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Perspective

Sherry Cooper *is Global Economic Strategist and Executive Vice-President, BMO Financial Group and Chief Economist of BMO Capital Markets.*

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Turning the Corner

The global credit crisis is over and most countries are now on the road to recovery. That road, however, may be long and bumpy. Canada has a golden opportunity to outperform most other industrialized countries as manufacturing is rebounding, especially in the auto sector, and demand for commodities such as oil and base metals will continue to strengthen. The TSX has outperformed the other G7 stock markets this year, especially on an exchange-rate adjusted basis. While the TSX in Canadian-dollar terms is up over 20% year-to-date, compared to a more modest 15% for the S&P 500, in U.S.-dollar terms, our stock market has appreciated a whopping 40%. The attractiveness of investments in Canadian assets has not been lost on global market participants. Our currency's strength is reflecting the continued positive outlook, and the loonie is likely to hit parity with the U.S. over the next 18 months. This is a headwind for investments in U.S. dollar assets.

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To be sure, the strong loonie makes it more difficult for our exporters to compete, but as the U.S. economy recovers we will undoubtedly benefit. We have seen this in spades with the success of the U.S. cash-for-clunkers program that encouraged car buyers to trade in their gas guzzlers for more fuel efficient models. The program was so successful over its very short life that the U.S. Transportation Department had to hire additional workers to process the dealer refunds, and sales were lost in some cases owing to extraordinary inventory depletion. This has triggered a jump in auto production in the third and fourth quarters and workers are finally enjoying the effects of a spurt in the industry.

In addition, the U.S. housing market is bottoming in no small measure due to markedly improved affordability. First-time homebuyers are the big winners, boosted as well by the first-time homebuyer tax credit. Canada's housing market has been red hot since the spring, more than making up for

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Year-End Planning Strategies – Consider Tax-Loss Selling

Given the volatility in the markets, many investors may want to review their investment portfolios to consider possible investment reallocations. If it makes sense to sell an under-performing security from an investment perspective, it may be beneficial to review your 2009 tax situation to consider the possibility of engaging in a 'tax-loss selling' strategy before the end of the year to reduce your overall tax liability or receive a refund of previously paid taxes.

Briefly stated, under this strategy investments that have declined in value are sold to generate a capital loss for tax purposes to offset capital gains already generated in the year. Alternatively, an aggregate net capital loss in the year can be carried back to be applied against net capital gains realized in the three preceding years.

The amount of capital gains subject to tax each year is based on the calculation of net capital gains, which is the sum of all capital gains less all capital losses realized in the year. Therefore, to the extent an investor realizes capital losses in the same taxation year that a significant capital gain is triggered, the tax liability on the capital gain can be reduced (or eliminated).

Consider the possibility of engaging in a 'tax-loss selling' strategy before the end of the year to reduce your overall tax liability or receive a refund of previously paid taxes.

Accordingly, it may be worthwhile to review your portfolio with your BMO Nesbitt Burns Investment Advisor to consider the sale of certain investments with unrealized losses, provided a sale makes sense from an investment perspective.

Before using this tax strategy, consider the following:

- Since capital losses can be applied in the current year and then any unapplied net capital losses can be carried back for up to three years, you should review your 2009 capital gains and losses realized to-date and review your tax returns from 2006, 2007 and 2008 to determine if you reported net capital gains in any of these years. If so, check with your tax advisor to understand the possible tax benefit of applying net capital losses to offset these gains.
- Remember that capital gains or losses on foreign securities denominated in another currency are generally calculated in Canadian dollars so that fluctuations in the foreign currency relative to the Canadian dollar over the period of ownership will also factor into the analysis.

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- Speak to your accountant or other tax advisor to ensure that you are aware of the actual tax cost base of your investments. The tax cost will often be different from the original purchase price as a result of corporate re-organizations, tax elections, distributions such as return of capital, or the requirement to calculate a weighted average cost for tax purposes with other identical securities held in all non-registered accounts.
- Be aware of the superficial loss rule which may deny a capital loss realized on a sale or disposition of an investment property. The rule generally applies if: i) during the period that begins 30 days before the disposition and ends 30 days after the disposition, you (or any person or entity considered to be affiliated with you for tax purposes) acquired the same or identical property and ii) at the end of the period you (or an affiliated person or entity) owned or had a right to acquire the same or identical property.
- Since it is the settlement date which is relevant for tax purposes, be aware that the final date to trade on the Canadian stock exchanges in order for the transactions to be effective in the 2009 tax year is expected to be December 24th.

If you are considering tax-loss selling or other strategies involving capital losses, ask your BMO Nesbitt Burns Investment Advisor for a copy of our publication entitled Understanding Capital Losses.

Please consult with your tax advisor prior to implementing a tax-loss selling strategy to ensure that the strategy is appropriate for your situation and is implemented properly ■

Inheritance: A little more conversation

It has been estimated that Canadian boomers stand to inherit approximately $1 trillion over the next 20 years. And while Canadians were expecting to receive inheritances of over $300,000, in 2006 the average inheritance received was $56,000. Earlier this year, a survey done by the BMO Retirement Institute found that despite the economic downturn, 30% of Canadian boomers are still expecting to receive an inheritance and 1 in 4 boomers will be relying more heavily on an inheritance to reach their financial goals. The risk of relying on an inheritance is that a financial plan may fall short.

One way to better plan for an inheritance is to have an open dialogue with family members. The discussion between family members on issues of death and the transfer of an estate can be sensitive topics to address but there are some things you can do to start a family conversation about inheritance:

1. **Initiate the conversation at the right time.** Avoid bringing up the topic when things are not going well.
2. **Proceed slowly and respect everyone's right to privacy.** You may want to start by sharing reading materials that may be pertinent to this topic.
3. **Position your questions carefully.** Avoid appearing too aggressive. Instead, ask if there is anything you should know with respect to the person's estate plans.
4. **Share your story.** Talk about some of the things that you or others have done to inform beneficiaries about their inheritance.

The BMO Retirement Institute found that not only is discussion deficient between family members, but also with advisors. Almost 80% of boomers and their parents have not discussed what to do with their inheritance with a financial advisor and furthermore, more than 50% do not plan to talk to a financial advisor about leaving an inheritance.

The risk of relying on an inheritance is that a financial plan may fall short

Seek Financial Advice

Inheritance planning does not need to be complicated. If you are expecting an inheritance, your BMO Nesbitt Burns Investment Advisor can show you the impact that the inheritance can have on your financial situation. You'll be able to evaluate your options which can include paying off your mortgage

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or other debt, making an RRSP contribution, opening a Tax-Free Savings Account or RESP and make an informed decision on how to use the inheritance.

On the other hand if your planning on leaving an inheritance, there are ways to minimize probate, income taxes and other fees as well as increase the value of an estate with the use of life insurance.

To learn more about these strategies, contact your BMO Nesbitt Burns Investment Advisor ■

Understanding and Managing Stress

Stress can be difficult to understand and therefore may be left unattended, which can lead to additional health concerns. Tina Di Vito, who leads the BMO Retirement Institute, spoke to Dr. Michael Baker, professor of Medicine at the University of Toronto about ways Canadians can better understand and manage stress. Dr. Baker defines stress as a human reaction to external influences that affect an individual's health and family life. He suggests some ways that people can try to cope with stress:

- Talk about a problem with someone you trust
- Take time off and relax
- Consult with a doctor

Stress can be managed; you can protect yourself by learning how to recognize the signs and symptoms of stress and taking steps to reduce its harmful effect. To listen to the informative interview or download a summary, visit the BMO Retirement Institute's website at www.bmonesbittburns.com/retirementyourway/bmoretirementinstitute.asp

Dr. Baker is the Professor of Medicine at the University of Toronto. He is a Fellow of the American College of Physicians and the Royal College of Physicians of Canada. Dr. Baker's research has focused on the diagnosis and treatment of leukemia and aspects of cancer control, leading to more than 100 publications in this field. He is also a member of the BMO Advisory Council on Retirement.

Charitable Insured Annuity Strategy

Over 85% of the Canadian population makes charitable donations. In addition to annual donations, many of us want to leave a lasting legacy and site charitable bequests as an important estate planning goal.

It can be difficult balancing the goals of leaving a legacy to your heirs and your favourite charities. Luckily, there are financial tools available to help you achieve your goals. If you are age 65 or older, you may want to consider using a charitable insured annuity strategy. This strategy is best suited to conservative investors who are charitably inclined and either:

- receive surplus income from interest bearing investments such as Canada Savings Bonds, GICs and treasury bills, and would like to reduce their annual taxes, or,

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- require a higher level of retirement income because the majority of their investments are generating interest income which is taxed at their marginal tax rate without any preferential tax treatment.

The charitable insured annuity strategy is designed to achieve two important objectives: 1) generate an increased tax-efficient income in retirement, and, 2) make a significant donation to favourite charities. A life insurance policy and a prescribed annuity are used to support the strategy.

Here's how it works

George is a 70 year old widower and plans to leave his home and RRIF to his two children as an inheritance. He recently retired with a $250,000 non-registered portfolio of GICs. He doesn't want to give up the security of GICs, but he realizes that he needs to generate a higher after-tax income to meet his retirement expenses. It's important to him that any alternative income strategy meets his higher income requirements and still leaves a valuable donation to charity after he passes on.

George has worked with his Investment Advisor and local community foundation to set up a donor advised fund through the BMO Nesbitt Burns Charitable Giving Program. This program, combined with the charitable insured annuity strategy can provide George with the confidence and peace of mind knowing that the donor advised fund will facilitate annual grants and provide sustainable funding to his favourite charities.

- A life insurance policy on George's life is established to facilitate a $250,000 transfer to charity upon his death. Because George's goal is to increase his cash flow in retirement, the community foundation is named as both owner and beneficiary of the life insurance policy. This way George can receive a charitable donation tax receipt for the amount of the insurance premium paid each year. (If George didn't use this strategy, his $250,000 GIC portfolio could still be left to charity and would provide a charitable donation tax receipt for his estate.)

- A guaranteed life annuity policy is also purchased on George's life using his $250,000 non-registered portfolio. Even after George pays the life insurance premiums, the annuity will pay him a guaranteed lifetime annual income of $9,993 versus the $4,050 annual income paid by the GIC portfolio. While the annuity income will not change, income from a GIC portfolio will fluctuate with interest rates. The decision to purchase a life annuity cannot be reversed.

- George's annuity generates a higher after-tax cash flow than his former GIC portfolio can provide because the annuity payments are a combination of taxable interest and non-taxable return of his original capital.

- In this example and factoring in the charitable donation tax credit, George's annual cash flow will increase to $14,626 annually – representing a 10.83% equivalent pre-tax yield versus 3% for the GIC portfolio.

GIC		Charitable Insured Annuity
$250,000	Initial Capital	$250,000
3%	Annual Investment Rate	N/A
$7,500	Gross Annual Cash Flow	$22,222
$7,500	Taxable Portion	$4,690
$3,450	Tax Payable (46%)	$2,157
$4,050	After-tax Cash Flow	$20,065
N/A	Annual Insurance Premium	$10,072
$4,050	Net Annual Cash Flow	$9,993
	Equivalent Pre-Tax Yield	7.40%
N/A	Charitable Donation Tax Credit (CDTC)*	$4,633
	Net Annual Cash Flow with CDTC	$14,626
	Equivalent Pre-Tax Yield with CDTC	10.83%
$250,000	Estate Value	$0**

* Charitable donation is restricted to 75% of annual net income. In order to receive the full benefit of the tax credit, additional sources of income are required beyond the annuity. Also, other charitable donations must exceed $200 annually in order to receive savings at the highest marginal tax rate.

** Unlike the GIC scenario, no donation tax credit is available at death for the $250,000 transfer to the community foundation. The potential tax benefit of a charitable bequest at death of the GIC to the community foundation should be considered for a complete analysis.

This chart has been prepared to help you understand how a charitable insured annuity may work. Tax calculations are only estimates and the values shown here are illustrative only and are not a guarantee of the future. Assumptions: a male, age 70, non-smoker, term-to-age-100 life insurance, a prescribed annuity, top marginal tax rate 46% and 3% GIC rate. July 2009

With the proper planning, you may be able to increase your annual cash flow, reduce your annual tax liability and at the same time, provide a generous donation to charity. For more information, please contact your BMO Nesbitt Burns Investment Advisor ■

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plummeting sales in January and February. The revival in U.S. housing will boost Canadian exports of lumber, copper and other building materials. Additionally, strong domestic home sales go hand-in-hand with stepped up expenditures for furniture, electronics, appliances and the like. Canadian consumers are among the most confident in the G7, as our banking system did not suffer the enormous losses experienced elsewhere, and household net worth has held up quite well in comparison to south of our border where homeowner equity was obliterated and stocks have underperformed.

Central bankers will no doubt continue to keep interest rates low for some months yet, despite concern in some circles of an ultimate inflationary impact. Inflation in Canada has been exceptionally low, below the target level of the Bank of Canada, so rest assured that we will see no aggressive tightening of monetary policy through the first half of next year. Central bankers will continue to be cautious in much of the industrialized world, as economic recovery continues to rely on government support—less so in Canada, but certainly in the U.S.

The recovery is unlikely to mimic the robust growth rates of earlier recoveries. In many countries, worries remain that the banking system is still under pressure, with mounting losses on loans especially on commercial real estate, and that banks and U.S. households still have a long way to go in reducing debt. European and American policymakers are concerned that, for example, incentives for car-buying merely pulled spending forward and continued high unemployment will keep a lid on consumer spending. Policy makers fear that the replenishment of inventories, which is helping to support growth now, might run its course by year-end.

While momentum might lag and setbacks will occur, the combined forces of a sharp revival in emerging market economies, low interest rates, and dissipation in the financial credit crisis should provide a moderate but sustainable recovery through 2010 and 2011. With the U.S. dollar remaining vulnerable, the TSX will continue to be a top performer in relation to other G7 stock markets ■

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