

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 overshoot 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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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 re-contributed 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 re-contributed 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 re-contribution.

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 *TFSA 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 (%)

Province	2008	2018 Combined Top Marginal Tax Rate*			
	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).

Planning for Retirement

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.

Thinking About Downsizing Your Home?

This may sound familiar: your first home started out small, but as your family grew you wanted more bedrooms and a backyard. Now the children have left the house and the bedrooms are empty — but over the years, with the rise in housing prices, you have built up significant equity through your home's value. Perhaps you may be asking: is there an opportunity to downsize?

Releasing some home equity has the potential to provide financial benefits such as better supporting your retirement longevity, helping out family members or increasing your retirement options. Downsizing to a smaller residence may also mean lower maintenance costs, property taxes or utility bills. If you are contemplating a move, here are some things to consider.

First, the potential financial upside may not be as large as you expect:

The sale price may be unrealistic. Real estate prices have the potential to fluctuate, and home values are dependent on many factors. To understand the real value of your home, a good starting point may be to ask for advice from an experienced realtor.

The cost of changing homes may be underestimated. Don't forget to factor in the costs involved in the sale process, such as real estate and legal expenses, for which estimates range between four and nine percent of the sale price.¹ You may also need to pay for renovations or maintenance to sell an old home or fix up a new one. Even the cost of "trading down" may be underestimated. A modern condominium with high-end appliances may cost more than anticipated, especially when considering monthly condominium fees that weren't a factor with home ownership.

Yet, the opportunity may have potential benefits:

Capital may be freed to invest for retirement. Capital can be invested and grown for the future, with the potential to offer the freedom and flexibility to do the things that you have always wanted.



Proceeds may help to draw down a mortgage. As interest rates rise, so do mortgage costs. Proceeds from the sale of a home may accelerate mortgage repayment. Of course, this depends upon the mortgage structure, as some may carry penalties for early repayment.

There may be non-financial benefits. Downsizing can be a way of adapting to a change in lifestyle. Advancing age or health issues may force a move — perhaps to a retirement or assisted-care facility, which can offer the benefits of becoming part of a community or increased security.

Have a Plan

As with any large financial decision, it is helpful to have a plan in place. Think ahead; don't rush into a sale process. If you wish to move to a different city, consider visiting during various times of the year to try out the new environment. If you decide to leave the country, be aware of tax, healthcare and other residency implications. Or, if you plan on downsizing to a condominium, do your research to understand the new building's rules. Perhaps you can't have a patio BBQ or paint the outside of your residence: certain restrictions may be deal breakers. Once you have fully explored the options, you can make the best decision.

What could be the end result? While your home may become smaller, the opportunities that lie ahead could multiply.

1. https://www.sunlife.ca/ca/Learn+and+Plan/Money/Drivers+and+homeowners/How+much+does+it+cost+to+sell+your+home?vgnLocale=en_CA

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