CIBC Wood Gundy

Perspective

Personal Newsletter from the Boychuk Knoblauch Financial Group

Fourth Quarter 2016

A Matter of Perspective: Opportunity or Risk?

At the beginning of 2016, it was difficult to find much market commentary that foresaw positive developments in the equity markets over the next twelve months. The problems were legion: continuing low oil and commodity prices, slow growth at home and abroad, low interest rates and ongoing geopolitical tensions. Although these global issues persist today, equity markets closer to home have largely seen positive performance to this point.

Bearish forecasters have not gone away. Some point out that the equity markets have only posted gains as a result of low interest rates, which have left investors with fewer opportunities for investment returns. During the summer, market pessimists were warning that the surprise Brexit "leave" vote would push global markets into turmoil. However, even this had a limited negative effect on the markets.

Of course, the ongoing issues we face are important and should not be trivialized. For investors concerned about market prospects and protecting their portfolios, they have created some worry. But fear is a common underlying emotion in the equity markets. It can often drive short-term market behaviour, sometimes resulting in decision making that isn't in an investor's long-term best interest.

How do you approach your own investing? Do you base your financial decisions on longer-term objectives or do shorter-term perspectives often prevail?

Keep in mind that anyone who forecasts a downturn has a good chance of eventually being right — such market corrections come on a seemingly regular basis. Yet, the financial markets have proven remarkably resilient throughout history, despite experiencing situations that were considered potential crises. Since the start of the millennium, we have seen the dot.com crash, the banking and credit crisis, two recessions and plunging oil prices, and yet the Canadian equity market had a compounded annual return of 6.0% (S&P/TSX Composite Total Return Index to 31/07/16).

Investors nervous about today's economic climate should try to focus on investing with longer-term, personal objectives in mind. Portfolios built on a solid foundation, with an emphasis on diversification, balance, quality and value, have been put in place with the aim of being successful, regardless of the immediate market situation. As a result, portfolio builders will welcome the up periods in the markets and view any downturns as opportunities.

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Speaking Personally: Global equity markets didn't take a summer vacation. The Brexit vote showed how excessive pessimism can quickly make room for renewed strength. Keeping a longer-term focus is key when market sentiment can change from week to week. As November approaches, many will be watching the U.S. presidential election to see what impact a new regime may have on financial markets. We will keep you posted. Enjoy the fall season.

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Thinking Ahead

Tax Planning Before Year End

Time flies! It may not seem like it now, but the end of 2016 is approaching. Consider taking certain actions today (and before year end!) to help save on 2016 taxes. Here are some ideas:

Charitable donations — Make eligible charitable donations before December 31 to benefit from the associated tax credits for the 2016 tax year.

Capital losses — Consider realizing capital losses to offset realized capital gains for 2016 (or to take advantage of the carryback provisions). Do this well before the year end. There may also be opportunities to transfer capital losses between spouses.

RRSP contributions — Although you still have until March 1, 2017 to make Registered Retirement Savings Plan (RRSP) contributions for 2016, the sooner you contribute, the sooner you can start sheltering investments from current taxation.

RESP contributions — While this won't save current tax, by contributing to a Registered Education Savings Plan (RESP) you may potentially benefit from the Canada Education Savings Grant (CESG) for 2016.

Income-splitting — You can lend funds to family members for investment. Investment income will be taxable to your family members if the rate of interest on the loan is at least equal to the government's "prescribed rate", which is 1% until the end of 2016. Other income-splitting opportunities may be available and a tax advisor can provide the best options for your circumstances.

Capital assets — Business owners planning on purchasing capital assets in the near future should consider doing so before the end of the year to take advantage of depreciation rules.

Turning 65? — Don't forget the pension income tax credit. If you're 65 years old or older, consider purchasing an annuity or opening a small Registered Retirement Income Fund (RRIF) to be able to claim the federal pension income tax credit (a withdrawal of $2,000 will need to be made). Eligible pension income may also be split with a spouse on a tax return.

Turning 71? — If you've turned 71 years old this year, you have until December 31 to make any final contributions to your RRSP before converting it into an RRIF or registered annuity.

Some of these actions may require pre-planning, so don't delay in considering your options. For other ideas or advice regarding your particular situation, contact your personal tax and legal advisors.

Pension Reform is Coming...

Changes to CPP: Are They Enough?

In an era of disappearing company-sponsored defined-benefit pension plans, nine of ten provinces have agreed to changes to the Canada Pension Plan (CPP). (Manitoba did not originally sign, but has agreed to join the CPP reform; Quebec has stated it will make changes to its own provincial pension law.)

What are the proposed changes? Currently, the maximum 2016 annual CPP payout is $13,110 at the age of 65. This is expected to rise to around $17,500. In order to fund this increase, the maximum amount of income covered by CPP is expected to rise from $54,900 to $82,700. CPP contributions from workers and employers are also expected to both increase by 1 percentage point, to 5.95% of wages (recall that the CPP is fully funded by workers and their employers). A lower contribution rate is expected for earnings over $54,900. These changes are proposed to be phased in between 2019 and 2025 and a new tax deduction is expected for worker contributions to help ease the financial burden associated with the increase.

Expanding the CPP does little to help affluent savers or seniors currently living in poverty, but many believe that this is a positive step to help improve the future support for working Canadians in saving for retirement.

Compounding "Magic"

Teaching kids about compounded growth? Or, looking for some dinner-table conversation? Here's a fun play on numbers that reminds us not to overlook the magic of compounding:

Q: Would you rather have $50,000 per year for 30 years or a penny that doubled in value each year for 30 years?

A: With the doubling penny, you would have over $10.7 million after 30 years, compared to only $1.5 million with the first option. Although a 100% annual rate of return is unrealistic, the doubling penny demonstrates the profound effect of compounding.

Taxes & Your Estate

Estate Planning for Capital Gains

As much as we may gripe about high personal income taxes in Canada, there is one area where Canada's tax law is comparatively favourable. Unlike certain countries globally, Canada doesn't have a formal estate tax. Consider that Japan's estate tax is the highest in the world with rates up to 55%! (Note that many of these countries provide some tax relief through exemptions.)

Top Estate or Inheritance Tax Rates Globally

Country	Rate	Country	Rate
1. Japan	55%	**6.** Spain	34%
2. South Korea	50%	**7.** Ireland	33%
3. France	45%	**8.** Belgium	30%
4. United Kingdom	40%	**8.** Germany	30%
4. United States	40%	**10.** Chile	25%

As at March 2015. Source: Tax Foundation, Fiscal Fact, March 2015. No. 458.

Although we have no estate tax in Canada, taxes are still likely to be payable upon the death of an individual. Certain provinces have probate or estate administration taxes payable on the estate assets.

For the year of death, an income tax return must be filed for the deceased and capital property is treated as though it was disposed immediately prior to death. As such, any resulting capital gains may be subject to tax. By planning ahead, steps can be taken to help minimize these taxes in the year of death and maximize the future transfer of wealth.

Transfer to a spouse. Assets transferred to a spouse/common-law partner (CLP) (or to a trust for the spouse/CLP's benefit during their lifetime) are automatically considered to be transferred at cost, deferring the capital gains tax on the assets until the spouse/CLP either sells them or passes away. If there are unused losses, tax deductions or credits in the deceased's final tax return, an election out of the tax-free rollover for certain assets can be made as necessary to create sufficient capital gains and increase taxable income in order to make use of these tax benefits.

Principal residence exemption. Capital gains on a principal residence can be exempt from tax. However, this exemption is shared between spouses/CLPs so if a couple owns more than one property, there may be tax benefits to designating one property over another as the principal residence.

Capital gains exemption. Small business corporation shares may qualify for a capital gains exemption of $824,176 (for 2016; the amount is indexed to inflation annually). For qualifying farming or fishing properties, the exemption is $1,000,000. Planning ahead can be important for these exemptions as there are certain conditions that must be met and some may require years of planning.

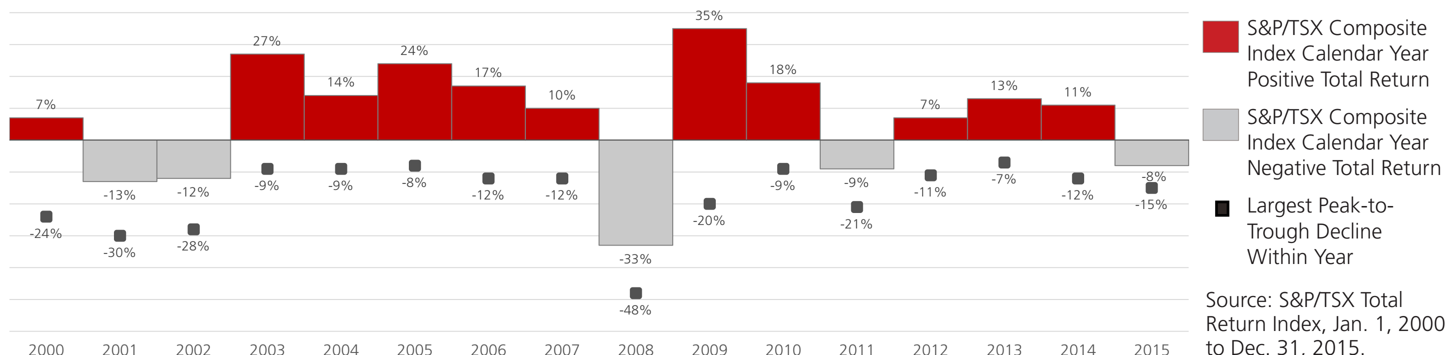
Donations to charity. For individuals who wish to create a legacy through donations, making the gifts to a charity from a stock portfolio may provide tax advantages versus using other forms of donations, such as cash. When publicly-listed securities are donated to a registered Canadian charity, any accrued capital gain is excluded from taxable income and the donor also receives a donation receipt equal to the value of the donated securities.

These are just some ideas that can add value with proper planning. Consult with an estate planning specialist and your personal tax and legal advisors to construct your estate plan in a tax-favourable manner.

Note that the 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.

Staying Focused: A Longer-Term Perspective

A look back at the performance of the S&P/TSX Composite Total Return Index may help remind investors to keep focused on the longer term. Since the start of the millennium, the good periods have outnumbered the bad. But even in good times, there were dark days. In fact, at some point during each year, the Canadian equity market saw a retraction of at least 7%. In spite of these fluctuations, the compounded annual return (with dividends reinvested) has been 6.0% (from 31/12/1999 to 31/07/2016, using market close data).



Source: S&P/TSX Total Return Index, Jan. 1, 2000 to Dec. 31, 2015.

Brexit: Investing Lessons Learned

Over the summer, the financial markets were shaken by the results of the Brexit referendum in which the U.K. voted to leave the European Union (EU). The result was somewhat of a surprise as a vote of "remain" had been widely predicted.

The immediate effects were significant. European markets had a two-day sell-off and the British pound fell to its lowest level in more than 30 years. Gold prices rose while government bond yields declined (as yields move in the opposite direction of prices) in a flight to safety.

How Does This Affect Investors?

As the formal exit from the EU may take years to complete, the longer-term implications are not yet clear. Many questions remain: What will be the terms of a formal separation agreement? How will this impact the EU economies? Is this a broader continuing trend towards deglobalization? The Brexit vote also magnifies a host of other problems that continue to affect the EU region, including rising unemployment, slow growth (and contraction) and the potential need for sovereign bailouts to address unstable financial systems.

What Are the Immediate Lessons Learned?

Markets Are Often Unpredictable (Don't Listen to the Noise!) — Even the best forecasters will never be able to predict with certainty what the future holds. With Brexit, the markets largely expected a remain vote. Once the surprise leave vote was determined, many headlines then predicted global economic turmoil. Despite two days of volatility, financial markets then gained back much of the losses and things generally calmed down.

Diversification is Key — Investors who have diversified portfolios can often be better protected when these types of events occur. The United Kingdom faces ongoing uncertainty and economic challenges as the exit path ahead is determined, Brexit demonstrates the importance

of maintaining geographic diversification within a portfolio. However, portfolio diversification extends beyond investing across different geographies, and having assets that behave differently under various conditions is important to help protect a portfolio from downside risk.

Downward Volatility Can Provide Opportunity — Investors may look at these events as potential buying opportunities. During times when equity prices are rising and it may be difficult to enter the equity markets, short-term periods of volatility can sometimes provide a good chance for investors to get cash working from the sidelines.

A Longer-Term Focus Can Have Its Rewards — In the short run, irrational human behaviour can be a key driver of the markets. But over the longer term, the markets are reasonable and act rationally. Investors should be reminded that uncertainty is a key characteristic of the equity markets, but the high risk associated with equity markets is coupled with potential for higher returns over the long term.

As the Brexit path ahead takes shape, there are a broad range of possible future outcomes. From an investment perspective, we will continue to monitor the changing situation, attempt to manage the associated risks and work to realize any potential opportunities.

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