Part 5
Saving and investing your money

The purpose of Part 5 is to provide an introduction to saving and investing and how they can help you reach your goals and improve your financial well-being. Savings options range from savings accounts such as a high interest savings account to registered plans such as the Registered Retirement Savings Plan. Investors invest in fixed income, equities and alternative investments expecting to generate a profit. But this may not always be the case, so it is important to consider risk vs. return. Saving and investing can be done at any stage in life, but it's never too early to start!

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First Nations Child & Family Caring Society of Canada

Part 5.1: Savings definitions and things to know

Reaching your financial goals

One way to reach your financial goals is by saving.

Two important terms to know when learning about saving money are interest and inflation:

Interest

- Money that's put into a savings account can accumulate interest.
- Interest on savings accounts is the amount of money a bank gives you for keeping your money with them.
- Interest is expressed as an Annual Percentage Rate or APR.
- There are three key types of interest you should know about:
  - **Fixed** interest does not change during the specified period.
  - **Variable** interest can change at any time.
  - **Compound** interest is when your initial savings earns interest and the interest also earns interest.

Inflation

- Inflation is the rate at which prices of goods or services rise over time, which decreases purchasing power. This means that as prices go up, money does not go as far as it used to.
- Purchasing power is the value of a currency expressed in terms of the amount of goods or services that one unit of money can buy.
- Inflation is caused by factors such as higher demand for a product or service and increased production costs.
- **Inflation can decrease the value of your savings.**

Example of fixed interest

Scenario

Joe opens a savings account.
The savings account has an interest rate of 1%.
The interest rate does not change throughout the year.
He deposits $5,000 into his savings account.
He does not make deposits to or withdraw money from the account the entire year.

Results

By the end of year 1, Joe has earned 1% of the $5,000 deposited.
10.01% x $5,000 = $50
Therefore, Joe has earned $50 in interest from his savings account after one year.

Example of inflation

Scenario

(Continued from the example above)

Inflation rate = 1.75%

Results

Inflation rate x Joe's original deposit = 0.0175% x $5,000 = $87.50

$87.50 represents a loss in buying power due to inflation. What Joe could have bought with $5,000 now costs him $5,087.50.

Although Joe earned $50 in interest, he is behind by $37.50 because of inflation.

$37.50 is the difference between the interest earned and the loss in buying power.

Getting started

When opening a bank account, you can request a savings account. From there, ask an advisor about other savings options available such as a Registered Retirement Savings Plan (RRSP), Tax-Free Savings Account (TFSA) or Registered Education Savings Plan (RESP).

Saving tips

- **Set up an emergency fund.** An emergency fund is cash that's accessible in case of an unexpected job loss, illness or accident. The goal is to build up an emergency fund that could cover your expenses for three months if an emergency occurred.
- **Set up automatic transfers to your savings accounts.** Set up a fixed amount from your chequing account to your savings account(s). This amount can be transferred on a routine basis, such as monthly.
- **Pay yourself first.** Instead of paying your expenses first and seeing what you have left over to save, pay yourself first! Make your financial goals a priority and put money into your savings account as soon as you get paid.
  - Income – Expenses = Savings ✗
  - Income – Savings = Expenses ✓
- **Grow your savings with investments.** Invest the money you are saving to earn more money.

Part 5.2: Savings options

Savings account

There are several types of savings accounts offered at different banks. Common types are:

Everyday/daily savings account	An account that pays a low to average interest rate.
High interest savings account	An account that pays a higher-than-average interest rate.
USD savings account	An account that is in U.S. dollars – use a U.S. dollar account to avoid converting currency or paying currency exchange rates.

A note about taxes at on-reserve bank branches: Generally interest income earned in a savings account is taxable. However if a First Nations person's savings account (or GIC) is registered at an on-reserve branch, the interest income is not subject to tax. For more information please visit https://www.canada.ca/en/revenue-agency/services/indigenous-peoples/information-indians.html.

Registered savings plans

Registered savings plans must be registered with the Canada Revenue Agency to qualify for tax benefits.

Registered Retirement Savings Plan (RRSP)

- Holds savings and investments that are meant to be withdrawn when you retire from work.
- An account you contribute to.
- Each person has a contribution limit per year, which is based on their income.
- Contributions are deductible for income tax purposes.
- Tax on RRSP contributions is deferred until the money is withdrawn at retirement (i.e. you do not pay tax until you take money out of the account).
- Can be opened at any financial institution in Canada.
- An excellent way to prepare for your long-term future.

Tax-Free Savings Account (TFSA)

- A savings account you contribute to.
- Contributions are not deductible for income tax purposes.
- The interest, dividends or capital gains earned are tax-free.
- There is a yearly contribution limit, and if contributions exceed this limit, there are tax penalties.
- You must be the age of majority in your province (18 or 19 years old) to open a TFSA.
- If your contribution limits are not met in the previous years (when you are eligible to have a TFSA), the contribution room rolls over to the next year, as seen in the example below.
- Withdrawals you make in the current calendar year will be added to your unused contribution room. You must wait until the following calendar year or later to re-contribute these amounts.

TFSA Example

In 2020 the contribution limit was $6,000, but you only contributed $5,000.

Contribution room that rolls over = *Contribution limit – Actual funds contributed*
= $6,000 – $5,000
= $1,000

Therefore, $1,000 can be rolled over from 2020 to 2021.

In 2021 the contribution limit was $6,000.

Total contribution room for 2021 = 2021 *contribution limit* + *Contribution room that rolls over*
= $6,000 + $1,000
= $7,000

Therefore, in 2021, you can contribute up to $7,000 to your TFSA.

Registered Education Savings Plan (RESP)

- An investment plan created for a beneficiary's future education that is contributed to.
- The person who opens the RESP can contribute up to $50,000 in total to it, and the government will also contribute up to $7,200 in total.
- Tax on the growth of RESP investments is deferred until the funds are withdrawn – typically when the beneficiary is ready for post-secondary education.
- The plan can be contributed to for up to 31 years, and the plan can remain open for a maximum of 35 years.
- Grow savings faster using government grants such as the Canada Education Savings Grant (CESG) or the Canada Learning Bond (CLB).

Part 5.3: Investing your money

Reaching your financial goals

Another way to reach your financial goals is through investing.

Investing means putting money into an entity, such as a company's stock, with the expectation that it will grow and generate a profit. This income is called a "return on investment." It is the amount of additional money you receive for investing a principal amount.

Getting started

Once you have an account at a financial institution, ask an advisor about investing options. You will then be able to purchase, open or contribute to various investment products.

A great option for beginners is to open a practice account. For example, you can open one in RBC Direct Investing®, the RBC® self-directed investing site. Try it out to buy and sell investments and explore tools and resources. To learn more, visit https://www.rbcdirectinvesting.com/practice-accounts.html.

The Government of Canada also has information about savings and investments at https://www.canada.ca/en/services/finance/savings.html.

Part 5.4: Investing options

Asset classes

An asset class is a broad category of investments (e.g. stocks) sharing distinct risk and return characteristics. They include various fixed income, equity and alternative investing options as discussed below.

Fixed income investing options

If you invest in a fixed income option, you will receive a specified amount on a specified schedule. The main types of fixed income investments are bonds and guaranteed investment certificates (or GICs).

Bonds

A bond is an investment where you lend your money to a borrower for a set amount of time until the maturity date. At the maturity date, you receive the initial money you lent along with interest. The borrower is either the government or a corporation.

How can you make money with bonds?

- If you buy a bond (lend money) when the borrower first issues it, you will receive interest payments from the borrower. The borrower will agree to pay you a certain amount of money per year. Once the bond reaches its maturity date, after a specified period, you will get the initial money you lent back.
- If you buy and sell bonds with other investors, interest rates will change, which will change the price of the bond. You can earn money if you sell the bond for more than you bought it for. But, you can also lose money if you sell a bond for less than what you paid for it.

GICs

You can deposit money into a GIC and earn interest on the money.

- You are guaranteed to earn back your original investment, while earning interest at a fixed or variable rate, or based on a specific formula.
- When you buy a GIC, you are essentially loaning a sum of money to the financial institution, and you will earn interest on your loan.
- Terms range from 30 days to 10 years.

How to invest in GICs:

1. **Choose a provider.** A bank, trust company, credit union, independent broker or online provider.
2. **Decide how much to invest and for how long.** In many cases, your money will be locked in for a term, so make sure you won't need the money before the end of the term. If you think you may need the money earlier, consider a redeemable or cashable GIC (meaning you can get the money out), or choose one with a shorter term.
3. **Decide which GIC you want to buy.** For example, a fixed-rate GIC, variable-rate GIC, market-linked GIC. Compare interest rates to help you decide!
4. **Purchase the GIC from your provider.**
5. **You will then begin to receive interest payments or you can decide to reinvest the payments.** Interest can be paid to you annually, bi-annually or monthly.

Equity investing options

Equities are where you invest in a company by purchasing shares in a stock market.

Stocks

Stocks are the ownership of a fraction of a company. When investors buy stocks, they buy part ownership in a company.

What is the stock market? It's the system that allows investors to buy and sell securities (a financial instrument that has value and can be traded) such as stocks and bonds.

What is a stock exchange? Companies belong to a stock exchange so people can buy and sell shares of their company stock. Examples: Toronto Stock Exchange, New York Stock Exchange.

Investors can make money two ways on a stock exchange:

- **Capital gains:** The prices of stocks rise and fall constantly. If you sell the stock at a higher price than what you purchased it at, you will earn a profit from the stock.
- **Dividends:** Money that is paid out to shareholders from the company's profit. Shareholders own a share of a company's stock.

Alternative investments

These investments are not fixed income or equities. Examples: foreign currencies, real estate, gold and precious metals, etc.

Investment vehicles

Investment vehicles are the financial products that help you access asset classes such as equities, fixed income or alternative investments. We'll discuss the most comment types here:

Mutual funds

A mutual fund is a pool of money from multiple investors that is used to invest in a portfolio of options, including stocks and bonds. Investors buy into the mutual fund and a professional decides where to invest the pool of money.

You can hold a mutual fund on its own as a non-registered investment, or within a registered plan such as a TFSA, RRSP or RESP.

Types of mutual funds:

Type	How it works	Advantages	Disadvantages
Equity fund	The fund invests in stocks.	▪ High growth and potential returns ▪ A safe way to invest in the stock market as you are not purchasing individual shares of companies, rather investing in the broader market, so your returns are not dependent on one company's value	▪ High risk of losing money (possibility of high growth also means the possibility of high risk)
Fixed income fund	The fund invests in bonds that provide a fixed rate of return.	▪ Safe investment option ▪ Stable, regular income that is often monthly (or you can reinvest the income)	▪ Lower return potential than an equity fund
Balanced fund	The fund invests in both stocks and bonds. **Aggressive:** More stocks, less bonds **Conservative:** More bonds, less stocks	▪ Less risk than equity funds because of a balance of exposure ▪ Stable and regular income	▪ Lower return potential than an equity fund
Money market fund	The fund invests in short-term fixed income securities such as treasury bills and government bonds.	▪ Low risk and safe ▪ Generally higher returns than a savings account ▪ Very liquid (see Part 5.5 for definition of liquidity) so it's simple to get your money back when needed	▪ Lowest potential return compared to other mutual funds
Index fund	The fund tracks the performance of a specific market index such as the S&P 500. A market index is a metric that tracks the performance of a group of investment securities. The fund invests in every company in the index. As the index goes up and down, so does the value of the fund.	▪ Low fees because it's not actively managed ▪ Highly diversified, which means less risk of losing money	▪ Less flexibility than a managed fund
Specialty fund	The fund invests in alternative investments such as real estate or socially responsible investments.	▪ High control over what the fund invests in based on what is important to you	▪ Can be risky as there is no diversification, so when the specific industry performs poorly, so does the specialty fund
Fund-of-fund	The fund invests in other funds, making your single investment spread to many securities.	▪ High diversification, which allows for a low risk of losing money	▪ Must be actively managed and therefore has high fees

How to invest in mutual funds:

1. **Decide which mutual fund you want to invest in.** Consider the fees, interest rates and minimum investment requirements.

   For example, different mutual funds have different Management Expense Ratios (MERs), which represent the combined total of the management fee, operating expenses and taxes charged to a fund during a given year. MERs are expressed as a percentage of a fund's average net assets for that year.
2. **Decide how much money you want to invest in the fund(s).** Review or edit your current budget to ensure you have the money to invest.
3. **Choose an investment provider.** Bank, credit union, insurance company, mutual fund dealer, investment firm or robo-advisor.
4. **Invest in your chosen mutual fund.**
5. **Observe the fund's performance and adjust your investments.**
6. **Specify whether you'd like to receive the income earned or reinvest it.**

How to make money with mutual funds:

- Capital gains:
  - If a mutual fund is sold for more than you paid for it, you will have a capital gain.
  - On the contrary, if a mutual fund is sold for less than you paid for it, you will have a capital loss.
  - Capital gains are often distributed annually to investors.
- Distributions:
  - Dividends from stocks
  - Interest from bonds

Decide whether you want to receive these distributions as a payment or reinvest the earnings.

- Net asset value:
  - If the price of your fund holdings increases but they aren't sold by the fund manager, the fund's share price increases. You can then sell the mutual fund units for a profit in the market.

You are not guaranteed to make the money you invest in mutual funds back.

Segregated funds

Insurance companies provide funds that invest in other investment vehicles such as mutual funds. These are called "segregated funds." They guarantee to protect a percentage of your original investment, and to provide a death benefit, which is a specific percentage of the value that will be passed on to your beneficiaries when you pass away. Your money is locked in for a long period of time, often 10 years.

Exchange-traded funds (ETFs)

ETFs hold investments and build a diversified portfolio fast and with less money. They pool the money of multiple investors to buy a variety of investments, similar to mutual funds.

The difference between ETFs and conventional mutual funds is the way units of each are bought and sold. Like individual stocks, ETFs are listed on a stock exchange and can be traded throughout the day. Mutual funds, meanwhile, are purchased and sold through an investment or mutual fund dealer at the end of each trading day.

- Diversification means you are investing in a variety of asset classes in various industries, which reduces risk because you are not putting all of your money in one place.
- At RBC you can manage ETFs yourself using RBC Direct Investing or let the experts manage them for you using RBC InvestEase®.

What is robo-investing?

If you don't want to choose and buy the funds yourself, opt for a robo-advisor. It provides digital financial advice and invests in stocks, bonds and alternative investments using algorithms and automation, through mutual funds and ETFs.

What is socially responsible investing (SRI)?

SRI refers to making investment decisions based on a personal code of ethics. SRI investors focus on industries and companies that are making a positive social impact. Deciding what encompasses a positive social impact is personal and can differ among individuals based on their beliefs and cultures. Screening based on environmental, social and governance (ESG) criteria is incorporated in the portfolio construction process.

Everyone has the right to invest in a socially responsible way. To begin socially responsible investing:

- **Inform your advisor** assisting with your investments that you would like to invest ethically, and they will help you with this process.
- **Research** the industries and companies you are interested in, focusing on the social impact they provide or do not provide. Review credible news articles, mission statements and annual reports.
- **Review the ESG scores** available from a variety of data providers and rating agencies that score companies on ESG. These ratings vary among agencies based on their ethical standards and may not be consistent.

Examples	
▪ Companies with products, services and employee practices that can be considered not socially responsible include pollution and companies with low employee safety.	▪ Companies with positive ESG practices include renewable energy and water treatment companies.

Part 5.5: How to choose the right investment

Short-term and long-term suggestions

- If you will need the money in the short term, keep your cash in a chequing or savings account.
- If your goal is to build up money to use in the long term, consider stocks and bonds.

Risk tolerance: How much risk are you willing to take?

- Risk tolerance varies by person.
- Your level of risk guides your investment decisions.
- Higher risk investments tend to have higher returns.
- Lower risk investments tend to have lower returns.

Return expectations

Stocks	Bonds	Cash (e.g. physical currency, balances in chequing and savings accounts)
High potential return	Low to moderate return	Low potential return
High potential fluctuations	Low to moderate fluctuations	Low fluctuations
No guarantee of return on capital (money)	Increased probability of return on capital (money)	Guaranteed return of capital (money)

Liquidity needs

- Liquidity is the ability to convert an asset such as a stock or bond to cash.
- Your liquidity needs depend on how much money you need to have readily available for regular purchases or future expenses.
- If you have high liquidity needs, it's best to invest in highly liquid investments such as cash and stocks that you can sell quickly.
- If you have low liquidity needs, you have the ability to invest in a wider range of options with longer terms and higher risk.

To learn more about investing at RBC, please visit https://www.rbcroyalbank.com/investments.

More information on investing can be found at https://www.canada.ca/en/financial-consumer-agency/services/savings-investments/investing-basics.html.

Activity: Who will retire with more money?

Let’s check your understanding of compound interest!

Jane and Keith both have Registered Retirement Savings Plans, but they started saving for retirement at different ages and save different amounts.

Compound interest per year = 5%

	Jane	Keith
Age when saving begins	22	30
Retirement age	65	65
Total term (years)	44	36
Amount put into RRSP per year	$1,200	$1,600
Total amount put into RRSP	$52,800	$57,600
Value at retirement		

Please indicate who will have earned more money from their RRSP at retirement:

☐ Jane ☐ Keith

See the answer on the next page.

Answers

Compound interest rate per year = 5%

	Jane	Keith
Age when saving begins	22	30
Retirement age	65	65
Total term	44	36
Amount put into RRSP per year	$1,200	$1,600
Total amount put into RRSP	$52,800	$57,600
Value at retirement	**$181,371.61**	**$153,338.12**

Jane is correct!

Jane earned more money from her RRSP by the time she retired. Even though she invested less than Keith per year, the money she was saving was sitting and earning compound interest for a longer period of time. It's important to start investing early so you can earn more money, too!

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