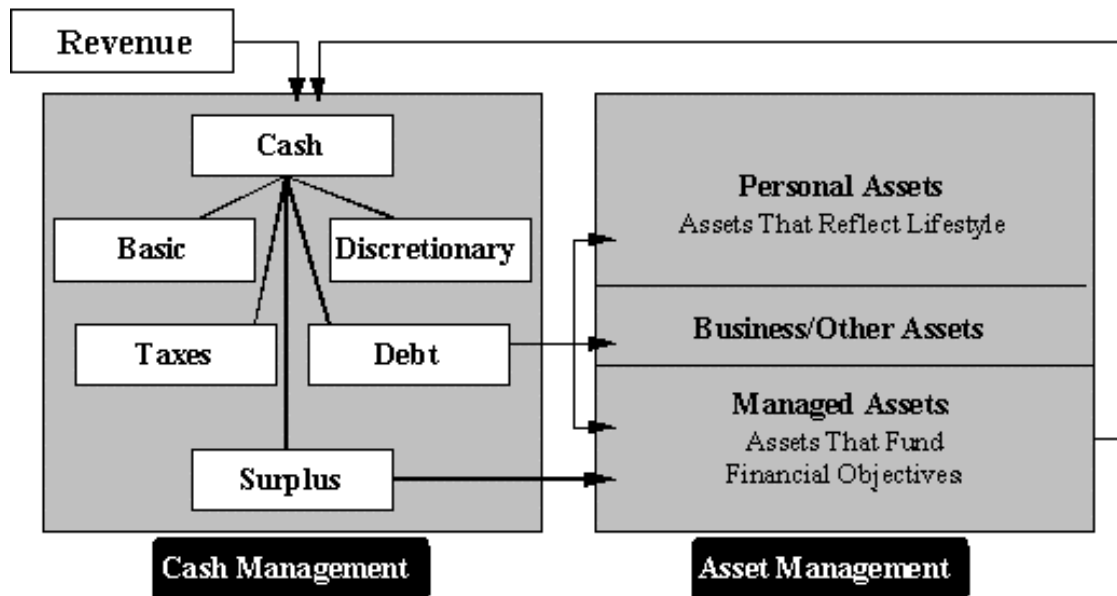


## - Client Information Summary -

### Strategic Financial Management

The following diagram provides an illustration of a person's personal financial world. The left side of the diagram is a picture of how money flows in and out of your personal financial world - we call it *cash flow*. The right side is a picture of the money you have saved in the past -- we call it your *net worth*. Your net worth is usually composed of two types of assets, *personal assets* - which provide an indication of your lifestyle *today*, and *managed assets* - which will ultimately help to support your lifestyle of *tomorrow*. Business owners and professional persons may have a third type of asset, which we refer to as *business assets*. These are the assets deployed for use in their business or profession.



### Cash Management

Looking at your cash flow, your primary source of *revenue* during your working years is your employment or business income. When you stop working, your source of *revenue* changes to pension benefits and/or government benefits. During your working years the *cash* coming in from employment should (at most times) exceed what has to go out to cover *basic living expenses* (food, clothing, shelter, transportation); *discretionary expenses* (holidays and entertainment); *debt repayment*, and taxes - leaving something left at the bottom for *savings*.

The exercise of managing your cash flow by controlling expenses, minimizing taxes, and the cost of debt to ultimately allow for more savings, is what we call *cash management*. One's ability to manage cash effectively to allow for savings is critical because unless you marry or are born into a wealthy family, or win a lottery -- *savings is where wealth begins*. The sooner in life that we learn the truth of that statement, the easier it will be for us to achieve our financial objectives.

To illustrate the point, consider two young women who both enter the work force at age 19. The first young woman contributes \$2,000 a year to an RRSP for 8 successive years, gets married at age 26 and does not return to the workforce. She simply manages her RRSP through the years and averages a return of 10%. By the time she reaches age 65, she would have \$1,035,000 in her RRSP. An amazing result considering she only invested \$16,000 (8 x \$2,000).

The second young woman approaches things a bit differently. She works for 8 years before she starts her RRSP contributions of \$2,000 per year. She invests her \$2,000 in the same investments as the first young woman, and continues to do so for the next 39 years. She would likely be quite satisfied if her \$78,000 investment (\$2,000 x 39) was to grow to \$883,000 by the time she is 65 -- until, of course, she compares notes with the other woman who had \$150,000 more, and had not invested any new money for nearly 40 years!

## Asset Management

Once money is saved, or transferred to your net worth, it must also be managed. Over time, your ability to manage what you have saved in the past will be as important, if not more so, than your ability to save. To illustrate this point, assume you have accumulated \$100,000 in your RRSP portfolio. How you manage that money will dramatically impact how it will grow. Look at the following chart that shows the impact of various rates of return on your invested capital:

Time Frame	6% Average Return	8% Average Return	10% Average Return	12% Average Return
Today	100,000	100,000	100,000	100,000
5 Years	133,823	146,933	161,051	176,234
10 Years	179,085	215,892	259,374	310,585
15 Years	239,656	317,217	417,725	547,357
20 Years	320,714	466,096	672,750	964,629
25 Years	429,359	684,848	1,083,471	1,700,006

## Achieving Your Objectives

Our ability to achieve our financial objectives will be directly related to the quality of the financial decisions we are called on to make throughout our lifetime. This is because these decisions relative to cash management and investment management will determine how much investment capital we'll accumulate and have available to supplement the revenue we receive from our pensions and government benefits. It will be this supplementary income that will determine our ability to provide enough cash flow to maintain the lifestyle that we would like to have during our retirement years. It is also these assets that will provide for the fulfilment of other financial objectives such as the education of our children, a larger home, or perhaps ownership of a recreational property.

## The Simple Truth

The simple truth that is often missed is that *today's decisions determine tomorrow's financial destiny*.

Unfortunately, most people make the majority of their financial decisions on what could be referred to as a *transactional* basis. That is, they make decisions in each specific area of their financial world in total isolation. They fail to recognize that their whole financial world is inextricably connected, and that today's decisions do indeed determine tomorrow's financial destiny.

Some simple examples may help illustrate the point:

- § A young couple in their 20's appeared to have a cash flow surplus (more coming in than going out). They decided to rent a slightly nicer apartment for \$150/month more than they had been paying. They also made the decision to start going out twice a month, rather than their customary once a month. Their "night out" normally cost about \$100. These decisions made in isolation of their long-term goals, simply meant there would be \$250 less available for savings each month, than would have otherwise been available.

There is no problem provided, they recognize that 30 years later, these "decisions" will impact their retirement goals to this extent. Had these discretionary expenses been directed to an RRSP earning 10%, they would have accumulated almost \$750,000 from these savings alone (assuming their contributions were indexed at 4%). Without the availability of this capital - they may have to work a few years longer or might have a retirement income that is less than they would have wished.

- § Another couple were saving money to buy a car. Once they had saved the \$15,000 they needed, they liked the idea of having money in the bank (for emergencies). Thus, they decided to borrow from the bank to buy the car, and leave their \$15,000 in the bank. The car was financed over 5 years at 8%. At the end of 5 years the car was paid for, costing them about \$3,200 in interest, and they had \$16,500 in the bank. (They had earned 4% on their money, roughly half of which was lost to tax.) Had they instead paid cash for the car and borrowed to buy a balanced portfolio yielding 10%, their interest costs would have been cut in half, as the interest would have been tax deductible, saving them \$1,600. Add that to their portfolio of approximately \$20,000 (verses \$16,500), and we can see the cost of one transactional decision was considerable -- over \$5,000.
- § An executive couple in their forties had done well in accumulating considerable investment assets. They opted to upgrade their residence from a \$250,000 home to a \$400,000 home during the downturn in the market. What is the probable long-term impact of their decision? With \$2,000 a year more in taxes, an extra \$1,500 in utilities, and an additional \$2,500 a year in maintenance for their bigger home, they could obviously save less -- \$6,000 a year less. In addition, they had now turned \$150,000 of their invested assets into personal assets (the investment assets they used for the upgrade). They also may become accustomed to the larger, nicer home and be loath to downgrade at retirement. The net result of their “upgrade decision” could mean over \$825,000 less in invested assets 20 years hence assuming a 10% return, top marginal tax bracket and 4% inflation). Their decision may not be a problem if the decision was made with full knowledge of the long-term impact to their overall situation. If not, they may well be in for a big disappointment as today's decisions do determine tomorrow's financial destiny.
- § Our final example is an older couple in their late 60's who have accumulated considerable wealth. They were comfortable. In fact, so comfortable that they were easily able to live off the interest income from their \$2,000,000 portfolio.

Their decision to “do nothing” in terms of tax planning (i.e. income splitting) meant an extra \$20,000 each year in taxes. Also, their decision to invest only in GIC's meant an average of about 3% per annum less than they might have achieved with a well diversified balanced portfolio (based on the last 50 years in history). Assuming a 20-year life expectancy, their beneficiaries ended up with \$2,000,000 but simple planning strategies could have easily turned it into \$4,000,000.

## **Creating a Framework for Effective Decision Making**

Our ultimate financial destiny is normally not the result of several major decisions like a home upgrade, but rather, the result of many small decisions made through the years relative to a multitude of cash management and asset management issues. Consequently, to attain your objectives in the most effective manner possible, all of your financial decisions should be made on a *strategic* basis. This is best accomplished through the use of a proper framework to more effectively guide the decision making process. Few people instinctively view things strategically. Hence, the value of working with a financial advisor whose primary function is to provide a framework to facilitate effective decision-making.

A specific *framework* or process that can help you make the right decisions is elaborated in some detail in CIS #103G entitled “Strategic Decision Making”.