

# Investment Insight

## For 2019: Focus on What You Can Control

The year 2018 will go down in the books as a difficult one for the Canadian equity markets. Trade tensions and tariffs imposed by the U.S. were a source of volatility at home and abroad. Canada's competitive position continued to be challenged. Gross Domestic Product (GDP) growth began to slow, foreign direct investment fell to an eight-year low and our energy sector, a significant part of the Canadian equity markets, continued to face headwinds. The large price differential between Western Canada Select oil produced here at home and the benchmark U.S. West Texas Intermediate oil highlighted the problems in getting Canadian oil to broader markets.

While the federal government acknowledged the need to support business competitiveness in its late November fiscal update, it remains to be seen how the proposed measures will help to impart change.

It is worthwhile to remember that financial markets have faced similar challenges over time and have eventually recovered to reach new highs. Longer-term investors are often at the mercy of events that take place over the short run. Most often, we can't do much about them or their impact on the markets. But, as investors, we can focus on the things within our control. In this time of new year's

resolutions, here are some ideas:

**Put trust in your plan** — This is a good reminder that portfolio guidelines have been put in place to help weather the inevitable periods of volatility. This includes diversification and asset allocation, rebalancing where necessary, limiting the size of any one holding and focusing on quality securities.

**Stay the course** — Portfolio gains do not always occur at a steady state. Volatility in the markets remains one of the certainties of investing. While keeping expectations on an even keel may be difficult, try and focus on your longer-term objectives and keep building your investment portfolio with them in mind. At the same time, volatility can provide opportunity and a good time to build portfolios often emerges during pessimistic market periods.

**Invest in yourself** — Follow through with your new year's pledge to eat better or get to the gym. Taking care of yourself can pay dividends to your financial well-being down the road. Consider that you may be able to work longer or reduce health care expenditures if you stay healthy until a ripe old age. In the words of Warren Buffett: *"anything you invest in yourself you get back tenfold and nobody can tax it away or steal it from you."*



### Young+Quinn+Cardy Wealth Management

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### To Our Clients:

Happy New Year!

After a challenging year for many Canadian equities, it may be easy to feel discouraged. But don't overlook the opportunity to continue saving for the future. Put time on your side and contribute to tax-advantaged accounts such as your TFSA and RRSP. A great way to build portfolios is by turning lower prices to your advantage.

We wish you health and happiness for the year ahead, and remain here to support you.

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# RRSP Season: Why do RRSPs/RRIFs Get a Bad Rap?

Participation rates for the Registered Retirement Savings Plan (RRSP) have been declining over recent years. In fact, some Canadians believe there is “no point” in investing in the RRSP because taxes eventually have to be paid in retirement. But the RRSP can provide a substantial tax advantage. Let’s look at some of the myths:

**Myth:** There is no point in investing in an RRSP as you pay all the savings back in taxes when you retire.

While you do pay tax on RRSP withdrawals, don’t forget that you received a tax deduction when funds were contributed. This is often overlooked; people confuse pre-tax with after-tax dollars. A \$4,000 RRSP contribution is equivalent to a \$2,800 after-tax contribution to a non-registered account, assuming a 30 percent marginal tax rate.

## RRSP Reminders

- **Contribute** — The deadline for 2018 RRSP contributions is **Friday March 1, 2019**. Consider an automatic monthly contribution plan to avoid missing the deadline.
- **Consolidate** — If you hold multiple RRSP accounts across different financial institutions, consider consolidating for convenience and cost savings.
- **Collapse** — If you are turning 71 years old in 2019, please get in touch to discuss options to convert your RRSP.
- **Update** — Ensure your plan has an updated beneficiary to avoid issues when settling your estate.

**Myth:** The RRSP is disadvantaged because investment earnings are subject to higher taxes, since RRSP withdrawals incur tax at regular rates, whereas capital gains realized in a non-registered account are taxed at lower rates.

If you assume a constant marginal tax rate and adjust for pre-tax and after-tax amounts, the RRSP will generally outperform a non-registered account that holds identical investments. The following chart shows this outcome, using a scenario in which a pre-tax contribution of \$4,000 has been made for 20 years. It assumes a 30 percent marginal tax rate and growth of capital at 5 percent.

## Example: Potential Tax Benefits of the RRSP Account

	RRSP Account	Non-Registered Account
Pre-tax annual contribution	\$4,000	\$4,000
After-tax contribution: 30% tax rate	n/a	\$2,800
Total contribution over 20 years	\$80,000	\$56,000
<b>Cumulative growth: 20 years at 5%</b>	<b>\$138,877</b>	<b>\$97,214</b>
Tax at withdrawal at 30%	\$41,663	\$6,182 <sup>1</sup>
<b>Net after-tax amount</b>	<b>\$97,214</b>	<b>\$91,032</b>
<b>Difference</b>	<b>+6.8%</b>	

1. Realized capital gain of \$97,214 - \$56,000 = \$41,214, taxed at a 50% inclusion rate.

The benefit is even greater with a lower marginal tax rate in retirement, which is the case for many retirees. As such, don’t overlook the tax-deferral benefits of compounding over time using the RRSP.

# Did You Know? The TFSA May Not Always Be Tax Free

The Tax-Free Savings Account (TFSA) is touted for its tax-free characteristics. But here are three instances in which TFSA funds may be subject to tax:

## 1. Holding foreign dividend-paying shares in the TFSA.

Foreign dividend-paying shares held in the TFSA may be subject to a withholding tax on dividends paid. The U.S. imposes a 15 percent withholding tax on the dividends paid to Canadians by U.S. corporations. RRSP and RRIF accounts are exempt from this tax under the Canada-U.S. tax treaty. For non-registered accounts, this withholding tax can potentially be recovered by claiming a foreign tax credit. However, you can’t recover this withholding tax within a TFSA. Also, be aware that eligible Canadian dividend payments held within a TFSA will forgo the dividend tax credit.

**2. After the death of the TFSA holder, a beneficiary could be subject to tax on a TFSA.** While the TFSA can be transferred to a beneficiary on a tax-free basis at fair market value at the time of death, any gains after the holder’s death would be subject to tax. If the intended beneficiary is a spouse/partner, consider designating them as a “successor holder”. A successor holder can continue to operate the TFSA after a spouse’s death relatively seamlessly, with assets remaining

in the TFSA. If a spouse is, instead, named as a beneficiary, they need to complete a transfer to their own TFSA and file certain forms with the Canada Revenue Agency (CRA) within specific time frames. Otherwise, any gains earned after death may not necessarily be tax sheltered.

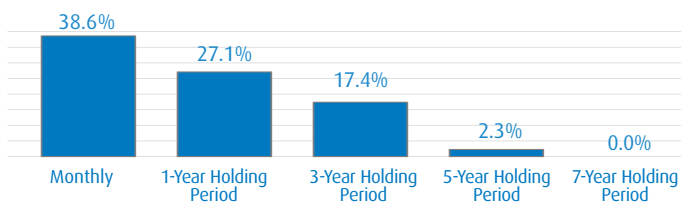
**3. Transfers between your own TFSA accounts may be subject to tax if not completed correctly.** Unless a “direct transfer” is completed by the financial institution, any TFSA withdrawals will only reset contribution room in the *following* calendar year. If no contribution room is available and these funds are deposited into another TFSA account, the amount may be subject to a penalty tax of one percent per month until contribution room becomes available. As such, if you are consolidating TFSAs, make sure the financial institution completes a direct transfer. With any TFSA contribution, ensure you have available contribution room. Information is available on your CRA online account “My Account”. You can also contact the CRA to request a *TFSA Room Statement*.

**Reminder: The annual TFSA dollar limit for 2019 is \$6,000.** The total lifetime amount is now \$63,500 (for eligible residents, at least 18 years of age in 2009, who have not contributed), making the TFSA a compelling investment tool. Have you fully contributed?

# In Volatile Times: The Merits of Holding On

For the Canadian equity markets, 2018 was a turbulent year. After solid performance in 2016 and 2017, coupled with low volatility, it may have been easy to forget that the markets are cyclical. But market fluctuations are normal, and although they may be a source of discomfort, it is worthwhile to remember the importance of staying invested.

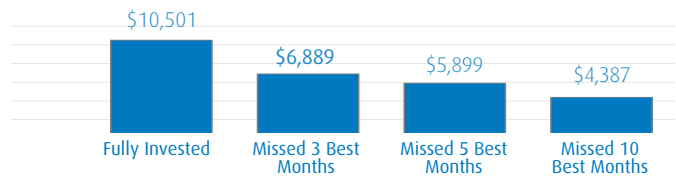
**Negative returns decrease over time.** Though difficult to remember during volatile times, negative market performance smooths out as an investor's time horizon increases. Since 1988, the likelihood of the S&P/TSX Composite Total Return Index experiencing a negative monthly return is 38 percent. Yet this decreases to 17 percent over a three-year rolling holding period, and drops to 0 percent when considering seven-year rolling holding periods and beyond.



Source: S&P/TSX Composite Total Return Index from 9/30/88 to 9/28/18.

**It is difficult to time the market.** Markets eventually rebound from their down periods, offering gains that have pushed values higher. But a change in market direction is often unpredictable, and trying to time the market is not only difficult, but also may be costly. The chart below shows the impact of missing the best performing months in the S&P/TSX Composite Total Return Index over a 30-year period.

This assumes a notional investment of \$1,000 at the beginning of the period, which would have grown to \$10,501 during this time.



Source: S&P/TSX Composite Total Return Index from 9/30/88 to 9/28/18.

**Equities continue to be one of the best asset classes in which to grow wealth, but that's not without market fluctuations.**

Since 1970, the S&P/TSX Composite Index (not including dividends reinvested) has returned an average annual return of 5.9 percent. Yet during this time, we experienced seven bear markets lasting on average 10.7 months and resulting in an average market drop of 33 percent.



Source: S&P/TSX Composite Total Return Index from 1/1/70 to 9/28/18.

**Worth Repeating:** Market fluctuations are a normal part of investing. Your portfolio has been built to help you achieve your longer-term goals, using techniques such as diversification and asset allocation to help minimize risk during volatile times. Stay the course and continue to look forward — remaining invested is one of the keys to longer-term success.

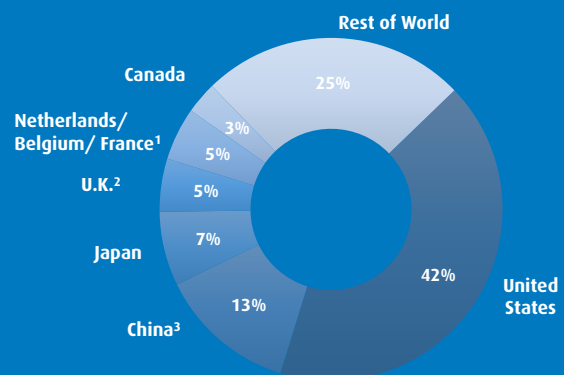
## A Global Perspective: Where Does Canada Stand?

We may sometimes forget that the Canadian equity markets are small. Just how small? Canada's equity markets represent less than 3 percent of the world's total equity market (by market capitalization) and we rank as the 6<sup>th</sup> largest in the world.<sup>1</sup> The largest, our neighbour to the south — the United States — represents around 42 percent of the worldwide equity markets.

While it is never possible to predict which market will be a top performer in any given year, many investors can benefit from exposure beyond Canada. At the same time, in today's world of globalization, international exposure may even be achieved by investing within Canadian markets. Some Canadian companies have multinational businesses that operate in different global markets. As well, certain funds listed on Canadian exchanges invest internationally.

1. When comparing total market capitalization of equity markets by country of origin.

### Global Market Capitalization % by Country As of October 2018



Notes: 1. Euronext; 2. LSE Group; 3. Hong Kong, Shanghai, Shenzhen exchanges.  
Source: World Federation of Exchanges, global market capitalization at 9/28/18.

# What the Wealthy Are Teaching Their Kids

There is a saying, “*from shirtsleeves to shirtsleeves in three generations,*” which suggests that wealth gained by a family can be lost in just three generations. Today, many wealthy families are now focusing on teaching children how to manage money to ensure its longevity. Instilling sound financial values at a young age can be relevant for any family to improve financial success. Here are some ideas to get children started:

## 1. Start with Your Money Message

Cultivating a healthy relationship with wealth may begin by sending a message that may appear counterintuitive: It’s not about the money. Too much focus on wealth can remove a child’s sense of purpose and drive. Instead, define other family values to deemphasize family wealth. Questions about wealth can create meaningful discussions. For example, if a child asks: “are we rich?”, it may provide an opportunity to discuss the realities of the world. Over 40 percent of the world lives on less than US\$2 per day, and there are many families who don’t have enough or have just enough to get by.

## 2. Put Children to Work

Developing independence and a strong work ethic at a young age can prepare children for the real world. Children should have the opportunity to fail. This can start early, such as not taking a child’s homework to school when they forget it, or not bringing forgotten hockey equipment on game day. Kids learn valuable lessons from consequences; you don’t want to disable behaviors that can be carried into the future. Learning the value of a hard-earned dollar is also important, even if a child comes from

a family that doesn’t need the money. First jobs can foster solid work habits, teaching the importance of saving and budgeting.

## 3. Teach Kids Ways to Manage Money

Children should be taught the difference between needs and wants, as well as the value of saving. If a child is given only a set amount of funds, they learn to prioritize. When money is earned or received as gifts, consider putting a portion into savings. You can then work with the child to define the purpose for these savings. Older children can be taught about compounding and investing to grow funds into the future.

## 4. Determine Your Family Strategy

Family meetings can be used to identify collective goals and create a sense of purpose. Some experts suggest that family members, including young children, develop financial, intellectual and social capital goals for the year, documenting and tracking these goals.<sup>1</sup> The family can then review their progress and celebrate accomplishments.

## 5. Give Back

Consider involving all family members in the process of giving back, such as making charitable contributions a family activity by volunteering together or donating in lieu of holiday gifts.

## We Are Here to Help

These are just a handful of ideas, intended as a starting point. We can provide tools and resources for your situation. By starting early, the rewards can be great: better communication, healthier family dynamics and the potential for your hard-earned wealth to continue well into the future.

1. <https://cnbc.com/2018/06/21/what-the-1-percent-are-teaching-their-children-about-money.html#clients>.

With the compliments of...

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