TD Wealth

Return On Investment

TD Wealth Private Investment Advice

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Certainty in an Age of Uncertainty

Over most of 2016, the market climbed a "wall of worry". The uncertainties were legion: ongoing questions about where oil prices would stabilize, continuing geopolitical issues, a surprise "leave" vote under Brexit and a stunning U.S. presidential election outcome where polarized Americans acknowledged their desire for change. Even Canada's path to stronger economic growth remained in question. As we start a new year, there is no doubt that many uncertainties persist.

Amidst all of the uncertainty, some things are more certain. Central banks have created a peculiar world, where interest rates have been kept at low levels for many years to help stimulate economies. In some parts of the world, negative interest rates prevail. Closer to home, we are likely to see interest rates held at lower levels for the foreseeable future.

Low interest rates are a double-edged sword. While they are great for borrowers, they are quite a different story for income investors. Returns of one or two percent can be quite discouraging, especially since they may represent a negative return in terms of purchasing power after factoring in taxes or inflation.

As such, today's reality is that the stock market has been, and continues to be, a better way to deliver a cash flow stream compared to alternatives like government bonds. One of the ways in which this can be achieved is through dividends. Many quality companies continue to have a history of paying or even boosting dividends through both good times and bad. In fact, a rising share of the total return from the equity markets has come from the dividend yield and dividend growth. This has been the case in Canada, where over the past 25 years the compounded annual return of the S&P/TSX Composite Index with dividends reinvested has been 8.6 percent and the total return yielded almost 1.8 times the return of the index alone (from 09/30/91 to 09/30/16). It should also be remembered that even during this time, there were various rough periods including two of three bear markets that saw the index drop by 45 percent. Investors shouldn't overlook the impact of dividends and on page 3 we discuss some of the reasons to embrace dividend-paying equities.

As we look forward to the year ahead, despite the many uncertainties, we shouldn't lose sight of the fact that Canada's financial and economic systems continue to function well and remain the envy of many other countries of the world. Many hardships have challenged the Canadian financial markets over recent years, but we should maintain confidence knowing that our economy has remained relatively resilient. Wishing you health, happiness and prosperity in 2017.

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In This Issue

RSP Season is Here

Happy 60th Birthday, RSP! (Time to Take Action)

For 60 years, the registered Retirement Savings Plan (RSP) has become a valuable part of many investors' wealth and investment plans. As the annual deadline for contributions approaches, we encourage you to do a more detailed check-up on your plan. Here are some things that may be reviewed:

- **Beneficiary Designations** — Ensure that you have updated beneficiary(ies) designated in the plan documentation (in Quebec this designation must be made in your will or marriage contract). Understand that there may be tax consequences to your estate depending upon who has been named as beneficiary(ies). There may also be special considerations to address if designating a minor child (which vary depending on provincial or territorial laws), an individual with a disability (whether or not they are a beneficiary of a Registered Disability Savings Plan) or non-residents.
- **U.S. Estate Tax** — Currently, U.S. securities held within your RSP can have U.S. estate tax implications, even if you are not a U.S. citizen. Depending on your particular situation, you should consider whether it is advantageous to hold U.S. securities directly or instead, indirectly – either through a holding company or through a Canadian mutual fund that invests in the U.S.

- **Spousal RSP** — There may be opportunities to split income through the use of a spousal or common-law partner (CLP) RSP. Remember that the total amount you can deduct for contributions you make to your RSP and your spouse/CLP's RSP cannot be more than your RSP deduction limit.

Please consult a professional tax advisor before acting on the above information; tax consequences vary with particular circumstances. **Reminder: The last day to make RSP contributions for the 2016 tax year is March 1, 2017. Please call for assistance with any RSP matters.**

Preparing Future Generations

Teaching Kids About Money

Having conversations with children or grandchildren about money has the potential to yield tremendous returns down the road. Just think about the head start that a young person could have with an "extra" $500,000 nest egg in retirement. That's what would result by the age of 65 if a TFSA was started at 18, by contributing $5,500 for only 12 years at a compounded annual return of 5 percent.

It Starts with Saving!

Some of the most financially successful people are able to consistently put aside a regular part of their income for the future. Children should learn that we are always balancing what makes us happy now and what will make us happy later, and that saving is one way to fulfill our future needs. Giving children the chance to work toward a goal can help teach the concept of saving. Older children can be taught that compounded interest can help to reach a goal more quickly.

It's not just the value of saving and compounded growth that are important lessons. Teaching children other financial skills can be beneficial, and experts say that conversations can start at any age:

Managing Money — Providing kids with an allowance may be one way to teach kids how to manage money through a discretionary income. It can teach that there is never enough money to buy everything we want and that we often need to prioritize our needs. For older children, an allowance can provide learning opportunities such as keeping track of money, understanding the cost of goods or budgeting.

Delayed Gratification — Our world has become "on demand", driven by influences like on-demand television and one-click internet shopping. This has challenged the concept of delayed gratification. But learning how to delay gratification can be an important skill. The Stanford marshmallow experiment was a series of studies in which a child was offered a choice between eating one marshmallow immediately or two marshmallows after waiting a short period of time. Children who were able to wait longer tended to have better life outcomes.[1]

Financial Education in a Changing World

As technology continues to play an increasing role in our lives, financial education should also include internet safety. Children should be taught the dangers of revealing personal information over the internet. Even the most innocent social media sites can broadcast personal data that can be used by unscrupulous individuals. Broadcasting family wealth can also have unintended consequences. Teaching how to filter false information can also help to protect against hoaxes.

In short, a little bit of financial education can go a long way. As the saying goes: "mighty oaks from little acorns grow".

Source: 1. "Cognitive and Attentional Mechanisms in Delay of Gratification", Journal of Personality and Social Psychology, February, 1972.

Maintaining Confidence

The Value of Dividend-Paying Equities

The long-term case for dividend-paying equities continues to be compelling. Here are some reasons to have confidence in the value of dividends within your wealth management strategy:

An integral component of long-term returns. Dividend-paying companies represent a significant part of long-term returns within the equity market. Over a period of 25 years from 1991 to 2016, the compounding effect of dividends on the S&P/TSX Composite Index has been profound – with reinvested dividends providing around 45 percent of total returns. On this basis, an investment of $1,000 would have yielded around $4,350 today on the index alone but around $7,800 if dividends were reinvested.[1]

May provide a reliable and steady cash flow stream that can be used for income, or reinvested. Today's persistently low interest rates and slower growth have made it challenging for investors to find income-generating investments. Dividend-paying equities continue to provide a steady stream of income to an investor. Many quality companies will consistently pay dividends year after year because it is seen as a sign of economic health (i.e., there is excess cash with which to pay shareholders).

Historically have provided greater protection in bear markets. The dividend yield of a stock can provide a degree of downside protection. The dividend yield reduces the potential impact of a decline in share price during economic downturns. Studies have also shown that dividend-paying stocks have proved to be a useful buffer when investors experience high degrees of volatility.[2]

A tax-efficient means of investing. Remember that not all income sources are treated equally by the tax authorities. Canadian dividends are potentially one of the lowest-taxed sources of investment income in Canada, when compared to interest income or foreign income. This is due to the non-refundable tax credit applicable to most "eligible dividends", generally dividends issued by Canadian public companies. Consider that for each dollar of dividend income received, an Ontario resident taxed at the highest marginal tax rate would keep about 14 cents more compared to a dollar of fully taxable income (based on an assumed 53.53 percent marginal tax rate and a 39.34 percent effective tax rate for eligible dividends).

The potential for dividend growth. Don't overlook the potential impact of dividend growth. The S&P/TSX Composite Index dividend has had an annualized growth rate of 5.2 percent over the past 25 years.[3] And, consider the extreme case of Johnson and Johnson, a company that has increased its dividend payout for 54 consecutive years. Shares of Johnson and Johnson purchased in 1972 (and held) would have had dividend returns of approximately 3,300 percent today![4]

In short, we continue to advocate the benefits of quality dividend-paying stocks as part of your wealth and investment plan.

Sources: 1. S&P/TSX Composite Index Total Return and Index price return from 07/30/91 to 07/29/16; 2. Franklin Templeton Investments, "The Case for Dividend-Paying Equities in Today's Market"; 3. Using same 25-year data. Index dividend = Index Total Return – Index Price Return; 4. Based on JNJ dividend factor to August 2016, provided on corporate website: investor.jnj.com

In Brief: Housing Market Changes

More changes are on the way relating to Canada's housing market. Here are some of the more important changes, in brief:

Selling your home? New reporting rules apply. As of the 2016 taxation year, you will now be required to report the sale of your home to the Canada Revenue Agency on ***Schedule 3, Capital Gains*** of the T1 Income Tax and Benefit Return. Previously, taxpayers were not required to report the sale of a home if it was their principal residence for each year of ownership. Penalties will apply if the sale of the home is not reported.

Only certain trusts will be able to designate property as a principal residence. Previously, various types of personal trusts were entitled to claim the Principal Residence Exemption (PRE). New rules impose additional requirements on trusts holding a principal residence and limit the PRE to the following general types of trusts: alter ego, spousal or common-law partner, joint spousal/partner, qualified disability trusts and trusts for minor children of a deceased parent, effectively limiting the beneficiary of the trust to family members of the person creating the trust.

A mortgage rate stress test will apply to all insured mortgages. All low- and high-ratio insured homebuyers must qualify for mortgage insurance at an interest rate that is the greater of their contract mortgage rate or the Bank of Canada's conventional five-year fixed rate. Other stress test rules also apply.

For more information, please see the Department of Finance website: www.fin.gc.ca/n16/data/16-117_2-eng.asp

Note: At the time of writing, some changes have not received Royal Ascent.

Perspectives After the U.S. Presidential Election

In a stunning upset that defied many expectations, Donald Trump was elected as the 45th president of the United States. Trump's explosive and polarizing campaign has led to some discomfort in predicting the next four years. From an investing perspective, here are some preliminary thoughts:

What are the potential implications?

Trump's election campaign was focused on actions to stimulate the U.S. economy. He has promised to lower the business tax rate from 35 percent to 15 percent, as well as implement tax cuts for individuals. This has the potential to increase U.S. corporate profits and lead to stronger economic growth if the tax savings are invested back into the U.S. economy.

Here at home, Canadians will be carefully watching as Trump refines his foreign policy stance. The U.S. is Canada's largest trading partner, with well over 70 percent of our exports going to the U.S.[1] During his campaign, Trump criticized trade agreements like the North American Free Trade Agreement (NAFTA) and promised to impose tariffs on foreign exports entering the U.S., but more specifically from Mexico and China. As such, it remains to be seen how potential changes to current trade policies will impact the ties between Canada and the U.S.

From an energy perspective, Trump's win may provide an opportunity for Canada's oil sector. Trump has stated that his longer-term goal is to be independent of the need to import energy from OPEC. As a supporter of offshore drilling and exploration, he has remained open to the possibility of reversing Obama's rejection of the Keystone pipeline deal.

As we process the election result, here are some initial observations.

Financial markets are unpredictable. It was largely expected that a surprise Trump win would result in a short-term equity market sell off and significant volatility. Often with black swan events, the initial market reaction is one of panic. However, in the immediate election aftermath, North American equity markets traded in positive territory, demonstrating their unpredictability and the importance of not hastily reacting to news.

Don't listen to media noise. The unexpected election result highlighted that media sources can sometimes be very wrong. Almost unanimously, even until late on election day, the media predicted that Clinton would be the next U.S. President. It wasn't until the close of many polls that media sources reversed this expected election outcome. As investors, care should be taken to filter the media noise.

Exposure to the U.S. remains an important part of a diversified portfolio. The U.S. equity markets are the largest globally and represent over 40 percent of total global market capitalization.[2] As such, a diversified portfolio should consider exposure to U.S. equities. Although political risk can impact financial market performance, it should also be remembered that the long-term value of company shares is driven by fundamentals and valuations.

Keep Perspective

These are early days and as the weeks and months ahead come to pass, Trump's policies will become more clear. We will keep you informed as we learn more about the potential impact from an investment perspective and chart the path forward.

Source: 1. Statistics Canada, based on September 2016 data. 2. World Bank Global Equity Market Capitalization, as of Jan. 2016.

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