INVESTMENT FOCUS

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To My Clients:

While we cannot control the direction of the markets, there are many wealth-building opportunities within our control. Have you made full use of your tax advantaged accounts or other tax-planning strategies, such as income splitting? Plan for your future care and make sure your powers of attorney and estate planning documents are updated. Let us know how we can help.

Here's to a healthy, happy and prosperous 2018!

--Rafeeza

The Real Risk? Not Participating

After another year of performance gains by North American stock markets, many investors are asking: where are the markets headed in 2018?

Some of us have found it difficult to enjoy the market's advances, instead expressing concerns about market prospects and preserving paper gains — eight years of a bull market can do that!

Of course, nobody can predict the course of near-term markets, except to say that fluctuations in either direction should be expected. Investing is often unpredictable, and this is a good reminder that your portfolio has been built to be enduring throughout the inevitable market cycles. We work to control risk in your portfolio in many ways, including maintaining a certain asset mix, ensuring diversification, limiting the size of any holding and emphasizing quality — all based on your own personal risk tolerance and objectives.

Having this discipline is important even in up markets. We have all seen superstar stocks turn into supernovas over time. Risk control helps to ensure that events such as these do not cause significant harm to overall portfolio values. During down markets, it helps to mitigate risk and limit the downside. Remember that avoiding all risk will often mean forgoing most return as well.

A focus on the longer-term can also serve us well. Renowned investor Warren Buffett recently declared that the Dow Jones Industrial Average (Dow) will reach 1,000,000 points within the next 100 years. At first glance, this figure seems extraordinary; 100 years ago, the Dow opened at a mere 77 points. Yet, this level could be achieved with an average annual growth rate of less than 4 percent.

But Buffett's view is not a bearish prognostication; rather a message for investors to focus on long-term expectations and goals. Over time, the markets are expected to continue their climb. Regardless of what happens in the short term, the longer-term wealth-building potential remains strong. The real risk? Not participating.

There are many reasons to remain optimistic. Our economy continues to grow despite lower resource prices. Oil prices have shown modest increases and corporate earnings have been strong. But there are also challenges: ongoing NAFTA negotiations may potentially impact Canadian business competitiveness. Growth is also anticipated to slow this year.

Nevertheless, don't overlook the opportunity for markets to continue their climb. Participate, for the sake of your future prosperity!

In This Issue

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RRSP Season Once Again

RRSPs: Help Kids Get a Head Start

It is Registered Retirement Savings Plan (RRSP) season once again. Remember that RRSP contributions for the 2017 tax year must be made by **March 1, 2018**. Contribution limits are 18 percent of your previous year's earned income, to a maximum of $26,010 (less any adjustments or plus any unused contribution room). If you are planning ahead for the 2018 tax year, the RRSP contribution limit increases to $26,230.

If you have teenage children or grandchildren who hold a part-time job, the benefits and discipline of investing in an RRSP should not be overlooked! Sometimes, when income earned from a part-time job is less than the basic personal amount for tax purposes, an income tax return may not be filed as no taxes are owing. However, if this earned income is not reported, the child loses the opportunities to compound savings for additional years on a tax-deferred basis and potentially reduce future personal income tax liabilities.

If the child reports income but decides not to contribute to the RRSP in the current year, the unused RRSP contribution room carries forward. This may be beneficial as it can be used to make a contribution in future years to reduce taxes. If the child

contributes to the RRSP and their taxable income is below the basic personal exemption, they can elect to not claim the RRSP deduction until a future year when they are in a higher tax bracket, as non-deducted RRSP contributions carry forward indefinitely.

Having built up an RRSP balance while children are young may provide additional benefits as they grow older. They could potentially access up to $25,000 from the RRSP under the Home Buyers' Plan to aid in the purchase of a home, or they could time withdrawals to create a tax-efficient income-replacement strategy to match a maternity leave or a sabbatical from work. Don't overlook the value of an early start!

Maintaining Confidence

Don't Overlook the Effect of Dividends

Warren Buffett may have proclaimed that the Dow Jones Industrial Average ("Dow") will hit the 1,000,000 point mark within 100 years, but when considering the impact of dividends it has already exceeded this level. Recall that the Dow is a price-weighted index that does not include dividend payments. However, if the Dow was to include reinvested dividends, by some estimates its current value would be around 2,784,000 points.[1] This demonstrates the significant potential impact that dividends can have when reinvested over time.

As investors, we should not overlook the power of dividends in positively impacting our own investment strategies. Here are some reasons why:

Drives long-term returns. Dividend-paying companies have provided a significant portion of long-term returns in the Canadian equity market. Between 1992 and 2017, reinvested dividends in the S&P/TSX Composite Index have accounted for around 44 percent of total returns. This means that an investment of $1,000 would have yielded around $4,740 today on the index alone but around $8,540 if dividends were reinvested.[2] At the same time, dividends in the Canadian equity markets continue to grow. The S&P/TSX Composite index dividend (which compares the S&P/TSX Composite Total Return Index with dividends reinvested and the index alone) has had an annualized growth rate of 5.5 percent over the past 25 years.[3]

Offers a reliable source of income. Retirees today have been faced with historically low interest rates and slower growth, which has made it challenging to find income-generating investments. However, many quality companies have continued to pay dividends year after year, and often because this is seen as a sign of economic health (i.e., there is excess cash with which to pay shareholders). Dividend-paying investments continue to be a reliable source of income for many retirees.

Provides a tax advantage. Canadian dividends are taxed more favourably than interest and other ordinary income. This is due to the non-refundable tax credit available for most dividends issued by Canadian companies. Consider that for each dollar of eligible dividend income received, an Ontario resident taxed at the highest marginal tax rate in 2018 (based on tax rates as of Nov. 1, 2017) would keep about 14 cents more compared to fully taxable income (assuming a 53.53 percent marginal tax rate and a 39.34 percent effective tax rate for eligible Canadian dividends).

Sources: 1. www.wsj.com/articles/SB10001424052970204571404577257373285657442 = Dow estimate of 1,339,410 with dividends reinvested on 2/28/12. Based on DJITR growth from 2/28/12 (24,249) to 11/20/17 (50,412) of 207.89%; 2. S&P/TSX Composite Index Price Return and Total Return Index, 09/30/92 to 09/29/17; 3. Using same 25-year data. Index dividend=Index Total Return–Index Price Return.

Avoid CRA Penalties

Contribution Errors? Review Your TFSA

Over recent years, the Canada Revenue Agency (CRA) has increased its reviews of the TFSA, targeting holders that it considers to have over-contributed to the account. If an individual has exceeded their TFSA contribution limit for the first time, (s)he is sent a warning letter and/or *Form RC243-P, Proposed TFSA Return*. This form shows the amount of penalty tax due according to CRA records. If the excess TFSA amount has been removed prior to receiving the letter, no further action is required.

As such, if you may have inadvertently over-contributed, it may be worthwhile to review your TFSA now to make corrections before a penalty tax is assessed. Here are two areas where mistakes are often made:

TFSA funds are withdrawn and recontributed within the same year. TFSA withdrawals do not create contribution room until the following calendar year. If you do not have contribution room available in a particular year, any recontributed funds would be considered as an over-contribution for that year.

TFSA funds are withdrawn and transferred to another TFSA at a different financial institution. Although this can be done without penalty, it must be done through a direct transfer completed by the financial institution. If funds were withdrawn from one TFSA as cash and moved to another TFSA, this would be considered to be a withdrawal followed by a contribution. Contribution room for the withdrawal would not be created until the next calendar year.

What is the penalty? A TFSA penalty is assessed at one percent of the over-contribution amount per month until the excess amount has been removed from the TFSA (or contribution room becomes available). For example, an indirect transfer of $5,000 from one TFSA to another that is considered an over-contribution would be assessed a penalty of $50 per month, or $600 per year. Over time, these penalties can quickly add up.

How can you determine your contribution room? TFSA contribution room information is available on your CRA online account: "My Account". You can also contact the CRA to request a *TFSA Room Statement* or *TFSA Transaction Summary* showing your contribution and withdrawal information.

If you have multiple TFSA accounts at different financial institutions, consider consolidating them to simplify their administration and avoid contribution errors. This may also improve management of your asset allocation or ease the settlement of an estate.

In Brief: Changes to the Taxation of Private Corporations

Last summer, the federal government released a consultation paper targeting certain tax planning strategies that it believed unfairly reduced the taxes of incorporated business owners. It focused on three areas: income splitting through income sprinkling, holding passive investment portfolios and converting regular income into capital gains. After significant opposition by many business owners, the government announced last fall that it would make adjustments to these proposals. Here are some of the changes, in brief:

The small business tax rate has been lowered. Although this was not part of the original paper, the small business tax rate is proposed to be lowered to 10 percent (from 10.5 percent) as of January 1, 2018. It will again be reduced to 9 percent as of January 1, 2019. (The tax rate for non-eligible dividends will be adjusted accordingly.)

Income-sprinkling measures will be focused on those who do not meaningfully contribute to a business. The government originally targeted owners of private corporations who were lowering taxes by sprinkling income to all family members. These changes are expected to be effective for 2018 and subsequent tax years. Measures to limit access to the Lifetime Capital Gains Exemption have been abandoned.

An annual threshold of $50,000 for passive investment income has been proposed. The government originally proposed limits on private corporations to make any passive investments within the corporation. The newly proposed threshold is intended to support a financial cushion for emergency or retirement purposes. Existing passive investments and related income will not be affected. Draft legislation, including a description of how the threshold works, is expected in Budget 2018.

A proposal to limit the conversion of income to capital gains has been abandoned. The government indicated that this would have made it difficult for farmers/fishers to pass along their businesses.

At the time of writing, these measures are still in proposal stage. For details, see the Government of Canada website: fin.gc.ca

Common Retirement Planning Pitfalls

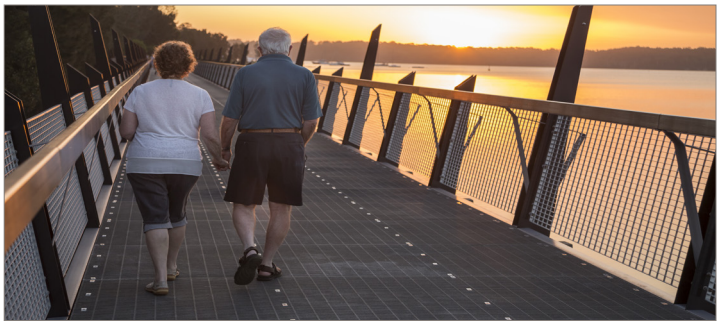
As individuals continue to live longer lives, one of the ongoing concerns is outliving planned retirement funds. But underestimating your longevity is only one of the factors that can derail the financial success of a retirement plan. Here are some additional considerations:

Underestimating health care costs. Did you know that care within a long-term care facility is not fully covered by the public health care system? Even with government subsidies, private room accommodations can require a co-payment of over $30,000 per year.[1] While it may be uncomfortable to contemplate that we may be afflicted with a health condition, be aware of the financial implications should care be required, especially over the long term.

Relying on income sources that may not materialize. You may be planning on working to fund your retirement, but have you contemplated a situation in which you become physically unable as you age? Or, you might suddenly find yourself without a job before retirement due to business or economic changes. Surveys show that some Canadians are counting on an inheritance to help fund a comfortable retirement. However, consider that your parents could outlive you, or that any inheritance may be less than expected.

Miscalculating the costs of dependents. There used to be a time when parents became empty nesters once a child turned 18 years old. Today, many parents are helping to support children well beyond post-secondary education. Have you planned for this? It may not end there. With rising housing prices and tightening mortgage rules, more children have been relying on parents for financial assistance with home purchases. What if your children never achieve financial independence and leave your home?

Relying on home equity. As housing prices skyrocket across many Canadian cities, it may be tempting to see your home's value as a potential source of retirement income. But



this has its dangers: future real estate prices may fall or be less than expected. Even if a retiree was to downsize, they could fail to factor in the true costs, such as renovations or maintenance to an old house prior to sale. The cost to purchase a smaller home may also be underestimated. Sometimes selling a lifelong home is emotionally traumatizing, making a move impossible.

Unanticipated divorce or death of a spouse. While no one plans on getting divorced or losing a spouse, many underestimate the financial impact. Divorcees may have less income post-divorce, yet may face high legal costs. The emotional impact of losing a spouse can make financial management difficult, especially if that spouse was the financial decision maker. While these events may be unpredictable, having a good understanding of your own financial position is important to help lessen the impact.

As advisors, we do our best to prepare you for retirement. That's why we stress the importance of having a financial plan and encourage investing discipline, while using strategies and tools like RESPs, RRSPs, etc. to help along the way. However, should any of these pitfalls stick out as a roadblock to achieving your retirement goals, we can help explore solutions. Perhaps there may be value in insurance or an annuity? Or maybe adjustments to your financial plan will be needed? Even if retirement is still years away, now is the time to consider these matters.

Note: Varies by province: based on Ontario. "Long Term Care Costs 2016", Sunlife.

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