3 Ways to Make the Most of Your RRSP

Description

Every year, there is a mad rush for investors to make their RRSP contribution before the deadline and to qualify for the tax deduction for the previous year, which leads to a few common mistakes.

First, in their rush to invest, investors sometimes buy funds or stocks that are not suitable for their risk tolerance. Second, the rush by *other* investors could temporarily raise the value of popular stocks. With RRSP contributions due March 3, 2014, here are some tips to maximize returns over the long term.

1. Avoid interest income

Investments that offer high interest rates, like bonds, are sheltered from taxes in RRSPs, but investors should look at the macro story first. Interest rates are at very low levels, and any hint of inflation would push rates higher. This will push bond prices lower, creating losses greater than the interest payments received. Look at the **iShares 20+ Year Treasury Bond ETF** (NYSE:TLT) and the **iShares 7-10 Year Treasuries Bond ETF** (NYSE:IEF). Their prices peaked in May 2013 and are off 9% and 4%, respectively:

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2. Pick dividend yield champs, but with caution

Stocks held outside RRSPs receive a dividend tax credit, but their payout is fully tax-free in the retirement plans. Be careful not to chase high yielding stocks. High yields might be compensating for higher risk. The company's underlying business could also be in trouble. Resource-based stocks like **Penn West Petroleum** pay dividends yielding over 6%, but its payout ratio is a *negative* 165.

Limited competition in the mobile smartphone market in Canada makes **Rogers Communications** (TSX:RCI-B) (NYSE:RCI) a much more attractive investment. Rogers shares yield 4.3% and its shares trade ex-dividend on March 12. In Q4 2013, Rogers raised its dividend rate by 5% to $1.83 per share. Last year, its payout ratio was 57%. Wireless profit margin rose to 41.7%, while profit margin in the cable unit was 49.7%. The firm earned $3.22 per share in 2013, so its trailing P/E is 13.3.

Bank institutions are also solid for retirement plans. **Bank of Montreal** (TSX:BMO)(NYSE:BMO) has the lowest price-to-book ratio among the banks. The bank is improving shareholder returns by repurchasing up to 15 million (2.3% of float) of shares and offering a quarterly dividend of $0.76 per share. The last dividend was increased by 3%.

3. Avoid speculative plays

Speculative stocks do not belong in a retirement plan. This could sometimes include penny stocks, but not always. Companies with a big market cap could still be speculative. **PotashCorp** might move 10% in a short time, but it is facing challenges from lower potash prices. A failure to benefit from sustained demand from emerging markets would hurt its stock, and generate capital losses that have no tax breaks for other gains for investors. **Barrick Gold** should also be considered speculative. Although its shares are around $21.20, up steadily from $15, a turnaround in its business has risks.

Foolish bottom line

Investors who have not yet contributed should do so before the deadline. The contribution could be parked in the account, and the investment decisions could be made later. Either way, investors get an RRSP deduction to lower their tax bill while investing for their future.

CATEGORY

1. Investing

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1. NYSE:BMO (Bank of Montreal)
2. NYSE:RCI (Rogers Communications Inc.)
3. TSX:BMO (Bank Of Montreal)
4. TSX:RCI.B (Rogers Communications Inc.)

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