

Choosing the right
**Mutual
Funds**
for your life plans...



PLANNING FOR LIFE

THE WEALTHY WAY™



**Canadian First™
Financial Centres**

WHAT ARE MUTUAL FUNDS?

Mutual funds are investments that represent the savings of many people who have pooled their money together to achieve a shared investment objective. Investments held within a mutual fund may include stocks, bonds, cash, money market instruments and/or other types of securities.

Every mutual fund has a stated objective which is defined in its prospectus document. Mutual fund investors can select funds with stated objectives that match their own specific investment objective, time horizon and risk tolerance. The investment portfolio is managed by a professional portfolio manager who strives to make the best investment decisions to support the objective and mandate of the fund.



WHY INVEST IN MUTUAL FUNDS?

The main advantages of investing in mutual funds include professional management, convenience, diversification, flexibility, liquidity, administrative services and support. These are explained in the following sections.

PROFESSIONAL MANAGEMENT

The portfolio managers who make investment decisions for mutual funds are trained professionals with specialized knowledge, training and expertise. These fund managers must meet high standards of education and experience before they can be registered by provincial regulators as portfolio managers. They have greater access to research and more sophisticated analytical tools than the average investor. Together, portfolio managers and their analysts build portfolios that aren't simply mirrors of market indices (such as the S&P/TSX Composite Index), which can be dominated by just a few industries. Instead, actively managed funds take advantage of professional management to make informed choices about which specific stocks, bonds and/or other investments across all industries have the best potential to achieve the fund's objective. Even the most sophisticated investors may not have the time required to research and monitor their investment portfolios.



CONVENIENCE

If you were to try to copy a mutual fund by buying all of the individual investments it holds, you would run into several challenges. First, commissions and fees for each trade would take a dramatic bite out of your performance – whereas mutual funds benefit from economies of scale that help to keep their costs lower. Second, depending on how much you planned to invest, you might end up buying one or two shares of each stock – rather than standard lots of 100 shares, which are easier and more cost-effective to trade. Third, you would have to monitor your portfolio every day, doing a portfolio manager's full-time job as well as your own. Investing in mutual funds is a much more convenient way to capture the growth and potential of the markets.

DIVERSIFICATION

Many mutual funds maintain diversified portfolios of investments. This means that a diversified mutual fund holds many different investments at the same time. Although investments may go up or down in value over time due to market and economic conditions, all of the investments in a diversified portfolio are not likely to go up and down in value at the same time or to the same extent. This has the effect of reducing risk and is, quite simply, the concept of not keeping all of your eggs in one basket. Most individual investors do not have enough capital to diversify beyond a small number of investments. Mutual funds often hold 60, 80, 100 or more securities, and that provides a level of diversification that is very difficult and expensive for individual investors to achieve. The diversification in a mutual fund may be across different countries (in the case of an international fund), across different industries or across different asset classes (for example, stocks and bonds).

FLEXIBILITY

The flexibility of mutual funds is one of the biggest reasons for their popularity among Canadian investors. The many categories of mutual funds allow investors with different investment objectives to find an investment vehicle to suit their specific goals, time horizons and risk tolerances. You can select one or several funds to provide the right combination for your individual needs. In addition, the nature of mutual fund investing allows investors with even small amounts of capital to participate in the market. Many mutual fund companies will accept initial investments of as little as \$250 and allow regular pre-authorized purchases of \$25 or less. Pre-authorized purchase plans are one of the simplest ways to accumulate savings and they give you the benefits of “dollar cost averaging” – allowing your fixed monthly investment amount to buy more units when prices are low and fewer units when prices are high.

LIQUIDITY

A mutual fund is very liquid and can generally provide you with cash from mutual fund redemptions within three business days. This means that you can easily get access to your money when you need it by redeeming the mutual fund securities you own from the mutual fund company (minus any sales charges if applicable). The purchase and sale price of mutual fund units are determined by the net asset value per unit – which for most funds is calculated daily and is the market value of the fund’s underlying investment assets at the close of each trading day, minus the fund’s management expenses, divided by the total outstanding number of fund units held by investors. This applies to most mutual funds with a few exceptions such as real estate funds and labour sponsored investment funds.

ADMINISTRATIVE SERVICES & SUPPORT

Many mutual fund companies offer administrative and support services including tax reporting, pre-authorized payment plans, simplified statements and reinvestment of distributions. The mutual fund companies and dealers provide a range of services to help you access, monitor, redeem or contribute to your mutual fund investments easily and provide you with detailed, easy-to-read statements. As a mutual fund investor, you are also entitled to receive fund prospectus documents, financial statements of the fund upon request, and you will be sent year-end tax slips for accounting purposes.





WHAT ARE THE DIFFERENT TYPES OF MUTUAL FUNDS?

The Canadian Investment Funds Standards Committee (CIFSE) has defined forty-five fund categories that classify mutual funds sold in Canada for the purpose of easier comparison between funds with similar investment holdings. Nonetheless, the many different fund categories generally fall into four main fund types which are:

- **Equity** funds,
- **Fixed Income** funds,
- **Balanced** funds
- **Cash and Equivalent** funds (which includes money market funds)

To better understand these fund types and what they represent, it is helpful to understand that there are generally only **two** forms of investment – **equity investment** (representing direct ownership in an asset) and **debt investment** (lending money to receive interest income in return for the use of the money). As this relates to the fund types, equity investments are the predominant asset type held in **Equity** funds; debt investments are the predominant asset type held in **Fixed Income** funds and **Cash and Equivalent** funds; and a combination of debt and equity investments are held in **Balanced** funds.

While the returns from equity investments (i.e. company stocks) tend to fluctuate more than fixed income debt investments (i.e. bonds), equity investments have historically provided the most potential for growth and capital appreciation over the long term compared to fixed income investments. Because equity investments tend to experience more market value volatility than debt investments, this can reflect a higher degree of risk for the investor – especially if the investor’s time horizon is of a shorter rather than longer duration.

EQUITY FUNDS

The main investment objective of equity funds is long-term capital **growth**. Common shares of publicly traded companies are the type of assets that an equity fund manager will primarily invest in. Because common share prices are typically more volatile than other types of securities, prices of equity funds tend to fluctuate more widely than Fixed Income, Balanced or Cash and Equivalent funds, and are therefore considered riskier. However, as previously mentioned, equity investments including common shares (stocks) have historically provided the most potential for growth and capital appreciation over the long term compared to fixed income investments. Therefore, an equity fund is more suited for investors with a growth investment objective.

Equity funds with broadly diversified holdings of blue chip income-yielding common shares may be classified at the conservative end of the equity fund scale while other equity funds may adopt a slightly more aggressive investment stance, for example, investing in young growing companies with an objective of above-average growth of capital.

Dividend Funds are technically equity funds but deserve special attention due to the hybrid nature of preferred shares. Preferred shares are equity investments but offer regular and fixed dividend payments to preferred share holders. The majority of investments held in dividend funds are preferred shares of Canadian corporations and to a lesser

extent, high-quality common shares of dividend-paying corporations. These funds provide investors with periodic tax-preferred income (due to the dividend tax credit) from the dividend-paying preferred share investments, as well as the potential to earn capital gains from growth in the value of the shares. Dividend funds are considered to be a moderate risk investment - riskier than bond and mortgage funds, because the market value of the preferred and common shares fluctuates as market conditions change – but less risky than equity funds (see Figure 1.1 'Risk and Return Characteristics of Different Mutual Fund Types'). Accordingly, they are suitable for investors with a moderate risk profile who would like a steady stream of tax-preferred **income**, but who also desire the opportunity to realize **growth** through capital gains or market value appreciation of the underlying preferred and common share investments held in the fund.

FIXED-INCOME FUNDS

Fixed-Income funds are designed to provide a steady stream of **interest income** from **debt investments** like bonds and mortgages which also offer greater safety of principal than equity investments – but typically at the expense of capital appreciation/growth relative to equity investments. Fixed-Income fund investors seek the maximum amount of income given their risk tolerance. They are willing to forgo capital appreciation and growth and may also be willing to assume some risk to their capital in order to seek a higher level of current income.

Bond funds are Fixed Income funds that mostly invest in good-quality, high-yielding government and corporate bonds/debt securities. The main objective of bond funds is to produce income in the form of interest, which is usually paid to unit/shareholders on a monthly basis. However, capital gains and losses may also be derived from the trading of bonds in the portfolio. Bond funds are considered to be low to moderate risk investments. They also tend to be more volatile than mortgage funds because they hold securities with longer maturities, which are often 20

years or more. The longer the maturity of a bond, the more it will be affected by interest rate changes – longer-term bonds rise in value more when interest rates fall, and drop in value more when interest rates rise. Bond funds are suitable for investors who want to protect their capital, but also require a stream of income.

Mortgage funds are Fixed Income funds that hold mortgage debt investments. Like other fixed income investments, mortgage fund values rise when interest rates fall, and fall when interest rates rise. Most people are familiar with mortgages as borrowers, but when mortgage fund managers purchase mortgages as investments they are acting as lenders. Cash flow to the mortgage funds comes from both the repayment of mortgage principal from the borrowers and from their interest payments on outstanding mortgage loan balances. The mortgage fund in turn, distributes the interest to fund unitholders on a monthly basis. Mortgage funds are considered to be a low-risk investment, although not as low-risk as money market funds. Mortgage funds are also considered to be less volatile than bond funds because mortgages typically have terms of less than five years. Mortgage funds are suitable for clients who want to protect their capital, require a steady stream of income, and do not have an immediate need for the invested funds.

BALANCED FUNDS

The main investment objective of balanced funds is to provide a “balanced” mixture of **income** and **growth** through capital appreciation. To serve these objectives, balanced funds invest in a portfolio of fixed-income securities for stability and income, plus a broadly diversified group of equity stock holdings for diversification, dividend income and growth potential. In most cases, the prospectus specifies the fund’s minimum and maximum weighting for each asset class. For example, a balanced fund may specify a weighting of 60% equity and 40% fixed income. Balanced funds are moderate risk investments. Returns from balanced funds are generally higher

than those from fixed-income funds but lower than those for equity funds. They are suitable for investors who match the moderate risk profile, and who have a combined growth and income ('Balanced') investment objective.

Asset allocation funds have objectives similar to balanced funds, but they differ from balanced funds in that they typically do not have restrictions requiring them to hold a specified minimum percentage of the fund in any class of investment (i.e. 60% equity and 40% fixed income). This flexibility can potentially result in a less diversified fund portfolio. Therefore, most asset allocation funds are generally considered to be higher in risk than balanced funds and are usually suitable for investors with a moderate to high-risk profile.



CASH AND EQUIVALENT FUNDS

As the name implies, Cash and Equivalent funds invest in short term near-cash securities or money market instruments such as Treasury bills, short-term bonds, bankers' acceptances and high-quality corporate notes. Funds in this category include Canadian and U.S. **Money Market** funds. Money Market funds add liquidity to a portfolio and offer **safety of principal** with a **low to moderate level of interest income**. They are considered to be the least risky type of mutual fund but also generate the least amount of return compared to the other fund categories. Money market fund returns move in the same direction as general interest rates and are **usually better than returns from a traditional bank account**. They are generally not a good investment for long-term goals, but they can be a smart choice for short-term goals, such as saving for a rainy day fund or parking money while deciding on long-term investments.

SPECIALTY AND SECTOR FUNDS

Not all funds fit easily into one of the previously described CIFSC fund categories. Some funds are more narrowly focused and concentrate their investment holdings in one main geographic region or industry sector. These funds are more speculative in nature, have a more aggressive growth objective and often carry substantial risk due to their concentration of assets in just one area or industry sector. They sacrifice broad market diversification, safety and income in the hope of achieving above-average returns through a targeted geographic region or industry focused investment strategy. Specialty and sector specific funds are typically suitable for investors who have a high-risk profile, and who are looking for **long-term growth**.



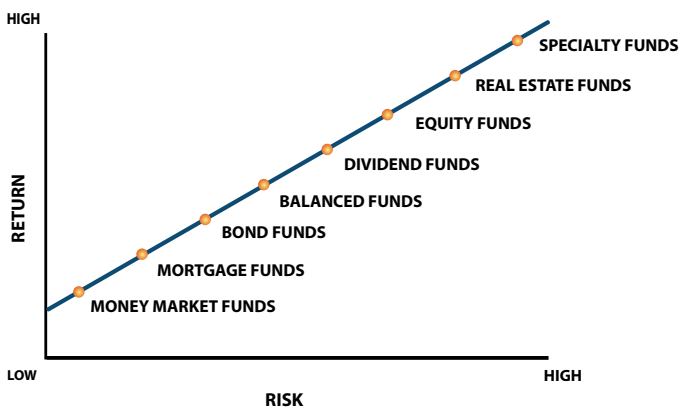


Real Estate funds are a sector specific equity fund type that may experience limitations affecting fund redemptions and share/unit liquidity due to the underlying real estate assets not being as liquid as other securities like stocks or bonds that can be traded on public exchanges and converted to cash more quickly. They also have certain tax advantages that are appealing to some investors. These funds invest in income-producing real property in order to achieve long-term growth through market value appreciation of the real estate assets (usually commercial and industrial properties) and growth through the reinvestment of lease/rental income from these properties. Due to their sector specific focus and the potential liquidity timing issues, Real Estate funds are generally suitable for growth investors who have a high-risk profile, who are looking for tax advantages, and who have a longer term time horizon.

RISK AND RETURN – COMPARING FUND TYPES

The analysis of the different fund types and categories above shows that there are many different fund types that serve a range of conservative to aggressive investment needs. Risk and return can be seen as a scale ranging from the lowest risk/lowest return funds being cash and cash equivalent funds (money market funds) to highest risk/highest return funds generally being specialty funds. Figure 1.1. below illustrates this risk/return trade off associated with each of the fund types and categories discussed.

FIGURE 1.1: RISK AND RETURN CHARACTERISTICS OF DIFFERENT MUTUAL FUND TYPES



The level of risk compared to the return of any fund is a key factor to consider when selecting funds that match your personal investment goals, the time you have to accomplish these goals, and the level of risk you are both willing and financially able to accept to achieve them. **When you understand what your acceptable risk/return balance is for any particular investment goal within the time that you have to achieve it, you will be better able to select the right fund investments to suit your needs accordingly.**

HOW CAN I KNOW WHICH MUTUAL FUNDS ARE RIGHT FOR ME?

Mutual funds offer many different benefits, risks and rewards to investors to suit a wide variety of different investment objectives, time horizons and risk tolerances. Your Canadian First Financial Centres Advisor can help you select the most appropriate fund/s for your specific personal, financial and investment needs.



To get started investing in mutual funds, or to get a fresh opinion on the mutual funds you already own, contact a Canadian first Financial Centres Advisor today!



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