BMO NESBITT BURNS

The Dorfman Group *Journal*

A Quarterly Review from the office of Michael Dorfman

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In this issue:

Why is it so hard to predict the unpredictable?

I often hear from clients a question I have difficulty answering and even more difficulty explaining; why can't you anticipate downward (or upward) market moves in such a way that we can take benefit?

The current situation in Europe is a perfect example. If it should proceed to its worst case scenario, clearly the markets would suffer. If we knew this was the likely outcome surely we would take defensive action. But will it work out that way, or will it improve? That is the $64,000 question. And the reason it is unknowable (except in hindsight) is that as it unfolds, at every turn there are forces mobilizing for a proactive solution and forces pulling it apart toward a disorderly outcome. And there is rarely a clear way to tell who or what will prevail.

A recent illustration occurred during the 2008 U.S. credit crisis. As was aptly portrayed in the laudable film, "Too Big to Fail", Treasury Secretary Paulson and Federal Reserve Chairman Bernanke were meeting and discussing the crisis unfolding in front of them without any confidence as to how it would end. After being briefed as to the negative possibilities, Secretary Paulson heads to his private office bathroom and throws up. Put simply, if these guys didn't know how things would turn out, how could you or I?

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Make your workplace DC pension plan work harder for you!

In Canada, the main sources of retirement income are government pensions (Old Age Security and Canada/Québec Pension Plan), employer-sponsored plans and personal savings.

Registered pension plans (RPPs) form the bulk of employer-sponsored plans: according to Statistics Canada, about six million Canadians are members of RPPs.1

The two main types of RPPs are defined benefit (DB) plans and defined contribution (DC) plans. With a DB plan, the employer is responsible for making lifetime fixed pension payments to a retired employee. With a DC plan, on the other hand, how much retirement income a retired employee gets depends on the amount of contributions that went into the plan and how the investments perform.

Over the past 20 years, a noticeable trend in the private sector workplace is the shift from DB to DC plans. The principal reason behind this phenomenon is the reluctance of employers to assume the risk of being their employees' retirement income guarantor. However, demographic changes also favour the growth of DC plans: few people now spend their entire career with one employer; instead, job mobility is the norm. So it is hardly surprisingly that a recent report of the BMO Retirement Institute found that attractive salaries and flexibility as to time and location of work are valued much more highly than a good retirement pension when people evaluate competing job opportunities.

An issue that arises with the increased prevalence of DC plans is investor behaviour. Many research studies have found that the average investor has a tendency to make sub-optimal decisions. In the context of a DC plan, some common mistakes that people make are:

- Not enrolling in the plan
- Not increasing contributions to the plan as earnings increase
- Not selecting the right investment mix

In an attempt to counteract these human tendencies, many DC plans have introduced "auto-features" to "nudge" plan participants in the right direction. These features include:

- Automatically enrolling employees in a plan as soon as they meet eligibility requirements (typically with the choice of opting out)
- Automatically increasing employee contributions in tandem with earnings increase
- Providing a default investment option where the plan participant does not actively select his/her own asset mix

While these mechanisms are useful, there is also evidence that over-automation can make plan participants over-reliant and complacently assume everything is already taken care of.

If you are a member of a DC plan that has auto-features, do not just rely on them. After all, it is your own retirement, and everyone's circumstances are different. Do not assume that there is a one-size-fits-all solution that works for everyone. Instead, remain fully engaged, take charge and view your DC plan as an integral component of your overall retirement savings.

For further information about the BMO Retirement Institute visit us at www.bmo.com/retirementinstitute

Tips on making your DC plan work harder for you:

- Enrol as soon as you are eligible.
- Take full advantage of employer matching contributions and additional voluntary contributions (if applicable).
- Review your investments on a regular basis to ensure they are appropriate for your retirement objectives, time horizon and risk tolerance profile.
- Consult your BMO Nesbitt Burns investment advisor to develop a financial plan to serve as your long-term financial roadmap.

Source: Perspective - Spring 2012
By Sherry Cooper Executive Vice-President and Chief Economist, BMO Financial Group

US Gift Tax for Canadians

When you decide to make a gift of property, you may not normally think about being subject to tax on the gift as the gift giver. However, if you are a US person (US citizen, US resident or Greencard holder), US gift tax should be a consideration whenever you are contemplating a gift. Even if you are not a US person, but are contemplating a gift of tangible property that is located in the US, you should also take US gift tax into consideration.

The IRS may impose a "gift tax" to the transferor when assets are gifted during a person's lifetime. The gift tax may apply when assets are transferred (ie. gifted) to another individual or, in some circumstances, to a trust. Based on the value of the gift, gift tax rates range from 18% to 35%.

The good news is that there are exclusions that may reduce or eliminate the US gift tax. A US person has annual gift tax exclusions of US$13,000 per recipient, and US$139,000 (inflation adjusted amount for 2012) for gifts made to a non-US citizen spouse. In addition to these annual exclusions, a US citizen has a lifetime gift tax exclusion of US$5,120,000 for gifts made in 2012 (as adjusted for inflation). However since the US gift tax and US estate tax regimes work in tandem, any amount of the lifetime gift tax exclusion applied toward gifts reduces the amount that can be used to offset US estate tax upon the individual's death.

Assuming there is no new US tax legislation, the future lifetime gift tax exclusion amount is scheduled to be reduced to US$1 million and the highest US gift tax rate will increase to 55% on January 1, 2013.

Even if you are not a US person, you will still need to consider US gift tax if you gift tangible property, such as a vacation home that is located in the US. Unlike a US person, you would not be eligible for the US$5,120,000 lifetime gift tax exclusion. However, the annual gift tax exclusion amounts of US$13,000 or US$139,000 (for gifts to a non-US citizen spouse) would apply to you. Gift tax does not apply to Canadians (who are non-US persons) who gift intangible US property (i.e. US securities).

As with any transaction, a Canadian resident would need to consider the Canadian income tax implications that may apply to any transfer of assets. These implications include the potential application of the "attribution rules" or the possible recognition of capital gains or capital loss if assets other than cash are transferred to a family member.

Since gifting is often incorporated in tax and estate planning, it will be important to carefully consider all of the legal and tax consequences that may result from the transfer of assets.

If you are contemplating the transfer of a significant amount of assets where US gift tax may be applicable, we can refer you to a qualified external tax professional who can provide you with additional guidance in your particular situation.

Contribution reminder

RRSP

With the holiday season behind us, it's now time to turn our attention to the year ahead. What better way to start off the New Year than by making your annual RRSP contribution. If you still haven't made your 2011 contribution, don't delay, the deadline is February 29, 2012. If you have already maximized your 2011 contribution, there's no better time than right now to make your 2012 contribution.

The easiest way to find your RRSP deduction limit is to look it up on the Notice of Assessment that Canada Revenue Agency (CRA) sends back to you after you file your annual income tax return.

If you would like to verify this amount, here's how to calculate it for yourself:

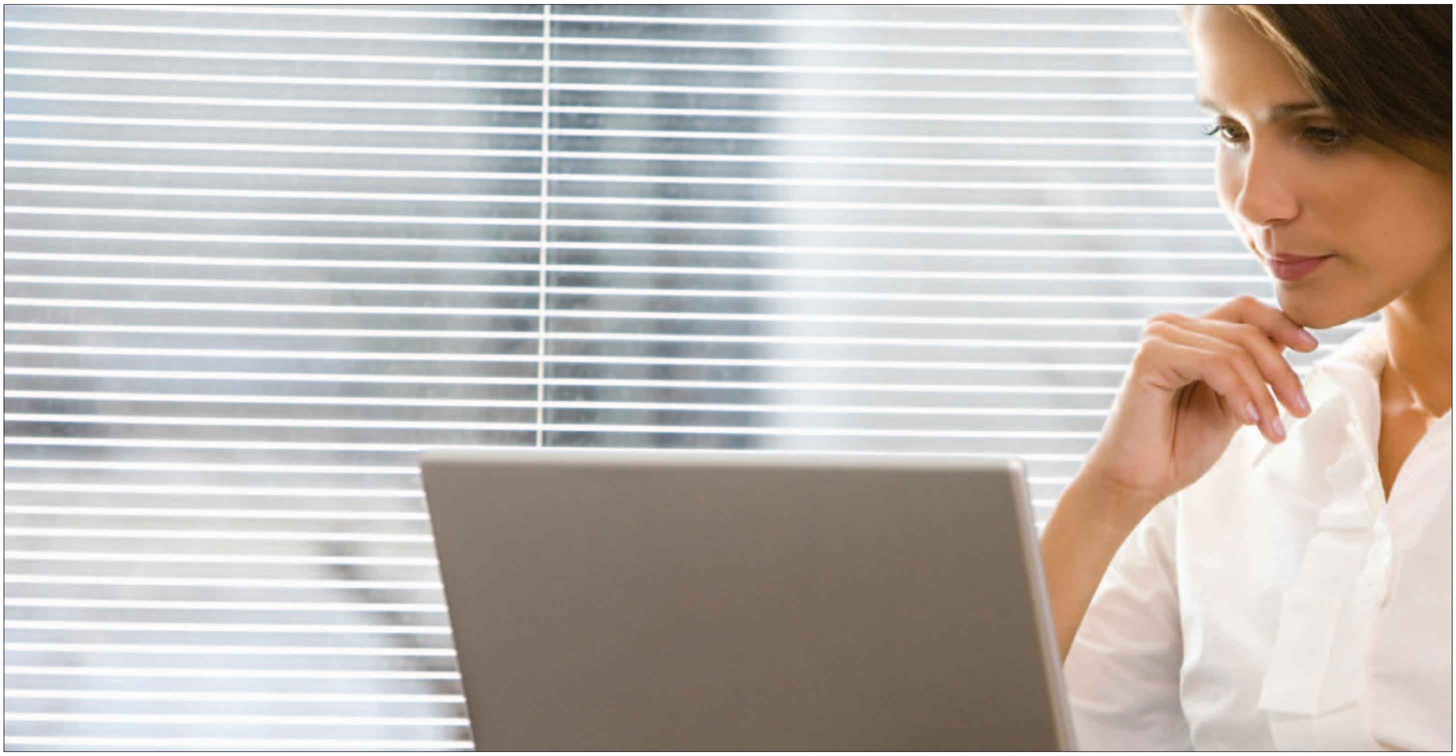
For 2011, your RRSP contribution amount is based upon your carry forward amount from 2010, plus your current year's contribution amount which is the lesser of $22,450 or 18% of 2010 earned income. If you are a member of a Deferred Profit Sharing Plan (DPSP) or Registered Pension Plan (RPP), you must deduct your pension adjustment (and net past service pension adjustment, if any) when calculating your RRSP contribution room.

TFSA

Canadians age 18 and over* can contribute $5,000 annually to a TFSA. Any unused contribution room, dating back to 2009 or the year you turn age 18, carries forward so it can be used in a future year. If you have never contributed to a TFSA and were age 18 or older in 2009, your contribution limit for 2012 will be $20,000. With the application of the indexation increase of 2.8% for 2012 and rounding the result to the nearest $500, the TFSA dollar limit for 2012 remains at $5,000. Unused TFSA contribution room can be carried forward to later years. Your annual TFSA contribution limit is reported on your annual Notice of Assessment from Canada Revenue Agency (CRA).

* For BMO Nesbitt Burns, TFSA account holders must be the age of majority to open a TFSA – for some jurisdictions (B.C., N.S., N.B., Nfld., Yukon, NorthWest Territories, Nunavut) the age of majority is 19.

Source: Perspective - Winter 2012
By Sherry Cooper Executive Vice-President and Chief Economist, BMO Financial Group



Getting Used to a Low Return World

The 2010's are not the 80's or 90's. We already know that from the very different way we live compared to 25 years ago. We are all wired 24/7 and communicate and operate differently. In some ways better, in some ways worse.

The investment markets clearly are different and not in such a positive way. We are having to get used to lower returns in all asset classes and we don't like it. But the reality is that 25 years ago interest rates were much higher and beginning an historic bull market for debt instruments of all kinds. Stocks too benefitted from the explosion in corporate profits, economic productivity and leverage. When we put together financial/retirement plans in that era we routinely used projected rates of return in double digits.

Not so much today. We now have an economy percolating at very low levels of growth, requiring low rates of interest, and producing negligible stock returns. Real estate has been a great place to hide, (for most Canadians not for most Americans!) but how long will that continue?

What has to change for investors are return expectations. This is not to suggest that investors can't or won't earn acceptable returns, but they will have to adjust their expectations. Ironically it is often the case that with lower return expectations come results that may surprise on the upside.

Michael Dorfman