Enemies of financial freedom identified

By PAUL J. ROCKEL

Three "Enemies" of Financial Freedom

IT'S YOUR MONEY

Paul J. Rockel

Recently we re-read an article that outlined some alarming statistics about the financial crisis many Canadians will be in when they reach retirement age.

Less than half of Canadians have an RRSP or a pension plan, and even with the Canada Pension Plan, (which at best only replaces 25% of a person's earnings) and Old Age Security, 48% of Ontario workers retire with an income below the poverty line. And all but about 5% depend on some financial assistance from the government or their family.

Why?

Procrastination and failure or lack of knowledge to plan ahead is the first "enemy."

The second "enemy" is taxation, the third "enemy" is inflation.

Can you afford to earn interest? I can't, even at 11 or 12% annual return. The very best rates now are around 9.5%.

I have no investments that earn interest, such as mortgages, Guaranteed Investment Certificates, Canada Savings Bonds, notes or loans to other people. I do have a bank account that pays interest but I only keep enough in it to pay regular bills, etc.

In fact when my son purchased a home and asked if I would like to assume the mortgage, my immediate answer was "No way, but I'll back you at the bank or trust company if you wish" (let them earn the interest.)

You see, I can't afford to lose purchasing power each year.

It has always surprised me that most people, in putting their savings to work look at only two things, and this is the interest rate and guarantees. Canadians love GIC's. In fact the banks hold well over $60 billion dollars in this type of investment.

If the rate is 11% many think they will have 11% to spend, but will they? If its guaranteed (by the Canada Deposit Insurance Corporation), what does the guarantee really mean?

It is far more important to look at the rate of return after taxes. That is a very, very important point. The third thing to look at is inflation. These last two points have made it a losing proposition for me to earn interest.

If I asked you to invest $10,000 in a common stock which would pay you a dividend of about 5% but at the end of five years would only be worth 75% of your original investment, would you buy it?

I think not!

Inflation has averaged a little over 5% for the last 30 years and this is likely to continue and maybe even go a little higher some years. If your tax rate (Federal and Provincial for 1991) is 48% and the rate increases 1% per year, your average after tax return from the investment for five years is $2,500. But, because inflation averages 5% over that same five years, the buying power of the $10,000 that you invested will only buy $7,700 worth of goods and services in five years. Inflation will eat up your real ater tax return leaving you with almost nothing gained.

Now in five years that $10,000 is still guaranteed by the Canada Deposit Insurance Corporation, but my investment earning interest is now only worth $7,700! Do I need that kind of a guarantee?

There are two other forms of investment where the returns on that investment attract much less and have over time provided a good measure of protection against inflation. They are dividends and capital gains.

People continue to remark: "How come no one has ever shown me the difference taxation makes in the return that I can get from an investment? I think the answer is quite simple. Most institutions that we deal with day after day, such as banks, trust companies, credit unions, specialize in vehicles which offer only one kind of return, and that is interest.

Even my bank manager admitted to me that he does not understand the difference taxation makes on interest, versus dividends and capital gains at the various marginal tax rates. And I don't blame him, all he deals with most days is how much interest he has to pay you for your deposit, and how much interest he can charge you for a loan or mortgage.

Where can you get dividends and capital gains? We believe mutual funds offer the best advantage to the "average" investor. If you are like me, you know little or nothing about the "stock market" and you are afraid of it. I know I am. Mutual funds employ professional managers who spend as much time with investments and the decisions they must make as most of the rest of us spend at our jobs. Can you compete with the professionals?

Are you taking advantage of the techniques available to minimize the effect of the three "enemies" so that you can maximize your financial future?

For a free comparison sheet on what you will have to spend after tax on various investments contact Peter C. Masson, 10 Fagan Drive, Georgetown, Ont. or phone 877-7216.

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