

Russell Insight

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Managed yield class: A tax-efficient income solution

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Investors in search of additional tax-efficiency in their portfolios can turn to structures such as Russell Corporate Class to provide the opportunity for enhanced after-tax growth.

Corporate class structures feature funds belonging to a mutual fund corporation which provides the taxable investor with certain tax-deferral benefits not available to investors who purchase units of mutual fund trusts.

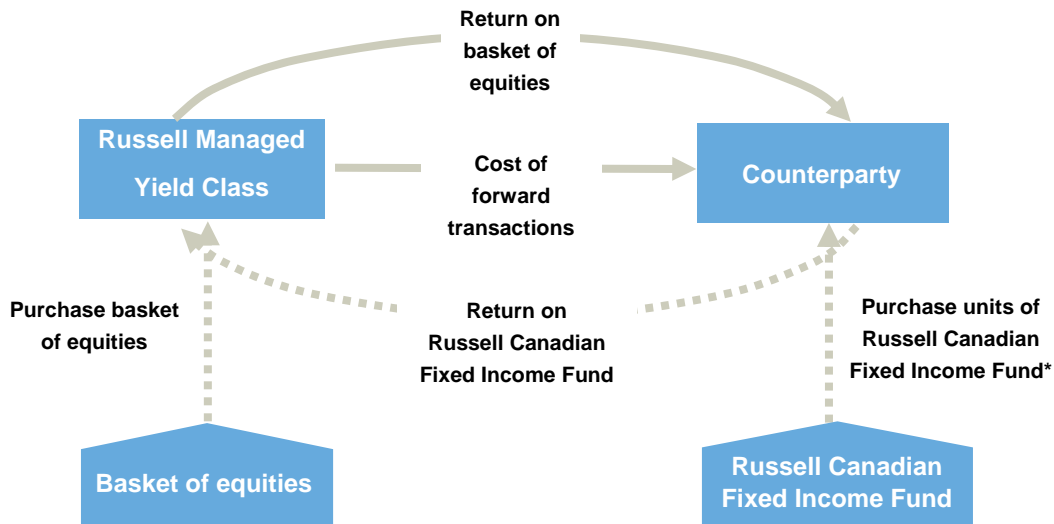
An innovative solution utilized in Russell Corporate Class is the Russell Managed Yield Class. While both mutual fund corporations and mutual fund trusts offer similar diversification opportunities through a range of choices covering all of the major asset classes, the nature of the corporate class structure addresses the fact that fixed income investments typically provide interest income that is taxed at nearly twice the rate of capital gains. The design of the Russell Managed Yield Class enables investors to enjoy the tax-efficiency of the corporate class structure within the confines of a well-diversified balanced portfolio.

What is a managed yield fund?

Efficient investment portfolios are built upon a foundation consisting of an asset allocation suitable to the investor's profile, and for most investors an appropriate asset allocation involves diversifying across equity and fixed income asset classes. Within the corporate class structure a managed yield fund provides investors with the diversification benefits of the fixed income asset class along with the tax-efficiency of capital gains.

Managed yield funds can generate fixed income-like returns without realizing interest income. Russell's Managed Yield Class achieves this by purchasing a basket of equity securities and entering into a series of forward contracts with a counterparty to swap the return generated by the basket of stocks for the return generated by a targeted fixed income fund (in this case, the Russell Canadian Fixed Income Fund). Figure 1 illustrates the process. In this manner the Russell Managed Yield Class realizes a fixed income return objective yet distributes this return to investors in the form of capital gains.

Figure 1 - Mechanics of Russell's Managed Yield Class



* The counterparty is not obliged to directly purchase units of the Russell Canadian Fixed Income Fund.

The conversion of income to capital gains with the Russell Managed Yield Class improves the after-tax return for investors. Figure 2 compares the after-tax impact of four fixed income choices for the 11-yr period ending December 31, 2008:

- I. 5-yr Guaranteed Investment Certificates
- II. A laddered bond portfolio comprised of 5-yr benchmark Canada bonds
- III. The Russell Fixed Income Pool (the "Pool")
- IV. The Russell Managed Yield Class

The historical performance data for the Russell Fixed Income Pool illustrates that \$100,000 invested in the Pool on January 1, 1998 would have grown to \$131,475 as of December 31, 2008. When the returns of the Russell Canadian Fixed Income Fund are adjusted to reflect the generation of capital gains rather than interest income in the Russell Managed Yield Class, the resulting tax-efficiency indicates that an investment in the Managed Yield Class would have resulted in an additional \$8,000 of portfolio growth versus the Pool over the eleven year period. Similarly, the 5-yr GICs and the laddered portfolio of 5-yr Canada bonds provide significantly less after-tax growth than the Managed Yield Class due to the tax treatment of the income generated by the Managed Yield Class.

Figure 2 - After-tax growth of Russell Managed Yield Class
(Based on hypothetical back-tested data)

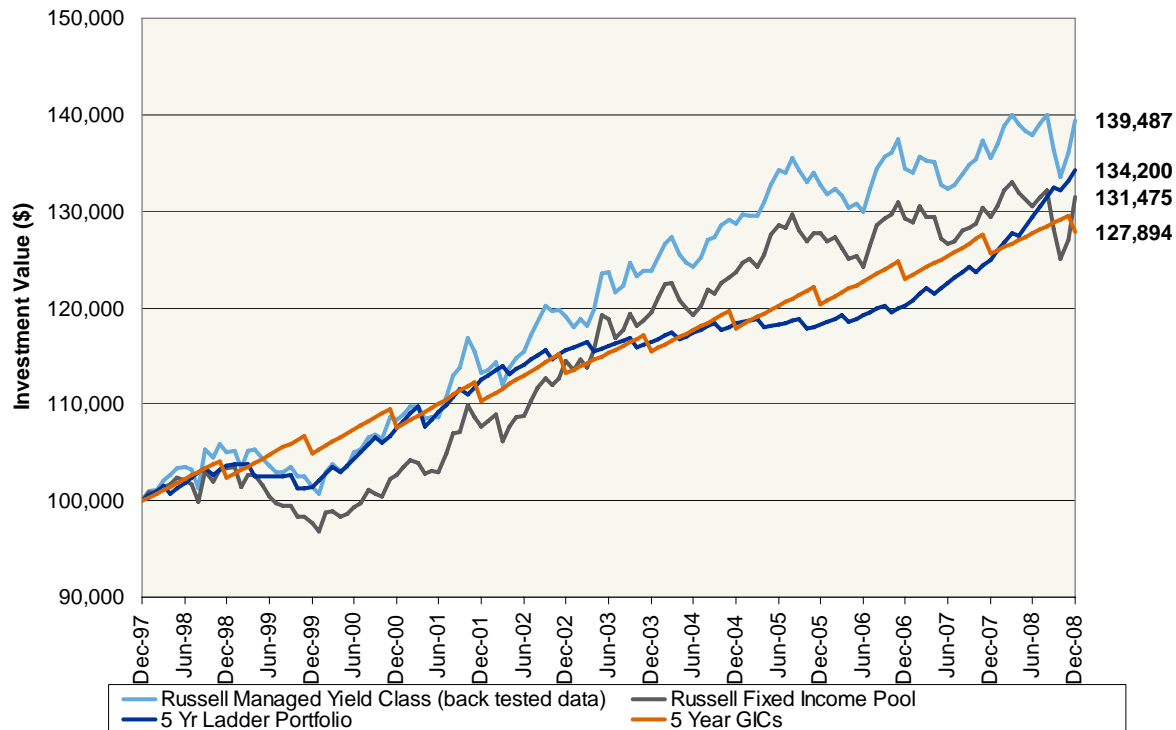


Figure 2 – The Russell Managed Yield Class is hypothetical back-tested data as it was inception on October 27, 2008, and is based on performance data for the Russell Canadian Fixed Income Fund Series A. It is not actual performance returns for the Russell Managed Yield Class and is calculated with the benefit of hindsight. For disclosure, assumptions and limitations of this back-tested data refer to Appendix.

Benefits of Russell Managed Yield Class

- Provides the freedom and flexibility to modify an investor’s portfolio allocation to match changes in their financial situation, goals or lifestyle.**
The tax-deferral feature of the corporate class structure removes the timing decision when rebalancing a portfolio and the Managed Yield Class makes it possible to adjust the fixed income / equity allocation in a tax-efficient manner.
- Offers the risk/return profile of fixed income investments.**
The Managed Yield Class provides the best of both worlds by allowing the diversification benefits of the fixed income asset class while generating steady cash flows.
- Provides capital gains distributions.**
The tax-efficiency of the cash flows realized by the Managed Yield Class provides investors with the opportunity to achieve enhanced after-tax returns.
- Offers the potential to defer realization of capital gains.**
The Managed Yield Class is designed to generate income in the form of capital gains and its corporate class structure makes it possible to defer realization of these gains until the final disposition of the mutual fund corporation shares. This provides incentive for taxable investors to hold the Managed Yield Class outside of registered accounts.

Russell's competitive advantage

Investment decisions are of primary importance and investors should evaluate a decision on its investment merits before analyzing its tax consequences. The Corporate Class structure allows the advisor to do the right thing for the client from an investment perspective first and then implement the strategy in a tax-efficient manner. Additionally, through the Russell Managed Yield Class option, advisors can now make an appropriate allocation to fixed income (recommended for most investors) and benefit from the classification of the Russell Managed Yield Class income as capital gains.

For more information please contact us at 888-509-1792 or by email at canada@russell.com

Appendix

Assumptions

- For the Russell Managed Yield Class, Russell Fixed Income Pool, the 5-yr Ladder Portfolio and the 5-yr GICs, the starting balance = \$100,000.
- Russell Managed Yield Class data is back-tested data using gross historical monthly returns and month-end NAVs for Russell Canadian Fixed Income Fund, including a management fee of 1.25% that reflects the current management fee of the Russell Managed Yield Class. Historical distributions (interest income and realized capital gains) are re-invested on an after-tax basis. Forward transaction counterparty fee for the Russell Managed Yield Class is 0.50%.
- Back-tested data is hypothetical performance, is not comprised of actual performance returns for the Russell Managed Yield Class and is calculated with the benefit of hindsight.
- Returns to the Russell Managed Yield Class may differ from the Fund in that there may be a delay between the time an investor purchases shares of the Russell Managed Yield Class, and the time the Russell Managed Yield Class obtains additional exposure to the Russell Canadian Fixed Income Fund by entering into forward contracts. Please see the prospectus of the Russell Managed Yield Class for further details of this risk, and for other risks associated with the Russell Managed Yield Class.
- Russell Fixed Income Pool uses historical monthly returns and month-end NAVs are on a net of fee basis based on actual historical data for the Russell Fixed Income Pool. Historical distributions (interest income and realized capital gains) are re-invested on an after-tax basis.
- Laddered bond portfolio growth is calculated using the annual total return of the 1-5yr benchmark Government of Canada bonds for each year in the period and includes after-tax re-investment of semi-annual coupons (yield). Retail commission estimated at 18bps has been applied to the annual total return of the bond ladder.
- 2008 Ontario highest marginal tax rates are used for calculating the tax liabilities (Interest Income = 46.4%, Eligible Dividends = 23.96% and Capital Gains = 23.2%).
- Income on the 5 Year GIC is calculated on the gross accumulated value (interest plus principal) on a monthly basis. For a comparable illustration to other fixed income products shown, the effective tax due on the GIC income is appropriately applied to the gross amount accrued and is deducted on an annual basis, rather than in a lump sum at the end of the term. The following monthly Bank of Canada rates have been used in this example: Dec 1997 5 Yr GIC rate = 4.5%, Dec 2002 5 Yr GIC rate = 3.8%.

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