



December 2011

Living Well

Tax-efficient allocation of Assets*

All investment incomes are not taxed the same way

Tax-efficient allocation of assets is crucial in tax planning as not all investment incomes are equal on an after-tax basis. Since, interest income, dividend income and capital gains are all taxed differently; it is possible to create tax efficiencies by carefully structuring your asset mix. As a general rule, this means allocating those assets which generate income that are the most unfavourably taxed (such as interest income, which is taxed at the highest rate) in tax-sheltered investment vehicles (i.e. RRSP or TFSA) where possible. You would then keep investments that generate returns that receive more favourable tax treatment (i.e. dividend or capital gains, which are taxed at lower rates) in taxable accounts. The benefit of this strategy continues through out your working life and into retirement. However, once retired, the advantage of eligible dividend income¹, can become a “double-edged sword” for a person who is 65 years or older who is also receiving Old Age Security (OAS).

Eligible dividend income: friend or foe?

Eligible dividend income is taxed in a unique way, for tax purposes, the actual amount of eligible dividend received by the taxpayer is grossed-up, or increased, by a prescribed percentage² and then included as income. However, dividend tax credits (available at the federal³ as well as provincial level) are applied to reduce the tax payable. For taxpayers in the lower tax brackets, the outcome can be a very low (in some cases, even negative) effective tax rate. For taxpayers in the top tax bracket, an eligible dividend incurs a lower rate of tax than capital gains in some Canadian jurisdictions.

For OAS recipients, however, caution is required. The OAS is a federal government pension that is paid to Canadian residents based on age and residency eligibility. It is income-tested, meaning that you can lose all or part of your entitlement whenever your net income surpasses a certain level, through a feature known as the “OAS claw back”⁴. The connection between eligible dividend income and the “OAS claw back” lies in the way that the income is grossed-up, as mentioned above. This is the yardstick that determines whether OAS benefit is clawed back or not.

You can visit our website at bmo.com/grs

Our HelpDesk can be reached at 1-877-446-8347 or by email at bmogrs.helpdesk@bmo.com

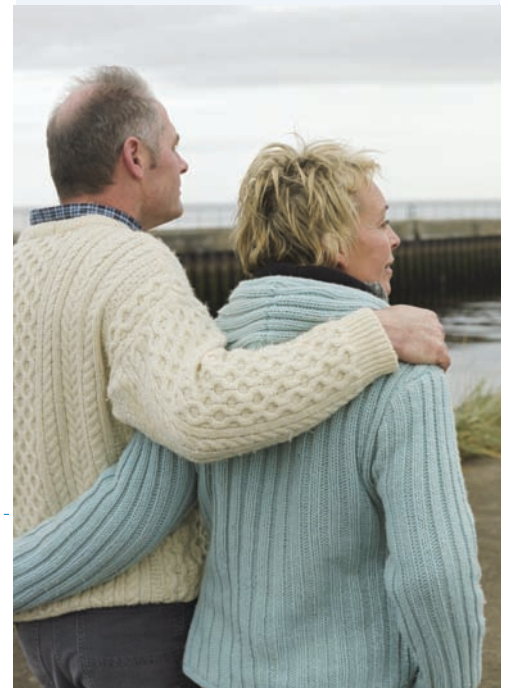
Contact us at BMO GRS

OAS Clawback

Old Age Security (“OAS”)

is a social insurance program that provides a basic level of pension income, on application, to anyone age 65 or over who meets residence requirements. The amount of your Old Age Security pension must be included in taxable income. The OAS is reduced for persons with high income through a recovery provision of the Income Tax Act.

For 2011, the tax recovery applies to persons whose net income exceeds \$67,668. For each \$1 of income above this limit, the amount of basic Old Age Security pension is reduced by \$0.15.



¹ Eligible dividends refer to dividends received by individuals from Canadian public corporations and Canadian-controlled private corporations paid out of business income that has been taxed at the high corporate tax rate.

² For the year 2011, the gross-up percentage for the purpose of the federal dividend tax credit is 41%.

³ For the year 2011, the federal dividend tax credit is 16.44% of the grossed-up dividend amount.

⁴ For the year 2011, higher-income taxpayers whose income exceeds \$67,668 will start to feel the effect of the OAS claw back; the entire OAS benefit will be clawed back for those whose income attains \$110,123

* This article is based on “Mind your taxes in retirement” October 2011; a copy of which is available at bmo.com/RetirementInstitute

Quarterly Commentary — December 2011

While the 2008 financial crisis taught us that you cannot live beyond your needs forever, 2011 taught us about patience. That patience was tested over and over again throughout the year. Even for investment professionals, at times, patience turned to impatience. We can all be grateful, however, that we survived the year, perhaps a bit more bruised than at the beginning of it. The year was challenging for most given the many political, social and financial events that shaped the first year of this new decade. Starting with the Arab spring in January and their thirst for democracy, market analysts and participants alike were plunged once again into another financial crisis that had already been brewing for a few months. Visions of the 2008 financial meltdown that had been born out of the U.S. housing market crisis came back to haunt us all. However, this time the crisis was on the other side of our Atlantic shores, affecting over 350 million citizens of the 17 country members of the Eurozone.

By the time financial books were closed off for another year, a solid and sound resolution had yet to have been crafted to remedy the European situation, notwithstanding a number of respected efforts on the parts of many governments, central banks and lending agencies. Adding to the general malaise were concerns over the health of the Chinese economy and its impact on the global economy, including that of Canada. Japan's devastating earthquake and subsequent tsunami in March also

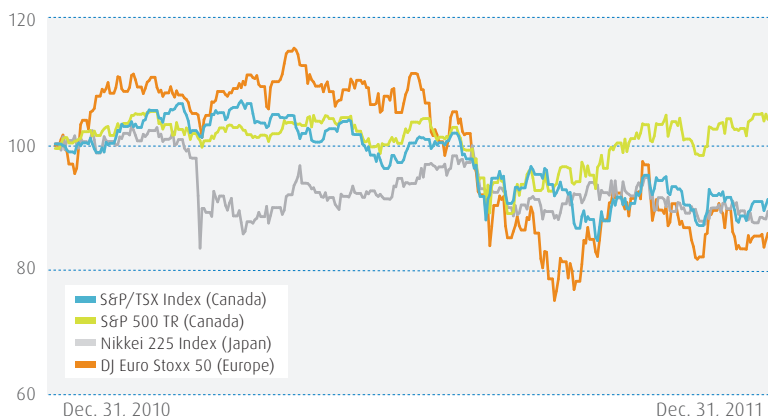
dampened investment sentiment given supply disruptions. Political rhetoric in the United States over the country's debt ceiling and news that a major credit agency, Standard and Poor's, had downgraded the number one economy's coveted triple-A rating one notch served to add to the pessimism. As a result and not entirely surprising, equity markets around the world experienced the kinds of returns and volatility that had been experienced three years before. The fourth quarter was no less challenging for investors. Thanks to a Santa Claus rally in the latter part of December, albeit late in comparison to other years, a number of stock market indices managed to recover from some of their bigger losses to end the year with less red ink. Canada's premier stock barometer, the S&P/TSX Composite Index (the "Index"), was a casualty of the world's ills. Given its make-up, the Index was heavily influenced by concerns over a Chinese economic slowdown and that country's need for resources and commodities including oil.

Investors continued to find solace in the fixed income market. Fears of a doomsday scenario pushed yields across the Canadian and global maturity curves sharply lower. The closely-watched 10-year benchmark government bond yield in Canada dropped to below two percent. There were some notable exceptions. Given fears of sovereign default, Italian and Spanish debt yields rose to unsustainable levels and spreads between

these and the German 10-year bund reached record levels. Our beloved loonie also experienced some ups and downs against the mighty dollar. Having traded above parity against the U.S. dollar for three quarters of the year, a slump in commodity prices pushed the Canadian dollar to end the year below parity if only by a few pennies.

What's in store for 2012? The same concerns and realities of 2011 will continue to play out in the New Year. We believe, however, perhaps with some reservations, that the worst of it may be behind us. While still tenuous, we do not believe that it's the end of the Eurozone experience nor do we believe in the demise of the euro. We do not believe that China will experience an economic hard landing but that Chinese authorities will manage to engineer an economic soft landing. Economic data out of the United States has become increasingly encouraging. Canada will benefit from the eventual resumption of demand for resources, including energy and from the renewed health of the American economy. More importantly, growing corporate earnings, clean balance sheets, high cashflows and low debt will once again be recognized as key fundamentals and drivers of economic wealth. As stated before, we maintain our belief that investors will continue to be well served by adopting a balanced approach to investing since the market volatility that was experienced in 2011 will likely continue for some time.

Market indices 2011: Growth of \$100



Annualized returns of capital market indices (%)

	Qtr*	1 Yr	3 Yr	5 Yr	10 Yr
S&P/TSX	3.59	-8.71	13.18	1.30	7.03
S&P 500	9.26	4.64	7.02	-2.88	-1.60
MSCI EAFE	1.02	-9.55	1.43	-6.79	0.50
DEX Universe	2.09	9.67	7.26	6.37	6.49
91-Day T-Bill Rate	0.22	1.00	0.72	1.97	2.41

Performance is presented in Canadian dollar terms. * The performance for the quarter ending **December 31, 2011** is not annualized. The above returns are preliminary as of the print date. Your fund returns are included with your quarterly member statements.

© Registered trade-marks of Bank of Montreal, used under licence. BMO Group Retirement Services Inc. is a group retirement services firm and separate legal entity from Bank of Montreal.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus of the mutual fund before investing. Mutual funds are not guaranteed or covered by the Canada Deposit Insurance Corporation, the Régie de l'assurance-dépôts du Québec or by any other government deposit insurer. The value of mutual funds changes frequently and past performance may not be repeated.

Except as otherwise noted, the indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. This communication is intended for informational purposes only. The information contained herein is not, and should not be construed as, investment advice to any party. Investments should be evaluated relative to the individual's investment objectives and professional advice should be obtained with respect to any circumstance.