SECURE INVESTMENTS?

Savings Bonds are being offered to "investors" right now at rates ranging from 1.75% to 5% and at the same time the inflation rate has just risen to 2.2% from 2%. I understand that the people most attracted to savings bonds are those who are risk adverse. But call me crazy, I don't see how someone who is a self-described financially risk adverse investor can justify guaranteeing themselves a negative return on their money - because that is exactly what they are doing at such low rates.

My experience managing investments tells me that there are some people who are literally petrified of losing money. And who really wants to anyways? But if you ask any financial advisor what the **real after-tax rate of return** on your money is, they will tell you that you are in fact losing money if you invest at these low rates – particularly if the money is held outside a tax sheltered environment such as an RRSP or RRIF.

If you consider an investment at 2.45% for a year when you are in a 38% marginal tax bracket (depending on where you live this rate is for people who earn approximately $31,000 to $62,000 per year), and inflation is 2.2%, your return is really -0.67%. That means that on a $10,000 investment your one-year return is $9,933 – you lost $67. If your $10,000 investment were tax sheltered it would really be worth $10,024.46. You would have really made $24.46 – not the $245 you thought you made!

The purpose of investing is to get your money working for you, not the other way around. I can't help but wonder if people who are so risk adverse that they always put their money in particularly "safe" investments simply aren't aware they are really guaranteeing they lose money. The survey released with the launch of Canada Savings Bonds found that security of savings ranked as the number one priority for 68% of those surveyed – ahead of potential rate of return. But building in a negative return seems like we really need is to be more informed about where we're putting our money – not "safer investments".

My guess is that the average person still considers savings bonds to be investments, when really they should be treated like their name says – as savings. Savings and investments are different. Investments are for long term growth of capital and savings are for short-term needs. Sometimes we need a place to "park" some money for a specific purpose such as saving for a home, emergency funds, holiday money, etc. This is what savings are for. But, if we are so concerned about having enough capital for future needs, that we are afraid to "lose" any money, then savings is not the place for this type of money.

The logical way to proceed is to get educated on how to best make sure future needs are met and to work with someone who can offer some simple tips to reduce the effects of taxes and inflation. Here are a few you can ask about when you meet with your advisors:

- Interest is fully taxable. Is there a more tax efficient way to invest in interest bearing securities – i.e., would it be better to hold them inside an RRSP or RRIF and have your equity mutual funds outside the registered plan?
- Capital gains and dividends have preferred tax treatment and offer the potential for tax planning. Find out how this might affect your own personal situation.

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- Interest is “deemed” to have been earned in the year it was credited to your account, so if you invest in compounded investments, where interest isn’t actually received physically into your hands until maturity, remember you must still pay tax on the money you earned but haven’t received yet – therefore you are out of pocket the tax owing with no cash received yet.
- If you receive interest at the end of the year you will be paying tax on those earnings in April of the next year; however, if you receive interest at the beginning of the year, you don’t pay tax until the following April – therefore you hold on to the full amount of your earnings longer until you have to pay the taxman.

And finally, there are a lot of different types of investment risk – inflation and taxes are only two. The one most people really fear is stock market risk, because this is the one that is most frequently discussed. But if you consider this simplified example below you might understand why diversification – not just safety of principal, is really the ONLY way to reduce investment risk. This is a chart of two investors, each with $100,000 invested for a 25-year period.

	Amount Invested	**Rate of Return**	**Investment**	**Value after 25 years**
Mr. & Mrs. Conservative	$100,000	8%	Government Bonds	$685,000
Mr. & Mrs. Investor	$20,000	100% loss	Gambling in Penny Stocks	$0
	$20,000	0%	Hid in mattress	$20,000
	$20,000	5%	Treasury Bills	$67,000
	$20,000	10%	Corporate Bonds	$216,000
	$20,000	15%	Blue Chip Stocks	$658,000
			Total:	**$961,000**
			Difference:	**$276,000 more** than the Conservatives

Maybe you don’t have $100,000, or maybe that’s all you have and you’re happy to still have your principal intact, but over time the erosion of purchasing power from taxes and inflation is a consideration that everyone needs to consider and every little bit counts. Find out how you can avoid unnecessary loss

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