



# Pension Watch

August 2004

---

The last edition of Pension Watch looked at “No Load Versus Load Investment Funds”. This edition takes a look at “Market Timing”

---

## Market Timing

Market timing is the act of buying and selling securities in anticipation of price increases and decreases. Successful market timing involves the accurate prediction of price changes, which we believe is impossible. There are many issues relating to market timing and investors (or should we say speculators) are often tempted by this type of activity.

Fear and greed are the two emotions that make market timing so tempting. The preponderance of information (and misinformation) and the general human tendency to be overconfident, make investors believe that they can be successful. The theory of market timing is related to predicting changes in the business cycle. Changes in economic growth foretell the direction of interest rates and corporate earnings and thus bond and stock prices. It is no surprise, then, why so much effort is dedicated to trying to predict the future. Many billions of dollars are spent world-wide each year attempting to forecast future price levels -- all to little avail despite the massive increase in information and market knowledge.

It is this surge of information that has fuelled the over-confidence. Human beings by nature tend to place too much stock in what they know or think they know, often with devastating results. A U.S. study conducted between 1991 and 1996 found that people who actively traded securities frequently achieved very poor returns. Active (day) traders posted average returns that were 10% to 40%, below the average household return of 17.7% (and the market return of 17.1%). The traders believed in their skills, however, in reality their experience was far worse. The evidence against market timing is overwhelming. One study concluded that for market timing to be profitable, the investor must be right at least 75% of the time just to break even after costs and mistakes.

Unless the market timer is extremely accurate, chances are an investor will significantly underperform the index.

In the nine year period between 1982 and 1990, missing the ten biggest positive market days resulted in under-performance of 6%

versus the S&P 500. Removing the 20 biggest positive days removes 10% of the return and missing the 30 biggest positive days removes 13%. Likewise, missing just a very few of the 63 years between 1928 and 1990, resulted in a substantial reduction in potential wealth. For example, had an investor missed the three years 1933, 1935 and 1954 (each of which followed particularly unpleasant stock return periods), the result would be less than one third (\$96 per \$1 invested) of the \$332 you would have from remaining fully invested. Therefore, just 7% of the time spanning two generations accounts for the majority of the return in the stock market.

An American study (by Belsky and Gilovich) of the ten-year period between 1984 and 1995 found that the average stock mutual fund had a return of 12.3% but the average investor in those funds had a return of just 6.3%. Though intuitively this sounds impossible, what it says is that in an attempt to time buys and sells, investors were relatively unsuccessful and bought high and sold low. This occurs because people chase the "hot" funds or markets only to be disappointed by the inevitable drop in relative performance. Disillusioned by poor returns, or panicked by belief in a market correction, they sell either in search of the next "hot" investment or to retreat to cash in defense. According to Belsky and Gilovich, this is a trend that has steadily increased over the last few years. Currently, the typical investor holds a fund for less than seven years compared to an average 16 years in 1970. Presumably, this has been prompted by the explosion of information available through various media. It appears that as investors gain better access to information and become more knowledgeable in investment matters, this does not necessarily translate into better returns.

Despite the temptation, market timing does not work. The only way it can work is if you can see the future.

# PERFORMANCE COMPARISON

<b>For The Period:</b> Ending June 30, 2004	<b>3 Months %</b>	<b>1 Year %</b>	<b>3 Year %</b>	<b>5 Year %</b>	<b>10 Year %</b>
<b>ACTIVELY MANAGED FUNDS</b>					
Balanced Fund	0.6	15.6	4.6	5.3	9.4
Canadian Equity Fund	1.6	23.6	4.5	7.0	11.4
Overseas Equity Fund <sup>(1) (2)</sup>	2.1	25.7	-2.1	N/A	N/A
U.S. Equity Fund <sup>(2)</sup>	2.5	15.8	-5.9	-5.5	7.8
Dividend Income Fund <sup>(3)</sup>	1.6	23.4	10.8	16.0	18.9
Short-Term Bond & Mortgage Fund	-1.1	3.8	6.5	6.4	7.7
Bond Fund	-1.9	3.6	8.3	7.3	9.3
Canadian Money Market Fund	0.5	2.6	2.8	3.8	4.5
<b>CUMIS FUND</b>					
Retirement Security Fund	5.3 <sup>(4)</sup>	5.4	5.9	6.3	7.0
<b>PASSIVELY MANAGED FUNDS</b>					
S&P/TSX Composite Index Fund <sup>(5)</sup>	0.1	24.5	5.3	5.8	9.8
U.S. Equity Index Fund <sup>(2) (6)</sup>	3.7	17.1	-5.1	-4.4	N/A
EAFE Equity Index Fund <sup>(2) (7)</sup>	2.3	30.3	-0.3	-1.8	N/A
Universe Bond Index Fund <sup>(8)</sup>	-2.0	3.2	7.8	6.7	N/A
Conservative Balanced Index Fund <sup>(9)</sup>	0.0	11.2	4.2	4.0	8.4
Moderate Balanced Index Fund <sup>(10)</sup>	0.2	15.6	4.2	4.8	9.4
Aggressive Balanced Index Fund <sup>(11)</sup>	0.6	19.9	3.5	4.3	9.4
<b>INDICES</b>					
Active Balanced Fund Benchmark	-0.1	15.0	4.1	4.2	8.7
S&P/TSX Composite Index	0.0	24.5	5.2	5.7	9.7
S&P 500	3.2	16.9	-4.8	-4.0	11.4
MSCI EAFE	1.7	29.9	-0.4	-1.8	3.7
ScotiaMcLeod Universe	-2.2	3.3	7.8	6.7	9.0
30 Day T-bills	0.5	2.6	2.7	3.6	4.2

(1) Overseas Equity Fund merged with Euro-Pacific Equity Fund March 9, 2001

(2) Subject to Canada Customs and Revenue Agency Foreign Content Limit of 30%

(3) Only available under group RSP and DPSP contracts

(4) Annualized

(5) Fund Inception: October 1999. Performance prior to November 1999 is for TSE 300 Equity Index Fund

(6) Fund Inception: January 2000. Performance prior to February 2000 is for Barclays U.S. Equity Index Fund - Canada

(7) Fund Inception: June 1999. Performance prior to July 1999 is for EAFE Equity Index Fund B

(8) Fund Inception: October 1999. Performance prior to November 1999 is for Universe Bond Index Fund

(9) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset mix and index returns

(10) Fund Inception: June 1999. Performance prior to July 1999 is modeled using the benchmark asset weights and index returns

(11) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset weights and index returns

## NEWS FROM THE GOVERNMENT

### Old Age Security

Old Age Security (OAS) benefit rates are increased for the July to September 2004 quarter.

Basic OAS benefits, paid to people age 65 and over, are \$466.63 per month. The Guaranteed Income Supplement is \$554.59. The Spouse's Allowance and the Widowed Spouse's Allowance are increased to \$827.87 and \$913.99 respectively for the July to September 2004 quarter.

# RETIREMENT INVESTMENT OPTIONS FOR COMPANY EMPLOYEES

This article is meant to help you understand your options when you leave the employ of your company and need to deal with the transfer of your pension assets. Determining your best available option will depend on many factors. Some of these factors are the regulations governing your existing plan, whether or not you have reached retirement age, what your income needs and objectives are and how you would like your retirement funds to be treated in your estate. We hope this article will provide a framework for making your decision. For more detail on transferring assets in your current plan, you will need to contact your employer's Human Resources department.

## Your employer-sponsored plan

The first step is to understand your pension plan. You may in fact have benefits accruing from more than one plan.

There are two basic types of plans, **Defined Benefit (DB) and Defined Contribution (DC)**.

**Defined Benefit Plans** guarantee the employee a certain benefit at retirement, based on a formula that usually takes into account earnings and years of service. The plan may be fully funded by the employer, or the employee may be required to contribute as well. The assets are earmarked as pooled employee pension benefits, and the employer carries the risk of meeting the promised pension liabilities. Whereas DB plans used to be very popular, new plans are now usually of the defined contribution type. If you have a DB plan, on retirement you will receive regular pension payments that are not a transferable asset. As an alternative, some plans allow you to convert your pension benefits into a lump sum payment (called a "commuted value") that can then be transferred to one of the locked-in plans (LIRA, LRSP, LIF, LRIF) described in detail below. This decision should be made in consultation with your company benefits plan specialist.

**Defined Contribution Plans** do not guarantee a defined benefit on retirement, but do involve a defined level of employer and employee contributions, usually based on a percentage of the employee's earnings. Each employee holds an individual account where these contributions, as well as investment income, accumulate tax-free until retirement. The level of pension benefits will depend on the amount contributed and the returns on the investments in the account.

There are two different types of defined contribution plans, **Money Purchase Plans (MPPs)** and **Group Registered Retirement Savings Plans (Group RRSPs)**.

The type of plan will determine the options open to you when you leave your company.

Assets in a **Money Purchase Plan** can only be transferred to a Life Annuity Contract or one of the locked-in plans (LIRA, LRSP, LIF, LRIF) under pension legislation. "Locked in" means that no withdrawals from the

plan are allowed except for the purpose of paying retirement income and only after you attain the minimum age (usually 55) set out in your pension plan. These options are explained in more detail below.

**A Group Registered Retirement Savings Plan (Group RRSP)** is not locked in. The capital accumulated in your account may be transferred on retirement to a personal RRSP if you are under 69, or otherwise to a Registered Retirement Income Fund (see RRIF, explained below). A Group RRSP account must, in any case, be transferred to a RRIF by the end of the year in which the beneficiary turns 69.

Other kinds of retirement benefits:

**Deferred Profit Sharing Plans (DPSPs)** are really a special kind of DC scheme. They are registered plans that allow companies to contribute a portion of profits to tax-sheltered retirement savings for individual employees. DPSP contributions can only be made by an employer up to a specified maximum and may be either a fixed percentage of salary or a variable amount. The retirement benefit depends on the amount of money accumulated in the account through contributions and the returns on investments over the life of the plan.

**Special Transfers - Retiring Allowance.** In addition to your pension entitlement, you may also be eligible for a Retiring Allowance from your employer in compensation if you are required to leave the company before your normal retirement date (usually at age 65). Part or all of your retiring allowance may be sheltered in your RRSP (not a spouse's RRSP). You may make a tax-free transfer of up to \$2,000 for each full or partial calendar year of service prior to 1996. You may transfer an additional \$1,500 for each year prior to 1989 in which you worked for your current employer but were not a member of a pension plan or DPSP, or were not vested in your employer's plan. (Generally, vesting refers to the length of time an individual must be employed or be a member of a plan before company contributions belong to the employee.)

## What are your choices on leaving your company?

If you are not yet of retirement age, the following options may be open to you, depending on your plan type:

1. **Transfer your funds to a Retirement Savings Plan (RRSP).**  
This option may be available to you if you have accumulated individual pension assets that do not have to be "locked-in".
2. **Transfer your funds to a Locked-in Retirement Account (LIRA) or Locked-in Retirement Savings Plan (LRSP).**  
Depending upon your plan and the province in which it is registered, you may have to transfer your pension assets into a locked-in plan. However, you retain control over your investment options within the LIRA and LRSP.
3. **Leave your funds in your company plan.** Some plans give you the option of leaving funds invested in your employer sponsored plan until you reach "normal retirement age" as defined by your plan.

# RETIREMENT INVESTMENT OPTIONS FOR COMPANY EMPLOYEES

*continued*

---

If you are ready to retire, you may have the following options, depending on the type of plan you benefit from:

1. Purchase a Life Annuity. A life annuity is a contract purchased from a life insurance company, normally for a defined amount of life-long income.
2. Invest in a Retirement Income Fund (RRIF). A Registered Retirement Income Fund can be opened with proceeds from an RRSP. This option is available at any age but is most commonly started in the year you turn 69. You retain control over your investments in the RRIF. There is a prescribed mandatory minimum income withdrawal but no maximum annual limit on income. When the plan owner dies, the balance of a RRIF may be transferred tax-free to a spouse or dependent minor if they are designated as beneficiaries. Naming other beneficiaries, including the estate of the deceased, will result in a tax liability.
3. Invest in a Prescribed RIF (PRIF). Available only for transfers of pension plans governed by Saskatchewan legislation. Unlike LIF and LRIF plans, there are no maximum withdrawal restrictions on a PRIF. Pension money may be transferred to a Prescribed RIF at age 55, or earlier if allowed by the pension plan. If applicable, a spousal consent is required and a spouse must be named beneficiary for the plan. In addition, clients who currently hold LIF or LRIF plans may transfer to a PRIF if the locked-in money originally came from a pension plan subject to the Pension Benefits Act of Saskatchewan.
4. Purchase a Life Income Fund (LIF). This retirement product, purchased with funds from a LIRA, LRSP, or MPP, is available for plans registered in all provinces except PEI. It combines the benefits of a RRIF and a Life Annuity. You retain control over your investment options until age 80, at which time the remaining funds in the plan must be used to purchase an annuity. The same mandatory minimum payments apply as in a RRIF, but a LIF also imposes a maximum amount that can be withdrawn annually. If the plan owner dies before age 80 and has not yet contracted to a life annuity, the balance of a LIF may be transferred tax-free to a spouse or dependent minor if they are designated as a beneficiary; otherwise it becomes part of the estate. Please note that in Nova Scotia and New Brunswick, you are no longer required to convert your LIF to an annuity at age 80.
5. Invest in a Locked-In Retirement Income Fund (LRIF). Available as of December 31, 2000 for plans registered in Ontario, Alberta, and Manitoba, a Locked-In Retirement Income Fund closely resembles a RRIF. You retain control over your investments and can withdraw annual income between a minimum and maximum amount. Conversion to an annuity is not mandatory, but is an option at any age. Rules for the transfer of an LRIF balance when the owner dies are the same as for a RRIF.

## Transfer Process

Your Human Resources or Benefits Department will be able to advise you on the options available to you and the specific requirements for completion of a transfer from your company plan. If you are transferring your pension assets to a credit union, bank or investment firm, you will generally be required to complete an RRSP transfer form and/or a Canada Revenue Agency (CRA) pension transfer form (T2151). For registered pension plans your employer will also require you to complete an employee plan transfer election form.

Pension Watch is intended to provide general information only.  
It is not intended to provide specific advice or recommendations for any individual.

### **IF YOU WOULD LIKE EXTRA COPIES FOR EMPLOYEE DISTRIBUTION,**

You can visit our web site at [www.cumis.com](http://www.cumis.com) and look for Pension Watch under publications, or please phone, write or fax Retirement Services, CUMIS Life Insurance Company  
P.O. Box 5065, Burlington, Ontario L7R 4C2 • (905) 631-4844 • 1-800-263-9120 ext. 4844 • Fax (905) 631-4887

**PENSION WATCH** is produced for CUMIS Life Retirement Clients