Quarterly Exchange

Q1 2014

THE BKE FINANCIAL TEAM

TYSON BOYCHUK, CIM
First Vice President
Portfolio Manager

DENNIS EWASIUK, MBA, CIM
First Vice President
Portfolio Manager

DEAN KNOBLAUCH, CFA
First Vice President
Portfolio Manager

Through the *Quarterly Exchange*, we'll keep you up-to-date on current investment trends and strategies. We are committed to working one to one with you to help you achieve your financial goals. Please contact us if you have any questions or wish to discuss any of the articles in this newsletter.

The BKE Financial Team
1285 West Pender Street
Suite 400
Vancouver, BC
V6E 4B1

Tel: (604) 641-4390
Toll-Free: (800) 661-9442
Whitehorse: (867) 667-7402
Edmonton: (780) 491-0113
Fax: (604) 641-4392
E-Mail:
BKETeam@cibc.ca

CIBC Wood Gundy

www.cibcwoodgundy.com

Homeward Bound

By Avery Shenfeld, Chief Economist

There are reasons to believe after lagging behind returns elsewhere, this could be Canadian equities' year to shine. Not because Canada's economy will outgrow the U.S. Rather, it's that Canadian equities have more elbow room, with current valuations not as stretched as those stateside, and earnings having more leverage to the global economy. The easing of the drag from budget tightening in the U.S. and Europe, and an export-led pick-up in activity in emerging markets, will see global GDP growth hit 4%, well above consensus expectations.

Canada's market is overweight in resource companies where output prices are particularly sensitive to global demand. Although new supply coming on stream will prevent a repeat of the very steep climb in commodity prices seen in the prior business cycle, upside surprises to world demand will still see most base metal and lumber prices improving this year. Oil prices should hold steady at healthy levels, as world demand growth absorbs supply growth associated with shale oil projects, and Canada's oil sector will see earnings gains associated with a ramping up of output. Gold could be an exception in the general rise in commodity prices, but precious metals carry less than half of the weight of the TSX that they held two years ago.

Our top-down model suggests that solid global macroeconomic fundamentals point to an above-consensus 13% climb in earnings for TSX companies, a pace that will outgun bottom line gains for U.S. stocks. The TSX Composite has outperformed the S&P 500 in each of the last six years in which global growth has topped 4%, and 2014 should add to that streak.

In the near term, that advantage could be eroded by a further slide in the Canadian dollar. The loonie has weakened on chatter that the Bank of Canada could cut interest rates in response to sluggish growth and low inflation. But by year end, the Canadian dollar should be no weaker than current levels, as only modestly faster growth and inflation will rule out an interest rate cut. Growth in oil and other exports should also help put a floor under our dollar by narrowing the trade deficit.

We'd like to be able to call for a long run in Canada's favour. But Canadian dollar appreciation isn't likely to be a long-term story given our productivity challenges, and equity leadership doesn't tend to persist. Still, we'll be happy to see at least a year in which Canada's stars shine brighter.

An Individual Pension Plan can play a valuable role in a business owner's retirement strategy

JAMIE GOLOMBEK,
CPA, CA, CFP, CLU, TEP

Managing Director,
Tax & Estate Planning
CIBC Wealth Advisory Services

An Individual Pension Plan (IPP) is a defined benefit pension plan, often set up for one plan member – typically the owner-manager of an incorporated business. IPPs may also cover other significant employees, including the owner-manager's spouse or children if they work in the business.

Like a Registered Retirement Savings Plan (RRSP), contributions, which are tax-deductible to the corporation, are made to an IPP and the plan assets accumulate on a tax-free basis with the intention of providing retirement income to the plan member(s).

Unlike an RRSP, however, the amount of retirement income to be provided by an IPP is predetermined. An actuary calculates how much funding is needed to ensure this retirement income can be paid and the corporation makes contributions to the IPP to meet the funding obligation. When an IPP is initially established, it may be possible for the corporation to contribute a large, initial lump sum amount in respect of the plan member's past service. To do so, a portion of the cost of funding past service under the terms of an IPP must be first satisfied by transfers from the plan member's RRSP assets, or a reduction in the plan member's accumulated RRSP contribution room, before new past service contributions will be permitted.

An IPP may, depending on the specific circumstances of the business owner, offer several advantages over an RRSP in a retirement strategy. The primary advantage in most cases is that the amount that can be contributed to an IPP on an annual basis is often higher than the amount the business owner could have contributed annually towards his or her RRSP. This is particularly true for owner-managers who are somewhat older, typically over age 40. This, in turn, can (at least theoretically) lead to a higher tax-deferred accumulation inside the IPP than could have been built up inside an RRSP, in turn leading to a higher stream of retirement income.

Another advantage of an IPP is that funds may be topped-up in years of poor investment performance. Typical actuarial assumptions for an IPP include a 7.5% return on investment, based on current tax laws. If actual investment returns are insufficient to meet the plan obligations, the corporation may increase its contributions to the IPP to make up for the shortfall in return. This can again result in higher tax-deferred accumulation inside an IPP than within an RRSP, for which no top-up is available in years when investment returns decline or result in decreased RRSP asset values.

IPPs may act as a form of forced savings for plan members, to better ensure funds will be available during retirement years. Contributions to an IPP are mandatory in certain jurisdictions and optional in others – your advisor will be able to inform you about the rules applicable in your jurisdiction. Funds in an IPP are not available to the plan member until retirement, which can generally occur starting at age 55 under most provincial legislation. In contrast, RRSP funds that are not locked-in can be withdrawn at will, making it easy to forego the discipline of retirement savings to satisfy current financial whims.

Although actuarial fees will be incurred to maintain an IPP, these fees are generally tax-deductible to the corporation that pays them. The deduction may mitigate any additional administration costs that may be incurred in an IPP.

For family businesses in which other family members are also members of the IPP, one further advantage is that having an IPP, rather than an RRSP, may help to avoid the deemed fair market value income inclusion of RRSP assets at death and related tax cost if a plan member dies and a tax-free rollover to a beneficiary is not possible.

Given the potential advantages, it may well be worth considering an IPP as part of a retirement strategy. Speak to your advisor about getting a free, no-obligation IPP consultation to find out specifically how the IPP may benefit your own retirement planning.

Investing in Bonds in a Rising Rate Environment

You might have heard warnings about the potential for rising interest rates and how they could affect your fixed income portfolio.

Right now, we're in a situation where the U.S. Federal Reserve has been keeping interest rates at historic lows as a part of its strategy to stimulate the U.S. economy. And with the economy showing some signs of recovery, the Fed is slowly starting to turn off the stimulus taps by reducing its bond-buying program known as quantitative easing. As this continues, it's expected that long-term interest rates will rise in response, both in the U.S. and in Canada. But when rates go up, bond prices typically fall.

Meanwhile, stock prices have been on the rise, spurring many investors to shift to a strategy of being overweight equities and underweight bonds. Although the prospect of climbing rates and falling bond prices might sound like a reason to forgo bonds altogether, the arguments in favour of portfolio diversification, income and stability still ring true. And depending on your life stage, going heavy on equities can be too risky. Instead, investors can consider products and strategies that reduce the risk of rising rates. Consult your Investment Advisor to see what might be right for your personal situation.

Bond Laddering

This is a diversification strategy that can decrease your interest rate risk during periods of rising or falling rates. To create a bond ladder you would buy equal amounts of securities that mature at regular intervals such as every year over a five-year period. If rates go up, the proceeds from your bonds maturing would be reinvested at the prevailing rate, which would reduce your portfolio's interest rate risk and increase your interest income.

Swap Long For Short

Generally, shorter-term bonds are less sensitive to interest rate changes. To protect your portfolio against rising rates, selling a block of long-term bonds and buying shorter-term bonds of similar market value can be effective. Shorter-term bonds tend to have lower yields, but depending on the type of bonds you buy, there are ways to make up for it.

Bonds With Stock Market Upside

Convertible bonds are corporate bonds that give investors the option to convert to stock at a specific strike price. They pay interest and provide downside protection when stock prices fall. Rising interest rates usually signal an improving economy and equities often rise as a result, so investing in convertibles can be a good option.

Tips for Canadian Snowbirds Heading to the United States

If your retirement dream is to become a snowbird and head to the U.S. for the winter, here are some things to consider before you go:

1. Be pro-active about tax planning

Canadian snowbirds who wish to avoid paying income taxes stateside should be mindful of the Internal Revenue Service's (IRS) rules surrounding U.S. residency status. Generally visitors are recommended to stay no more than 183 days and also submit a "Closer Connection Exception Statement for Aliens" form to the IRS, indicating you are considered a resident of Canada. But the rules are not always so straight forward. The IRS also evaluates visitors with a "substantial presence" test, which considers your stay over multiple years to see if you will be considered a U.S. resident for tax purposes. Consult your personal tax advisor ahead of time to be sure of your status. You should also consult Canada Revenue Agency's guide for Canadian residents going south and arrange to file your Canadian taxes before the deadline.

2. Know how long you can be out of province

This amount of time varies by province, and most provinces require you to actually reside in them for at least six months plus a day each year to maintain health care eligibility. If you exceed your allotted time out of your home province, you may need to undergo a waiting period to re-establish your health care eligibility after returning home.

3. Choose the right travel health insurance plan

Buy travel health insurance. You should not rely solely on your provincial health plan to cover costs if you get sick or injured while abroad. Each type of policy has a different price, different benefits and will suit different scenarios. Be sure to shop around and choose an insurance plan that will meet your specific needs.

4. Organize your finances

It is important to ensure your finances are in order before heading south. This can include setting up pre-authorized payments for bills, setting up online banking for easy accessibility, checking expiry dates on all your credit cards and personal identification, and letting your financial institutions know where you're going and how long you will be gone. Also, don't forget to update your Will and power of attorney.

5. Beware of taxes on your vacation property

Many Canadians own property in the sunshine states but the tax implications for foreigners can be surprising. You should be aware of potential taxes on capital gains when you sell, renting it out while you're at home and estate taxes when you pass away. Before you buy, explore different ownership options and consult tax and legal experts to make sure you don't take any unnecessary or unexpected financial hits down the road.