

# OUR VIEW

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In addition to "Our View", Philip and Sheena write a personal newsletter for our clients. We value our existing relationships and we welcome new clients. Please contact us for more information.

## IT'S ABOUT TIME...

The positive sentiment that started the year has more recently been met with considerable tension and volatility. It is not unusual to see daily moves of several hundred points in either direction on North American markets reflecting the most current outlook or news reports. How long any period of uncertainty will last is impossible to predict, but a look back in time suggests that these periods eventually pass.

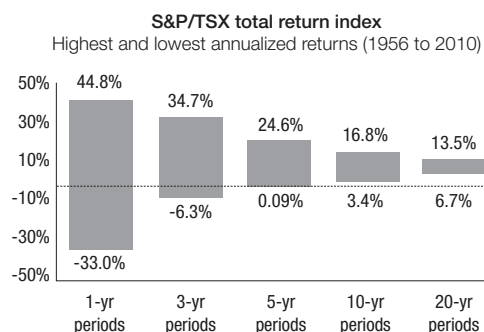
A closer look at longer-term holding periods for Canadian equity returns may remind investors that time is one of the investor's greatest allies. Year-end returns for the S&P/TSX Composite Total Return Index from 1956 to 2010 were analyzed for one-, three-, five-, 10- and 20-year holding periods.

Over time, short-term volatility had an insignificant impact on total returns. As the duration of the holding period increased, the number of negative total returns decreased. During this period, there has never been a five-, 10- or 20-year holding period with a negative total return. The chart depicts the highest and lowest annualized returns for the specified rolling time period.

Will this observation continue into the future? History suggests that it will.

For individual investors, a financial plan and a focus on a longer-term time frame may be the keys to success. Attention to such things as diversification, quality of holdings and rebalancing will also be important as time passes.

While we are currently experiencing unusual events in the financial markets, it is certainly not the time to abandon securities which were selected with our personal needs in mind. Instead, keep perspective through these inevitable short-term market swings. Focus on the long term and maintain confidence. Time is on your side.



Source: S&P/TSX Total Return Index (includes reinvested dividends) closing figures for years ending 1958 to 2010.

## ESTATE PLANNING

# YOUR WILL AND TAXES

In previous publications, we've discussed the importance of effective estate planning. This includes updating beneficiary designations for all plans and policies and reviewing your will periodically to ensure it is current based on changing circumstances. It also means ensuring that your will distributes your estate according to your wishes in the most tax-efficient manner.

### Minimizing taxes

When drafting or updating your will, it may be useful to consider various ways to minimize taxes and enhance the amounts to be distributed to your beneficiaries.

For tax purposes, an individual's assets are considered to have been sold at their fair market value immediately before death. This may be problematic if capital gains have accrued on your assets as that may lead to a significant tax liability. Under some circumstances this tax can be deferred by transferring assets to a spouse or a qualifying spousal trust, for example.

When reviewing the distribution of assets in your will, you should estimate your expected tax liability at death. This will allow you to plan now to ensure you have sufficient liquid assets or enough insurance on hand to fund the estimated future tax liability.

There are a number of ways to minimize taxes on your estate. Testamentary trusts, or trusts created by way of your will, may provide tax savings through income splitting opportunities. Here, the trust is considered to be a separate taxpayer subject to tax at progressive rates, just the same as individuals. Testamentary trusts also provide the benefit of having specific terms surrounding the administration of assets, allowing you to determine when certain beneficiaries will be entitled to receive their portion of your estate.

Charitable giving may also be another way to help minimize taxes. Careful planning will ensure that any tax benefits resulting from donations made in your will are fully utilized. For instance, you would not want donation credits to end up in your estate without having offsetting income if all of your income was reported in your terminal return.

### Other considerations

To ensure that your will best takes advantage of tax minimization opportunities, you should provide your trustees with sufficient powers to allow for tax planning on behalf of the estate. Most generic will templates are either silent on this issue or provide very basic and insufficient powers.

Some jurisdictions assess estate administration fees (or probate fees). Here, you may consider the use of multiple wills (i.e., a primary will to hold assets subject to probate and a secondary will to hold assets not subject to probate, such as private company shares) to reduce the fees charged to the estate. These fees can also be avoided by holding assets in joint tenancy such that they will pass directly to the joint owner upon your death or by transferring the assets to a trust during your lifetime.

If you or any of your proposed beneficiaries are US citizens or green card holders, you may require specialized terms and conditions in your will to avoid US tax and/or US estate tax complications.

As always, we recommend seeking advice from legal and tax professionals to ensure that your will takes into account all tax-efficient opportunities available.

## HOLDING ON...

# TSX INVESTING

A look back at the S&P/TSX Composite Total Return Index from 1956 to 2010 shows the merits of longer-term investing. Here are some figures for 10-year holding periods:

**45**

Number of 10-year periods  
from 1956 to 2010

**20**

Number of 10-year periods where returns  
exceeded 10 percent annualized

**0**

Number of 10-year periods with  
a negative return

**3.4 percent**

Annualized return for the worst  
10-year period

**16.8 percent**

Annualized return for the best  
10-year period

**9.9 percent**

Average annualized return for all  
10-year periods

**166.5 percent**

Average cumulative return for all  
10-year periods

**\$14,013**

Amount returned if \$10,000 was invested  
over the worst 10-year period

**\$47,060**

Amount returned if \$10,000 was invested  
over the best 10-year period

## INVESTING IN YOUR FUTURE

# YOUR (GRAND)KIDS AND THE PATH TO MILLIONAIRE DOM

Why not help your kids or grandkids get a healthy head start on their retirement? The key is starting early. Even a few years can make a dramatic difference down the road for their future well-being.

Consider this — a child with \$18,000 invested on his or her fifth birthday at a seven percent growth rate per year would have \$1,000,000 by the time he or she reaches 65 years of age.

One of the ways to make a difference in the financial lives of new generations is through education. Instilling financial responsibility and teaching the virtues of investing will be some of the greatest lessons you can give to a child or grandchild.

Here are five simple ideas that apply to almost everyone with children or grandchildren.

1. **Fund an RESP** — Education can be expensive! A tax-sheltered Registered Education Savings Plan (RESP) is a great way to get a head start in saving for post-secondary education costs. Consider the current average tuition at a Canadian university for an undergraduate degree of \$5,138 per year. South of the border, tuition can cost anywhere up to US\$30,000 per year for international students.
2. **Teach the pitfalls of credit card debt** — Coach your child on the importance of paying off credit card balances on time. The average Canadian's credit card debt is around \$4,000. At the 19 percent interest rate charged by many credit card companies for unpaid balances, this equates to over \$15,000 in interest charges throughout a 20-year period!
3. **Start an investment account** — The time value of money is one of the greatest lessons that a child can learn. Open an investment account for a child to educate him or her about compound interest. Saving \$2,000 each year for the next 55 years will grow to over \$1,000,000 at a seven percent interest rate (ignoring taxation).
4. **Train your child to budget** — Start early as good habits can last a lifetime. If you provide an allowance, consider giving a child a larger sum of money to manage over time versus smaller amounts more frequently. Teach about saving for future purchases, trade-offs and how to make funds last over a period of time.
5. **Hire your child** — If you run your own business, consider paying your child to work for the business. If reasonable, it may be deductible for your business and your child may be able to offset these wages with the basic personal tax amount, as well as tuition, education and text book credits.

## CHALLENGING CONVENTIONAL WISDOM

# LOW RISK, HIGHER REWARD?

Modern finance has taught us to believe that with higher risk comes the prospect of higher returns. But a recent study conducted by three finance experts, including Malcolm Baker from Harvard Business School, has shown that this may not always be the case.\*

The study examined the 1,000 largest US stocks from January 1968 to December 2008 and sorted the equities by risk, defined by raw volatility (fluctuations in price over time) and beta (relative price movement versus the market). The riskiest 20 percent of all stocks (updated on a monthly basis) performed poorly versus the least risky 20 percent of stocks. A dollar invested in the

risky portfolio would have declined to less than \$0.10 after inflation over the 41-year period whereas a dollar invested in the least risky portfolio would have increased to over \$10 adjusted for inflation over the same period of time.

Investors seeking lottery-like payoffs increased the demand for high-risk stocks, pushing their prices higher than otherwise would have been. Most of the well-performing, low-risk stocks were shunned by investors for a variety of reasons, including that the companies existed in mature or slowing industries, which pushed their prices down.

Should investors have given the slower, steady stocks such a bad rap since they outperformed the riskier stocks?

If all investors invested in the least risky stocks, the prices of these equities would have risen and higher returns would likely have been eroded. As well, it is human nature to prefer lottery-like payoffs, which often only come with the most volatile, risky stocks.

What are the lessons to be learned? Although lottery-like payoffs may exist with the most risky stocks, the likely outcome is that the high-risk investor will end up losing money. History has shown that lower risk may mean higher reward!

\*Baker, Bradley and Wurler. "Understanding the Low Volatility Anomaly". Financial Analysts Journal, Vol. 67, Feb. 2011.

# IN DIFFICULT TIMES, THE CASE FOR DIVIDENDS...

## **Dividend-paying equities may provide stability and healthy returns during volatile times.**

Investors requiring income from their portfolio of assets have been challenged by recent turbulence in the financial markets. In these circumstances, dividend-paying equities may be a good addition to an investor's portfolio.

Dividend-paying firms are often larger, more mature companies that may have stable growth prospects, which can work to the investor's advantage during times of volatility. These firms are less likely to be severely affected by downturns and offer the investor income where other options may not. There may also be other advantages associated with dividend-paying companies.

## **Tax advantages**

Most eligible Canadian dividends paid are subject to a tax credit which is intended to give the investor a credit for the tax that the Canadian corporation is presumed to already have paid on earnings that are

distributed as dividends. The tax savings vary depending upon province of residence (as each province has its own dividend tax credit, in addition to the federal dividend tax credit), but can be significant in terms of providing a tax advantage to the investor.

## **Growth opportunities**

If a company's earnings increase, dividend-paying companies may increase the payout. Conservative companies will likely only increase dividend rates when they feel confident that new rates can be sustained over the coming years.

Some equities have had dividend rates increase over time resulting in extremely positive yields for the investor. This is in addition to any capital gains achieved from the growth that has supported increased dividend yields. Shares of companies with a track record of increasing dividends provide a good hedge against inflation, especially if dividend payouts are reinvested.

However, prospective buyers should be aware — sometimes a high yield may be

a sign of corporate problems. In some circumstances, a stock may have dropped in price to produce the high yield; in other cases, the company may not have sufficient cash flow in order to sustain dividend payments.

## **Portfolio inclusion**

Even those investors who have reached retirement can benefit by carrying quality dividend-paying equities in their portfolios. In today's low interest rate environment, investors looking to balance their portfolio with risk-free investments such as government treasury bills will receive miniscule interest returns. Instead, a strategy that includes providing balance with quality dividend-paying equities may be a good option.

If you are considering the addition of dividend-paying equities to your portfolio, a great place to start may be to look at companies with a strong record of past earnings, regular dividend increases and reasonable payout ratios. We would be happy to discuss this, or any other income-generating opportunities, with you.

## **Yes, we accept new clients**

Our advisory practice is built on the satisfaction of clients like you. We continue to accept new clients and would welcome your introduction to friends, business colleagues or family who could benefit from our experience and advice.

We would be grateful for any such referrals and will, of course, deal with them in the strictest confidence, as you would expect.

Whether it's a second opinion on an existing portfolio, or advice on a new situation, we're here to help.

Have them get in touch at the numbers below. Alternatively, call our office and we will follow up.

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