TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

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Volatility: The Norm

While equity market volatility is not new, the historically low levels we experienced in 2017 may have lulled many investors into thinking that this was the norm. As a result, recent market volatility has been met with some surprise. Yet, since 1970, almost 60 percent of the annual returns of the S&P/TSX Composite Index have been year-over-year changes — either gains or losses — of greater than 10 percent. Almost 30 percent of the annual returns have been year-over-year changes of greater than 20 percent.[1] Simply put, larger swings in volatility play a common role in the equity markets.

While it may be uncomfortable, volatility in the stock market may deliver the opportunity to achieve the higher returns that investors seek within their investment portfolios. It can be difficult to find another asset class that has helped to provide many investors the prospect of achieving such returns over time as equities. Even with the swings noted above, the S&P/TSX Composite Index has had an annualized return of almost 6 percent since 1970,[2] and this doesn't include the positive impact of dividends.

Those of us who follow the markets on a regular basis have seen how quickly the focus of many market commentators can shift with equity market movements. After a volatile December for both Canadian and U.S. markets, the media was consumed with recessionary talk. This was quickly muted after significant January and February gains. In the U.S., the Federal Reserve took a less aggressive stance in its monetary policy, downplaying its position on the prospect of further interest rate rises. This, combined with solid U.S. earnings reports, as well as a delayed tariff deadline in U.S./China trade talks, provided much relief to investors for the starting months of the year.

Here at home, the picture is less clear. Growth has slowed. The struggle continues for certain segments of the housing market and the oil and gas sector. Although corporate earnings results have been mixed, the labour market is still solid, and cash levels on many corporate balance sheets remain healthy. While certain voices of the media continue their pessimistic narrative, many investors are wondering where the markets are headed.

During these times, it is important to keep perspective. Markets are volatile and cyclical by nature. There is no denying that volatility can cause discomfort, especially when we may see portfolio values under attack. Yet, time can be one of an investor's greatest allies. Portfolio gains do not happen at a steady rate, and in order to participate in the equity markets, we must accept that volatility in the equity markets is, in fact, the norm.

1. S&P/TSX Composite Index annual returns at year end, 31/12/1970 to 31/1/2018; 2. S&P/TSX Composite Index annualized return from 31/12/1970 to 31/1/2018.

In This Issue

Planning Ahead for Retirement

Government Benefits: OAS Timing Considerations

Part of your retirement planning should include considering the timing of various income streams, such as government benefits including Old Age Security (OAS). The timing decision will depend on each individual's particular situation, including current and future income sources, life expectancy and envisioned retirement, among others. But, here are some reasons why it may make sense to start OAS benefits as soon as possible.

Consider the Benefit of Delaying Other Income Streams — The OAS pension can start at age 65. Unlike the Canada Pension Plan (CPP), you cannot start benefits early; however, you can delay until age 70 to increase the benefit by 0.6 percent for each delayed month (for a maximum enhancement of 36 percent). While the payout is larger if you delay, most people struggle with the unknown: will you live long enough to make the deferral worthwhile? Some who decide not to delay OAS benefits consider it a hedge if they defer CPP benefits. This is because the additional benefit from delaying OAS is often less than delaying CPP: The maximum monthly OAS payment is $601.45 (Q1 2019), leading to a maximum difference by delaying OAS of about $216/mo. This compares to the maximum monthly CPP payment of $1,154.58 (2019), or a maximum difference by delaying of about $485/mo.

Remember the Clawback — Unlike the CPP, the OAS is clawed back at a rate of 15 percent if net annual income is greater than

$77,580 (2019) and fully eliminated when net income reaches $125,696. As such, it may make sense to begin OAS at age 65, in the six-year window before mandatory withdrawals of the registered Retirement Income Fund (RIF) start at age 71.

What if Circumstances Change? If you encounter a shortened life span, Service Canada may allow for retroactive payment of OAS. An individual who is above the age of 65 and has not yet applied for OAS may request an earlier effective OAS start date. Generally, retroactive payments will be available for up to 12 months preceding the application date, except in the case where a person was incapable of making the application. In the event of death, an estate/survivor can apply for an OAS pension that the individual was entitled to prior to date of death, if such OAS payments have not been made. OAS payments for all individuals stop at death.

As you plan for the timing of your various income streams, remember that we are here to provide assistance.

Tax Season Considerations

Pension Income-Splitting *Can* Make a Difference

Individuals have the opportunity to split eligible pension income with a spouse/common-law partner, which may reduce family taxes and minimize the loss of income-tested tax credits and benefits. But just how much of an impact can this make?

For tax purposes, up to 50 percent of eligible pension income can be split with a spouse. Eligible pension income is determined by the age of the recipient and the nature of income. In general, for those under age 65, it includes amounts received from a registered pension plan. For those over age 65, it also includes amounts received from a registered Retirement Income Fund, Locked-in Retirement Income Fund, or other annuity payments. In Quebec, a recipient must be at least 65 to split pension income.

While the obvious benefit of pension income-splitting can be the tax benefit that may potentially be achieved by allocating income from a spouse in a high-income tax bracket to one in a lower tax bracket, there are other potential advantages:

Age Amount Tax Credit — The 2018 federal age amount is $7,333, available to those 65 years or older. It is reduced for income over $36,976 and eliminated at $85,863. In certain circumstances, a benefit may be achieved if a spouse can reduce income to access the credit. However, income-splitting may increase the other spouse's income and potentially reduce their access to the credit.

Pension Income Amount — This provides a tax credit on up to $2,000 of eligible pension income. Allocating pension income to a spouse who otherwise wouldn't have eligible pension income could entitle the spouse to claim this credit.

Old Age Security — Splitting eligible pension income may enhance the family unit's ability to receive OAS payments.

The chart below shows two scenarios for two spouses over age 65. Spouse A earns $86,000 of eligible pension income and Spouse B earns none. When they income split, they use lower tax brackets, enhance tax credits and avoid an OAS clawback for Spouse A. As always, consult with a tax advisor for your particular situation.

	No Splitting		Income Splitting	
	Spouse A	Spouse B	Spouse A	Spouse B
Eligible Pension Income	86,000		43,000	43,000
Interest Income		12,000		12,000
CPP	13,610		13,610	
OAS	7,040	7,040	7,040	7,040
Taxes Payable	-25,834	0	-11,923	-11,397
OAS Clawback	-4,611			
After Tax Income	76,205	19,040	51,727	50,643
Difference			**7,125**	

FOR ILLUSTRATIVE PURPOSES ONLY. Note: Example uses estimated 2018 federal and Ontario tax rates. Assumes maximum amount received for CPP benefits in 2018 and applies annualized Jan. 2018 OAS figures.

Effective Estate Planning

Don’t Overlook the Importance of Beneficiary Designations

The importance of planning and updating beneficiary designations can easily be overlooked. When accounts are opened, sometimes beneficiary designations may be completed without much forethought. As the years go by, it isn’t uncommon to forget who was named as the beneficiary of these accounts.

In most provinces, registered accounts, life insurance policies and certain assets allow you to name beneficiaries directly. Quebec is an exception — designations for registered accounts must be made in a will; however, life insurance policies allow for beneficiaries to be named directly. If many years have passed since you named certain beneficiaries, perhaps a review is in order. Here are some considerations that may lead you to revisit designations or form a basis for discussion with a lawyer for your estate planning.

1. Failing to name a beneficiary — If you have not named a beneficiary, assets will pass through the estate upon death. These assets will be probated and could be subject to potentially avoidable tax consequences in provinces where probate (estate administration) tax is applicable. As well, if assets pass through the estate, these assets may not be protected from creditors if there are claims against the estate.*

2. Directly naming a minor — In certain jurisdictions, if the proceeds are not directed to a trust set up for a minor, the courts may decide who will manage them.

3. Directly naming a beneficiary with a mental disability who is not contractually competent — If a trust has not been named for their benefit, the court may appoint someone to make decisions on their behalf.** This could lead to potential delays or additional costs. As well, directly naming the beneficiary may unintentionally disqualify them from receiving government benefits.

4. Overlooking the impact of taxes when equalizing an estate for multiple beneficiaries — If you intend on equalizing your estate for multiple beneficiaries, do not forget the impact of taxes. When certain assets do not pass through an estate, it may be difficult to accurately equalize amounts for different beneficiaries. For example, suppose you have two grown children as your heirs and you designate child #1 as the beneficiary of your RSP, leaving the rest of the estate to child #2. When you die, the entire amount will be included in your final year’s income while the account itself will be transferred to child #1. However, any taxes due in respect of the RSP would likely be payable by the estate, potentially reducing the amount intended for child #2.

5. Not updating beneficiaries — With every major life change, there may be a need to update beneficiaries. If an intended beneficiary is no longer alive, proceeds will likely pass through the estate. To avoid this, naming a contingent or secondary beneficiary may be useful.

6. Using non-specific designations — If you use non-specific designations, such as ”my children”, there may be uncertainty regarding intent. For instance, in a blended family, children of a new spouse may be unintentionally included. Or, if a child predeceases you, that child’s share may go to your other children and not that child’s family, which may not be what is intended.

*Note: In certain provinces, plan proceeds that may form part of the estate may be available to creditors of the estate. **Should a guardian for property not be in place.

China in the News: A Rapid Economic Ascent

There is good reason why China has been dominating the global news more recently, from trade tensions with the U.S. to the Huawei scandal. The country is well on its way to being the world’s dominant economy. It ranks second when measured by nominal GDP, and is the largest when measured in purchasing power parity terms. It is the largest exporter in the world. While China’s strides in its rapid economic ascent may be difficult to conceptualize as a Canadian watching from afar, here are several facts to provide some perspective:

- Just 30 years ago, 66 percent of China was living in poverty; today that number is less than one percent. In fact, China accounted for more than 75 percent of global poverty reduction between 1990 and 2005.[1]
- China currently has a population of over 1.4 billion people. By 2025, it is expected that China will have more than 200 cities with a population of over 1 million people. Today, there are only around 560 cities globally with this population mass.[2]
- China’s impressive infrastructure continues to connect people and move goods quickly and efficiently, increasing productivity and supporting economic growth. Its rail network is expected to span 175,000 km by 2025. Canada has only 78,000 km of rail, despite having a landmass of similar size. The world’s fastest train, China’s Shanghai Maglev, travels at speeds of up to 267 mph. Canadian passenger trains travel at speeds of up to around 90 to 100 mph.[3]
- China is on its way to being one of the first countries to deploy a 5G network, which can dramatically change our interconnectivity. 5G is expected to be around 100 times faster than a 4G network: it may enable an entire HD film to be downloaded in less than 10 seconds![4]
- In 2018, China’s GDP growth slowed to around 6.6 percent, its lowest in 28 years. The last time Canada’s GDP growth exceeded 6 percent was in 1973, when GDP growth was 6.3 percent.[5]

Sources: 1. povertydata.worldbank.org/poverty/country/CHN; 2. McKinsey: Preparing for China’s Urban Billion; citypopulation.de; 3. cntraveler.com/stories/2016-05-18/the-10-fastest-trains-in-the-world; en.wikipedia.org/wiki/High-speed_rail_in_Canada; 4. cnn.com/2019/02/25/tech/what-is-5g/index.html; 5. worldbank.org/en/country/china/; worldbank.org/en/country/canada/

Navigating the Passive Income Rules: IPPs for Retirement

With the changes to passive income rules* now in effect for small businesses, business owners may be looking for ways to efficiently invest the income earned in their corporation. While the Individual Pension Plan (IPP) has been around since 1991, there has been renewed interest in the plan as business owners look to direct money away from their corporation's accounts. Instead of keeping retained earnings in the company subject to the new rules, contributing funds to an IPP may help to increase retirement savings on a tax-deferred basis outside of the corporation.

What is an IPP?

An IPP is a defined-benefit pension plan that is registered with the Canada Revenue Agency (CRA). It behaves similarly to a registered Retirement Savings Plan (RSP) in that contributions are made to the plan and can grow on a tax-deferred basis for retirement. However, contributions are actuarially set to provide the maximum pension allowed per year of service. As such, contribution limits typically increase with years of service and for individuals over the age of 40, the IPP contribution limit is usually greater than that of an RSP.

Advantages

In addition to potentially higher contribution limits, the IPP can guarantee a certain level of retirement income for the account holder since it acts as a defined benefit pension plan. This is because the annual returns of the IPP are prescribed at a particular rate (currently a rate of return of 7.5 percent, under the Income Tax Act), unlike the RSP which depends on market performance. If annual returns generated by investments held in the IPP do not meet this level, additional tax-deductible funding can be made by the corporation to ensure the benefits will be paid (note that this is mandatory in some provinces). In good years (when performance exceeds the prescribed rate), the corporation can take a contribution holiday.

In certain provinces, funds held within the IPP may be protected from creditors. As well, payments from the IPP may be eligible pension amounts for income splitting.

Disadvantages

There are a variety of costs associated with the IPP, including for set up and maintenance, as well as annual government filings and actuarial reports (required every few years). However, unlike the costs associated with managing an RSP, these costs, as well as the annual investment management fees, are generally deductible to the corporation.

Seek Professional Advice

An IPP may provide an opportunity for incorporated business owners to improve retirement savings, while also helping the corporation to navigate the recent changes in passive income rules. However, this is not a simple tax-planning exercise. Should you have an interest, please get in touch to discuss how an IPP may benefit your particular situation.

*Note: Measures have been introduced that focus on a business owner's ability to earn passive income within a corporate structure by limiting the company's capacity to claim the $500,000 small business deduction (SBD). If you have questions, please contact us to discuss.

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