TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

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In This Issue

The Psychology of Investing

Why do investors sometimes fall into the trap of buying high or selling low? Why do many of us procrastinate in saving for retirement, despite knowing its importance? It turns out that our brains are hard-wired to sometimes make decisions that aren't always logical.

After the October 1987 stock market crash, a day in which the equity market fell 20 percent despite there being no rational economic explanation, economists started to critically rethink their views about the fundamentals of economics. As a result, the field of behavioural economics was born, which linked psychology with economics to show that human behaviour can have significant effects on economic decision making.

Behavioural economists have determined that cognitive biases often prevent individuals from making the best decisions. This is because our brains operate in two cognitive states: automatic and reflective. Our automatic system is uncontrolled, fast and unconscious. Our reflective system is controlled, effortful and deductive. Behavioural biases occur when the automatic system, often influenced by the current environment, dominates the reflective system. This is why going grocery shopping while hungry can lead to unhealthy food choices: our reflective system is easily overridden by a state of hunger.

When it comes to investing, human emotion drives behavioural biases. "Herd behaviour", the tendency to follow the actions of a larger group, may cause investors to buy or sell investments due to pressure from others who are doing the same. "Loss aversion", or the fear of a potential short-term loss, can cause investors to second-guess a portfolio strategy and sell a position too soon or hold on to a losing position for too long. Other investors may "anchor", becoming fixated on a particular price target even as new information should adjust that target.

The good news? With a bit of effort, we can learn to control these behaviours. Some of the best investors have trained themselves to avoid emotional impulses. Others use market sentiment as a reverse indicator: in the words of renowned investor Sir John Templeton, "invest at the point of maximum pessimism."

We can also integrate different techniques into our investing programs, like regularly rebalancing portfolios, using managed products to put buy/sell decisions in the hands of experts, or incorporating systematic saving or investing programs to avoid market timing. Our proprietary "TD Discovery Tool" can help to identify blind spots in investing decision making.

Most importantly, you should be aware of the influence that human behaviour can have on investing and plan ahead before it can have an impact. This may include sticking to your wealth and investment plan during volatile times or avoiding the urge to react to social and media pressure. And, remember, I am here to help remove the impact of temporary emotions from investing and support you as you chart the course for longer-term success.

Estate Planning

Planning for Incapacity

It is often difficult to address the realities of aging, particularly as it relates to our finances. Although many of us are aware that one day in the future we may be unable to directly manage our finances, many of us fail to plan ahead — perhaps because it is a reminder of our own mortality.

Although we are unable to control what happens to our health, we do have the ability to control how our financial resources will be used to care for us. Planning ahead can help ensure that future choices to be made are yours. It can also help to take the burden off family members.

Carefully Select an "Attorney"

One of the most important aspects of planning for incapacity is to identify people that you trust to make decisions — not only financial, but also healthcare — on your behalf. The person(s) you choose to act on your behalf is called an "attorney".

Experts suggest selecting an attorney who is trustworthy, diligent and able to withstand potentially stressful situations and will act according to your wishes. They should have time available to represent you and possess some financial management skills. If no suitable individual is identified, professional institutions/individuals are available to act in this role. Key family members should be made aware of your choice, to prepare them and help to avoid future conflicts.

The careful choice is especially important because once documentation is signed, there is generally no monitoring standard to ensure that power is used appropriately. Elder abuse continues to be a growing problem, and, in most cases, is caused by a family member.

Formalize Your Plan

Keep in mind that without proper documentation in place your family may have to apply to the provincial government/courts to appoint someone to manage your affairs. This can be a lengthy and costly process. It is incorrect to assume that a spouse/partner can automatically act on your behalf. For example, unless financial accounts are held jointly (in provinces where applicable), spouses/partners will not generally be given access or be able to make decisions for you.

Here are some basic documents that can be used within your plan:

Power of Attorney — The name and the exact terms and conditions vary by province. Generally speaking, these documents allow the attorney(s) to make financial or healthcare decisions if you cannot act for yourself.

Living Will/Advanced Directive — In provinces where applicable, this allows a person to specify medical or lifestyle decisions in the event of illness or incapacity. This is useful to clearly indicate one's wishes and provide guidance to caregivers.

Trusts — Some trusts (e.g., alter ego trusts and joint partner trusts) may be used as an option for incapacity planning.

Be sure to keep your documents in a safe place where they can be found by a trusted person.

Get Advice

Having a plan in place today can help to provide significant peace of mind for tomorrow. Always obtain appropriate legal advice. If you would like assistance in connecting with an estate planning specialist, please get in touch.

Farewell to the Canada Savings Bond

Canada Savings Bonds (CSBs) have had a long history in the saving habits of Canadians for generations. Established in 1946, these bonds, offering a guaranteed interest rate, were issued by the Canadian government as a successor to War Savings Certificates and Victory Bonds that helped to finance Canada's war efforts.

The 2017 federal budget announced that future sales of CSBs, now in their 71st year, will be discontinued and the program will be phased out. This is largely because historically low interest rates and higher yielding investment alternatives to CSBs have led to a decline in the popularity of the program.

This wasn't always the case. The CSB developed a strong reputation as a low-risk investment vehicle that offered a competitive interest rate return. An article published by the Canadian Broadcasting Corporation in 2007 identified the CSB as the first investment of around two-thirds of Canadian respondents.[1] In the 1980s, it was not uncommon for a CSB to bear an interest rate in the double digits (given high inflation). In fact, in 1981, the interest rate on a CSB was 19.5 percent!

As we bid farewell to the CSB, this is a good reminder to investors that different assets and even entire asset classes can become less relevant with the changing times.

Source: 1. "An Old Standby Faces New Challenges", CBC, 10/3/2007.

Understanding the Taxes You Pay

Capital Gains Taxes

Leading up to this year's federal budget tabled in late March, there was much speculation that Canadians would be seeing increases to the capital gains tax rate. It is widely believed that there were no changes this year possibly due to Canadian economic uncertainty. Although Finance Minister Bill Morneau has indicated that future changes to the capital gains tax are not ruled out, recently proposed personal income tax reductions in the U.S. may help to keep the Canadian capital gains tax rate at current levels.

Capital gains tax is generally paid when investments are sold for more than their cost. The current capital gains inclusion rate is 50 percent, which means that only 50 percent of the capital gain is taxed as regular income. As of April 30, 2017, in all provinces and territories, the combined top marginal personal tax rate for capital gains is lower than those for interest income (taxed as regular income) and eligible Canadian dividends (which are eligible for a dividend tax credit).

Since the capital gains tax has not changed in almost 17 years, it may be difficult to remember that it has not always been this way. Introduced in 1972, in part, to make up for the elimination of inheritance tax, there have been various changes (see chart).

How to Reduce Capital Gains Tax

Here are some ideas to consider as you structure your investments to reduce your capital gains tax:

Be Aware of the Tax Treatment of Registered/Non-Registered Accounts — Tax-Free Savings Accounts are an excellent way to hold investments as withdrawals of contributions, income and gains are not subject to tax. For registered Retirement Savings Plans (RSPs) or registered Retirement Income Funds (RIFs), keep in mind that any investment gains will not benefit from capital gains tax rates as withdrawals are fully taxed as regular income. These capital gains could end up being taxed at higher rates, depending on your marginal tax rate at the time of withdrawal, although the tax-deferral opportunity of these plans should not be overlooked.

Report the Principal Residence Exemption (PRE) — When a residence is sold by an individual, the capital gain may generally be eliminated by a claim of the PRE if certain conditions are met. As of the 2016 taxation year, the sale of a principal residence must be reported on the individual's tax return.

Donate Securities — Donations of publicly-listed securities to a registered charity are exempt from the capital gains tax.

Use the Lifetime Capital Gains Exemption (LCGE) — You may be able to claim an exemption on a portion of the gain realized upon the sale of shares of qualified small business corporations or qualified farming/fishing properties. The LCGE available to shareholders of qualified small business corporations is $835,716 in 2017 and $1,000,000 in 2017 for owners of farming/fishing properties if certain conditions are met.

A History of Capital Gains Tax in Canada

- **1972** – Capital gains tax introduced; Inclusion rate set at 50%
- **1985** – General capital gains exemption introduced – Up to a lifetime maximum of $100,000
- **1988** – Inclusion rate increased to 66.67%
- **1990** – Inclusion rate increased to 75%
- **1994** – General capital gains exemption abolished
- **2000** – Inclusion rate reduced to 66.67% (Feb.) and then reduced to 50% (Oct.)

Source: "A Primer on Capital Gains Taxes in Canada", CBC, 10/18/2000.

Happy 150th Birthday, Canada: Remember When?

Do you remember when...

...the cost of a house was only around $24,000?
...the price of gas was only 9 cents a litre?
...the cost of a litre of milk was only 25 cents?

It may be hard to believe, but this was the situation just 50 years ago when Canada turned 100 years old. Since that time, we have come a long way. We are living longer and healthier lives. The average Canadian life expectancy has increased by an average of 10 years, from 72 years to 82 years, and GDP per capita has risen from US$3,200 to US$46,200. The chart shows how other things have changed in only 50 years.

What will the next 50 years bring? Happy 150th Birthday, Canada!

Source: Canada Fact Book 1967, www66.statcan.gc.ca/eng/acyb_c1967-eng.asp

	Back in 1967	Today in 2017
Population	20.4 million	35.2 million
Life Expectancy	72 years	82 years
GDP Per Capita	$3,200 USD	$46,200 USD
Interest Rates	5.64% (10+ Yrs.)	2.24% (10+ Yrs.)
Top Marginal Tax Rate	80% (CAN/$400K+)	54% (N.S./$200K+)
S&P/TSX (TSE) Composite	843.44 (1/31/67)	15,385.96 (1/31/17)
Avg. Home Price (Toronto)	$24,000	$1,336,000 (Jan.)
Minimum Wage	$1.25/hour	$10.65 to $13.60
Price of Gas	9 cents/litre	$1.05/litre
Cost of Milk	$0.25/litre	$2.47/litre

Purchasing a House as an Investment?

As housing prices continue to soar in certain Canadian cities, it may be difficult not to question the potential to build wealth through purchasing residential real estate. The reality is that putting a significant amount of capital into buying a house and assuming that it will yield future significant returns may have risks. Here are some perspectives.

Although in recent memory housing prices have been increasing steadily, over the longer term, the housing market has seen prices fluctuate. Recall that a boom in Toronto's housing market in the late 1980s was followed by a sharp decline in housing prices that lasted for almost the entire period between 1990 and 1997. The average sale price during this period fell by 28 percent.[1]

More recently, certain factors have helped to drive the rise in housing prices including supply constraints in major metropolitan areas like Toronto and Vancouver. Interest rates are also at historical lows, creating housing affordability (through low mortgage rates) to support these price increases. However, this may change.

As economic recovery takes a foothold in Canada, interest rates are expected to rise, thereby impacting the ability of many individuals to afford a mortgage. Regulations can also change. The foreign buyers tax recently put in place in Vancouver appears to have temporarily cooled the market; it is yet to be seen how newly announced measures will affect Toronto's booming market.

Unlike shares in a company that are traded on the stock exchange, a house may not generally be considered a liquid asset. If you own a rental property, keep in mind that rental income is taxable and capital gains taxes will generally be due on the appreciation of a property sold as an investment rather than as a principal residence. While investments like dividend-paying stocks and fixed-income instruments can provide income streams (and can also be held in tax-sheltered accounts), owning a house comes with many costs.

Illustrative: Costs of Home Ownership & Impact on Return

	National	Toronto	Vancouver	Calgary
Value at Feb. 2012	$400,000	$400,000	$400,000	$400,000
Value at Feb. 2017	$567,840	$653,840	$594,720	$461,640
% Change	*42.0%*	*63.5%*	*48.7%*	*15.4%*
Avg. Annual Return	*7.3%*	*10.3%*	*8.3%*	*2.9%*
Real Estate/Closing Costs[1]	$30,000	$30,000	$30,000	$30,000
Routine Maintenance[2]	$60,000	$60,000	$60,000	$60,000
Property Tax[3]	$12,098	$18,125	$7,872	$13,299
Home Insurance[4]	$4,200	$4,500	$4,920	$4,740
Mortgage Interest[5]	$13,455	$13,455	$13,455	$13,455
Total Costs	$119,753	$126,080	$116,247	$121,494
After-Cost Value	$448,087	$527,760	$478,473	$340,146
% Change	*12.0%*	*31.9%*	*19.6%*	*-15.0%*
Avg. Annual Return	*2.3%*	*5.7%*	*3.6%*	*-3.2%*

Notes: 1. 5% real estate agent cost; 2.5% closing costs. 2. Annual upkeep of HVAC, electrical, plumbing, landscape, etc., est. between 3% and 5% per annum. 3. Based on 2016 tax rates on avg. home price for five years. 4. Based on 2012 estimates, Insureye. 5. Interest costs for 5 years on a 20-year, $200,000 fixed-rate mortgage at 2.49%. Sources: 1. Canada Mortgage & Housing Corp. (closing costs est. between 1.5% and 4%). 2. "Ultimate Home Maintenance Guide", Moneysense, Oct. 2011. 3. Municipal government websites.

These costs should not be underestimated, including maintenance, property tax and insurance. The chart illustrates their potential impact on an overall return. Between 2012 and 2017, a period in which housing prices have risen at record rates, the return on a home valued at $400,000 is shown in three different Canadian cities. Although the costs may vary based on individual circumstances, conservative estimates have been used. Over the same period, the S&P/TSX Composite Total Return Index (including reinvested dividends) returned an average of 7.6 percent per annum.[2]

While the purchase of a home can have its benefits as a financial tool (e.g. acting as a forced savings plan), there may be risks for investors considering it as an opportunity to build wealth.

Notes: 1. Toronto Real Estate Board. Average sale price in 1989: $273,698; 1996: $198,150; 2. S&P/TSX Composite Total Return Index from 01/31/12 to 02/28/17.

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