

Financial EXCHANGE

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Strategies to help minimize the cycle of emotional investing

the market goes down, as it did in 2008, investors appear to abandon their principles and sell. The problem is that investors often sell after the market has already experienced significant declines. This is behaviour leads to a situation where investors are buying high and selling low. And that's the exact opposite of what we all know we should be doing.

How do you explain this irrational behaviour? Looking at full market cycle makes it easier to understand why investors may react in this way. Those who exit the market during significant periods of decline also tend to be hesitant to get back in.

Many remain "on the sidelines" until they feel assured that the stock market is once again gaining momentum in an upward direction. Unfortunately, at this point prices have risen considerably from the bottom and the market offers less upside potential.

So how do you avoid making investment decisions at the wrong time, and position yourself to sleep better at night? The first step is to remember that involves risk. Keeping this in perspective can help you weather the rollercoaster. Secondly, by working with your advisor to combine a number of investments, you can smooth out the ride and

take advantage of the opportunities that market declines can present.

Diversification is more than not putting all your eggs in one basket. For some Canadian investors, asset allocation can be as simple as having some money invested in bonds. What many investors may not realize is that there are many different types of stocks and bonds, each reacting differently to market conditions.

By investing in different asset classes, investment styles, market capitalizations, geographic regions and sectors you can improve the risk/return characteristics of your

portfolio, creating a diversification benefit that, in turn, can help insulate your portfolio during times of market turbulence.

You can't control the markets but if you remember that investing involves risk (some of which can be mitigated), and you understand the way your brain works (and the biases that can work against you), you can keep your long-term investment goals on target.

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The number one rule of investing is to "buy low and sell high". It may appear to be a simple concept, but it takes considerable discipline. That's because humans have cognitive biases, which at times may lead to poor investment decisions. When the stock market is performing well, investors continue to put money into the market. However, when



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The ABC's of ACB's

of capital reduces the fund's ACB.

Most mutual fund companies provide adjusted cost base information where possible on client statements. However, the ultimate responsibility for the accuracy of this information when it comes to tax filing lies with the investor — for two important reasons. The first is that adjusted cost base applies on a product level, not an account level. If an investor owns the same fund in two different brokerage accounts, the ACB is the weighted average cost of all the units held. There is no separate ACB for the two different accounts. So should an investor buy 100 units of a Fund X in one account with an average cost of \$15, and another 100 units of Fund

X in another account at an average cost of \$17, then the ACB of all 200 units is \$16. And should the investor sell 100 units, the ACB of the units sold will be \$16, regardless of which account sells the units. Accordingly, investors need to get into good record-keeping habits, saving confirmation slips and keeping track of partial redemptions.

Generally, for tax purposes, switches between funds are treated as though an investor redeemed units in one fund and purchased units in another. Such a transaction is considered a 'deemed disposition'. This may not be true for all switches though as many fund companies offer corporate structures which allow investors to switch

between funds within the structure with no 'deemed disposition' and therefore no tax liability, but the original ACB is carried on to the new fund.

The bottom line is to keep good records of all your securities transactions and don't hesitate to ask your tax preparer and financial advisor for some help to determine your ACB.

Remember, you only need to determine ACB for tax purposes for non-registered investments; anything inside your RRSP, RRIF, RESP, or TFSA is sheltered.

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About this time of year we sometimes hear the phrase 'tax selling' which refers to the selling of individual securities and mutual funds to realize a capital gain or loss within the calendar year. This year, investments would have to be sold by Dec 23rd, & most mutual fund "switches" by Dec 29th to be included in a 2011 tax return. Adjusted Cost Base (ACB) is a vital part of every tax calculation related

to the disposition of investments. But it's still one of the least understood elements of investing. First, a word about what it isn't. It isn't what an investor paid for an investment. It's the cost of an investment for tax purposes. It's the amount an investor paid to purchase units, including any commissions, plus the amount of distributions reinvested in additional units. "Return of capital" distributions which are reinvested have no effect on the overall Adjusted Cost Base — but do reduce the ACB *per unit*, as there are more units outstanding. Cash distributions of interest, dividend or capital gain income have no effect on your ACB, however, cash distributions of *return*