TD Wealth

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Straight Forward

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TD Wealth Asset Allocation Committee: Market outlook

Bruce Cooper, Chief Investment Officer, TD Asset Management and Senior Vice President, TD Bank Group

2015 was a trying year for investors, who were subjected to bouts of sharp volatility but, in many cases, only rewarded with modest (or negative) returns. The year was also marked by low growth, low yields and low returns. In anticipation of this, the TD Wealth Asset Allocation Committee ("we") adjusted its positioning early in the spring, reducing its equity overweight to neutral and increasing cash holdings in order to preserve capital and reduce portfolio volatility.

For 2016, we expect a continuation of these muted returns and episodes of increased volatility. Given high debt levels, current demographic trends and weak aggregate demand, we believe the low growth environment will persist, which will mean a continuation of accommodative central bank policies, low rates and low earnings growth. In addition, a number of potential sources of volatility exist, including emerging market risks, high debt levels and a lack of central bank flexibility. With this backdrop, we remain neutral equities and underweight fixed income. We are cautious about both emerging markets and high yield, and prefer developed markets and investment-grade bonds.

We continue to believe that the best way to navigate this challenging environment is to hold a diversified portfolio of high quality assets, including domestic and global equities that have the ability to increase their earnings and dividends in a low growth environment, an allocation to cash to provide safety of capital and investment-grade corporate bonds to provide some income and diversification. The value of diversification was highlighted in 2015 when many portfolios were supported by exposure to a strong U.S. dollar.

Equities

After generating double-digit equity returns in 2013 and 2014, Canadian equities were on track to post losses in 2015 (as at November 30, 2015) while U.S. equities began December on pace to eke out very small local currency gains. Further afield, European and Japanese equities were on target to produce solid returns.

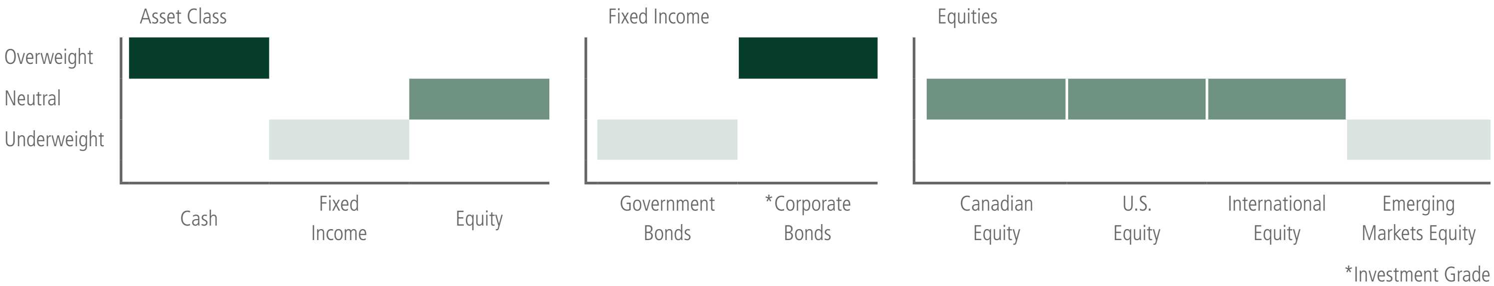
During the year, we saw earnings growth decelerate from the rapid pace of the past five years, and we expect that it will continue to be modest in 2016. The current environment is making it more challenging for companies to grow their revenues, which in turn will make it more challenging to grow earnings, particularly as extensive cost cutting has already taken place. As a result, our projection is for low- to mid-single-digit earnings growth. With modest earnings growth and valuations already approaching or at fair value, we anticipate that equity returns will also be modest.

In spite of this, we continue to prefer equities over fixed income because we expect they will outperform bonds, which we believe will produce coupon-like returns. Dividend yields remain attractive, particularly compared to bonds, and we believe dividends will be an important component of returns going forward. We continue to prefer high quality dividend paying equities that offer a stable, gradually rising stream of income.

TD Wealth Asset Allocation Committee

Market outlook (cont'd)

Asset Allocation Summary



Geographic Split

We maintain our preference for developed markets over emerging markets. Within the emerging markets, valuations are attractive; however, high debt levels, slowing economic growth and weaker commodity prices pose risks, which could be exacerbated as the U.S. Federal Reserve (Fed) begins to raise interest rates. Developed markets also have elevated debt levels, but economic fundamentals appear stronger.

Canadian equity returns were weak in 2015, due in large part to the sharp decline in energy and commodity prices as these sectors are significant components of the Canadian economy and the broad Canadian index. The effects of lower commodity prices have depressed corporate earnings and are weighing on the domestic economy. However, many companies stand to benefit from the improving U.S. economy, the lower Canadian dollar should benefit manufacturers and exporters, and a recovery in the price of oil would be a significant tailwind.

In the U.S., the strong dollar is likely to continue to be a headwind for U.S. corporate earnings, but economic growth and employment are both improving, which should allow high quality businesses to grow earnings, albeit at a more modest pace than in recent years.

While Europe still faces challenges, growth is improving, valuations are reasonably attractive and weakness in the euro should be supportive of corporate earnings growth. In addition, the European Central Bank's recently extended quantitative easing program should provide liquidity and keep rates low.

Fixed Income

Bond markets were choppy over 2015, with yields fluctuating as investors engaged in endless speculation about if and when the Fed would begin to raise rates and inflation expectations shifted up or down depending on recent economic data releases and the price of oil. Broadly, federal government bonds did well as they benefited from flights to quality, but credit markets were weak and spreads widened as profits declined and the economic growth outlook diminished. High yield in particular struggled amid energy sector weakness and liquidity concerns. In spite of widening spreads, yields remain low.

The Fed's December increase to the federal funds rate has not changed our fundamental view: we still believe we are in a long-term "lower for longer" rate environment. In this environment, we believe that the role of fixed income in a portfolio will be to provide a modest level of income and diversification benefits. We expect that bonds will provide coupon-like returns, which is why we are underweight. We prefer investment-grade corporate bonds to government bonds as they offer a yield advantage, and we are overweight cash given the likelihood of increased volatility.

High yield bonds do offer higher coupons, and spreads widened notably over 2015. However, they remain low from a historical perspective, particularly outside of the commodity sector. In addition, commodity prices remain a concern, as does the potential for limited liquidity. Therefore, we remain underweight high yield.

Canadian/Foreign Currency Exposure

The Canadian dollar weakened significantly over the year, due in large part to two Bank of Canada rate cuts and weaker commodity prices. The weaker Canadian dollar should help exporters, manufacturers and domestic consumption, and it provided a meaningful tailwind to investors who held unhedged U.S. and international investments as their returns were notably enhanced once they were repatriated into Canadian dollars. Holding U.S. dollar assets can be an important source of diversification for Canadian investors, particularly as the U.S. dollar tends to perform well in more volatile market environments.

Conversely, the U.S. dollar was strong over the year versus most other currencies, driven by its perceived safe-haven status and the Fed's monetary policies, which began to diverge from those of other central banks, most of which were increasing their accommodation. The higher U.S. dollar has had a negative impact on U.S. exports, earnings for U.S. companies with international operations, and U.S. investors with international holdings.

Given low commodity prices and weak growth in Canada, it is likely that the Canadian dollar will remain at current low levels for some time. As monetary policy in the U.S. continues to diverge from that in Canada, there is potential for further weakening of the Canadian currency. However, we maintain our neutral weighting in the Canadian dollar, believing it is close to fair value and a significant further decline is unlikely.

TD Economics

The changing seasons of the global economy

Beata Caranci, Vice President and Chief Economist, TD Economics

Few can say the world economy is uninteresting. 2015 began with a chill, with U.S. and Canadian economic growth in a deep freeze. The spring stirred up market angst over the ongoing Greek saga. Almost immediately after these concerns were put to rest, the summer brought a shift in market focus to the economic prospects of China and other emerging markets. With winter upon us, what will 2016 bring?

> The global economic expansion is expected to remain tepid at roughly 3.5%

The global economic expansion is expected to remain tepid at roughly 3.5%, with the gradual improvement among advanced economies counterbalancing continued softness within emerging market economies. China is pursuing broad structural reforms aimed at evolving the economy to one with less dependence on state-directed investment and more reliance on a market-oriented financial system. This is no small feat for a centrally planned economy of roughly 1.4 billion people. Missteps will occur as the government tries to find the right balance between the speed of growth and sustainability. China's Fifth Plenum implied an annual target of 6.5% real GDP growth over the next five years (down from 7% previously). It is likely to underperform this metric, but not by a wide margin. Chinese authorities would not find such an outcome tolerable against their objective to narrow the development gap within their borders. Any unexpected weakening in economic momentum would likely provoke monetary and fiscal stimulus to shore up growth.

For other emerging market economies, this means an ongoing adjustment to slowing growth in China and only a modest improvement in crude oil and base metal prices during the second half of 2016. Even so, weakness in emerging markets is not expected to deepen dramatically, nor stymie the expansions in the advanced nations.

The U.S. and UK economies are expected to maintain a leadership position relative to their peers. Although the euro area experienced a marked improvement in 2015, the region's expansion has not yet proven to be self-sustaining. Likewise, a stable and healthy inflation environment continues to elude Japan, despite numerous monetary and fiscal policy measures. Central banks within these two regions will remain in a bond-buying mode in 2016 to guard against the threat of deflation and soft economic growth. In contrast, the U.S. and UK will cast their attention towards raising rates, albeit in a cautious and gradual fashion.

Global monetary policy divergence will be a key financial theme in 2016. This shift in paradigm lends itself to near-term strength for the U.S. dollar and the UK pound against major currencies, before pulling back moderately over the next few years as other central banks pare back on stimulus. This also means that heightened financial market volatility may reassert itself in this brave new world. But, even for those countries raising rates, the push-and-pull forces of global financial linkages should temper the pace of increase of their longer-term yields.

How will Canada fare amidst these cross currents? Consistent with a slow uptake in economic slack and lackluster national income gains, the Bank of Canada is not expected to follow the U.S. Federal Reserve (Fed) in raising rates until mid-2017. Policy divergence raises the risk that the loonie will come under renewed downward pressure, but this is likely to be only a near-term phenomenon. Should this occur, it will help to further improve the competitiveness of the export sector, which is serving to underpin Canada's economic growth prospects amidst a household debt cycle that is long in the tooth.

Another reason the Bank of Canada will wait patiently on the sidelines until 2017 is because higher borrowing costs will likely seep into the economy on their own accord. Canadian longer-term yields move largely in step with their U.S. counterparts, with roughly an 85% correlation. This is true even in times when the Bank of Canada's monetary policy diverges with that of the Fed. So even with the central bank standing put on short-term rates, longer-term yields are likely to edge up, leading to a modest steepening in the yield curve. These forces suggest that cash will continue to return less than 1% over the next two years, while longer-term bond yields could suffer a capital loss as the curve steepens. With the expectation that commodity prices regain their footing later in 2016 and into 2017, the resource-heavy S&P/TSX Composite Index should more than make up for recent lost ground.

> Longer-term yields are likely to edge up, leading to a modest steepening in the yield curve

Putting the pieces together reveals a picture where Canada's 2016 economic fortunes are deeply tied to the external environment. Be it commodity price dynamics, financial market linkages or global demand essential for the export-led growth, it is clear that Canada is not the master of its destiny as it once was. Having said that, next year is poised for a better economic performance relative to the low bar that was set in 2015.

TD Wealth

It’s a new year: is your estate plan up-to-date?

Wealth Advisory Services, TD Wealth

With the New Year upon us, it is a perfect time to review and update your estate plan to make sure it continues to meet your personal and financial goals. This is especially important given tax changes that became effective on January 1, 2016 which may impact your existing estate plan. This article provides a brief overview of some of the issues that you should consider when reviewing your estate plan.

Have there been any changes in your life since you last reviewed your estate plan?

An upcoming marriage (yourself or perhaps a child), a birth of a child, a death in the family, or even the sale of a business would require a review or update of an estate plan. Life changes occur all the time and it is important to update your estate plan to ensure changes are accounted for. For example, a birth of a child or grandchild may require a revision of a Will to ensure the new child is accounted for in the estate plan.

Does your estate plan include a testamentary trust?

New tax legislation may impact estate plans that have testamentary trusts. Effective January 1, 2016, testamentary trusts can no longer benefit from graduated tax rates and all income retained in a testamentary trust will be taxed at the highest marginal tax rate. The new rules apply to both existing and future testamentary trusts but exclude “graduated rate estates” (GRE) and “qualified disability trusts” (QDT), which will still benefit from graduated tax rates. Although the tax advantages of testamentary trusts have generally been eliminated, a testamentary trust may still be relevant in your estate plan. If you have a testamentary trust in your estate plan, consider reviewing the plan in the context of the new rules with your estate advisor.

Do you have a life interest trust (spousal, alter-ego or joint-partner trust) in place?

New tax rules also bring significant changes to what happens upon the death of the beneficiary of a spousal, alter-ego or joint-partner trust (“life interest trust”). Effective January 1, 2016, when the surviving life interest beneficiary dies, the taxes owed on the assets and income inside the trust will be included on the terminal tax return of the deceased beneficiary. In the past, the trustees would generally use the assets of the trust to pay the tax liability.

This new tax rule may have negative income tax implications in certain situations, particularly where the income beneficiary of the trust is different than the residual beneficiaries of the trust.

For example, in a second marriage situation, it is common that the surviving spouse is the life interest beneficiary of a spousal trust, and the children from the first marriage receive the remaining capital held by the trust. Under the new rules, on death of the second spouse, the spouse’s terminal return would be liable for any taxes owed by the trust thereby reducing the residual of his/her own estate, and the children from the first marriage would receive the gross value of the assets inside the trust.

Did you make any charitable bequests in your estate plan?

Currently, charitable donations made by Will are deemed to be made immediately before death and the resulting tax credit can be used in the final tax return of the individual or carried back to the preceding year.

Effective January 1, 2016, donations made by Will are deemed to be made by the individual’s estate. The estate can carry any unused donations forward for up to five years, but cannot carry the donation back to the tax returns of the deceased person, unless the estate qualifies as a GRE (the rules are beyond the scope of this article). If you plan to make a charitable donation in your Will, you should revisit your estate plan to ensure your estate can qualify as a GRE to maximize the resulting tax credit.

Review your estate plan

Having an up-to-date estate plan can help ensure your wishes will be carried out in the manner you intended. You should speak to your estate advisor about reviewing your Will and any estates, testamentary trusts or other life interest trusts to ensure that they continue to reflect your estate planning goals.

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