TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

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Volatility Returns...

After a steady climb by equity markets throughout 2017, the start of 2018 has proven to be somewhat of a stark contrast. Volatility has once again returned.

The relative lack of market volatility during 2017 was an anomaly. Typically, market volatility is driven by political or socio-economic instability. But last year, the threat of nuclear war, the after-effects of various hurricanes and wildfires and even the "#MeToo" social movement that rattled powerful men left the markets strangely calm. In fact, the VIX — the Chicago Board Options Exchange Volatility Index — known as the stock market's collective "fear gauge", remained muted for most of the year and fell to an all-time low in November 2017.

As such, investors may have forgotten that volatility is a common part of the equity markets. Take, for example, the S&P/TSX Composite Index: when comparing monthly returns over time, over the past 20 years, the index actually fell in almost 40 percent of the time, month over month. This shows just how common downward market movements are. Compare this to 2016 and 2017, when the index fell in only 20 percent of time. In other words, the markets have been strangely placid over recent years.[1]

After almost nine years of a bull market, sometimes a pullback is necessary. Often equity prices may have overshot their underlying fair values during the bullish times. Regardless, these fluctuations can still be a source of discomfort. As investors, what can we do to cope with periods of volatility?

Look for opportunity. Downward movements should be welcomed by those looking to their build investment positions.

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"Helping clients make better decisions."

Periods of decline are not the time to run and hide. Seasoned investors look for ways to turn lower prices to their advantage and build their portfolios, when others may be fearful to act.

Focus on the positives. Our economy continues to grow, along with all of the major economies globally. It is at its strongest in many years, with unemployment still at low levels, continuing positive earnings reports and solid consumer spending. South of the border, tax reform measures in the U.S. are expected to continue to fuel growth.

Pay attention to your personal objectives. Focus on how your investments fit into your longer-term plan. Remember that your assets are working hard to help you achieve your goals, which may put day-to-day fluctuations in proper perspective.

Patience can be one of our greatest allies to see us through periods of volatility: longer-term investors can take comfort in knowing that short-term fluctuations tend to smooth out over time. Try and leave the worry over short-term developments in the markets to the professionals who oversee your investments. Remember that we are here to provide counsel and perspective.

1. S&P/TSX Composite Index month over month closing figures, 31/12/97 to 29/12/17.

Avoid Penalties

Time to Review Your TFSA

Do you hold multiple Tax-Free Savings Accounts (TFSAs)? Have you transferred funds between accounts or withdrawn funds and recontributed them within a calendar year? If so, you may have inadvertently over-contributed to your TFSA. Here are two areas where mistakes are commonly made:

TFSA funds are withdrawn and recontributed within the same year. TFSA withdrawals do not create contribution room until the *following* calendar year. Any re-contributed funds would be considered an over-contribution if no contribution room is available in the year of recontribution.

Funds are withdrawn from one TFSA and transferred to another TFSA at a different financial institution. This can be done without penalty through a "direct transfer" completed by the financial institution. If funds were withdrawn from one TFSA and moved to another TFSA without a direct transfer, this would be considered to be a withdrawal followed by a contribution. Contribution room for the withdrawal would not be created until the next calendar year. If no contribution room was available, it would be considered an over-contribution.

Recently, the Canada Revenue Agency (CRA) has increased its TFSA reviews to determine if holders have over-contributed. If an individual has exceeded their contribution limit for the first time, they are sent a warning letter and/or Form RC243-P, *Proposed Tax-Free Savings Account Return.* This form shows the amount of penalty tax due according to CRA records. If the excess amount has been removed prior to receiving the letter, no further action is required. As such, it may be worthwhile to review your TFSA now to make any necessary corrections before a CRA review.

A TFSA penalty is assessed at one percent of the highest excess TFSA amount in the month, for each month until the excess amount has been removed or contribution room becomes available. So, for an indirect transfer of $5,000 that is considered to be an over-contribution, a penalty of $50 per month would be assessed, or $600 over an entire year. Over time, the penalties can quickly add up.

TFSA contribution room information is available on your CRA online account: "My Account". You can also contact the CRA to request a *TFSA Room Statement* or T*FSA Transaction Summary* showing your contribution and withdrawal information.

If you have multiple TFSA accounts at different financial institutions, consider consolidating them to simplify their management and avoid this mistake. This may also improve your overall asset allocation and facilitate the settlement of an estate.

Tax Season Once Again

Are You Paying Too Much Tax?

It is tax season once again. A look back in time shows just how much Canadian personal income tax rates have risen over the past decade.

Based on recent reports, the top 10 percent of income earners in Canada paid over 54 percent of total federal income taxes collected. This figure has grown over the years due to increases in income tax rates for top earners. Today, the Canadian government relies more on income tax revenue than most developed nations. Income tax comprises around 36 percent of Canadian government revenue, versus a global average of 24 percent.[1]

Are you exploring potential strategies to minimize your annual taxes? The difference in top marginal tax rates that apply to various types of income highlight the importance of structuring your investments to take advantage of lower rates. Beyond that, consider maximizing your tax-advantaged accounts, such as TFSAs and registered Retirement Savings Plans (RSPs), and taking advantage of income-splitting opportunities with family members. Also, check all the deductions and credits available to you when you file your income tax return. Please call for support.

Combined Federal & Provincial Top Marginal Tax Rates (%)

	2008	2018 Combined Top Marginal Tax Rate*			
Province	Interest & Regular Income	Interest & Regular Income	*10-Year Change*	Capital Gains	Eligible Dividends
BC	43.70	49.80	***+14.0%***	24.90	34.20
AB	39.00	48.00	***+23.1%***	24.00	31.71
SK	44.00	47.50	***+8.0%***	23.75	29.64
MB	46.40	50.40	***+8.6%***	25.20	37.79
ON	46.41	53.53	***+15.3%***	26.76	39.34
QC	48.22	53.31	***+10.6%***	26.65	39.83
NB	46.95	53.30	***+13.5%***	26.65	33.51
NS	48.25	54.00	***+11.9%***	27.00	41.58
PEI	47.37	51.37	***+8.4%***	25.69	34.23
NL/LB	45.00	51.30	***+14.0%***	25.65	42.62

Notes: *As of Jan. 1, 2018. Source: 2018 KPMG Personal Tax Rates. 2008 TaxTips.ca.

1. Source: "Income Tax at 100: Milestone or Tombstone", Financial Post, 04/05/17. Global average as noted by the Organization for Economic Cooperation and Development (OECD).

CPP: What's Your Magic Number?

The Canada Pension Plan (CPP) provides eligible individuals who have worked in Canada and made CPP contributions with a partial replacement of earnings in retirement. A key question for those who are approaching retirement is: When should I start taking CPP benefits? For many, the timing decision is based on a "collect now and think about it later" approach. But, if you are in good health and can afford to live without CPP in the short term, did you know that delaying payments could be lucrative?

The Decision

The standard age for applying to receive the CPP pension is age 65 but you can start as early as age 60 at a reduced pension amount, or as late as age 70 for an increased pension.

If you start early, payments are reduced by 0.6 percent for each month that the pension is received before the age of 65 (e.g., starting at age 60 will reduce the pension by up to 36 percent). If you wait, payments increase by 0.7 percent for each month that the pension is delayed beyond the age of 65 (e.g., starting at age 70 will increase the pension by up to 42 percent).

Mathematical Models for Your Crystal Ball

Knowing when to start collecting your CPP pension would be made easier…if you knew exactly how long you were going to live. Of course, we know that this is not possible.

There are other factors that can influence the decision, including your immediate/future income needs, the preservation of other income-tested benefits (e.g., Old Age Security) and your current/future income tax bracket. While a detailed analysis specific to your particular situation should include these elements, a simple optimization analysis can help start the thinking process.

The table below estimates the different ages an individual who turns 60 years old on January 1, 2018 could start collecting CPP benefits. It assumes (s)he is entitled to receive the maximum monthly pension amount in 2018, a 1.5 percent rate of annual inflation and a 5 percent discount rate to account for the "time value of money", assuming funds could yield this return over time.

Starting to collect too soon may be costly. For example, based on the assumptions above, if you expect to live until age 88, the value in today's terms of your cumulative CPP benefits would be $154,628 if you started collecting at age 60, versus $184,228 if you waited until age 68, resulting in a lower overall benefit of $29,600.

For a review of your particular situation or more information on CPP benefits, please get in touch or consult a tax advisor.

Estimate Age to Start CPP for a 60-Year Old in 2018

If you think you'll live to age…	Start collecting at age…
71	60
72 to 74	61
75 to 77	62
78 to 79	63
80 to 82	64
83 to 84	66
85 to 87	67
88 to 89	68

The above figures are based on an illustrative model that uses the maximum pension amount as of Jan. 2018, 1.5% inflation, 5% discount rate.

Rising Interest Rates: Here for Now?

Interest rates have remained at historically low levels for many years, helping to support economic growth and significantly propping up the housing market, much to the chagrin of retirees who would like to rely on interest income to support their expenses. But what is in store as rates begin to climb?

Many investors understand the inverse relationship between interest rates and bond values. As interest rates rise, the capital value of existing bonds goes down. Here's why: Consider an investment of $100 in a 10-year bond that pays a 2 percent coupon. If interest rates rise to 3 percent, you wouldn't be able to sell the same bond at its $100 face value because you could buy a new bond for $100 with a higher coupon rate. As such, the earlier issued bond's market value will decrease to offset its lower interest rate.

This change can be managed in different ways. In a rising interest rate environment, it can be helpful to keep maturities of bonds relatively short to protect capital. As bonds mature, the principal can be reinvested in new bonds that provide higher interest rates. A laddering approach, which spaces maturities over time, may also help to manage interest rate changes and offer predictability in generating future income streams. Various types of bonds

(government, investment-grade, high-yield, etc.) can perform differently when interest rates are rising or falling so, depending on an investor's particular situation, diversifying across fixed income assets may help to provide asset protection.

A rising interest rate environment can also affect equity markets. A popular belief is that rising rates put downward pressure on stocks. But this may not be cause for alarm. Interest rates typically rise during a strengthening economy, which can help offset this effect over the longer term.

Remember that fixed income can play an important role in your investment portfolio, helping to preserve capital and create diversification. Please call if you would like to discuss.

Estate Planning: A Multi-Generational Insurance Strategy

Are you a grandparent who wishes to provide a legacy gift to your grandchildren? If you have accumulated wealth during your lifetime that you will not need in retirement, or have received an inheritance and would like to give a similar gift to future generations, a cascading life insurance strategy may be a consideration.

How does it work?

In general, the strategy involves acquiring a permanent life insurance policy structured in a way to transfer wealth on a tax-efficient basis from one generation to the next. For example, you could purchase a permanent life insurance policy on the life of your child (as the contingent owner) and name your grandchild as the policy's beneficiary. With proper structuring, upon your death, the ownership of the policy would be transferred to your child on a tax-free basis. When the child whose life is insured passes away, your grandchild receives the death benefit tax free. As such, this strategy may enable a tax-efficient accumulation and transfer of wealth from you to the third generation of your family.[1]

Why use permanent life insurance?

Aside from providing a death benefit, a permanent insurance policy[2] allows deposits above the cost of the insurance, known as the cash value (CV), to accumulate on a tax-sheltered basis. For a policy acquired on the life of a child, there should be sufficient time for additional cash value to accrue, relative to a policy on your own life.

Permanent insurance also provides financial flexibility to the owner of the policy. If the policy owner requires funds, they may withdraw or borrow from the CV. However, such a withdrawal or loan may have immediate tax consequences.

What are the advantages?

The tax-sheltered growth of funds deposited provides a tax advantage when compared to the alternative of investing the same funds in marketable securities or real estate for which there

would be annual taxation on dividends, interest, or rent received or tax on any gains that are realized. Similar to other insurance products, the strategy can sometimes be structured to avoid probate fees, in jurisdictions where probate is applicable.

Given the ability to access funds from the CV during your lifetime (as the policy owner), this strategy may offer significant financial flexibility to you. Once the policy is transferred to the next generation, your child as the new owner may also access the CV to supplement his/her own retirement income or use the funds to help pay for your grandchildren's education or home purchase.

For the named beneficiaries, the policy's death benefit will be received on a tax-free basis. You may find it comforting to know that irrespective of how your child manages the assets that they may receive from your estate during their lifetime, funds will still remain for the benefit of your grandchildren.

If you are interested in learning more about this strategy, please get in touch or consult your own tax and insurance advisors.

1. A cascading life insurance strategy may have variants to this example. 2. Policy must be an "exempt policy" under the Income Tax Act (Canada).

The information contained herein has been provided by TD Wealth Insurance Services and is for information purposes only. The benefits illustrated may or may not be achieved depending on how the actual experience compares with the assumptions used in this illustration including but not limited to the amount and timing of deposits, interest rates, inflation and taxes. Information in this document about historical returns on investment is not indicative of future performance as past performance may not be repeated. We recommend that you review them with your tax and legal advisor before making any decisions. TD Wealth Insurance Services is not liable for any errors or omissions in the information or for any loss or damage suffered. TD Wealth Insurance Services means TD Waterhouse Insurance Services Inc., a member of TD Bank Group. All insurance products and services are offered by the life licensed advisors of TD Waterhouse Insurance Services Inc.

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