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Perspective

Personal Newsletter from The BKE Financial Team

Third Quarter 2015

Today's New Normal

As a result of slow economic growth, we continue to experience a low interest rate environment that has shaped a new normal in today's investing landscape. Short-term interest rates have been influenced by the monetary policies of the central banks. The Bank of Canada (BoC) has held its key interest rate at a low level to keep the cost of borrowing low, with the intent of increasing business and consumer spending to stimulate growth.

Canada's monetary policy has historically been aligned to that of the U.S. However, this year, we have seen a rare divergence. The BoC cut rates earlier in the year at a time when the U.S. Federal Reserve signalled that it would raise interest rates in the near term.

Many other countries have also lowered interest rates. The situation in Europe is peculiar, with some debt trading now with negative yields. In other words, a bond purchased and held to maturity returns less than the principal invested. This seems counterintuitive — why would anyone want to invest an amount for which they will eventually get less back? Yet, many European investors have concerns about deflation and the instability of the Euro.

Due to lower interest rates, and the potential for rising rates, the risk and return profiles for various fixed income assets continue to change. Adjusting expectations has been a challenge. Many retirees, for example, can recall the days when low-risk, fixed-income products generated double digit yields (yet the impact of high inflation is often forgotten!).

For some investors, managing through this period may mean re-evaluating risk tolerance levels based on the investor's time horizon, which may impact a portfolio's overall asset allocation. For other investors, portfolio adjustments may be needed depending on the changing risk and return profiles of assets held or term to maturity, as examples.

No one knows precisely what will happen to interest rates over the longer term. Keep in mind that challenges like this are a common occurrence in modern capital markets — the cyclical nature of the markets affects different asset classes at different times — and one of the greatest roles that we play is to ensure that your portfolio continues to adapt over time.

In This Issue:

THE BKE FINANCIAL TEAM
LIFESTYLE STRATEGIES FOR TOMORROW

Speaking Personally:

The Tax-Free Savings Account (TFSA) continues to be a compelling savings vehicle and the recent increase in its annual contribution limit is great news for many Canadians.

If you have yet to maximize your TFSA contribution, or would like to discuss TFSA strategies, please let us know.

Starting early and contributing the maximum each year can make a difference to a retirement plan. Enjoy the summer.

Estate Planning & Your Family

What Have You Told Your Kids?

It's quite common for parents to avoid raising the topic of inheritance or succession planning with their children. After all, it can be a private and awkward topic to discuss. There may also be concerns that opening up a discussion will generate a sense of entitlement amongst children or negatively impact their work ethic.

However, avoidance of the subject can be counterproductive. How will your family know how to best deal with your assets if you have kept your finances secret?

Having the conversation with your heirs before death or serious illness can often help protect your wealth in the long term because your children will be better prepared to step into a money-management role.

How much information needs to be shared? The conversation doesn't need to give detailed information about your finances. The objective may be simply to share your general intentions and avoid any surprises. In some cases, discussion with your heirs may lead to changes in your initial plans. Perhaps a child doesn't want to be involved in your business' succession or in the sharing of a vacation home. Or, your children may express interest in acquiring a particular family heirloom that extends beyond any dollar value. The opportunity to personally explain the reasoning behind your decisions to your children may help promote family harmony and avoid any hostility later on.

When is the best time to have the discussion? Ideally, you should start the dialogue with your children when they have established themselves financially. It doesn't have to happen on just one occasion; a series of discussions over a period of time may be a great way to help your children to better understand your expectations and values, or for you to introduce the responsibility of asset custodianship.

Planning ahead has the potential to produce immense gains down the road for your beneficiaries. If you need assistance with investment or wealth management points to consider as you prepare for the discussion, please don't hesitate to get in touch.

Tax Planning: Thinking Ahead

Holding U.S. Assets Could Mean U.S. Estate Tax

It is often surprising for many Canadians to learn that simply owning the shares of U.S. corporations — even in a Canadian account, regardless of whether it is registered or non-registered — could subject you to the U.S. estate tax.

For Canadians who are not U.S. citizens (and are not otherwise resident in the U.S. for U.S. estate tax purposes), the U.S. imposes an estate tax on "U.S situs assets" held by a person at death. In 2015, U.S. federal estate tax rates start at 18 percent and can reach as high as 40 percent of the fair market value of the U.S. situs assets, which includes U.S. real estate and shares of U.S. companies held in Canadian brokerage accounts. Canada doesn't impose an estate tax. Instead, individuals are generally subject to tax on accrued gains resulting from the deemed disposition of their assets at death.

Your exposure to U.S. estate tax depends on the value of U.S. situs assets you own at death and the value of your worldwide estate. In 2015, if you own more than US$60,000 of U.S. situs assets and the value of your worldwide estate exceeds US$5.43 million, you may be subject to the tax. Your worldwide estate includes assets held in all countries (including Canada) and may include items such as the death benefit on an insurance policy.

The Canada-U.S. tax treaty may provide some relief from the U.S. estate tax, including a foreign tax credit to be claimed for any U.S. estate tax paid by a Canadian resident that may decrease the taxes payable in Canada. However, in some situations, the U.S. estate tax liability could be significantly higher than the Canadian tax liability. As an extreme example, if a Canadian buys $1 million of U.S. shares today and dies tomorrow, U.S. estate tax would be based on the $1 million value of those shares. However, if there was no change in the share price, no Canadian capital gains tax would be due.

The U.S. estate tax rules have changed frequently over the years and the tax continues to be hotly debated. Consult with Canadian and U.S. tax advisors to help determine your exposure and provide strategies to mitigate the potential taxes on your U.S. assets.

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.

The World's Most Wealthy

The Billionaires Club: Continuing to Grow

Each year Forbes Magazine publishes its list of the world's billionaires. This year, there are a record 1,826 members with an aggregate wealth of $7.05 trillion dollars — up from 1,645 billionaires in 2014. There are 39 Canadian billionaires this year, representing only 2 percent of the global list.

Only 13 percent of the world's billionaires inherited their wealth; in fact, over 65 percent of the world's billionaires are self-made, with the remainder inheriting a portion of their wealth but largely working to increase their fortunes. Entrepreneurship is the key to most of these individuals' successes. The world's youngest billionaire is just 24 years old and many newer members share stories of finding success through start-up enterprises.

One of the distinctive traits shared by these billionaires is that they work hard. Here are some other characteristics of the group, as polled by Forbes:

- **They are early risers:** 43 percent get up before 6 a.m. (and the majority of billionaires are up before 7 a.m.).
- **They have long working weeks:** 60 percent work at least 60 hours or more per week.
- **They didn't have affluent upbringings:** 40 percent came from poor/working class families; 30 percent were middle class.

Source: Forbes Magazine, "Billionaires", March 2015 edition.

Good News for Saving

Tax-Free Savings Accounts (TFSAs) Get a Boost!

In April of this year*, the federal government increased the annual TFSA contribution amount from $5,500 to $10,000. (The annual contribution limit from 2009 to 2012 was $5,000). This new limit is effective immediately and will no longer be indexed to inflation. The current total contribution room available to eligible Canadians who were at least 18 years of age in 2009 and have not yet contributed to a TFSA in previous years is now $41,000.

The TFSA continues to be a compelling savings vehicle and the increase in the contribution limit has renewed interest in the plan. Here are some things that you may not have considered when it comes to the TFSA:

A Great Way to Split Income. The TFSA can be a great way to split income with a spouse/common-law partner or with children over the age of 18. Often, attribution rules under the Income Tax Act do not permit income-splitting between spouses/common-law partners and any income or capital gains are attributed back to the original spouse/common-law partner. The TFSA provides an exception to this rule. If the higher income-earner in a couple gifts funds to a spouse/common-law partner who then contributes such funds to a TFSA, there is no attribution on the income/gain earned in the TFSA. This could result in a sizable tax-savings opportunity over the years.

Note that the exemption from the spousal attribution rules no longer applies when transferred funds or property is withdrawn from the TFSA (i.e.: future income/capital gains earned on withdrawn funds or securities would be attributed back to the individual who was the original source of the funds).

Money for a TFSA can also be gifted to children who are 18 years of age or older.

Pass on Wealth Tax-Efficiently. There will not be tax arising on TFSA investment growth upon the holder's death. If a successor holder or beneficiary is named in the TFSA, these assets will also bypass the will, avoiding the application of a probate tax in provinces where applicable. If leaving the TFSA to a spouse/common-law partner, it is generally preferable to name them as the plan's "successor holder" (and not the beneficiary), so as to avoid being taxed on any income or gains arising after the holder's death (except in Quebec). The TFSA will transfer to the spouse/common-law partner who has the choice to either continue operating it tax free or close the account. If a spouse/common-law partner is named as the beneficiary, taxes would be due on any gains made or income earned between the time of the holder's death and the closing of the account.

Beware of Transfers In! If transferring investments "in-kind" to a TFSA, you are considered to have disposed of the investment for its fair market value at the time of transfer. If there is a capital gain, you will be taxed on the gain. If there is a loss, a capital loss will be denied.

*The annual TFSA contribution limit increase was announced in the 2015 federal budget, which at the time of writing has not yet been passed.

Seven Habits of Highly Effective Investors

Establishing certain habits can help to make you a better investor. Here are seven considerations.

It has been over 25 years since Stephen R. Covey's book *Seven Habits of Highly Effective People* became a bestseller. It offered a common-sense approach on how to be more effective in attaining your goals by undertaking personal change. Investing can be thought of in a similar light; establishing certain habits can help to make you a better investor. Here are seven practices that can serve investors well.

1. **Accept that markets are cyclical.** Just as we embrace the up times in the markets, effective investors also accept that down times are a normal part of investing. Your mindset will often determine whether you can get through these times in the best shape possible, or whether you succumb to emotional investing. Here is a positive perspective on the cyclicality of the markets: since 1970, the average bull market of the S&P/TSX Composite lasted over 58 months, whereas the average bear market lasted only around 11 months.*

2. **Diversify across multiple asset classes.** The value of diversification may be even more apparent in today's world. Canada's economy continues to be affected by lower oil prices, which again illustrates the risk associated with a significant reliance on any one particular sector. Continuing low interest rates have also highlighted the value of diversification when it comes to fixed income assets.

3. **Keep your longer-term goals in mind and stick to your plan.** Focus on your plan's goals and not on any day-to-day changes in the markets. Remember that your plan was likely put in place with a longer-term focus and meant to withstand temporary changes in the markets. At the same time, revisiting your plan on a periodic basis, to rebalance or make updates based on life changes, can help you to keep on track.

4. **Have confidence in the value of support.** Whether it is instilling discipline, offering investment advice or providing comprehensive wealth management, we are here to provide support at every stage of the investment journey and help you to achieve your goals. We believe in the value that comes with this support. It's a fact that investors who work with advisors have three times the net worth and four times the investable assets than those who don't work with an advisor.**

5. **Stop listening to the noise.** Everyone has an opinion on investing and the markets. In good times, everyone can sound like an expert. In difficult times, the media seems to magnify economic misery and instill fear. At the end of the day, thoughtful analysis, rather than peripheral noise, should drive decision making.

6. **Save more.** Saving continues to be one of the cornerstones of building future wealth. Consider taking advantage of the recent TFSA contribution limit increase. Also consider the effect of finding hidden savings in regular expenses, such as cable, cell phone, internet or insurance premiums. Reducing costs by $250 per month can generate over $100,000 in 20 years, assuming a 5 percent annual rate of return.

7. **Look beyond your investments.** There are many other considerations that should be taken into account when maximizing your overall wealth. Proper tax planning, estate planning and insurance planning can help to make a significant impact on your wealth.

Sources: *Based on the S&P/TSX Composite Total Return Index, Jan. 1970 to May 2015 – a bull (bear) market defined as a positive (negative) move greater than 20 percent based on monthly closing data.**Ipsos Reid "Value of Financial Advice" Investment Funds Institute of Canada, 2012.

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