CIBC Wood Gundy

Perspective

Compliments Of Voronoff Private Wealth Management

Fourth Quarter 2013

Maintaining Your Perspective

The economic news around the world continues to have a positive tone. Recent growth figures from Europe indicate that the Eurozone region has emerged from recession and the U.S. continues to produce improving economic data. Several international markets have been performing well based on this positive news. But here at home, the Canadian market continues its slow crawl largely due to challenges in the resource sector.

Although nobody can predict when the next upturn will occur, history has shown us that it is likely only a matter of time before domestic markets will begin to climb. After all, markets are cyclical by nature. Rather than focusing on the short term, a look at the bigger picture may help put things in perspective.

A recent study using the iconic Big Mac hamburger compares the time it takes a worker to afford a Big Mac using the minimum wage rate relative to the cost of a hamburger in various countries. The highest ranking country is Australia, where it takes only 18 minutes to 'earn' a Big Mac. Canada ranks near the top of the list, where it takes about 30 minutes. Contrast this with Russia, where it takes almost 2.6 hours, or Sierra Leone, Africa, where it takes a shocking 136 hours!

Canada's standard of living remains one of the highest in the world and is the envy of many world peers. In the Economist Intelligence Unit's recent ranking of the world's 10 best cities in which to live, three of Canada's major cities once again ranked in the top five.

Canada also allows us the opportunity to grow our wealth in a free-market environment. We continue to increase our personal wealth and are more financially secure, even compared to just 10 years ago.

As we have seen in the past, a lift in the markets can happen at any time. In the meantime, as we enjoy the Thanksgiving season, let's give thanks for the many great things about Canada — good reminders to help maintain perspective.

Voronoff Private Wealth Management

Speaking Personally: The fall often brings new life changes, including youngsters starting school and older children leaving for university. These life changes may have financial implications that require revisiting your investment strategy. If this is the case, give us a call and we can work through solutions.

Wishing you warmth as the cooler months approach.

Financial Market Monitor

	Recent 09-05-13	*Six Months Ago (03-06)*	*One Year Ago (09-07)*
S&P/TSX Composite Index	12845.10	12831.96	12268.01
Dow Jones Industrial Average	14937.48	14296.24	13306.64
Canadian Interest Rates/Yields			
Canadian Prime Rate	3.00%	3.00%	3.00%
Treasury Bills* -3 month	1.00%	0.95%	1.00%
-6 month	1.03%	0.99%	1.07%
Gov't. of Canada Bonds* -5 year	2.15%	1.30%	1.42%
-10 year	2.80%	1.84%	1.85%

* Approximate annual rates.
Subject to transaction volumes, availability of specific issues, and other important factors.

In This Issue:

Page

Donations & Reducing Taxes 2
Income Splitting: Family Trusts 3
Interest Rates & Equity Markets 3
Fixed Income & Interest Rate Cycles 4

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Giving Season

Donations And Reducing Tax Liabilities

> "My pledge...More than 99 percent of my wealth will go to philanthropy. Measured by dollars, this commitment is large. In a comparative sense, though, many individuals give more to others each day."
> – Warren Buffett,The Giving Pledge

Perhaps the largest philanthropic endeavour in our lifetime, the "Giving Pledge" is championed by esteemed investor Warren Buffett and challenges the world's billionaires to dedicate the majority of their wealth to efforts that address the world's problems. It includes 114 billionaires who have pledged at least 50 percent of their wealth to philanthropic causes. Each billionaire has written a pledge detailing the thoughts on this giving, some of which are very inspiring. They can be found on the Giving Pledge website at: http://givingpledge.org.

As the holiday giving season approaches, many Canadians also consider making gifts to charity. Although individually we may not have the same magnitude of donation dollars as those who are part of the Giving Pledge, we can certainly do our part to help others. At the same time, donations to registered charities made before the end of the year can also help to reduce your potential tax liability for the 2013 taxation year.

Here are some tax tips relating to charitable donations:

Accumulate — Donations over $200 result in a credit calculated at the highest federal marginal tax rate of 29 percent (plus provincial tax credits), regardless of the individual's own tax rate. Spouses or common-law partners can combine donations together for claiming by one individual. As well, donations made in different years can be carried forward for up to five years and claimed in one tax year. First-time donors may also be able to take advantage of a new tax credit (see inset for details).

Gift appreciated securities — Donations of publicly-traded shares that have appreciated in value are exempt from the capital gains tax. A donation receipt will also be issued for the fair market value of donated securities. If you are considering this option, please contact us well in advance of the year end so that we can ensure that the gift applies to the 2013 tax year.

Consider bequest giving — Naming a registered charity as a beneficiary of a life insurance policy, registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) may help to reduce or eliminate taxes payable by the donor's estate.

First-Time Donor's Super Credit

If you haven't claimed a donation tax credit since 2007, the First-Time Donor's Super Credit (FDSC) may be a great reason to consider donating. The FDSC is a federal tax credit that can be claimed by first-time donors on a one-time basis during the 2013 to 2017 taxation years. This is an additional 25 percent tax credit (on top of the federal Charitable Donation Tax Credit (CDTC)) for up to $1,000 of donations made after March 20, 2013.

To be considered a first-time donor, the individual (or the individual's spouse/common-law partner) may not have claimed a CDTC or FDSC in any of the five preceding tax years. The FDSC can be shared by the individual and spouse or common-law partner but the total that may be claimed by both may not exceed $1,000.

A Snowbird Checklist

Estate Planning Before Leaving

It's the time of year when many Canadians plan their escapes from the cold and head to warm weather destinations. While many planning efforts are focused on setting up tee times and protecting houses before leaving, one important consideration should be making sure your estate plan is in good order. If you are a snowbird, here are some things to consider:

- Have a valid and updated will and powers of attorney. Those empowered by the documents should know where they are stored should something happen to you while you are away.
- Keep an updated list of all of the institutions where you have assets or that provide professional services to you (i.e., banks, accountants, lawyers, insurance brokers, etc.) and a contact person at each company.
- If you own property outside of Canada, you may need to seek legal advice to determine if you need a separate will and powers of attorney for that country. If so, ensure that your foreign will and powers of attorney are properly integrated with your Canadian documents.
- Consult an accountant to plan around any potential income or estate tax liabilities relating to the ownership of foreign property.
- Keep track of the number of days you spend away. You may be deemed a resident for tax purposes in another jurisdiction if you spend more than 182 days per calendar year outside of Canada.

Please note that comments included in this publication are not intended to be a definitive analysis of tax law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances.

Income Splitting

Tax Benefits Of A Family Trust

These days, it seems that the cost of raising children continues to rise. If you are a parent or grandparent who has expenses associated with a child, you may want to consider a family trust as a way to split income and save taxes.

A family trust can be used for income splitting when it comes to expenses such as a child's education, athletics or other lessons. When properly structured, it may allow you to provide income, which would have otherwise been taxed at a higher tax rate in your hands, to minor children "beneficiaries" at their lower marginal tax rate.

Depending on your objectives, two of the main ways to contribute capital to the family trust are gifting and lending funds to the family trust. To lend funds to the family trust, a demand loan must be made using the Canada Revenue Agency's (CRA) prescribed rate. The prescribed rate in effect at the time the loan is established will prevail for the duration of the loan.

Each method of contributing capital has its own tax implications:

Gifting funds — Capital gains realized in the trust can be taxed in the hands of the beneficiaries. However, interest and dividend income are attributed back to the contributor for tax purposes and the contributor cannot reclaim the gifted capital.

Lending funds — Here, all income earned in the trust, not just capital gains, can be taxed in the hands of the beneficiaries, less the interest paid on the loan. The lender must pay tax on the interest paid on the loan. However, unlike gifted funds, the capital can be reclaimed by the lender by calling back the loan.

If you plan on establishing a family trust with loaned funds, the CRA prescribed rate is 2 percent as of October 1, 2013.

Tax savings can be substantial, but depend on the way in which you fund the trust as well as the marginal tax rates of the contributor and beneficiar(ies). As an example, assume that an individual has two minor children with no sources of income and has a $300,000 non-registered investment portfolio that produces $10,000 of interest income and $5,000 of capital gains annually. If income is taxed at the top marginal rate of 45 percent and there is a basic tax exemption of $10,000, by using a family trust, this individual can potentially save $1,125 or $2,925 per year in taxes by gifting funds or loaning funds, respectively.

We recommend consulting with a professional legal or tax advisor prior to establishing a family trust to ensure that it is structured properly to avoid potential tax or legal consequences.

Challenging Conventional Wisdom

Rising Interest Rates And Equity Markets

Although interest rates have been kept at historically low levels since the most recent financial crisis, over the past year bond yields have been rising. As austerity programs are pared down and the global economic situation improves, it is likely that interest rates will continue to rise.

A long held belief is that higher interest rates are bad for equity markets. Yet, a recent study by Standard & Poor's (S&P) in the U.S. shows that this conventional wisdom may not always hold true. In fact, there may be a correlation between rising rates and a rising stock market.

Why are higher interest rates perceived as bad for equity markets? Higher rates encourage saving and discourage borrowing, which results in a reduction of the money supply and spending. A slower spending environment can negatively impact business performance. For companies in industries that borrow heavily, higher interest rates also raise the cost of operations, which may lower earnings and share prices.

Contrary to this notion, the S&P study looked at U.S. stocks from 1953 to 2012 and showed that stocks actually posted their best returns when 10-year U.S. Treasury yields rose to almost 4 percent. The 10-year Treasury yield is often a benchmark for U.S. interest rates. It started this year at 1.86 percent and has increased over the year, rising to its highest point (at the time of writing) of 3.0 percent at the beginning of September.

However, when historical yields exceeded 6 percent, the study showed that equity performance slowed or fell. Historically, equities performed with great strength in a rising rate environment in which interest rates were between 3 and 4 percent, in a growing economy where unemployment rates decreased and corporate earnings increased.

This study is good food for thought during times of rising rates. In the near term, interest rate increases in an improving economy may not be such a bad thing when it comes to equity markets.

Source: Study of S&P 500 performance from 12/1953 to 01/2012 in rising rate environments, S&P Chief Equity Strategist, March 2012.

Fixed Income And The Interest Rate Cycle

Fixed income markets are currently at a crossroads, facing the potential for interest rate increases. Short term yields have been successfully held at low levels for years since the financial crisis. Here at home, the Bank of Canada has been holding the trend-setting overnight rate at a low level. In the U.S., the government has been purchasing U.S. Treasuries and agency mortgage-backed securities to keep short-term rates low.

However, stimulus programs are expected to be wound down as the economic situation improves. This has been reflected in medium-term yields, driven by investor demand, which have been rising this year due to concerns that policy makers will reduce stimulus actions sooner than expected due to improving economic data.

Conventional wisdom holds that rising interest rates are bad for fixed income markets because, from a very basic perspective, when rates rise, bond prices fall. But, this simple view may be challenged when considering a diversified fixed income portfolio which may actually perform well during periods of rising rates.

Just twenty years ago, a diversified fixed income portfolio usually meant having a mix of Canadian government and corporate bonds. Fast forward to today where investors now have access to a broader array of fixed income products. The addition of different types of fixed income investments into a portfolio may assist investors to achieve improved returns with marginal changes in volatility.

A recent study in the U.S. (see chart) looked at different fixed income investments in differing interest rate environments. During periods of rising rates, emerging market bonds and high-yield bonds (debt issued by corporations with credit ratings below investment grade) historically performed well.

U.S. Fixed Income Returns During Differing Interest Rate Environments

Fixed Income Investment Type	*Return over entire period*	*Rising rate environment*	*Falling rate environment*
Government bonds	6.1%	-0.3%	10.0%
Investment grade corporates	6.6%	0.4%	10.3%
High-yield bonds	7.4%	6.3%	8.0%
Emerging market bonds	10.1%	11.0%	9.6%

Source: Government bonds: Merrill Lynch US Treasury Master Index (GOQO); Investment grade corporates: Merrill Lynch US Corporate Master Index (COAO); High-yield bonds: Citigroup US High-Yield Market Index; Emerging market bonds: JP Morgan Emerging Market Bond Index (EMBI). Jan. 1994 – Dec. 2011.

Why has this been the case? Interest rates typically rise in a strong or strengthening economy. During these times, investors may be more likely to invest in products that may be considered more risky, such as emerging market bonds or high-yield bonds.

For high-yield bonds, as corporate profits improve as a result of an improved economy the financial health and business prospects of the bond issuers can also potentially improve, which may reduce associated risks.

In a rising rate environment, high quality, shorter duration bonds can also help to lower exposure to potential long-term risks because they are less sensitive to movements in interest rates.

However, diversification within a fixed income portfolio may go beyond simply cushioning against the effects of interest rate changes. Here are some other considerations:

Income Preservation/Potential — Other global economies may be in a different part of the interest rate cycle, or may offer better fixed income returns due to better market performance or growth potential, when compared to domestic markets. Expanding a fixed income portfolio to include investments from other markets may help to preserve or improve the income generated.

Inflationary Hedging — Although inflation does not appear to be a threat in the near term, some fixed income products are designed to protect investors from rising inflation. Examples include: TIPS, real-return bonds, and other inflation-indexed products.

We Are Here To Help

As with any investment, there may be risks to consider when diversifying a fixed income portfolio, ranging from default risk to foreign exchange risk. We can help to provide options that may be suitable to your particular situation.

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