THE SEVEN BIGGEST MISTAKES RETIREES MAKE WITH THEIR INVESTMENTS

The financial industry is dominated by endless conversation concerning the movement of stock and bond markets, if equities are over-valued, when interest rates will rise and how to effectively diversify risk. The financial media's intense focus on all things investing is understandable because their audience has a vested interest: Canadians have trillions invested in investment funds, stocks and bonds.

Needless to say, the stakes are high. Investors spend 30 to 50 years, working, saving and investing their money for the time when they ultimately retire and begin to draw down on the fruits of their labour. Mistakes have to be minimized and there are countless pitfalls.
This article focuses on an equally important aspect of investing that does not receive as much attention as it should: the mistakes retirees make with their investments and strategies to avoid making them.

Mistake #1: Preoccupation with Dividends

Dividends sound like an investor's dream — particularly a retiree. You buy a stock and receive a steady quarterly payment that generally rises over time. There are five Canadian banks, three pipelines and three telecoms, amongst other stocks on the S&P/TSX 60, currently paying dividends of more than 3.5 percent. Some retirees would buy these 11 stocks and call it a day.

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Besides not being well diversified, there are other problems with this approach.
Dividends are a cash distribution of profit agreed upon by a company's board of directors. Companies that do not pay dividends may be equally profitable, but their board of directors may decide to reinvest the profits in the business, leading to future growth or future dividends. So, a company that does not pay out a dividend or pays a lower dividend may provide more of its return to an investor in the form of future capital gains, stock price increases or dividends. Dividend yields alone do not make one stock a better investment than another.

From a taxation perspective, in a taxable non-registered account, capital gains are only 50 percent taxable and tax is only payable once capital gains are realized when a stock is sold. Dividends, on the other hand, are taxable every year as an investor receives them. Capital gains may therefore allow for better tax deferral and even better tax efficiency in non-registered accounts.

The point is, there are different ways to earn a return. You can create your own dividend by simply selling appreciated investments over time as you need the income. There is also research that suggests that smaller companies that pay lower dividends or no dividends may generate higher all-in returns than established dividend-paying stocks over the long run.
Try to avoid accumulating a portfolio of bank stocks, pipelines and telecoms simply because they have high dividends. Everyone else knows they have high dividends too, so buying them is not somehow outsmarting the stock market or other investors.

Mistake #2: Reluctance to Realize Capital Gains

Capital gains can be a bit of a trap. Investors buy stocks, sometimes hold them for a long time and often end up with large deferred capital gains in taxable non-registered accounts. Tax paralysis can prevent people from selling appreciated investments that they do not really want to own anymore or can cause an individual holding to become too large a proportion of an

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investor's portfolio.
The result may be that tax deferral becomes more of a priority than prudent investing. In these cases, the benefits of tax deferral — which is not like tax savings and is only temporary — may be offset by a poor investment strategy.

Seeing as how capital gains will need to be realized eventually, whether to help fund retirement or at the very least at death when you are deemed to sell all your assets, a strategic realization of capital gains may be better than indefinite deferral.

Mistake #3: Drawing a RRIF Too Late

You may not have to take withdrawals from your Registered Retirement Income Fund (RRIF) until you turn 72, but that does not mean that you should always wait that long. Particularly for those who retire early, taking RRIF withdrawals long before age 72 should be considered. RRIF withdrawals are fully taxable and if a retiree has a low income in their 60s, but a high income in their 70s, they often end up paying more lifetime tax by deferring their RRIF withdrawals. Delayed RRSP conversion could lead to a retiree being pushed into a higher tax bracket or even having their Old Age Security (OAS) pension reduced or outright eliminated through OAS clawback if their income is too high.

Mistake #4: Preserving Investments by Starting CPP/OAS Early

Most Canadians start their Canada Pension Plan (CPP) and Old Age Security (OAS) pensions at age 65. The reason is two-fold.

The first is because they get CPP and OAS applications in the mail when they are 64. It is suspected that most people simply assume they are supposed to fill them out and just start their pensions at 65 by default, without much foresight.

Another reason is that most people would rather preserve their investments by starting their

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pension incomes than draw down their investments and delay their pensions. CPP and OAS can be delayed until age 70 at the latest and result in 8.4 per cent and 7.2 percent annual increases in pension entitlement respectively. For those who expect to live a long life into their 80s, deferring their CPP and OAS and withdrawing from their investments may be advantageous and provide more retirement income in the long run.

Mistake #5: Poor Use of TFSAs

The name "Tax Free Savings Account" is misleading. It suggests it is like a savings account, as opposed to a Registered Retirement Savings Plan (RRSP), meant for retirement. They are both meant for saving, investing and retirement. Statistics show most money in TFSAs is in cash instead of invested. This may be a mistake for retirees who hold cash in their TFSA.

Another mistake is that people may forego TFSA contributions in retirement because they feel they do not have the cash flow to make contributions. They are in drawdown mode, so how can they contribute to their TFSA?

If retirees have non-registered savings, they would be wise to shift money to their TFSA each year to make their annual contribution. And as stated previously, early RRIF withdrawals often make sense for retirees and may generate the opportunity to contribute to or at least preserve TFSA savings.

Mistake #6: Incorrect Asset Allocation

Many investors have the same asset allocation across all their accounts. This may not be the best approach.

It is important to look at which accounts you will be drawing from when determining where to hold more conservative investments versus more aggressive ones. Different investment income is taxed differently as well, so tax efficiency is also important when determining where to hold

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what.

It can also be very taxing to hold more conservative investments in a taxable non-registered account or a tax-free TFSA account, while holding stocks in a registered account. Imagine you had two $100,000 accounts. One of them was in GICs earning two percent and the other in stocks earning six percent. After 10 years, the GIC account would be worth $121,899 and the stock account would be worth $179,085. Would you rather the larger account be your tax-deferred RRSP account, where your withdrawals are 100 percent taxable to you, or would you prefer that growth in your more tax-efficient accounts? In a TFSA, those withdrawals would be tax free, and in a non-registered account, capital gains are only 50 percent taxable, with the other 50 percent tax free.

Mistake #7: Going It Alone

Having a professional financial plan prepared by a qualified certified professional planner should be near the top of the list for every investor. If you plan to work for 30-50 years of your life, wouldn't it be valuable to invest three or four hours in creating a roadmap for your investments, retirement, estate, insurance, and any other important aspect of your financial lives?

Sightline Wealth Management offers a holistic financial process that connects a multi-skilled team of best-in-class professionals entirely focused on identifying your financial needs and implementing strategies to meet your goals. They spend a great deal of their time helping prevent avoidable mistakes with retirees' investments.

Looking Forward

We suggest you focus on what you can control. It is cliché, but it is very true. We cannot tell you exactly how the trade wars will end and if interest rates will rise next quarter, however, what we do know is that retirees make a lot of avoidable mistakes with their investments. Each of the seven mistakes are preventable, and they can literally add up to thousands or hundreds

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of thousands of dollars of savings over the course of your lifetime.

There are plenty of competing factors well beyond our control when we invest. We encourage investors to take great care in selecting what you believe to be the best-of-the best portfolio managers for your asset allocation, to manage your emotions and to allow time to compound your wealth.

We would be pleased to hear from you at invest@sightlinewealthmgt.com

A portion of this article was originally published in the Financial Post

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