BMO Nesbitt Burns | Summer 2017

Investment **Insight**

How Far We've Come

As we celebrate Canada's 150th birthday, let's consider just how far we've come. At the start of Canada's centennial celebration 50 years ago, Prime Minister Lester Pearson declared that it was "a time of assessing our place in the world community". An article in the New York Times in 1967 painted a less than rosy picture of Canada's prospects for global prosperity, describing Canada as "not exactly a land of milk and honey."[1]

Back then, we were a nation of only 20.4 million people, a time when the average home cost only $24,000, gas cost 9c/L and milk just 25c/L. Although the economy was performing well, the prevailing issues included inflation, largely driven by higher input costs, and declining productivity.

In 1967, the Toronto Stock Exchange (TSE), with roots extending before Canada's birth, attracted foreign interest largely for its "potential". Criticized for not having the depth or breadth similar to the New York or London exchanges, the TSE still included a variety of blue chips like International Nickel, Falconbridge, Canadian Pacific and Weston.

Fast forward to today and Pearson would be proud. Canada is now an admired country, with a strong and stable economy. We are ranked 2nd in the World's Best Countries survey in 2017, released by the World Economic Forum, and we repeatedly place near the top of many economic indices. We are a nation of resilience. Over recent years, despite struggling commodity prices, our economy has continued to grow, strengthen, and attract foreign capital.

Canada is now home to the 6th largest (developed nation) stock exchange in the world, among 80 listed global exchanges (by market capitalization). It continues to be one of the most reliable ways for investors to generate a return. On Canada's birthday in 1967, the TSE index closed at a mere 843 points; today's index levels are over 15,000.

Today's financial challenges are different than those of the past. We face historically low interest rates, skyrocketing housing prices and new retirement challenges arising from disappearing company pensions and a population that is living longer.

Despite the many changes, some things remain the same. For investors, the basic principles of investing haven't changed: managing risk, maintaining value, quality, diversification, appropriate asset allocation and minimizing taxes. Likewise, the fundamentals that lead to financial independence remain the same: continue to pay yourself first, save wisely and invest.

Source: 1. "Canada in Her Centennial Year", NY Times, 1/2/67.

L to R: Michael Tomkins, Colleen Thorpe, Michael Mereszak, Victor Chan

To Our Clients:

As economic recovery continues, recent GDP figures have surpassed expectations. Canada is expected to be one of the fastest growing economies of the developed world in 2017.

As we look forward, keep market volatility in perspective. Corrections, when they occur, should be viewed as a normal part of the market cycle, especially when late in the cycle.

If you know someone who could benefit from our support, please contact us and we would be happy to set up a meeting. We hope that you take some time to enjoy the summer with friends and family.

Michael, Victor, Michael & Colleen

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Planning Ahead: CPP/QPP Sharing

Over recent years, the federal government has continued to eliminate various income-splitting opportunities and tax rates continue to rise for higher-income individuals. As such, tax planning should remain top of mind. For those nearing retirement age, a strategy that involves sharing Canada or Quebec Pension Plan (CPP/QPP) benefits with a spouse/common-law partner (CLP) may be considered. This can result in valuable tax savings, but planning ahead is important.

What is CPP/QPP Pension Sharing?

Sharing CPP/QPP pensions should not be confused with pension income splitting, which is basically an election on your tax return to allocate up to 50 percent of eligible pension income to a spouse/CLP. (The CPP/QPP pension is not considered eligible pension income for the purposes of pension income splitting.) In order to share CPP/QPP, an application must be made to the government and certain conditions apply.

If you have a spouse/CLP with a limited working history and contributions to the CPP/QPP, this may be a viable strategy because pension sharing allows up to 50 percent of your CPP/QPP pension benefit to be received and taxed in your lower-income spouse's/CLP's hands. This has the potential to reduce your overall family tax bill. For an individual receiving $13,000 in annual CPP/QPP benefits in the top marginal tax bracket, sharing 50 percent of the benefit with a spouse/CLP who pays tax at the lowest marginal tax rate could potentially save $1,170 in federal taxes (assuming a 33 percent top federal tax rate) plus provincial taxes.

Beyond the benefit of lower taxes, CPP/QPP sharing may help to minimize or prevent income-tested benefits such as the Old Age Security benefit from being clawed back (if at least 65 years of age). It may also help to limit any reduction in the age tax credit amount.

In order to share CPP/QPP, certain conditions must be met. First, you and your spouse/CLP must be living together. Your spouse/CLP must be at least 60 years of age and receiving CPP/QPP pension benefits (unless you are sharing a single retirement pension because your spouse/CLP never made CPP contributions). You must apply to the government and be approved; this cannot be done retroactively. Finally, the amount that is eligible for pension sharing is based on the combined CPP/QPP pension entitlement that you and your spouse/CLP earned during the time you lived together.

Since the CPP/QPP retirement pensions of both spouses/CLPs must be shared, this strategy may not make sense if your CPP/QPP entitlement is lower than that of your spouse/CLP at a time when your spouse/CLP expects to be in a lower tax bracket. This is because sharing the CPP/QPP would result in additional pension income to you which would be taxed at your higher marginal rate.

Certain events, including the death of a spouse or divorce/separation, will terminate a CPP/QPP pension sharing arrangement.

As always, consult a tax advisor regarding your particular situation.

Minimizing Taxes: The RRSP & Your Future Exit Strategy

Many of us do a good job of maximizing contributions to the Registered Retirement Savings Plan (RRSP), but we often forget to plan our future exit strategy for these funds. In most cases, postponing withdrawals until retirement makes sense as most individuals have a lower marginal tax rate in retirement. Since every dollar withdrawn from the RRSP (or Registered Retirement Income Fund (RRIF), if converted from an RRSP by the end of the year in which a plan holder reaches age 71) will incur tax at regular income rates, this can create a major tax liability. Having an exit strategy can help to minimize these taxes. Here are some considerations:

Withdraw During Low Income Years — If your income will be lower in certain years relative to what you anticipate in the future, either before or during retirement, consider taking withdrawals so that income will be taxed at lower marginal rates. If you don't need the funds and wish to continue to maximize the potential for investments to grow, consider contributing withdrawn RRSP assets to a Tax-Free Savings Account (TFSA). Although you may pay tax on the income when RRSP funds are withdrawn, assets can continue to grow tax free in a TFSA.

Coordinate Withdrawals with Other Sources of Income — RRSP/RRIF income may impact income-tested benefits such as Old Age Security (OAS). In order to maximize these benefits, you may wish to start RRSP withdrawals before the years in which these benefits begin. Also consider using other income sources to keep you in a lower tax bracket as you withdraw RRSP/RRIF income over time, such as TFSA income.

Split Income with a Spouse/Common-Law Partner (CLP) — After age 65, you can split up to 50 percent of eligible pension income, which includes RRIF income, with a spouse/CLP. If you have a spouse/CLP in a lower tax bracket, you can convert a portion of your RRSP to an RRIF to take advantage of pension income-splitting, which may also allow your partner to claim the pension income tax credit.

Set Up a Spousal RRSP — If one spouse/CLP is expected to have a high level of income in retirement while the other will have little income, setting up a spousal RRSP in your working years may provide future income-splitting opportunities. In retirement, income may be withdrawn by the lower-income spouse/CLP at lower tax rates. Certain rules need to be followed, so advanced planning is necessary.

Planning will vary based on individual situations, so please call if you would like to discuss potential RRSP withdrawal strategies.

The Power of the Dividend

S&P/TSX Composite Index at 15,575 or 50,918?

Dow Jones Industrial Average (Dow) at 20,913 or 2,436,369?

Imagine the S&P/TSX Composite Index at a level of 50,918 and the Dow at 2,436,369. At first glance, these figures may appear outrageous, but they represent each index's value on May 1, 2017, when taking into account the impact of reinvested dividends over time. Recall that the Dow is a price-weighted index that doesn't factor in the value of dividends. An article in the Wall Street Journal in 2012 estimated the Dow's value to be at 1,339,410 with dividends included, which translates to a value of over 2 million in today's terms.[1]

As investors, we shouldn't overlook the power of dividends in positively impacting our investment strategies. Here are some reasons why:

Drives long-term returns. Dividend-paying companies represent a significant portion of the long-term returns in the Canadian equity market. Between 1991 and 2016, reinvested dividends in the S&P/TSX Composite Index have accounted for around 45 percent of total returns. This means that an investment of $1,000 would have yielded around $4,350 today on the index alone but around $7,800 if dividends were reinvested.[2] At the same time, dividends in the Canadian equity markets continue to grow. The S&P/TSX Composite index dividend (which compares the S&P/TSX Composite Total Return Index (with dividends reinvested) with the index alone) has had an annualized growth rate of 5.2 percent over the past 25 years.[3]

Provides a reliable source of income. Given historically low interest rates and slower growth, investors, and especially retirees, have been challenged in finding income-generating investments. However, many quality companies have continued to pay dividends year after year, and often because this is seen as a sign of economic health (i.e., the company has excess cash with which to pay shareholders). Dividend-paying investments continue to be a reliable source of income for many retirees.

Allows for a tax advantage. Canadian dividends are taxed more favourably than interest and ordinary income. This is due to the non-refundable tax credit available for most dividends issued by Canadian companies. Consider that for each dollar of eligible dividend income received, an Ontario resident taxed at the highest marginal tax rate (at January, 2017) would keep about 14 cents more compared to fully taxable income (assuming a 53.53 percent marginal tax rate and a 39.34 percent effective tax rate for eligible dividends).

Have confidence in the benefits of quality dividend-paying equities as part of your investment portfolio. They are working for you.

Sources: 1. wsj.com/articles/SB1000142405297020457140457725737328565742 assuming DJITR growth from 24,385 (03/05/12) to 44,356 (05/01/17); 2. S&P/TSX Composite Total Return Index and Index Price Return, 07/30/91 to 07/29/16; 3. Using same 25-year data. Index dividend=Index Total Return–Index Price Return.

Digital Education: Cyber Safety Tips

As we spend increasing amounts of time online, the sophistication of criminal activity targeting unsuspecting users continues to grow. One of the latest scams promises a Canada Revenue Agency refund through an authentic-looking interac email. It attempts to trick taxpayers into clicking on a link that will copy banking login information.

One of the best ways to protect yourself and others is to be educated about the risks. Here are some practical tips, in brief:

Always validate the source. New hoax websites, impostor emails and false information continue to appear on the internet. Be wary of unsolicited messages. Never click on a link or open an attachment when prompted by an unknown or untrusted source. If you are conducting internet searches, do a background check to validate the source.

Take precautions when internet banking and investing. Conduct transactions only on secure (https:) and encrypted sites and avoid using public computers when personal financial information may be involved. Use strong passwords for accounts. Always remember that legitimate businesses will never ask for personal information via email or texts. If in doubt, please call the financial institution.

Help the young and the elderly. Understanding what an individual is doing online can be a good starting point in helping to protect them. Teach others about cyber safety. It's never too early or too late and the lessons continue to evolve.

Erase information from old devices. Just as it is important to shred paper documents that contain personal information, make sure to erase all personal data from the hard drives of electronic devices that you no longer need before you dispose of them.

Be aware when broadcasting on social media. Remember: you generally can't retract items posted on the internet. Personal information about your identity or belongings can be unintentionally shared through comments, postings or photographs, and be seen by strangers and potentially used for unscrupulous purposes.

For more information, refer to the Canadian government website: getcybersafe.gc.ca, which outlines many cyber security risks and how to safeguard against these threats.

A New Perspective: Active vs. Passive Strategies

As the number of index funds has grown, active investments have often been given a bad reputation by the media. Certain studies have shown that passive investments, like index funds, outperform active (or managed) investments, such as mutual funds.

A new study by Dalbar, a financial services market research firm, sheds some light on the benefits of active investing. The study looked at the performance of active and passive investors over a 15-year period from the start of 2001 to the end of 2016. A longer time period was used to reflect a full market cycle, in which there were both boom and bust phases. During periods of more than five years, the average active investor outperformed the passive investor. In fact, when the full period of 15 years was considered, the active investor had an average annual return of 4.04 percent, versus the passive investor with a 2.85 percent annual return.

Active investors had the largest performance margin over passive investors during periods of negative market returns. Actively managed funds provided the benefit of having capital preservation strategies used by the fund managers to help minimize the effects of temporary market drops. Periods of market volatility were less visible in the active funds, whereas passive funds mimicked every up and down of the market.

Passive investors tended to underperform over the long term because they were more likely to invest in response to exuberance or fear in the news. Active investors were less likely to withdraw from a down market if they knew that a fund manager had a capital preservation strategy in place. Staying invested over longer time periods led to greater returns.

This study may provide a more balanced perspective that supports the value of professional management in active funds, as well as the merits of sticking to a plan over the longer term.

Source: investmentexecutive.com/-/active-investment-strategies-outperform-passive-ones-in-the-long-run-dalbar

Summer: A Time of Fresh Perspectives

Our advisory practice is built on the satisfaction of clients like you. We continue to accept new clients and would welcome your introduction to friends, business colleagues, or family who could benefit from our experience and advice.

We would be grateful for any such referrals and will, of course, deal with them in the strictest of confidence, as you would expect. Whether it is a fresh opinion on their existing portfolio or advice on a new situation, we're here to help. Please have them contact us or call our office and we would be happy to follow up with them.

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