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KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 7, ISSUE 4 APRIL 2018

"I will tell you how to become rich. Close the doors. Be fearful when others are greedy. Be greedy when others are fearful." – Warren Buffett

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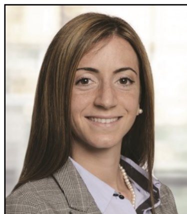
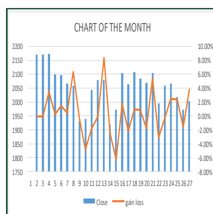
Sergio Simone
EDITORIAL COMMENT



Kristina de Souza
PENSION EXIT STRATEGIES



MOST VOLATILE YEAR SINCE 2009

Ryan Simone
SELLING THE COTTAGE TO A CHILD -TAX IMPLICATIONS

Editorial Comment

Sergio Simone

In earlier newsletters I have written that we should expect a more volatile 2018, but I never anticipated this type of volatility. I haven't seen this kind of movement since the financial crisis in 2008/09. It is more staggering when we put it into context with last year which was historically one of the least volatile markets we've experienced in more than 50 years.

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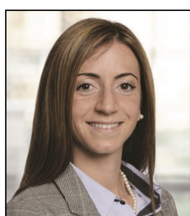
Pension Exit Strategies



Kristina de Souza

In past years when an individual changed employers, it was a fairly standard practice to leave their defined benefit pension plan with the original employer, knowing that a pension would be received in retirement. In light of the not-so-distant economic downturn, many pensions are either being discontinued, or may not have ample funding available to pay out all of the pension benefits that were promised.

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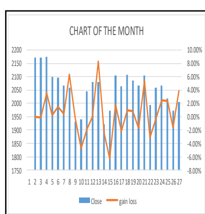
Most Volatile Year Since 2009



After a very docile 2017, investors were expecting and preparing for a more volatile 2018, but the severity of the swings has us scratching our heads. The last time we experienced these vast, daily swings was during the financial crisis in 2008/09. The impact has been enhanced by last year's vapid volatility that has not been seen since the 1960's.

Continue Reading

Selling The Cottage To A Child: Tax Implications

Ryan Simone

Toronto has had a brutal winter this year but it seems Spring may be upon us. For many people this means its time to start thinking about the cottage again. For a few of these people it may mean it's time to start thinking about a change in ownership.

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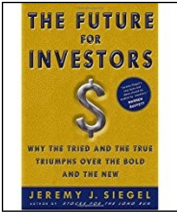
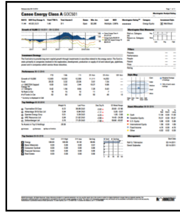


BOOK OF THE MONTH

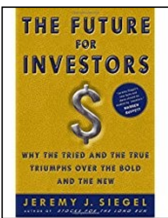


FUND OF THE MONTH FIDELITY GLOBAL CON-CONCENTRATED EQUITY FUND

INVESTMENT TERMINOLOGY

DOES THE BEAR ENTER OUR LIVES IN 2018?

Book of the Month

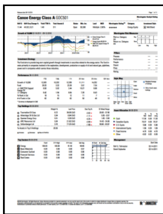


The Future For Investors

By Jeremy J. Siegel

The new paradigm for investing and building wealth in the twenty-first century. The book reveals new strategies that take advantage of the dramatic changes and opportunities that will appear in world markets. The faster the world changes, the more important it is for investors to heed the lessons of the past.

Fund of the Month—Fidelity Global Concentrated Equity Fund



This fund is ideal for investors seeking a concentrated U.S. equity portfolio focused on large-cap growth companies like Adobe Systems, Microsoft and Humana. It seeks to capitalize on investment opportunities in the world's largest and most diversified market. The fund aims to invest in companies that are expected to grow over the long term and that are trading at a reasonable price.

Investment Terminology

Event Risk

An event risk is the possibility that a unforeseen event will negatively affect a company, industry or security. It can be defined as the risk associated with a changing portfolio value due to large swings in market prices. It is also referred to as "jump risk." These are extreme portfolio risks due to substantial changes in overall market prices. Activity of this nature was seen during the global financial crisis of 2008.

Companies also face event risk from the possibility that the CEO could die suddenly, a key product could be recalled, the company could come under investigation for suspect wrongdoing, the price of a key input cold suddenly increase substantially.

Glen Brown, Vice President and Managing Director—Manulife Private Wealth

PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

DOES THE BEAR ENTER OUR LIVES IN 2018

The first quarter of 2018 was certainly an interesting one; from the largest daily losses by points in the history of the Dow, to a market rebound later that month. It felt like an amusement park ride at times.

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Markets: April 2018

Following February's market gyrations, which saw inflation fears exacerbated by the unwinding of ill-fated short-volatility

Both Sides Would Lose a U.S.—China Trade War

As a businessman, I have been encouraged by the U.S. administration's pro-business policies

Fed In March Discussed 'Slightly Steeper' Future Rate Hikes

Federal Reserve officials signaled rising confidence last

Inflation Paradigm Shift May Be Underway

We've been living in a disinflationary environment for the last 30 years and, overall, this has

Blackrock Global Investment Outlook Q2 2018

We see the overall environment as positive for risk assets, but expect more muted returns and

Scotiabank's Global Outlook

Global momentum remains strong, but US trade policy is generating much uncertainty.

Firms Still Positive About Future: BoC Survey

Canadian firms remain upbeat about future sales, business investment and hiring even as the country faces stubborn

Bitcoin Joins Binary Options in Scam Warning

One old scam is making the rounds and anew one has surfaced. The Investment Industry

2018: When 400-point Stock Swings Became Normal

Volatility was essentially absent throughout 2017—the calmest

IMF Predicts Stronger Growth But Warns Of Risks

The IMF has forecast that 2018 will be he strongest year for

WTO Warns Over Tit-For-Tat Trade Wars

Global trade has seen its most rapid growth in six years, says the World Trade Organization's

Bank of Canada Maintains Overnight Rate Target At 1.25%

The Bank of Canada maintained its target for the overnight rate at

Investec—Market Commentary March 2018

The first quarter of 2018 can be succinctly described as one during which we witnessed the return of volatility to financial markets. Following a record breaking period of calm during 2017 when equity investors, in particular, enjoyed strong gains, there was much expectation that a return to more volatile markets was overdue, but that still didn't' prevent the change in conditions from taking many by surprise. Adding to the new sense of uncertainty was the fact that investors had several different factors to consider during the quarter, none of which appear to have been resolved at the time of writing this review. In order of appearance, as it were, they were an inflation scare, potential trade wars and a fall from grace of certain mega-cap technology companies.

VIDEO LINKS

Jack Bogle Says He Hasn't Seen A Market This Volatile In His 66 Year Career

Vanguard founder and former

A Rising Dollar Is Among The 'Biggest Threats' To The Global Economy

A trade showdown between the U.S. and China is widely

Bank of Canada Keeps Key Interest Rate Steady At 1.25%

The Bank of Canada is maintaining its trend-setting interest

Transcript of the Press Conference on the Release of the April 2018 Economic Outlook

April 2018

The world economy continues to show broad-based momentum. Against that positive backdrop, the prospect of a similarly broad-based conflict over trade presents a jarring picture.

Three months ago, we updated our global forecast for this

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EDITORIAL COMMENT CONTINUED

Watching the stock market in 2017 became somewhat dull as we yawned through one new record after another. Not so this year!

We are being bombarded with almost daily catalysts causing the massive movements we are experiencing this month. If it isn't Donald Trump taunting the Russians by hinting at a missile strike on Syria, then it is Trump sparring with the Chinese on trade tariffs. In the first two weeks of April we have experienced two percent daily moves on nearly half the days.

What is strange for me is that I don't see this causing a market meltdown, instead I see it as emotional reactions to various stimuli. Corporate earnings are still expanding amidst the mess. I expect to see double digit first quarter announcements over the next few weeks. Also, the global economy is still strong and getting stronger and it is being led by earnings.

Although indices like the S&P 500 which is down around 7.5% from its 52-week high, I do not anticipate a bear market and therefore these brief market declines are buying opportunities. Although past performance is and should not be a guarantee of future results, April has been the best-performing month for the S&P 500 in the past 20 years, delivering average monthly returns of 1.8%.

By the time you are reading this commentary, companies will begin releasing their Q1 results and based on analysts' projections, companies in the S&P 500 could be reporting earnings which are expected to be more than 17% greater than those reported three months ago. If this comes to pass, we will see the highest rate of earnings growth since 2011. As the year progresses, we should expect to see economic growth from the stimulative effects of tax reform and the recently passed congressional spending deal.

Unfortunately, in the background we must deal with the unexpected consequences of President Donald Trump. Will he instigate a trade war? Will he create another cold war with Russia? Will inflation move higher and put pressure on bond yields and interest rate increases?

I know it seems there is too much news to follow these days, but I feel that investors, or those looking after their portfolios are spending too much time trying to analyze these news reports and react to them immediately. It becomes a vicious circle. First a negative article is published, then investors sell their positions, this triggers electronic selling and at the end of it all the markets drop more than the news warranted and in most cases the news byte turns out to be insignificant causing investors to lose on their trades.

All this brouhaha in the news should not concern long-term investors, instead these long-term investors should take a step back and look at these movements as part of the big picture. If they do, they will see enormous buying opportunities. Many of the mutual fund managers we deal with have been increasing their cash positions in recent months, so they can take advantage of these situations. In a year or so, we will likely look back and marvel at the returns created during a time when most investors were too scared or too nervous to commit to their long-term outlooks.

For years I have been stressing the value of owning dividend paying mutual funds. If you do own these, then you should focus on the payouts rather than on the crazy market movements. Good companies will pay dividends during both boom times and recessions. According to research done by professor Jeremy Siegel in his book "The Future For Investors", dividends have historically made up about 50% of stock returns in US markets. So, stay calm even if the market becomes volatile or negative for a year. Just focus on your dividends and growth rates of those dividends.

Q1 has made for a very turbulent stock market, but long-term investors shouldn't stress about short-term events. Trying to time the markets is a loser's game. It is difficult even for the most experienced professionals.

The outlook still looks very positive for U.S. markets and interestingly, the recent bout of market volatility has not changed the bullish sentiment of most investors.

Continue Reading

EDITORIAL COMMENT CONTINUED

Investing when stock prices are fluctuating this much can be very intimidating, but this shouldn't dissuade investors from participating in what has proven to be, and what many expect will continue to be a tremendous long-term market. We can expect to continue to see extreme volatility for a while, so it is important that investors ensure their investments are diversified across a variety of assets and asset classes and develop a discipline of investing regularly. Take advantage of the market dips and you will be rewarded in the long-term. Do not lose sight of the fact that today's current market price has very little to do with your long-term returns.

Continue Reading

Pension Exit Strategies—CONTINUED

Thus, many employees who are given the choice to commute or keep their existing pension are giving serious thought to commuting the pension. There are pros and cons to each alternative and therefore there is no one size fits all solution. Rather, the best decision will be based on the plan features and individual circumstances among other factors. There are several considerations one should take before making such a decision; so let's start with the basics and go from there.

As mentioned, when leaving an employer or entering retirement, one of the major decisions you're faced with is whether to leave the pension in place, or remove your funds from the plan and deal with the assets on your own. In other words; one must choose guaranteed monthly payments for life, or an immediate lump sum instead. This applies particularly to those who have a defined benefit pension plan. Over time we have watched life expectancies climb year over year, and the value of having a defined benefit pension plan has increased. This factor in combination with low interest rates has ultimately contributed to a decline in the overall "health" of defined benefit plans. Recently, the Canadian media has reported on the underfunded status of defined benefit plans for large employers such as Canada Post. Similarly, we can all recall dismal cases involving the uncertain status of pension payments for plans where the employer has gone bankrupt, such as Nortel and Sears. Therefore, employees with defined benefit pension plans may be weighing the benefit of a large lump sum available today versus a stream of payments that comes with the very real risk of falling short of the promised amount.

Again, one of the first steps in retirement planning is deciphering what the options are with respect to taking or leaving a defined benefit pension plan. Your options at retirement will be provided by the pension administrator. As previously mentioned, one of the options that may be offered is to take the funds out as a single lump sum amount, and this amount is known as the "commuted value". The commuted value represents the amount today required to fulfill the pension's future monthly payment obligations to the payee. This value is based on several assumptions; including life expectancy, gender, whether one takes early or normal retirement, anticipated long-term interest and inflation rates, and then of course the specific features of the pension plan, including whether it would pay a survivor pension to a spouse if the member predeceases them.

Generally speaking there are typically two ways to take your funds out of the pension plan; either retirement or terminating your employment. However, even in these circumstances, the lump sum commuted value is not always available. The theory is that the commuted value of your plan (should you leave) is equal to the expected value you'd receive if you stay; thus one should have no financial preference between the two options. However, the reality is that the choice is rarely that simple.

If facing this decision, there are several key issues to consider. The first step to confirm whether or not a plan allows you to take the commuted value, and then to decide whether or not to take it.

Perhaps one of the biggest considerations of commuting a pension is the associated tax implications. Specifically, when taking the commuted value of a pension in one lump sum, the amount typically exceeds the annual amounts that can be transferred to tax sheltered vehicles such as RRSPs; resulting in any excess amounts qualifying as taxable income. Particularly when plans have generous benefits, commuted values can lead to hefty tax bills, especially given that many jurisdictions have top marginal tax rates in excess of 50%. However, some of the benefits when opting for the lump sum include but are not limited to: control over the investment assets, flexibility to begin payments at your own leisure (aside from any locking in provisions of course), and very important is the potential for the remaining assets to become part of the plan members' estate upon their death.

Conversely, the benefits affiliated with remaining in a pension plan are as follows: guaranteed payments for the balance of the plan members' life, potential for spousal benefits, and the ability to opt for pension income splitting when appropriate. Given the state of the economy; pension plan funding has been referred to as somewhat of a wild card; the risk that the promised benefits will not be available come time for cashing in. The risk is real; we've seen it happen. Of course on the flip side there is the possibility of investment risk and ensuring that the assets are well managed once the funds are withdrawn.

There is also a third option that some feel provides a valid solution; which is similar to taking an annuity. The income tax act allows pension plan members to transfer their entitlement to an annuity type product offered by life insurance companies. If a pension plan approves of this, a member can create a pension type stream of retirement income while locking in the present value of a plans' benefits; which of course is interest rate sensitive and is reliant on the funded status of the plan. This option also eliminates the tax liability that would normally come with taking the commuted value in cash. The reason is that when funds are directly transferred to this type of annuity, the benefit is not included in one's annual taxable income.

Pension Exit Strategies—CONTINUED

In order for this to be allowed under the pension plans' regulations, the rights under the annuity contract must be similar to the rights under the pension plan. Again, this route ensures a monthly income in retirement and avoids the risk (and possible benefits) of having the funds invested in the market, while eliminating longevity risk. This option can be somewhat complicated to ensure it is done properly and is therefore not a very well-known path; which leads to my next point of the importance of sound financial advice.

I have given somewhat of a simplified explanation of the various scenarios surrounding pension plans. Most plans are unique, complex, and pension administrators rarely provide unbiased, detailed explanations of the options available. Given the demographic trend we are facing where the baby boomers are reaching retirement, we are seeing a surge in pension related cases. I've touched on a few of the reasons why seeking independent advice is essential, however, the key take away is that an independent financial advisor can provide a detailed comparison of all options as well as all pros and cons of taking a lump sum vs. remaining in your specific plan.

The Most Volatile Year Since 2009 - CONTINUED

The S&P 500 has moved at least one percent at least once every two and a half days this year. If we extrapolate this volatility until the end of the year, we will be seeing similar moves to those of 2009.

So the big question is why the abnormally high volatility?

In part it can be attributed to the trade war threats and an assault on the tech industry. Over a 13 day run, these were responsible for market swings of at least two percent per day, nearly half the time.

I believe investors are a little confused at the information overload. They are selling on news releases relating to these trade wars and tech stock attacks, but then, jump back in when they read about expanding earnings. The last time we saw this these huge swings we were in the midst of an earnings recession. Not so today. Now we have earnings that are increasing almost 20% in the first quarter of the year. The global economy is still riding a surging tide and remains strong led by earnings.

According to LPL Financial’s Ryan Detrick, “historical moves and the fundamental picture do support a higher breakout for the stock market after a period of these lows.” He continued to add: “We don’t anticipate at all a bear market. We think these dips could be buying opportunities led by small caps and value.”

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Selling the Cottage to a Child: Tax Implications —Continued.

Cottages tend to stay within families, often being passed down from generation to generation, which is why it is important to understand the tax implications. Unfortunately, it's not as simple as passing the keys over and letting a lawyer know about the new owners. Instead, children have to purchase the property from their parents.

If Canada Revenue Agency could repeat only two things for the rest of eternity it would be this: 'all transactions occur at fair market value and we want our cut of the money'. Two very simple concepts with big implications for passing the cottage down to adult children.

For many young adults affording the fair market value of the family cottage may not be possible, especially given the trend of real estate over the last few years. Common sense would dictate that a reasonable parent might offer the cottage for a price affordable to his or her child. The problem is this will also lead to double taxation. Here's why.

Regardless of who buys the cottage, the sellers will have to pay capital gains on the sale of the property. The capital gains amount for the seller is always calculated as the difference between the property's adjusted cost base and fair market value. Keep in mind, in the eyes of CRA, the child that buys the cottage will have an ACB equal to whatever the purchase price is.

Assume a couple owns a cottage with a FMV of $1,000,000 and an ACB of $500,000 (the ACB is what the couple paid for it). The parent's sell the cottage to their child for $1. Remember the CRA says all transactions happen at fair market value, so the parents will have a capital gain of $500,000 (the difference between the ACB and FMV).

Impact of Cottage Sale to Parents	Values for Parents
Fair Market Value (FMV)	$1,000,000
Adjusted Cost Base (ACB)	$500,000
Capital Gain	$500,000
Taxable capital gain	$250,000
Capital gains tax payable at top personal	$133,825

The child who pays $1 for the cottage will have an ACB of $1. Now, you're probably reading this and thinking: hey Ryan, didn't you just explain that the CRA says all transactions (i.e. purchases) happen at fair market value? Shouldn't the child's ACB be the fair market value of $1 million since the CRA says all purchases happen at FMV? I did write that; and I also wrote that the CRA always wants their cut. In this case the CRA's share of the transaction will ultimately be twice as much when the child disposes (sells) the cottage they purchased for $1. For example, assume the child decides to sell the cottage which has since appreciated in value to $2 million.

Impact of Cottage Purchase to Child	Value for Child
FMV	$2,000,000
ACB	$1
Capital Gain	$1,999,999
Taxable capital gain	$999,999.50
Capital gains tax payable at top personal	$535,390

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Selling the Cottage to a Child: Tax Implications —Continued.

The child will ultimately pay a significant sum of over half a million dollars in capital gains. Alternatively, if the property had originally been purchased at FMV, the child's taxable outcome would be the following:

Impact of Cottage Purchase to Child	Value for Child
FMV	$2,000,000
ACB	$1,000,000
Capital Gain	$1,000,000
Taxable capital gain	$500,000
Capital gains tax payable at top personal	$133,825

That's a difference of $401,565 meaning the child who paid $1 for the cottage will ultimately pay $400,000 more in taxes than the child who pays FMV.

Now you might be thinking: 'if the CRA says all transactions have to happen at FMV, why are parents allowed to sell property to their kids for $1? I think the answer to that question is in the idea that the CRA likes to get paid and they won't complain about receiving a few hundred-thousand dollars extra.

There are solutions that will mitigate the tax effects on the parents and/or the children. If you find yourself faced with this situation, please call our office and we will discuss your options.

Does the Bear Enter Our Lives in 2018? —Continued.

Recent American policy on trade has led to a level of volatility not seen in a long time, and have many questioning whether we are due for a major correction. While no one enjoys volatility for its own sake, the role of an active investment manager is to garner opportunities from solid company fundamentals that will be rewarded regardless of political noise.

History has demonstrated time and again in the investment industry, that acting in a vacuum of real information and data often leads to poor outcomes. This is precisely why the average retail investor often underperforms both industry benchmarks and institutional investment managers.

Studies have shown that the average investor is twice as sensitive to losses as they are to gains. Human behavior is such that when you experience market volatility and losses, the tendency is to act rapidly, which thereby crystalizes the loss. It has been found that frequent portfolio evaluation, when combined with a higher sensitivity to losses can leave many investors emotionally drained and with underperforming investment portfolios.

Small investors also tend to enter the market as securities are rising rapidly, which leads to buying near the top. The role of a manager and investment counsellors is to ensure that one does not become their own worst enemy in trying to time the market. While no one should believe a bull market can run forever and as we are in the 9th year of this bull market, we are definitely closer to the end than the beginning in our opinion.

People have been calling the end of this bull market for the last 2 years and those who pulled their money out would be fuming on the sidelines as they watched the markets climb another ~25%. Building a structured portfolio and investment strategy that can endure volatility, is how you can model your portfolio to align with your long-term goals.

When the Brexit referendum vote result was announced, the market reaction was dramatic but quickly stabilized over the following days in the absence of any real changes. Too often investors trade based on conjecture rather than waiting for true facts. We have seen the similar events unfold this quarter first with the NAFTA negotiations, and more recently with the US/China trade squabble. In the absence of real data, making a leap out of investment accounts is really a leap of faith or gamble.

This is a great time to take a long look at your financial goals to ensure that they are unchanged and that the timelines remain the same. If something has changed, work with your investment counselor to update your investment policy statement and adapt your portfolio to match your goals.

There are opportunities in all markets be they up or down, bull or bear. It is the diversification of a portfolio that helps assist with down side protection and overall return. Perhaps the most important activity one can do is ensure you are watching the longer-term gain, while ignoring the short-term fluctuations.

So while the bull may be getting tired, there is no need to flee the markets and we believe there will still be opportunities during new periods of volatility as we move further into 2018.

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An investor proposing to borrow for the purchase of securities should be aware that a purchase with borrowed monies involves greater risk than a purchase using cash resources only. The extent of that risk is a determination to be made by each purchaser and will vary depending on the circumstances of the purchaser and the securities purchased.

Discuss the risks associated with leveraged mutual fund purchased with an investment funds advisor before investing. Purchases are subject to suitability requirements. Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same if the value of the securities purchased declines.

Investors should educate themselves regarding securities, taxation or exchange control legislation, which may affect them personally. This newsletter is for general information only and is not intended to provide specific personalized advice including, without limitation, investment, financial, legal, accounting or tax advice. Please consult an appropriate professional regarding your particular circumstances.

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