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FALL 2012

Perspective

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The clouds are parting – a bit

September is turning out to be a much better month for the stock market than many had feared, boosted in large measure by the gradual dissipation of uncertainty. To be sure, risks remain and the future is far from clear. But the 'tail risks'—those outcomes that have low probability but enormous costs—appear to be reduced.

In Europe, the ECB has said it would do whatever it takes to preserve the euro. Germany openly supports its commitment to the rescue fund and opposes Greece leaving the 17-nation eurozone. A regulatory body will be formed to oversee the banks in the region and interest rate spreads for Spain and Italy are off their peak, albeit still very wide.

China's economy has slowed to about a 7.5% growth pace as new leadership prepares to take over. The new regime intends to encourage consumer spending, relying less heavily on exports to sustain the economic expansion. Chances of a hard landing remain, but they appear to have declined.

Geopolitical risks in the region, however, have grown as China and Japan dispute territorial issues surrounding the contested group of Senkaku islands in the East China Sea. The U.S. is urging a diplomatic solution as the repercussions of a breakdown in Chinese-Japanese economic ties would have huge negative implications for the global economy and

financial markets. Scores of Japanese-owned factories and stores in China were shuttered as anti-Japan demonstrations erupted in a dozen cities. Japanese companies play a big role in the Chinese economy and employment. In Tokyo, business slowed for the many store and restaurant owners catering to Chinese tourists.

In addition, the U.S. announced it was filing a trade case against China at the WTO, accusing it of unfairly subsidizing autos and auto parts exports. Not only is it seen by China as an election ploy by the Obama administration, but it also could lead to retaliatory action, disrupting potential trade flows. As well, Romney has threatened to label China as a currency manipulator on his first day in office, which would seriously impede U.S.-Sino relations. China retorted that much of Romney's wealth was actually obtained by doing business with Chinese companies before he entered politics. China's

official Xinhua news agency called Romney *"foolish and hypocritical"* and said such an action would *"trigger a catastrophic trade war and damage the already weak global economic recovery."*

Middle East tensions are also roiling with the death of the U.S. Ambassador to Libya and some of his colleagues and continued anti-U.S. demonstrations in many Muslim countries. Moreover, the Israeli government has stepped into U.S. election politics with its own pleas for U.S. support of stepped up actions against Iran. This is not only dangerous from a peace perspective, but it would have significant unintended consequences, both political and economic.

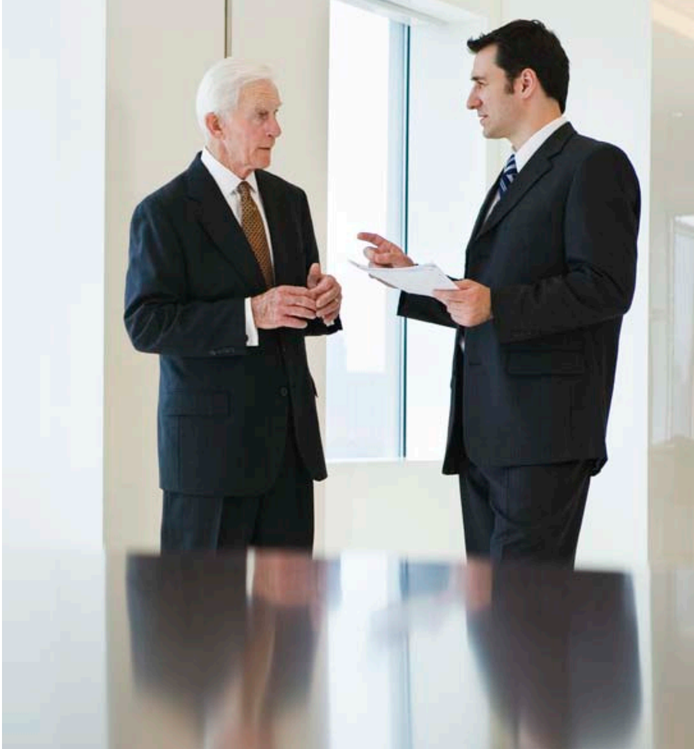
> "Canada remains a safe haven and has one of the few rock-solid triple – A bond markets."

With this backdrop, no wonder the Canadian dollar is so strong. Canada remains a safe haven and has one of the few rock-solid triple-A bond markets. But the strong loonie has caused a marked deterioration in Canada's competitiveness and its trade balance. This is mirroring the solid improvement in the U.S. trade position. But Canadian manufacturing can no longer rely on price competition to give it an edge in trade. Better products and services using the most advanced production practices, marketing and technology are key to future success. Moreover, as the U.S. gains greater energy independence thanks to the surge in shale oil and gas production, the Canadian energy sector must develop the capability to export energy to the rapidly growing emerging economies of the world.

With this backdrop, the Federal Reserve decided recently to pull out all the stops and introduce open-ended support for the U.S. economy through additional purchases of mortgage-backed securities, government bonds and any other measures needed for however long it takes to improve substantially the U.S. jobs market. While some disapprove of these measures, suggesting they will be inflationary, the markets appeared to take heart. In addition, the U.S. election is only weeks away and the polls now suggest the incumbent will prevail. Nothing is certain, of course, but it is likely the U.S. will pass a major budget package in 2013, reducing the chances of a downgrade and enhancing the prospects of stepped up growth next year.

For Canada, the government has also suggested that it would temper fiscal drag sufficiently to ensure continued near-potential growth. The output gap, however, is much smaller in Canada and is likely to be closed sometime next year, increasing the prospects of a Bank of Canada tightening action well before the Fed is ready to re-normalize interest rates.

Year-end planning strategy – consider tax-loss selling



With assistance from your BMO Nesbitt Burns Investment Advisor, it is a good idea to periodically review your investment portfolio 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 2012 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).

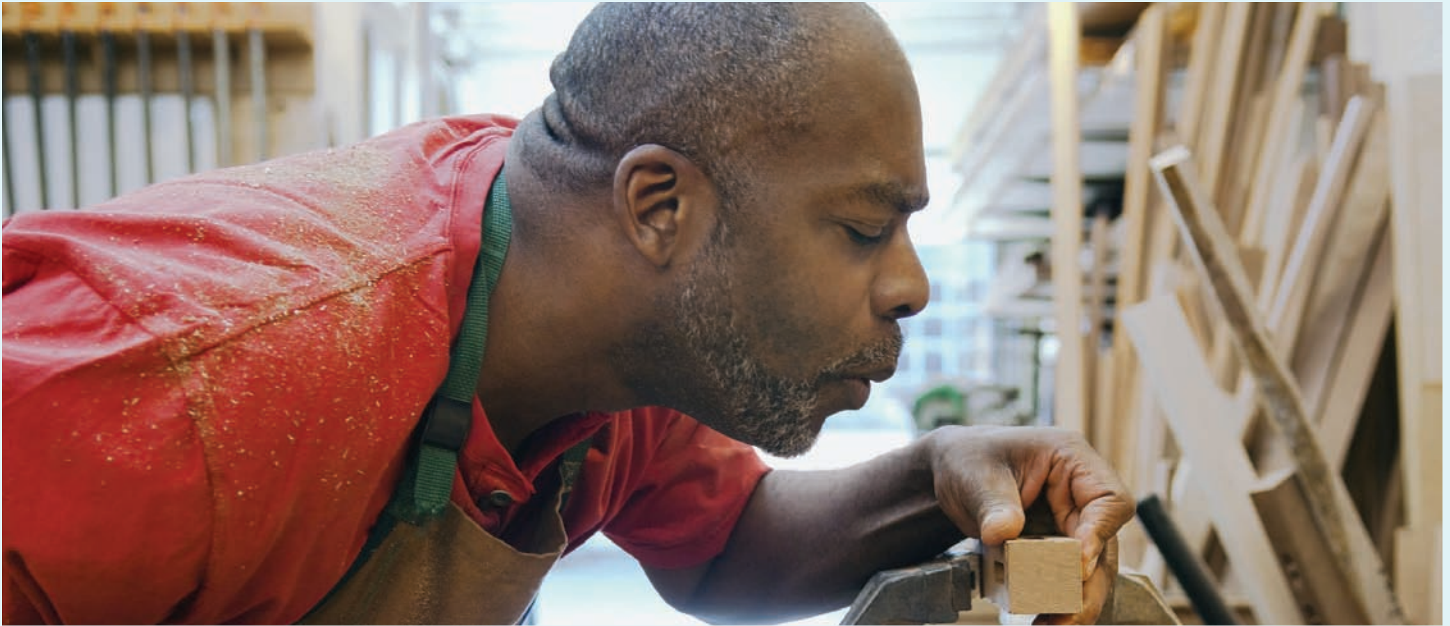
Accordingly, it may be worthwhile to review your portfolio with your BMO Nesbitt Burns Investment Advisor to consider the sale of certain investments with unrealized losses, provided a sale makes sense from an investment perspective.

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 2012 capital gains and losses realized to-date and review your tax returns from 2009, 2010 and 2011 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.
- 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, ensure that there is sufficient time remaining after the trade date to allow the transaction to settle in 2012.

Be sure to 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.

Retirement income options for your retirement savings accounts at age 71



Turning 71 in 2012?

If you are like many Canadians, you have spent your working years saving for retirement. You may have accumulated these savings in a Registered Retirement Savings Account (RRSP), in a employer-sponsored pension plan [e.g. Defined Benefit (DB), Defined Contribution (DC), Individual Pension Plan (IPP)]. Additionally, you may have transferred the commuted value of these employer pension plans to a locked-in RRSP (LRSP) or a Locked-In Retirement Account (LIRA) when you left your employer or retired. If you are currently retired, you may have decided to receive a regular pension payment from your DB pension plan or IPP.

However, are you aware that RRSP, LRSP, LIRA and DC pension plan can no longer exist after Dec 31st of the year in which you turn 71? These retirement savings vehicles have a limited shelf life and must be converted to an eligible retirement income option. In other words, if your 71st birthday falls in the year 2012, you will need to make a decision about what to do with these accounts- that is, if you haven't already done so prior to turning 71. However, if you had a DB pension plan and decided to leave it in the company DB plan when you retired or left your employer before retirement, this conversion decision does not apply as this decision would have entitled you to collect a retirement pension from your DB plan.

RRSP retirement income options

You can convert your RRSP to any one or a combination of the following three options by December 31st of the year you turn 71:

- Lump-sum withdrawal: it is important to note that the amount you withdraw will be treated as earned income and be fully taxable in the year of withdrawal.
- Registered Retirement Income Fund (RRIF): like an RRSP, your investments will continue to grow tax deferred, but you will be required to receive at least a minimum annual payment (subject to tax in the year received). There is no set maximum annual withdrawal amount. If you have a younger spouse, you can elect to have the minimum withdrawal amount calculated based on your younger spouse's age, resulting in a lower annual minimum withdrawal amount. This could be beneficial if you do not depend on the RRIF

income on an annual basis as it will reduce your overall family tax bill.

- Purchase an annuity: a contract between you and an insurance company that provides you with a guaranteed fixed income payment, usually for your lifetime (and possibly your spouse's lifetime upon your death). Each annuity payment will be taxable, but not until you receive the actual payment.

What about Spousal RRSPs?

Spousal RRSPs also mature on December 31st of the year in which you turn 71, and your retirement income options are the same as for regular RRSPs (see above). However, if you decide to convert your spousal RRSP to a RRIF, note that the assets within your new RRIF will retain their "spousal" status for tax purposes (referred to as a "spousal RRIF"). This means that the three-year income attribution rule will continue to apply, but only on withdrawals that exceed the annual minimum payment. For example, if your spouse made an RRSP contribution to any of your spousal RRSP accounts in the year of your RRIF withdrawal or in the previous two calendar years, the amount you withdraw from your spousal RRIF will be taxed in the hands of your contributing spouse to the extent it exceeds the mandatory annual minimum payment.

Retirement Income Options for Locked-In Retirement Savings Accounts (LRSP/LIRA) and DC pension plan.

Your retirement income options are as follows:

1. Life Income Fund (LIF): available under most provincial pension plan jurisdictions as well as accounts governed under the federal pension legislation.

2. Locked-in Retirement Income Fund (LRIF)/ Restricted Life Income Fund (RLIF)/ Prescribed Retirement Income Fund (PRIF): depending on the pension legislation governing your plan, you may be able to choose one of these maturity income options.

3. Purchase an annuity: a contract between you and an insurance company that provides you with a guaranteed fixed income payment, usually for your lifetime (and possibly your spouse's lifetime upon your death). Each annuity payment will be taxable, but not until you receive the actual payment.

RRSP Contributions after age 71:

Can I still make an RRSP contribution for 2012 (taxation year when I turn 71) if I have unused RRSP contribution room in 2012?

Yes, but you must make your 2012 RRSP contribution by December 31, 2012, before you wind-up your RRSP. You will no longer have the first 60 days of the following year (2013) to make your contribution.

Can I make RRSP contributions after I turn 71?

- If you have unused RRSP contribution room and have a younger spouse, you can continue to make RRSP contributions to your spouse's spousal RRSP until December 31st of the year in which your spouse turns 71.
- If you have earned income in 2012 and are also turning 71 in 2012, consider making an over-contribution to your RRSP in December 2012 which will give you an additional tax deduction in 2013 when you create the additional RRSP contribution room. Although the over-contribution will be subject to a 1% penalty (keep in mind the lifetime over-contribution of $2000 that is not subject to this penalty), the penalty will only apply for one month (i.e. December).

IPP retirement income options

Your retirement income options are as follows:

1. Receive pension income directly from the plan.

2. Transfer the assets to a LIF (or LRIF in certain provinces), or to a RRIF if governing pension jurisdiction permits unlocking (e.g. Quebec).

3. Purchase an annuity : a contract between you and an insurance company that provides you with a guaranteed fixed income payment, usually for your lifetime (and possibly your spouse's lifetime upon your death). Each annuity payment will be taxable, but not until you receive the actual payment.

Benefits of account consolidation

This is an important time to consider the advantages of consolidating your accounts with your BMO Nesbitt Burns Investment Advisor as it will simplify the management and administration of your retirement income.

Is your Estate Plan based on equality or equity?

Most of us aspire to ensure that the manner in which we plan our succession and the transfer of our wealth to our loved ones will foster and facilitate long term harmony in the family. We do not want our actions to create roots of dissention, resentment or division, in the family.

The Concepts

We often say that everyone should be treated *equally*, when actually, what we mean is everyone should be treated *equitably*. The meanings of the two words are very different, so that what may be considered equal is not necessarily equitable. Equal treatment is rooted in treating all objects in the same way, regardless of circumstances or attributes of each object, whereas equitable treatment is rooted in the consideration of circumstances or attributes of each object. Equality means dealing with all objects in the same way. Equity means dealing with all objects equally *and* fairly, justly.

Application of the Concepts

In most aspects of our lives, equity rather than equality governs the way we treat others.

- In everyday life, parents typically treat their children equitably, not equally. For example, the older child may stay up later at night than a younger child and may watch movies which the younger child may not watch. This is not equal treatment, but it is fair and just (equitable) treatment. Likewise, one child may receive more (monetary) allowance than another child and more expensive birthday gifts, because that child's circumstances and attributes are different from the other child's.
- Likewise in family law, an equal division of property between divorcing spouses may not be the same as an equitable division. For example, where a stay-at-home wife and mother had no opportunity to develop a career of her own, the husband's share of the divided property may be less than the wife's share, to account for the lower earning power of the wife as she enters the work force after the divorce. This is not an equal division but rather, may be considered an equitable division.
- In the context of the Canadian taxation regime, income tax is imposed on taxpayers equitably, not equally, by way of marginal income tax rates.
- In the context of financial and estate planning, the issue becomes - equal distribution of wealth versus equitable distribution of wealth. It is possible that an equitable distribution (fair, just) of wealth among all the children is not equal.

Let us consider this example. Diane has two children and two original Group of Seven paintings. Diane's Will states that each child can choose one of the Group of Seven paintings. Diane's Will further states that after choices are made, each painting is to be appraised and the new owner of the higher valued painting must deduct the difference in values from his/her cash inheritance, so as to equalize the child who chose the less valuable painting. Assuming that neither child is financially needy and that the reduction in cash inheritance will not be a hardship on that child, this distribution is both equal and equitable.

Conclusion

Keeping both concepts in mind – equality and equity – reminds us that we are striving to treat our loved ones, in our estate plan, equitably and fairly, by way of recognizing individual differences which, depending on the circumstances, may or may not result in an equal distribution.

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