



***EASY RESP GUIDE by A. Dawn - An RESP eBook  
Bonus Item – Chapter 1 and 2 from Award-Winning Book Invest Now***

***EASY RESP GUIDE by A. Dawn***  
***Canada's Personal Finance Website – A Dawn Journal***

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## What Is An RESP?

An RESP is a type of savings account that has been registered with Canada Revenue Agency (CRA). Savings inside an RESP account grow tax free until your child enrolls in post-secondary education and a withdrawal is made for education purposes.

### Subscriber, Beneficiary, Promoter

The subscriber is the individual who opens RESP account and makes deposits for the beneficiary. The beneficiary is the individual who pursues education and receives the contribution and the income earned (The income earned is paid as educational assistance payments = EAP) from the promoter. The promoter is the financial institution (banks, fund companies etc) offering RESP plan to the public. The promoter usually pays the contributions, and the income earned on those contributions, to the beneficiaries.

### You Need To Know This Stuff

- As defined by the Income Tax Act, only common-law partners and spouses can be joint subscribers.
  - Charities, Churches, Corporations or Trusts can not be subscribers.
  - The original subscriber may be replaced/changed for an existing or a transferring new account under certain conditions.
  - A beneficiary may be replaced with a new beneficiary. If such happens, contributions made for the former beneficiary will be treated as if contributions had been made for the new beneficiary on the date they were originally made. This may result in an overcontribution (if the new beneficiary already has an RESP). However, this rule does not apply if:
    - The replacement beneficiary is a sibling of the former and is under 21 years of age.
- OR
- B. Both beneficiaries are connected by blood or adoption to the original subscriber and are under 21 years of age.
- If either A or B happen, previous beneficiary's contributions will not affect new beneficiary's annual and lifetime contribution.

### Three Types of RESP

There are three general types of RESP: Individual, Family, and Group.

#### Individual Plan

This type of plan is for one beneficiary. Beneficiary does not have to be related by blood or adoption. You can name anyone as the beneficiary. No beneficiary age limit for contributions and age restrictions on the beneficiary when named. Contributions can be made up to and including the 22<sup>nd</sup> year of plan's existence.

#### Family Plan

You can name one or more beneficiaries but they must be related by blood or adoption. There is a beneficiary age limit for contributions ( you can not make contributions once the plan reaches

21 years after its opening and/or beneficiary reaches 21 years of age) and age restrictions on the beneficiary when named ( beneficiary has to be under 21). One unique feature this type offers is that CESG grants may be shares among all beneficiaries. However, \$7,200 maximum grants per beneficiary still apply.

### **Group Plan**

A group plan is a group or team RESP where many subscribers are pooling their money together under a group plan dealer or administrator. You can include either single or family RESP in a group plan but it all depends on the dealer. Each dealer can have its own rules.

### **RESP General Facts**

- Contributions made inside an RESP account are not tax deductible. However, contributions grow tax free as long they remain inside the account.
- There is no annual contribution limit
- Lifetime contribution limit is \$50,000 per beneficiary
- Missed contributions can not be carried forward. However, unused grant room carries forward for each beneficiary.
- The beneficiary has to be a Canadian resident to open and make contributions in an RESP.
- If beneficiary becomes non-resident, he/she will not accumulate grant room during that period.
- RESP has a lifespan of 26 years; RESP can not stay open more than 26 years.

### **Canada Education Savings Grant (CESG)**

CESG is what makes RESP a very attractive savings vehicle. Regardless your family income, Human Resources and Social Development Canada (HRSDC) pays you 20% of annual contributions to all eligible RESPs to a maximum of \$500 CESG. You will receive \$1,000 in CESG if you have unused grant room from previous years. Lifetime CESG limit is \$7,200.

HRSDC pays additional CESG amount for each quailed beneficiary. This depends on family income and can change if family income changes. Let's look at the additional CESG rate for an under 18 years of age beneficiary on the first \$500 contribution:

- If qualifying net income is \$37,885 or less = 40% (extra 20% on the first \$500)
- If qualifying net income is more than \$37,885 but less than \$75,769 = 30% (extra 10% on the first \$500)

The CESG is available up to and including the year in which the beneficiary turns 17. Special contribution rules apply for 16 and 17 years old beneficiaries to receive grants. Beneficiaries can only receive CESF if at least on the following conditions met:

- \$2,000 or more has been contributed and not withdrawn before the year in which the beneficiary turns 16 years of age; OR
- \$100 or more has been contributed and not withdrawn in at least any four years before the year in which beneficiary turns 16 years of age.

All of the above means that to get CESG, you must start to save in RESPs before the end of calendar year in which beneficiary turns 15 years of age. CESG is returned to the government, if the beneficiary does not pursue post-secondary education.

### **Canada Learning Bond (CLB)**

Families entitled to Canada Child Tax benefits and with an income of under \$37,885 qualify for CLB. This is applicable for born on or after January 1, 2004. An initial \$500 CLB and subsequent annual \$100 CLB will be provided until age 15. There are other terms and conditions. Call 1-800-622-6232 for more information.

### **Alberta Centennial Savings Plan Grant**

Alberta RESPs are able to receive \$500 initial grant if beneficiaries born on or after January 1, 2005. In addition, beneficiaries who have turned 8, 11 and 14 years of age on or after January 1, 2005 will receive subsequent grants of \$100. There are other terms and conditions. Alberta residents can call 1-866-515 2237 for more information.

### **Over Contributions**

Over Contribution occurs when lifetime limits are exceeded. CRA does not add CESG payments counting over contribution. An over contribution exists until it is redeemed. CRA charges 1% per month on the over contribution amount. Penalty tax is payable within 90 days after the end of the over contribution year.

### **Payments from an RESP**

I believe that this is one of the most complicated and least understood parts of an RESP. This part can be broadened so much that it gets confusing. I have tried my best to present it in an easy and simple way. RESP payments can be made the following four ways:

- EAP
- PSE
- AIP
- ROC

### **EAP (Educational Assistance Payments):**

EAP is the amount beneficiary gets from an RESP to help finance the cost of post-secondary education. EAP does not include capital. EAP is made of grants and growth. One of the following conditions must be met to qualify for EAP –

- the student is full-timer in a qualifying educational program (distance education courses, such as correspondence courses may be eligible), or
- the student has attained the age of 16 years and is enrolled part-time in a specified educational program

A qualifying educational program is a program that is at post-secondary level, lasts at least three consecutive weeks, and requires a student spend no less than 10 hours per week.

A specified educational program is a program that is at post-secondary level, lasts at least three consecutive weeks, and requires no less than 12 hours per month.

A post-secondary educational institution can be the following:

- Canadian designated educational institution such as a college, university etc.
- HRSDC certified educational institution in Canada offering non-credit courses
- Non-Canadian educational institutions may be eligible if the course is at the post-secondary level and lasts at least 13 consecutive weeks.

### ***Limits***

There are limits on EAP payments. However, on a case-by-case basis, HRSDC may approve amounts above the limit. Please contact your RESP promoter regarding this issue.

### ***Tax Implications***

EAPs are considered taxable income for the beneficiary and reported in box 42 on s T4A slip.

### **PSE (Post Secondary Education)**

If beneficiary is qualified for EAP, but the subscriber is redeeming only contributions – it is called PSE. PSE is made of contributions. It is not required to repay any grants on PSE withdrawals because beneficiary is pursuing post-secondary education.

### ***Limits***

There are no limits.

### ***Tax Implications***

PSE is not taxable because RESP contributions do not generate any tax receipts.

### **AIP**

AIP is a payment made to the subscriber which includes earnings from an RESP. AIP is made when beneficiary does not continue post-secondary education, or beneficiary has completed post-secondary education but there is money left in the RESP.

AN RESP can make AIP payment if the following conditions are met:

- Subscriber is a Canadian resident
- the payment is made to, or for, only one subscriber of the RESP; and

Any One of the following three:

- the RESP has been in existence for 10 years and each individual is or was a beneficiary has reached 21 years of age and not eligible to receive EAP
- the RESP has existed for 26 years (31 years for specified plans)
- all the beneficiaries passed away

**Special Note:** AIP payment must be made to a single person. Once AIP Payment is made, an RESP must be terminated by the end of the February of the next year. AIPs are taxable; however, you may be able to reduce the amount of AIPs subject to tax. I find AIPs are the most complicated in an RESP, and hence I am not going to discuss AIPs in detail. I would suggest you to contact a qualified professional, or call CRA, or HRSDC. I will provide contact information at the end of this article.

### **ROC**

When you redeem your own contributions from an RESP, it is called ROC (Return of Contributions). ROC does not include any earnings or grant. Once ROC withdrawal is made, CESG must be paid back to HRSDC. It is possible that (if beneficiary does not pursue education) earnings can be paid to the subscriber as an AIP. However, certain conditions have to be met. Contact a qualified professional, or call CRA, or HRDC to obtain more information on this.

### **Limits**

There are no limits.

### **Tax Implications**

There are no tax consequences because RESEP contributions are not tax deductible.

## RESP FAQs

**1. Can an account holder (subscriber) and subscriber be the same on an RESP account?**

Yes, this can happen only on a non-family plan. Family plan does not allow this because each beneficiary has to be connected by blood or adoption.

**2. Can new beneficiaries be added to an existing RESP account?**

Yes, this can be done only on a family plan. However, the new beneficiary has to meet the requirements for a family plan.

**3. Is it required to have an RESP account to accumulate CESG contribution room?**

No. A Canadian resident child born on January 1, 1998 or after, start to accumulate contribution room whether there is an account opened or not. However, the maximum grant that can be received in any year is \$1000.

**4. Can assets from an RESP be transferred into an RRSP?**

Only AIP assets are allowed to be transferred. However, it has to be lesser than \$50,000 and you need to have contribution room in your RRSP.

**5. Can assets from an RRSP be transferred into an RESP?**

No, this is not allowed.

**6. Can a non-resident beneficiary be eligible to attract CESG?**

No, the beneficiary must be a Canadian resident to attract CESG grant.

**7. Are contributions made in an RESP account tax deductible?**

No. RESP contributions are not tax deductible like RRSP.

**8. Can I open an RESP for myself?**

Yes. However, adult beneficiaries are not eligible to receive CESG grants.

**9. What are the benefits to open an RESP?**

It allows you to grow your money tax free for your kids' education until it is withdrawn for post-secondary education. In addition, you get government grants

such as CESG, Canada Learning Bond, Alberta Centennial Education Savings Grant (in Alberta) if eligible.

#### **10. When Should I open an RESP account?**

The sooner the better. If you open an RESP account early, you will have time on your side to grow your money.

#### **11. Where can I open an RESP account?**

Most of the financial institutions such as banks, credit unions, discount brokerage dealers can open an RESP account. It is recommended that you do your research and pick the one that best suits your needs. Some institutions charge annual administration fees. Avoid paying unnecessary annual fees. Pick one with no fees.

#### **12. Do I need a bank account to open an RESP?**

No.

#### **13. Do I need a Social Insurance Number (SIN) to open an RESP account?**

Yes.

#### **14. Are there risks associated with RESP?**

It depends on your investment planning and strategies. You may lose your capital if you choose risky products. Also, there is the risk of losing the growth and grants if the money is not used by the beneficiary. My best advice on this would be to contact a reliable financial professional and discuss your questions and concerns.

#### **15. Where can I get more information?**

Call -

Canada Revenue Agency: 1 800 959 8281

Canada Education Savings Program: 1 888 276 3624

Visit –

[HRSDC RESP Site](#)

[CanLearn RESP Site](#)

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*Invest Now – A Canadian's Guide To Investing*

## INVESTNOW

### A Canadian's Guide to Investing

By A Dawn

Whether you are just beginning to think about putting away a little something for a rainy day, or you are looking for ways to protect your hard-earned nest egg from scams and poor investments, *Invest Now* provides a realistic, doable plan to put you on the road to financial security.

Jam-packed with timely information and timeless advice for the beginning Canadian investor, *Invest Now* delivers a convincing case for avoiding daily spending temptations and then shows you the secrets to smart investing. With as little as \$25, you can become a successful investor by following A. Dawn's three simple and practical steps. Dawn carefully explains the ins and outs of mutual funds and financial markets and reveals why it's so wasteful to leave money in bank savings accounts.

You don't have to be a financial guru to develop a consistent savings plan and accumulate wealth. *Invest Now* offers all the tools and motivation you need to start building a safe and secure financial future now for you and your family.

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## *Preface*

Every day, we face tempting opportunities to spend money. A sea of indulgences can distract you from investing for your future. “Buy now!” “Pay after one year!” “Don’t pay interest for six months!” Everyone everywhere is urging you to spend, spend, spend. I’ve even seen a “Vacation now, pay later!” advertisement on the subway. But every dollar you spend now is a dollar in lost investment opportunities that could have grown a lot more in the long run.

Most Canadians were never taught any personal-finance lessons in school and in university; it is no wonder our savings rate is one of the lowest among industrialized nations. To make things worse, Statistics Canada reports that our average savings rate went below zero for the first time in 2006. This is scary—why is it happening?

Our main problem is a lack of information. Also, we have this idea that in order to invest, we need a lot of money, a PhD, and status as an investment guru. In this book, I will show you how you can start investing with very little money—and even less expertise. Investing can be as simple as walking into a bank or picking up your phone.

Start investing today toward a better future. No one else will do it for you; this is *your* future, and *your* investment decisions will have enormous impact. Don’t wait until tomorrow, or next month, or next year. Do it now. This is the time.

# *Introduction*

## **Why This Book?**

If you walk down the personal-finance aisle in a bookstore like Chapters, you will find thousands of finance books covering a wide range of topics. These books will promise to share the secrets of millionaires: how to make millions working on the weekends, how to retire as a millionaire, how to make millions in real estate, how to be rich within a few months ... it goes on and on. If you've never invested before, you will leave the bookstore even more confused than when you started.

All of those books have something in common: they aren't for amateurs. Hardly any books on that shelf will stick to the basics, much less provide a step-by-step starter guide. What kind of account should you open? Where should you go to do that? What research is required? What investments are ideal for those of modest means? You may not find the answers to those questions on the bookstore shelves, but you will find them here. I have answered those questions and more in a very simple way. Read, do your research, and start investing.

## **Why We Never Invest**

Ten years ago, I earned my degree in economics, and I have worked in the financial industry ever since. Such a career has many advantages; I really enjoy being able to help friends and family with questions they hesitate to ask anyone else. No one wants to be the person peppering a complete stranger with questions that may seem stupid, so they come to me.

It's just not my friends and family. Most Canadians are in the same situation. They work hard, earn their money, and content themselves with the minimal to nonexistent interest they are getting from their bank accounts. This has to change. You don't have to be a loaded financial genius to invest. All you need is the right information, and that is why I created my first Web site, [www.adawn.net](http://www.adawn.net): to make the world of personal finance accessible to Canadians. This book will teach you all the basics you

need to become a successful investor, and [www.adawn.net](http://www.adawn.net), *Canada's Personal Finance Web Site*, can give you that extra push toward success.

## **A Failure in Education**

Our education system does not teach how to handle our own money. Usually, we learn it from our friends, our families and from our own mistakes. And the results are obvious: most of us enter the workforce without knowing anything about managing money and investments. If, like many others, you never thought of investing, the simple language of this book will help you invest successfully on your own.

## **This Book Is Not for You If ...**

If you want to become a millionaire overnight or are praying for some other financial miracle, this book is not for you. As I will mention repeatedly, investment is an art. As such, it requires discipline, hard work and consistency. I don't believe in making quick bucks without hard work, and I don't enjoy anything that comes easy. In my book or on my Web site, I will not recommend or review any risky products promising to make you a millionaire (such as penny stocks). In fact, I will ask you to stay away from such products.

## **This Book Is for You If ...**

If you have always wondered whether it is possible to invest without being rich, this book is for you. If you have always wanted to invest but are not sure how to start, this book is for you. If you have just finished school and entered the workforce, this book is for you. If you are a hard-working Canadian and want more value for your money, this book is for you. If you want a better future tomorrow by working hard today, this book is for you.

## **Frequently Asked Questions**

I have tried to answer some of the most common questions you may have regarding this book. Introductions do not usually feature an FAQ section, but I thought, why not give it a try?

- **Who are you?**

I come from a strong financial background. My extensive education, training and experience have enabled me to develop the knowledge and

skills required to write this book and run two popular personal-finance Web sites.

- **Why is this book so thin?**

Are fat books better than thin ones? I don't think so. I have eliminated chitchat, small talk and stories of John and Jane, organizing this book with only the stuff you need to know. I could have made this a 300-page book, if I valued quantity over quality. But that wouldn't help beginners invest any more wisely. All of the information you need is here.

- **I don't have money; how can I invest?**

Contrary to popular belief, you don't need a lot of money to invest. This book teaches how to start investing with a small amount, such as \$25.

- **Why can't you just tell me what to buy?**

Every individual is different. What is right for you may not be right for someone else. Rather than recommending specific funds, this book provides all the tools and information necessary for finding what is right for you.

- **OK, I think the tools and information provided here are great, but I'm still not ready to act on my own.**

That's OK. This book covers several techniques. Following any one will make you a successful investor. If you are not ready to invest on your own, follow the procedures mentioned in this book to obtain advice from a financial advisor without paying any fees.

## Chapter 1

# *The First Thing You Need to Know*

### **Let the Journey Begin**

To begin investing, you need to open an investment account (also known as a trading account). But even before doing that, you need to know a few things. This chapter discusses the first thing you need to be aware of.

If you go to a bank or a discount brokerage, you should be asked this question at first: *Would it be a registered or non-registered account?* The alternative phrasing of *an open or a registered account* might be used.

Let's discuss both open and registered accounts. It's up to you which type to start with. You can have either a registered account, or an open account, or both. The important part is to start.

I have both types of accounts, and after reading this chapter and this book, you will be able to figure out what type of account best suits you.

### **Open or Non-Registered Account**

Non-registered accounts are not registered with the Canada Revenue Agency. This account type is more common than registered accounts. Now let's look at the advantages and disadvantages of both account types.

## Advantages of an Open Account

- Easy to open—less paperwork.
- No limit on the amount of money you can deposit.
- No restrictions on withdrawing money.
- Amounts you withdraw are not taxed.
- You can keep this type of account as long as you live.

## Disadvantages of an Open Account

- You don't get a tax break on your deposits.
- If it generates income, you pay taxes on your income.
- If you sell your holdings and achieve profit (capital gains), you pay taxes on the profit as well.

## Registered Account

An RRSP (registered retirement savings plan), or registered account, is not something you actually buy. This is just an account type, and you buy qualified investments to hold inside that registered plan. Think of the RRSP as an umbrella sheltering you from the sun. Think of the sun as the Canada Revenue Agency. As long as you are under the umbrella, you are protected from the heat. As long as you are inside your registered plan, you are protected from taxes.

## Advantages of a Registered Account

- Deposits generate tax receipts to provide tax breaks.
- If the account generates income, no taxes have to be paid, because income is sheltered.
- If you sell your holdings and achieve profits, you pay no taxes on capital gains, but you pay withholding taxes on withdrawals.
- You pay no taxes on growth and switches made inside your account, as long as you are not going outside the registered plan.

## Disadvantages of a Registered Account

- The account is registered with Canada revenue Agency (CRA). That's where the term *registered* comes from.
- You are only allowed to deposit so much money.

- Withdrawals are restricted.
- You are taxed on the amount you withdraw. The more money you withdraw, the more taxes you pay. See withholding tax rates listed at the end of this chapter.
- You can't keep this account forever. The account has to be terminated once you are 71, and you have to convert this account to a Registered Income Fund (RIF), from which you have to receive annual income by law. Also, you can take out all your money once you are 71, but this is not a good idea, as you have to pay hefty taxes.

## RRSP Annual Limit

You can only invest so much money into your RRSP. The formula goes as follows:

$A + B - C$ , where

A = Any unused portion of prior year's contribution

B = 18% of prior year's earned income (up to a maximum for that tax year as below)

C = Pension adjustment for the current year (RPP contributions, etc.)

### Contribution Limit

2006	\$18,000
2007	\$19,000
2008	\$20,000
2009	\$21,000
2010	\$22,000
2011	indexed*

\*Starting in 2011, the limits will be indexed for inflation.

## Miscellaneous

- Income can be earned in many forms. When your savings accounts pay interest, that is income. When your mutual funds pay distributions, that is income. When your stocks pay you more stocks, that is income.
- The amount you save by putting money in an RRSP depends on your marginal tax rate. The minimum tax savings will be 22% of your contribution—e.g., a \$5,000 contribution would save you  $\$5,000 \times 22\% = \$1,100$ . But the same \$5,000 would save you

\$1,400, if your marginal tax rate is 28%  
\$2,150, if your marginal tax rate is 43%  
\$2,500, if your marginal tax rate is 50%

- The amount of withholding taxes you pay by taking out money from an RRSP depends on the amount you are withdrawing. Follow the rate below:

Default rates in Quebec

\$0–\$5,000: 21%  
\$5,000.01–\$15,000: 26%  
\$15,000.01 and up: 31%

All other provinces

\$0–\$5,000: 10%  
\$5,000.01–\$15,000: 20%  
\$15,000.01 and up: 30%

- Although the registered account type looks very cool, many personal-finance columnists would argue that it is only tax deferred, not tax sheltered, because eventually, you pay taxes at a later date. There is no escape from paying taxes.
- If you are not sure what type of account to choose, just start with an open account for now. You will be able to change the account type later on.

## Chapter 2

# *Why Keeping Money in a Bank Account Is Not Good Enough*

### **You Are Not Alone**

If you are reading this book, chances are high that you've never invested in your life, like many other Canadians. You are not alone; very few people actually invest. Just ask all your friends and family members, and see how many actively think, plan, and invest. We were never given any personal finance lessons in school and university, and we assume that we will be just fine in later years. Some of us are just happy to keep money in a savings account. We don't realize that if we don't plan and invest for the future, we will not be OK. Life expectancy is increasing every year, and we will run out of money before we even reach retirement. In this chapter, I will discuss why savings accounts are just not good enough. Even if your savings account offers a relatively high interest rate of 4%, you will lose money in the long run. Hard to believe? Keep on reading.

### **It's Called Inflation**

Inflation will decrease the worth of your saved money over time. Inflation can be debated over nights and days, but to keep things simple, I will only discuss what you need to know.

## The Effects of Inflation

You must have heard from complaints from older family members that a cup of coffee used to cost fifty cents or even less. These days, a cup of coffee is \$1.25 to \$2.00, or even more. This increase is a result of inflation. Inflation is defined as an increase in the price level for goods and services (basically everything). Inflation is measured by the Bank of Canada as an annual percentage increase. As inflation rises, your money buys less and less. A \$100 bill today is not going to be the same as a \$100 bill in 10 or 20 years. Coffee—and everything else—gradually becomes more expensive due to inflation.

## The Flaw in Savings Accounts

Let's say your savings account is giving you 2% interest (in reality, big banks pay almost no interest). And consider that the annual inflation rate is 3%. If you keep \$100 in your savings account for one year, you should have \$102 in your hands after one year, right? Well, yes, technically, but that \$102 is less than you started with. Due to inflation, you need \$103 to buy same goods you would have bought with \$100 a year ago. So actually, you lost money—\$1, to be exact.

Losing just \$1 does not feel that bad, but losing your chance at retirement funding will. The amount of money you could potentially lose is scary.

## Inflation and Investments

There is no need to discuss the types and causes of inflation. But you need to know what you should do about inflation, and this should not be taken lightly. Investors should always adjust investment options and take necessary steps to minimize losses caused by inflation. If you keep all of your money in bank accounts, you will hit hard by inflation. Fixed-income investors—investors who invest in bonds, GICs, and savings accounts—are equally at risk.

If you invest in stocks, mutual funds, and the like, you should be OK in the long run; the important thing is to invest in the first place. This book emphasizes mutual funds for first-time investors. Mutual funds are made of stocks representing good companies. A good company's earnings should increase enough to keep up with or beat the pace of inflation.

## Miscellaneous

- Stay away from savings accounts. Even if you hold one of those high interest-paying savings accounts, you will not beat inflation in the long run.
- Assume you invest \$100 in a bond that pays 10% interest annually. After one year, you collect \$110. What is your rate of return? 10%? It looks that way until

you consider inflation. If the inflation rate is 5%, your actual rate of return is 5%, not 10%.

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