

July 2017

Market Update



Important Topic: Taxation

When evaluating any investment, it is always critical to consider the **after-tax** and **after-inflation** return. This final result is what matters.

Taxation

Simply, taxation is the percentage of your investment return that goes to the government. If a bond returns 4% and taxation is 53.5% then the government takes 2.14% and you get to keep only 1.86%.

Since the rate of taxation is so important and since it is different dependent on the form of the return – interest, dividends, capital gains, return of capital – understanding the type of return you receive from an investment is critical.

Tax Rates

- Interest is taxed at the same percentage as income – 53.5% for the highest income earners in Ontario (income over \$205,000).
- Eligible dividends are taxed at roughly 3/4 of this rate – 39.3% for the highest income earners
- Capital gains are taxed at half this rate – 26.75% for the highest income earners
- Return of capital is not taxed at all when received, but lowers one's cost basis resulting in a capital gain when sold. This can therefore be described as a deferred capital gain.

The following investments, therefore, all have the same after tax return of 4.00%:

- Interest of 8.60%
- Eligible dividends of 6.60%
- Capital gains of 5.46%
- Return of Capital (sold - deferred - after 10 years) of 5.14%

Conclusion

Focusing on minimizing taxation matters. This can have a significant effect on your net worth over time and on your ability to meet your goals.

TD Wealth Private Investment Advice

5140 Yonge Street, Suite 1600
North York, Ontario M2N 6L7
T: 416 512 6689

Meir J. Rotenberg, MBA, CFA
Vice President & Investment Advisor
meir.rotenberg@td.com

Adam D. Shona, B.Comm
Assistant Investment Advisor
T: 416-512-7645
adam.shona@td.com

Nelson Gordon
Client Service Associate
T: 416-512-6813
nelson.gordon@td.com

Market Update – July 2017:

July proved to be an average month - average for the capital markets. It began with the markets continuing the decline seen in June, but then it reversed course and regained all that it lost. Much of the reversal was due to strong corporate earnings. Note that overall, positive earnings, a rise in oil and strong economic data all combined to push markets back up to its highs.

So let's take a moment to consider where we are – are markets fairly priced, cheap or expensive?

A simple indicator is the Price-Earnings (P/E) multiple. This is simply the Price of a stock divided by its Earnings per Share. For example, if a company's stock trades at \$16 and it earns \$1 per share, then the P/E = 16. Historically, the average P/E is 16. And therefore, in general, markets are cheap at 10x, inexpensive at 13x, fair at 16x, expensive at 20x and very expensive at above 24x. I say "in general" as different industries shift these goal posts depending on profitability and growth.

Currently, the overall market is trading at a P/E level of 22x – an expensive level. If the P/E ratio were to return to its average of 16x then the market would have to fall 27% (22-16/22).

However, consider the effects of earnings' increases: If earnings rise 30% to \$1.30 then a 16X P/E ratio would put the price at \$20.80 (1.3 x 16) reflecting a 5% decline from \$22. At present, earnings' growth (as measured by

the Forward P/E) is expected to grow by 30% over the next twelve months.

Conclusion

Markets are expensive but earnings are increasing and exceeding expectations. The expectation is that the P/E ratio is justified by the fast growing P. I expect earnings to increase but I do wonder if they can increase this quickly.

So let's continue being careful. Avoid the market as a whole (indices), steer clear of companies trading at the higher multiples, and focus on the undervalued prudent opportunities.

Looking forward, the economy is performing just fine by most measures, political uncertainty has increased but market volatility has decreased, and inflation remains benign. We hold our positions and continue to invest cautiously.

For the month the bond market was down 1.8%, the Canadian market was flat, and while the US market was up 2%, International markets were up 2%, the Emerging markets were up 1%, the large downward movement of the US dollar negated these returns when presented in Canadian dollars.

Have a great month and let us know if there is anything we can do for you,
Meir



The information contained herein has been provided by Meir Rotenberg, Vice President and Investment Advisor and is for informational purposes only. The information has been drawn from sources believed to be reliable. Where statements are based in whole or in part on information provided by third parties, they are not guaranteed to be accurate or complete. The information does not provide financial, legal, tax, or investment advice. Particular investment, trading, or tax strategies should be evaluated relative to each individual's objectives and risk tolerance. TD Wealth Private Investment Advice, The Toronto-Dominion Bank and its affiliates and related entities are not liable for any errors or omissions in the information or for any loss or damage suffered. Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS. TD Wealth Private Investment Advice is a division of TD Waterhouse Canada Inc., a subsidiary of The Toronto-Dominion Bank. TD Waterhouse Canada Inc. – Member of the Canadian Investor Protection Fund. All trademarks are the property of their respective owners. © The TD logo and other trade-marks are the property of The Toronto-Dominion Bank. The attached report is not an official record of your account, your account statements, tax slips, and other records should be used for tax purposes. For specific tax inquiries, please contact your tax specialist or accountant. Performance figures are calculated on a money-weighted basis, net of fees and include accrued income. Security values include transactions that have not settled as of the report date (if applicable). The attached report doesn't account for accrued interest or dividends. Transaction amounts in other currencies have been converted to the currency of the report. For information regarding the exchange rates used, please contact your representative. The book value shown for your holdings has been calculated to the best of our ability based on the information available to us, unless provided by you or your agent, and we do not guarantee its accuracy. For certain securities positions, market value has been reported as the book value of some or all of the position and may not reflect the actual book value. Please refer to your official account statements. N/D means that all or a portion of the market value of the security position cannot be determined. The total market value provided for your portfolio excludes security positions whose market value is "N/D". Market value has been determined in accordance with our valuation policy. This report has been provided by TD Wealth Private Investment Advice and is for illustrative purposes only. While we believe the information to be reliable, we cannot guarantee its accuracy and completeness. TD Wealth Private Investment Advice is not liable for any errors or omissions contained in this report and the use of any information contained in this report is entirely at the discretion of the recipient. TD Wealth Private Investment Advice is a division of TD Waterhouse Canada Inc., a subsidiary of The Toronto-Dominion Bank. TD Waterhouse Canada Inc. - Member of the Canadian Investor Protection Fund. All trademarks are the property of their respective owners. ©The TD logo and other trade-marks are the property of The Toronto-Dominion Bank.