BMO Nesbitt Burns | Spring 2020

Investment **Insight**

Investing & the Art of Patience

Over recent months, the world has been caught off guard by the spread of the coronavirus. As we continue to grapple with the potential implications and uncertainties, this is a good reminder of the possibility of "black swan" events — a term coined by former Wall Street trader Nassim Taleb. Black swan events are unpredictable occurrences that have major consequences.

We can't always predict how the markets will respond to surprise events — some have major effects, while others do not. It is worthwhile to remember that past reactions to global pandemics have often been temporary in nature. During the Ebola outbreak in 2014 and SARS epidemic of 2003, the S&P 500 declined by double-digit percentages over their course. Yet, in the 12 months following both events, markets regained their losses and posted additional gains.[1]

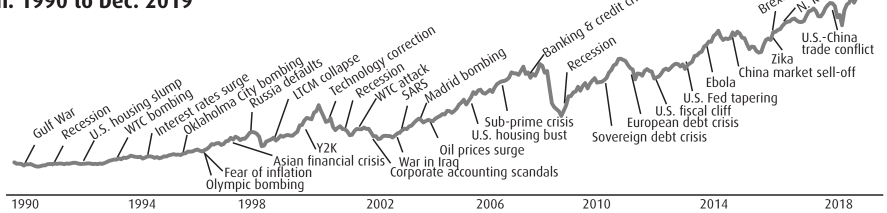
Surprise events may also occur more frequently than we realize. A look back over 30 years shows just how common negative events have been (chart below). Yet, despite their frequency and the potential for short-term volatility, the S&P/TSX Composite Index still gained over 800 percent during this time.[2]

As individual investors, we have little control over the markets' reaction to unpredictable events. What we do control, however, are the decisions we make about our own portfolios. During these times, the prevailing view can be one of worry and we may feel the urge to take action. Yet, for the longer-term investor, patience is often most rewarded.

As Taleb has said, "history doesn't crawl; it leaps." Much of what was expected to shape the past 30 years never happened, and what did help to shape it was often unexpected.[3] Even in the most difficult of times, we have persevered and progressed. This serves as a good reminder not to get too consumed by the news of the present. Expect the unexpected, remembering that patience can be one of an investor's greatest allies.

1. marketwatch.com/story/heres-how-the-stock-market-has-performed-during-past-viral-outbreaks-as-chinas-coronavirus-spreads-2020-01-22; 2. Motley Fool, 07/29/16, with permission; TRI; 3. The Black Swan, N. Taleb. 04/07, p. 11.

S&P/TSX Composite Index & Select Unanticipated Events
Jan. 1990 to Dec. 2019



Scott Kok, Garett Surcon, Tim Mahoney

To Our Clients:

For some investors, recent market volatility has been unsettling. While short-term economic impacts from the coronavirus outbreak are anticipated, we should remember that the situation is expected to be resolved. At the same time, central banks continue their stimulus efforts to support economies. During these uncertain times, maintain confidence that your portfolio continues to be positioned for the longer-term. This, too, shall pass.

If friends or relatives could use some reassurance during these times, we would be happy to offer our perspectives.

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Have You Considered Your RRIF Withdrawal Strategy?

Over the years, many of us contribute to a Registered Retirement Savings Plan (RRSP) to achieve tax deductions and tax-deferred growth to plan for retirement. When the RRSP must be collapsed, funds are often converted to a Registered Retirement Income Fund (RRIF), which requires minimum withdrawals prescribed by the government based on age.[1] RRIF withdrawals are treated as taxable income.

If you plan on holding a RRIF, some forethought should go into your withdrawal strategy. Why? In some cases, withdrawing more than the minimum amount, either regularly or intermittently, can improve an overall lifetime tax bill. On the other hand, funds kept in the RRIF for as long as possible can benefit from tax-sheltered growth.

Here are some considerations, depending on your particular situation:

1. Use a younger spouse's age as a basis for withdrawals. If your goal is to continue growing tax-sheltered funds and you have a younger spouse, consider using the younger spouse's age to determine the minimum withdrawal for your own RRIF. This may be a way to preserve income-tested benefits such as Old Age Security. Keep in mind that you will need to notify us (or the financial institution where the RRIF is held) to make the change before the first RRIF withdrawal. Changes cannot be made once the spouse's age has been used.

2. Accelerate withdrawals to optimize your lifetime tax bill. If your RRIF minimum withdrawal amount and other income put you in a lower tax bracket today than in the future, it may make sense to withdraw more than the RRIF minimum to minimize your overall lifetime tax bill. In the absence of a spouse (which would permit a tax-free rollover of the RRIF), if significant RRIF funds remain at death (depending on the estate value), the estate may be subject to the highest marginal tax rate. Keep in mind that a withholding tax will apply to withdrawals in excess of the required minimum amount.

3. Use RRIF income to split income and for tax credits. If you have a spouse who is in a lower tax bracket, RRIF income may be used for income-splitting purposes. Transferring a portion of the RRSP to a RRIF can occur as soon as the year in which you turn 65 to take advantage of pension-income splitting and the pension tax credit.

4. Use withdrawals to fund a TFSA. If you have excess funds not immediately needed from RRIF withdrawals, consider contributing them to your TFSA.[2] This may be a great way to continue benefitting from tax-preferred growth: future growth in the TFSA will be tax free.

RRIF withdrawal considerations should be part of a larger retirement withdrawal strategy. Every situation is different, so call for assistance.

1. See the CRA website for minimum withdrawal rules; 2. Subject to available contribution room.

Saving Tax is a Year-Round Exercise

For many of us, this is the time when taxes are top of mind as we look to file our personal income tax returns for the previous year. Did you take action last year to reduce your tax bill in 2019? If the answer is no, perhaps you can do better this year. Here are four ways to help minimize your payables to the Canada Revenue Agency (CRA).

"Reduce" Your Refund — If you receive a tax refund from the CRA on a regular basis, this shouldn't be a cause for celebration. You're effectively providing an interest-free loan to the government. If you have an employer, consider updating Form TD1, which is used to calculate how much tax to deduct from your pay cheque. You may also file CRA Form T1213 if you know you'll have significant deductions in a given year to reduce the tax taken from your pay.

Maximize Your RRSP & TFSA — For RRSPs, consider setting up a monthly contribution plan: if you provide your employer with confirmation of the deductibility of these contributions, it may reduce the amount of tax withheld at source. Don't underestimate the value of tax-free compounded growth through a Tax-Free Savings Account (TFSA) — ensure you have maximized your contribution (see page 3).

Split Income with Your Spouse — If your spouse/common-law partner is in a lower tax bracket than you, consider income-splitting opportunities. Contribute to a spousal RRSP. There may be an opportunity to split investment income through a prescribed rate loan strategy with your spouse/partner. Seniors may consider splitting Canada Pension Plan benefits or eligible pension income.

2019 Tax Filing Reminders

Sold a home? If you sold property in 2019, and in order to claim the Principal Residence Exemption (PRE), it must be reported on an income tax return. The CRA continues to crack down on tax compliance for real estate transactions.

Held foreign assets? If you held "specified foreign property" (SFP) with a total **cost** in excess of CA$100,000 (outside of a TFSA, RRSP or RRIF) at any time in 2019, you are required to file Form T1135. For a full list of assets considered to be SFP, see the CRA website.

Optimize Asset Location — Different types of income (i.e., interest, dividends, capital gains) can be taxed differently depending on the type of account (i.e., registered, non-registered) from which income is generated. For instance, if foreign investments that pay dividends are held in a non-registered account, you may receive a foreign tax credit for the amount of foreign taxes withheld. If the same asset is held in a TFSA, no foreign tax credit is available. By having a comprehensive view of your assets, there may be opportunities to optimize asset location across different accounts while maintaining a balanced allocation.

Of course, these ideas and others depend on your own personal circumstances. Please seek the advice of a professional tax specialist, or call if you have questions. Now is the time to take action to maximize your tax savings for 2020!

TFSA: Don’t Delay!

Have you fully contributed to your TFSA? The latest statistics show that the average TFSA holder has a significant amount of unused contribution room — around 60 percent of available contribution room remains unused.[1] With cumulative eligible contribution room now at $69,500,[2] the TFSA has the potential to be a compelling component of your retirement nest egg.

How compelling? Consider an investor who maximized annual TFSA contributions since 2009. With no further contributions, in 30 years, the investor would have over $400,000 — at an assumed 5 percent rate of return per annum (see table). Most important: any income earned will not be subject to tax.

What Is Your TFSA Strategy?

Don’t overlook the opportunity to grow investments on a tax-free basis within a TFSA. When the TFSA was first introduced, many individuals held cash or low-risk, interest-bearing investments inside the plan — possibly because it was introduced as a “savings account”. However, this approach forgoes the opportunity for longer-term, compounded, tax-free growth over time, which can be significant. As such, longer-term investors may be better served by using their TFSA as part of their investment strategy.

Use the TFSA to Your Retirement Advantage

The flexibility of tax-free withdrawals — no limitations on timing or amounts to be withdrawn, and the ability to recontribute withdrawn amounts[3] — can make the TFSA a savvy retirement planning tool.

Here are some of the potential opportunities:

- Preserve income-tested benefits or tax credits;
- Reduce taxable income in retirement;
- Supplement income to allow for the deferral of CPP/QPP benefits, potentially maximizing their value;
- Permit continued investment growth (beyond the age of 71, the age in which the RRSP must be collapsed) on a tax-free basis.

TFSA: Don’t Overlook the Opportunity!

Year	Annual Dollar Amount	Cumulative Amount
2009 to 2012	$5,000	$20,000
2013 & 2014	$5,500	$31,000
2015	$10,000	$41,000
2016 to 2018	$5,500	$57,500
2019 & 2020	$6,000	$69,500

Growth Potential*

	Assuming full contribution to 2020; No further contributions	Assuming continued future annual contributions of $6,000
In 20 years	$253,880	$462,196
In 30 years	$413,545	$832,109
In 40 years	$673,620	$1,434,659

*At a 5% compounded annual rate of return since TFSA inception in 2009.

A Valuable Estate Planning Tool

The TFSA may play a valuable role in estate planning. Consider that the value of TFSA assets at the time of the holder’s death can be transferred tax free to beneficiaries. In provinces other than Quebec, if the TFSA does not pass through the estate, no probate will be payable in provinces where applicable. Most important, if a surviving spouse is named as a successor holder,[4] the TFSA can continue to be operated by the spouse on a tax-free basis. Any income earned after the holder’s death will continue to be sheltered from tax. For a review or update of your TFSA beneficiary designations, please call.

Are you making the best of your TFSA?

1. advisor.ca/tax/tax-news/average-unused-tfsa-room-rises-12-year-over-year/; 2. For those eligible since 2009; 3. Contribution room will be available starting in the next calendar year; 4. Based on their own contribution room. Not in Quebec, where designations are not named in the plan.

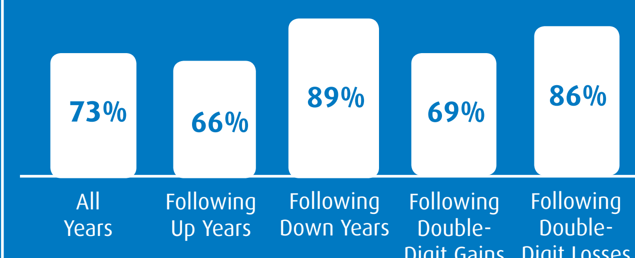
Maintaining Perspective: Looking Back, Looking Forward

From year to year, stock market returns can vary widely. Volatility will always play a common role in the markets. Yet, while nobody knows how the equity markets will perform in the short term, history has shown that it is reasonable to expect markets to continue their upward climb over the longer term.

A look at the S&P/TSX Composite Index over the past 70 years provides good perspective for maintaining an optimistic outlook. On average, annual returns have been positive most of the time — regardless of the previous year’s performance.

Note: Past performance is not necessarily indicative of future performance. Chart has been used for illustrative purposes only.

Percentage of Time the S&P/TSX Index Was Up in a Calendar Year: 1950 to 2019



Source: S&P/TSX Composite Index Total Return Annual Data, 1950 to 2019.

Estate Planning: Choosing One Executor

If you have children and are planning your estate, chances are you have considered appointing them as your estate executor. As you are able to name more than one person to serve as estate executor, in some instances parents name multiple children to act as joint-executors. The reasons are many: they want to treat children fairly; they don't want to hurt any children's feelings by appearing to name favourites; and perhaps by including all children in the administrative process, it helps to share the burden or effort.

While the motives are understandable, naming more than one estate executor has the potential to cause more harm than good. Here are three reasons to exercise caution:

No executor generally has the legal right to act alone. If multiple executors are named to act jointly, they must work together and will be jointly held responsible for the estate.[1] Each is considered to have equal legal authority. Because co-executors must generally agree and act together, there may be delays to the settlement of the estate in order to reach agreement.

Potential for disagreement. Reaching consensus in any group can be difficult, but things are further complicated when emotion or money is involved. Even the most agreeable of siblings can experience differing views and there are plenty of decisions that need to be made, which may include choices about dividing sentimental items or large financial decisions about the selling price of a home. Disputes have been known to cause years of resentment — perhaps the exact situation you were trying to avoid by appointing multiple executors.

Scheduling can be difficult. Acting in unison can be challenging. Co-executors are generally required to perform their duties as one, which includes activities such as signing all of the documents relating to the estate. The process may be further complicated if executors live in different locations as it may be difficult to coordinate meetings with lawyers or financial institutions.

Think Ahead, With Care

Instead of naming co-executors, there may be other alternatives. One child could be named as executor and the other as the alternate executor, in the event that the primary executor is unable or unwilling to fill the role. Perhaps one child lives closer than the other, which could be the determining factor to mitigate the appearance of favouritism. If a co-executor arrangement is still preferred, including dispute resolution language in the will may be a consideration.

Or, it may be money well spent to consider a corporate executor to act in the role. This can help to preserve impartiality, as well as take the burden off of loved ones during a very difficult time.

Regardless, it may be helpful to have a discussion about your choice with your children while you are alive to prevent any surprises. It may also help them to understand the rationale behind your decision, which can go a long way in preserving harmony once you are gone.

Seek Assistance

For assistance connecting with an estate planning specialist, please call.

1. This may not apply in the case where the will provides dispute resolution mechanisms.

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