3 Big Mistakes to Avoid With Your RRSP

Description

The deadline to contribute to your Registered Retirement Savings Plan (RRSP) for the 2019 tax year is just around the corner (March 2, 2020). Given this, there will be plenty of last-minute decisions made by investors this week.

Although waiting until the last minute to top up your RRSPs is not a mistake in itself, the rush to contribute can lead to hasty decisions. At times, this haste can also lead to poor decisions. If you are one of those last-minute investors be mindful of the following pitfalls.

Don't put all your eggs in one basket

Having a well diversified portfolio is one of the best ways to protect yourself against a bear market. It is also proven to generate consistent returns. For example, Canada's Big Banks are synonymous with retirement investing. They are considered some of the safest investments on the **TSX Index** and provide investors with considerable income.

However, putting all your investments in a single bank such as **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM) is not a wise approach. True, CIBC'a yield is a very attractive 5%, which is tops among the Big Five. A $10,000 investment will generate approximately $526 in annual income.

The problem is that CIBC has also underperformed its peers in a meaningful way. In fact, it has been the worst-performing Big Five bank in three of the past four years. Had you invested solely in CIBC, you would have underperformed not only the banks, but the broader index as well.

Furthermore, having a big percentage (or all) of your portfolio in Big Banks can also lead to underperformance. The TSX Index more than doubled the returns of the Big Five last year, and if a Canadian recession hits the banks will be vulnerable to further underperformance. CIBC even moreso as it is the most exposed to the domestic economy.

Not having a plan

Don’t contribute to your RRSP just for the sake of contributing. The RRSP is but one investment vehicle for investors and it is important to fully understand the tax implications of your investment decisions. The RRSP may not be the best way to invest your funds. The Tax-Free Savings Account (TFSA), a non-registered account, or Registered Education Savings Plan (RESP) may be better options depending on your situation.

Each individual has a different investor profile, and it is important to have a plan. Not having a plan can lead to poor decisions that can in turn lead to missed opportunities, or have negative impacts down the road. If you are unsure, it is best to speak with a professional who can help develop your plan.

Let’s assume you have a plan and the RRSP is the right vehicle for you. Once you contribute, don’t invest the money just for the sake of putting your cash to use. Once again, it is important to know what investments you want to buy and how they fit into your overall plan.

If you need time to decide what to buy, there is no harm in keeping that cash liquid in your account. Don’t wait too long, however, as holding significant amounts of cash also has an opportunity cost.

Don’t over-contribute

If you over-contribute to your RRSP, it can be an expensive proposition. Every year, the government publishes the amount that investors can contribute to their RRSP. For the 2019 tax year, that is equal to 18% of your earned income up to a maximum of $26,500.

It is very important to be mindful of how much room you have. Investors have a low, $2,000 lifetime over-contribution limit. Once you go over that threshold, the government will tax you 1% a month on the amount of the over-contribution. At $10,000, that is equal to $100 monthly – a steep tax that can quickly eat up your profits.

There is no excuse not to know your limit and the government has proven to be non-sympathetic to those who make this avoidable mistake. Given this, it is wise to double check before you make that last-minute decision.

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