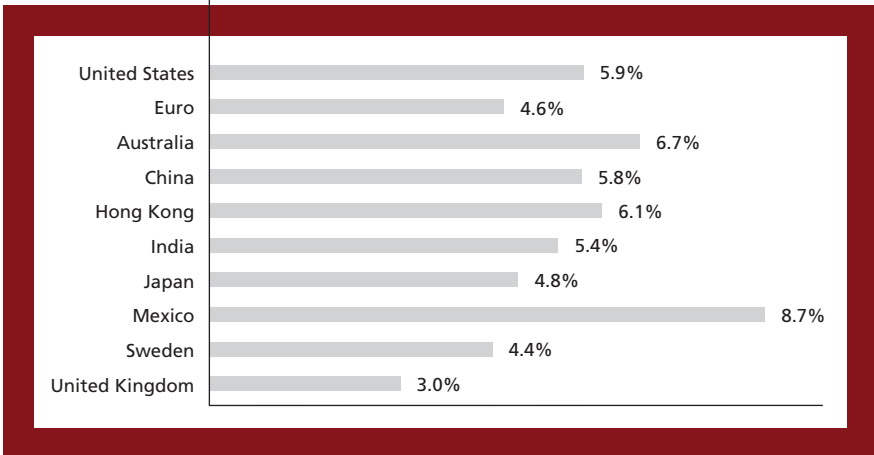
Asset allocation is based on diversification. As academic studies have shown, it is very difficult to consistently predict market turns. So, prudent investors spread out their investments, fully expecting that some will soar at various times and slump at others. Canadian stocks are riding high now in large part because there is strong demand for natural resources. But the resource market is cyclical.

Canada still accounts for less than 3% of the total capitalization of the world's stock markets, and only a handful of Canadian companies rank among the top global competitors in their sectors.

The Canadian economy is thriving, but our future growth prospects are still not as strong as those for emerging powerhouses such as China and India. Globalization has made world economies more interdependent, as the bear market showed, yet countries still vary widely in economic activity and outlook.

Our perception of the loonie's rise has been skewed by its incredibly strong gains against the U.S. dollar. Just three years ago the Canadian dollar was worth 62 cents; now it's over 80 cents. Be aware, though, that it has not appreciated anywhere near as much against other currencies.

The levitating loonie
Canadian dollar gains for January–October, 2004



The loonie has been gaining value due to a variety of fundamental factors that will likely continue for some time. But there is absolutely no guarantee that this is a permanent state of affairs; currency trading is volatile and unpredictable. Most financial advisors recommend foreign investing to help hedge exposure to adverse changes, not to maximize short-term gains. Remember that the imported goods and food we buy will become more expensive if – or when – the loonie dives. So will those mid-winter getaways Canadians cherish so much – a key concern if your retirement dream includes wintering down south.

Should you fully capitalize on the 30% in foreign content allowed in your RSP or RIF? There is no one-size-fits-all level. Your NBF Investment Advisor can provide the latest commentary from our Chief Economist, Clément Gignac, help you assess the risk-reward tradeoff of foreign investing and relate it to your own goals and objectives. You might even find that an increasingly strong loonie makes this a buying opportunity, as foreign investments cost less in Canadian dollars.

Options offer RSPs insurance and income

Suppose your RSP holds a blue chip stock that has done really well and you're concerned that it, or the market as a whole, might be poised for a downturn. Wouldn't it be nice if there was some way to protect those gains? Well, that's in the works – and may be available by the time you read this.

Last year, Finance Canada published a huge volume of proposed tax-law changes. Among them was a little-noticed proposal to allow RSPs and RIFs to buy "put" options that trade on public exchanges. This change had not yet been enacted at the time of writing, but tax officials told us they were working on it. Once finalized, it will be retroactive to February 27, 2004.

A put gives you the right to sell a stock at a pre-set price anytime during a set period. You could set the put's "strike price" at today's value, a bit higher or a bit lower. As you might expect, you would have to pay more for a put with a strike price above today's level. The put's cost will also depend on the time left until the option expires. The longer the term, the greater the cost. Options normally run no more than 12 months, but there are certain ones called LEAPs that run up to two years.

The Montreal Stock Exchange lists options on more than 60 Canadian companies. Your NBF Investment Advisor can easily tell you if there are options on the shares you own in your RSP, their cost and availability. Options trade like stocks; prices change constantly and each contract covers 100 shares. There are also options available on several exchange-traded funds which reflect a whole stock market index or subindex. An ETF put might be able to insure all or part of your entire portfolio.

Is this call for you?

Tax rules already allow RSPs and RIFs to buy and sell "call" options, but many investors overlook this opportunity. A call is the reverse of a put. An investor who buys a call gets the right to acquire stocks at a pre-set price any time during a set period. Here are two ways in which your plan might use a call.

"Covered calls" are often used by conservative investors to generate income from stocks that are eligible for options trading. Suppose your RSP owns 100 shares of the Marvellous Mythical Company (MMC) that you bought at \$35. You ask your NBF Investment Advisor about selling a call on those shares. Your Investment Advisor says your plan can earn \$2 per share if

you are willing to let the stock go for \$45 anytime over the next three months. (For simplicity, we're ignoring commissions.) If the market value of MMC reaches \$47 – the \$45 strike price plus \$2 option premium – your shares will be called away. You've then made a profit of \$12 per share – \$10 on the stock and \$2 from the option premium. What if MMC doesn't go that high? The call will likely expire and your plan will keep the 100 shares and the \$200 in option premiums. That \$200 amounts to a 5.7% return over three months – and you still get to keep any dividends paid during that time. You're then free to write a new call and start the process again. Note, though, that writing a call means capping your upside potential. Suppose, in this example, that MMC soared to \$80. Your plan would have had to sell its shares at the agreed-upon price of \$45.

Here's a strategy if you are an aggressive investor and feel confident that a stock is heading up. Ask your Investment Advisor about the pros and cons of buying a call instead of the shares themselves. A call contract for 100 shares would cost much less than the actual shares, so your plan could benefit from substantial leverage – if the stock does indeed rise before the call expires. There's a variation on this. Suppose an unexpected corporate or market development creates a great buying opportunity for a stock you've been eyeing, but at a point when your plan doesn't have much cash. If the stock is options-eligible, you could buy a call for exercise when the cash will be available, maybe after a bond matures or when you make your RSP contribution for the coming year. You could then buy the shares at the strike price, rather than the price at which the stock is trading when you exercise the option, and hopefully save enough to cover the premium you paid for the call.

Get professional advice

There is a wide range of options strategies. They can be quite powerful, but also quite complex and risky as time works against you. Your NBF Investment Advisor has the training, expertise and access to information required to help you navigate these waters.

A long-term tax-saving RSP strategy

Spousal RSP contributions offer an easy – but often misunderstood – long-term way for couples to save tax by balancing their income in retirement.

Take the case of two retired couples with taxable income of \$80,000 in 2004. One spouse in the first couple had \$70,000 in taxable income, while the other had \$10,000. The second couple's \$80,000 of income was balanced at \$40,000 each. The first couple paid as much as \$3,000 more in tax, depending on the province. The higher-income spouse also lost some Old Age Security benefits due to the OAS high-income "clawback."

This income-splitting strategy can pay off before retirement, too. Many couples plan for the recipient spouse to withdraw the money well before then. Maybe this spouse will quit his or her job to raise children, become a full-time student or launch a business. The withdrawals would then face little or no tax.

Here are six common questions about spousal RSPs.

- **Do I save tax today?** No more so than with a normal RSP contribution. This is a long-term strategy. Unless the recipient spouse stops working early, the benefits normally come only in retirement, but to reap them you must start balancing your savings long before then.
- **Does this increase my contribution limit?** No. Your limit stays the same; you just put some or all of it into a plan for your spouse.
- **Who gets the tax deduction?** The contributor.
- **What happens if we break up?** Provincial equalization laws usually grant each spouse 50% of the retirement assets accumulated during the marriage, or 50% of their value. So you and your spouse have a claim on each other's RSP with or without spousal contributions. There is, however, a potential pitfall for common-law and same-sex couples. The federal RSP rules treat them the same as formally married couples if they've lived together for at least one year or have a child together by birth or adoption, but they may not be subject to provincial equalization laws if they split up. Consult a lawyer about the equalization law in your province and whether any gap might be covered by a cohabitation agreement.

- **Who gets taxed when the money is withdrawn from the RSP?** The recipient spouse – if the contributions have passed their "attribution period." Withdrawals during that period get taxed in the hands of the contributor, not the recipient. The attribution deadline falls two years after the end of the year in which the contribution is made. Since RSP contributions tend to be made in January and February, many advisors refer to this as a "three-year holding period."

The attribution period for a contribution made anytime in calendar year 2005 will end on Dec. 31, 2007 – whether the contribution gets claimed for 2004 or 2005. The deadline is based on the calendar year the contribution is made, not the tax year for which it's claimed. Suppose that instead of waiting for RSP season, you made a 2004 spousal contribution on Dec. 31, 2004. Its holding period will actually run just two years – to Dec. 31, 2006.

Be careful, though. Tax authorities do not distinguish between spousal contributions that have passed their attribution deadlines and those still in the holding period. In other words, the first withdrawal should be delayed for at least two years after the end of the year in which the last spousal contribution was made. Usually it's wise for the recipient spouse to have two RSPs – one for spousal contributions and one for his or her own. Withdrawals can then be made from his or her plan at any time without facing attribution.

There are several situations in which withdrawals can be made during the attribution period without the contributor getting taxed. Attribution ends if the marriage fails and the spouses live apart. It also ends if either spouse dies or becomes a non-resident for tax purposes, or if the RSP is converted to a registered retirement income fund (RIF) and only the minimum required withdrawals are made.

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There is also a loophole for some couples if a withdrawal is made from the spousal RSP under the RSP Home Buyers' Plan or Lifelong Learning Plan. That money is supposed to be paid back. Any annual instalment that's missed gets added to the planholder's income and taxed accordingly. Even though the money was taken out during the holding period, the recipient spouse – not the contributor – will be the one taxed if it's not paid back.

- **Should the higher-income spouse always contribute to the other's plan?** Not necessarily.

The focus is on future, not current, income. Sometimes it's better for the lower-income partner to make the spousal contributions. Here are six examples:

- > The lower-paid spouse has a good pension plan while the other has a poor one or none at all. Though one spouse earns less now, the pension might be enough to reverse the situation in retirement.
- > The higher-paid spouse plans to start a business. That often means a substantial drop in income during the early years, and therefore less ability to save for retirement.

- > The lower-income spouse's RSP is far larger thanks to earlier investing, higher contributions or better growth. Say both are 35 and one RSP has \$30,000 while the other has \$10,000. If both grow at an average of 8% a year, today's \$20,000 gap will widen to more than \$200,000 at age 65.
- > The lower-paid spouse is in line for a large inheritance.
- > The lower-paid spouse is starting out in a profession, such as law or medicine, that demands great sacrifice now with considerable rewards later on.
- > The higher-paid spouse plans to take off time for child-raising, education, travel or some other purpose. With little or no income, he or she could withdraw RSP money at little or no tax – if it's outside the spousal contribution holding period.

Your NBF Investment Advisor can help you analyze your situation and determine if spousal RSP contributions would be worthwhile, as well as who should be making them.

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