As many of our clients have recently, or soon-to-be, graduated students, in this month's note we include an article on Financial Considerations for Recent Graduates as well as our regular piece on financial markets.

A Lesson on Financial Considerations for Recent Graduates

With their hard-earned degrees in hand, most recent graduates are focused on securing full-time employment and building their careers. In addition to these priorities, it's also important to start planning for their financial future. This article outlines some considerations that can set a recent graduate on the path to long-term financial success.

Equity Strategy

Our asset allocation strategy is to continue to overweight equities and to underweight fixed income. After 9 years of economic recovery, we are likely later in the economic cycle, however, we think it is premature to get overly defensive at this stage and continue to see better value in high quality dividend-growing stocks than in other asset classes. We would assert that the severity of the financial crisis of 2008/2009 and the relatively slow recovery argue for prolonged global growth and an associated longer bull market than typical cycles. In other words, rather than the typical V-shaped recovery from the depth of the last recession, we have witnessed a slow, steady return to normalcy both in the U.S. and in other developed economies. GDP growth in most regions has been barely 2% per year following the crisis versus a more typical 4-5% rate following the previous five recessions going back to the late 1950s.

This view also fits the narrative from BMO Nesbitt Burns research as well as many other market pundits. Taking a very long term view, the argument states that the U.S. stock market has exhibited fairly consistent 16 year cycles throughout history – a 16-year bear market is followed by a 16-year bull market. Within this theory, the current secular (i.e. long term) bull market would still have several years to run. Of course, markets never go up in a straight line and there will be cyclical (i.e. medium term) bear markets along the way. As an example, during the 1950-1966 cyclical bull market, there were four significant pullbacks with an average decline of 20% and length of 7 months. In the 1982-1998 episode, there were 5 cyclical bear markets with an average decline of 21% and length of 5 months. The conclusion for long term investors, based on our fundamental and technical models, is that pullbacks will occur and will present potential buying opportunities.

Historically, economic cycles and bull markets end because an economy overheats, leading to rising inflation which forces central banks to raise interest rates rapidly. Since it is hard to precisely gauge the amount of tightening required to contain inflation, bankers push rates too high, too quickly limiting growth and making equities far less attractive relative to bonds. Given the pain inflicted during the financial crisis, central bankers this time appear determined to avoid tightening conditions too quickly. In effect, they would prefer that the next recession not happen on their watch. While the U.S. Federal Reserve is leading the charge in raising rates, they are doing so in a slow, deliberate fashion while monetary conditions remain very accommodative in other regions such as Canada, Europe and

Japan. We would argue that inflationary pressures are building in North America (wages, commodities and producer prices paid for example) but that has yet to translate into an ominous rise in the consumer price index (CPI). This gives central banks room to continue on the current dovish path for the time being with obvious positive implications for equity markets.

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Pay down debt

Graduates of today are starting their careers with better skills and education than any previous generation. However, this education also comes at a higher cost and many graduates will have accumulated significant student debt along the way. Whether accumulated through student loans, lines of credit or credit cards, paying down student debt should be a priority. Focus on paying down the debt that carries the highest interest rate first so that you minimize the amount of interest paid. Also try to pay more than the minimum payment due whenever possible.

Develop a budget

A budget will help you understand how much money you have coming in and how you're spending your income. Begin by tracking your expenses for three months. Knowing how you're spending your money allows you to develop a budget that sets priorities for spending and paying down debt, while starting to build investment assets to fund future goals. There are many online apps and websites that can help you set up a budget and monitor your spending.

Establish an emergency fund

An emergency fund is a pool of money set aside specifically to cover the cost of unexpected expenses or the loss of income, reducing the need to rely on credit cards, loans or personal savings intended for other financial goals. Work towards building an emergency fund of at least three to six months' worth of living expenses. Your emergency fund should be easily accessible and it should be kept separate from your day-to-day bank account. A Tax-Free Savings Account ("TFSA") may be a good option to accumulate your emergency fund savings, as the funds grow tax-sheltered and can be withdrawn tax-free at any time.

Build and protect your credit score

Building and maintaining a good credit history is important as lenders will view your credit report and credit score when deciding whether to grant you a credit card, loan or mortgage, as well as determining the interest rate you'll be charged. Ensure that you're paying your credit cards and loan payments on time, and don't become overextended by taking on too much debt. Also remember, a potential employer or landlord may use your credit report to help determine your dependability.

Retirement planning

While retirement may seem a lifetime away, it's important to start saving early because of the tremendous impact compounding will have on the growth of your retirement assets. With a Registered Retirement Savings Plan ("RRSP") your contributions are tax deductible and once in the plan, continue to grow on a tax-deferred basis until the funds are withdrawn. However, starting early is key.

If, at age 25, you begin saving $100 every week in an RRSP, assuming a compounding rate of return of 5% per annum, by age 65 your investment will grow to $663,724. By comparison, if you don't start saving until you are 45 – and you save double the amount (i.e., $200 per week) – your investment will only grow to $357,131 by age 65, even though the total savings amount is the same ($208,000).

If you do require funds from your RRSP before retirement, there are two federal programs that may allow you to make tax-free withdrawals from your RRSP, including:

- The Home Buyers' Plan ("HBP") allows you to withdraw up to $25,000 tax-free from your RRSP to purchase or build a qualifying home. To be eligible, you must be a first-time home buyer, as defined by the Canada Revenue Agency, and the funds must be repaid to your RRSP over a 15-year period. Your annual repayments do not affect your RRSP deduction limit. If you fail to repay the required annual repayment amount to your RRSP in any year, the amount is considered taxable income.
- The Lifelong Learning Plan ("LLP") allows you to make tax-free withdrawals from your RRSP to finance full-time training and education costs, including post graduate degrees, for you or your spouse. The LLP allows you to withdraw up to $10,000 a year, to a maximum of $20,000. If either you or your spouse is disabled, part-time training and education costs are eligible. LLP withdrawals must be repaid to your RRSP within 10 years. As with the HBP, your annual LLP repayments do not affect your annual RRSP deduction limit. If you fail to repay the required annual repayment amount to your RRSP in any year, the amount is considered taxable income.

Insurance

Your ability to earn income through your chosen career is one of your greatest assets. However, if you're unable to earn income due to health issues or a disability, having adequate insurance coverage is important for meeting your long-term financial security. Disability insurance is designed to replace a portion of your income in the event you become disabled due to accident or illness and are unable to work. Even if your employer provides disability coverage as part of their company benefits package, the disability benefits usually cover only a percentage of your income, so it may be beneficial to purchase supplemental disability insurance coverage.

You may also want to consider critical illness insurance, which provides a lump sum benefit if you are diagnosed with an eligible critical illness. The funds can be used to help offset the costs of home care, used to take a sabbatical and recuperate, pay off a mortgage, make adjustments to a home or car to accommodate any special needs, or even pursue private medical treatment outside Canada. How you use the money is entirely up to you.

It's never too early for a financial plan

Developing a financial plan can help prioritize your short- and long-term goals, and determine the actions that can be taken to achieve them. A financial professional can provide information and guidance to help increase your financial literacy in areas specific to your financial concerns. Over time, as your income, personal situation and priorities change, your financial plan can be updated to ensure it continues to reflect your situation.

Beginning your investment journey

A BMO financial professional gives you access to a wide range of investment products and solutions designed to help you build and protect your wealth – now and for the future.

As you begin your investment journey, the need for sound investment advice and guidance is particularly important. BMO financial professionals are committed to building long-term client relationships and providing superior advice and service, so you can make the right investment choices for your future.

! For more information, please contact your BMO financial professional.

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