The Francis Forum

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INSIDE THIS ISSUE

Don't be caught off guard when the bear comes knocking
By Tom Bradley, Globe and Mail

It feels pretty quiet. There's nothing big going on in business news. Market volatility is very low. Interest rates and the loonie are staying in a narrow range. In times like this, there are two things investors can do: Enjoy it while it lasts and get ready for when it's not so quiet.

On the latter, our firm recently set time aside to get ready for the next downturn. It might seem out of step with the benign market conditions, but as I said to our team, we have no excuse for being unprepared. Bear markets are a necessary and unavoidable part of investing. It's not a matter of "if," but "when."

Down markets are never quiet and are guaranteed to feel lousy. The headlines will be filled with disappointing economic data, earnings disappointments and cancelled mergers. Doom-and-gloomers will have the spotlight.

If the downdraft is severe, nothing will escape the carnage. Speculative securities will be crushed, and even high-quality stocks will take a hit.

When the bear arrives, many investors will be unprepared because memories are short. Consider our current situation. We're experiencing one of the best and longest bull markets in history. It's easy to forget about the other side of the equation.

As investment professionals, we know our calls and meetings with clients will be tougher. It's an emotional time. Most clients will be disappointed and/or scared.

Some will question why we didn't avoid the downturn. It's the point in the cycle when the gap is the widest between what clients expect and what investment professionals can do.

You'll need to be prepared for the next downturn. You'll feel beaten up and your plan won't appear to be working. Knowing that, here are some suggestions on how to get ready.

Have a good sense of what you want your long-term asset mix to be (cash, bonds and stocks). It doesn't change much over time, so it will provide you with a baseline when your portfolio gets out of whack.
Mentally rehearse what you're going to do when your account is down 10 per cent to 20 per cent.

You'll want to maintain your regular contributions or possibly accelerate them. You'll undoubtedly need to do some rebalancing.

Freshen up your target list for securities and funds you want to purchase or add to. Pay attention to valuations.

And finally, makes sure you know who you're going to lean on when you need a steady hand.
Bear markets are not a cheery topic, but they're a necessary part of investing. Without exposure to risk and volatility, it's impossible to generate adequate returns.

And of course, for investors who have a long time frame and are building their wealth, it's a time to look forward to. After all, they're buying, not selling. Lower stock prices are a beautiful thing.

As always, I'm always available to discuss the topics in my newsletter, or any other financial inquiries you may have.

Sincerely,

Duane

Behind the Scenes – Advisor Focus

This section was added to this quarterly newsletter in early 2015. It focuses on what advisors in this branch have done to go above and beyond the call of duty. Most of the time, our clients don't know how far we'll go to ensure advocacy on their part.

By Michael Prittie CFP, CIM, CPCA, CIWM, FCSI
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Life insurance is often overlooked as a solution to so many financial planning needs.

In one such case, a longtime client we will call Ms. Smart, was concerned about her retirement should her partner predecease her. When we took into account all income sources at normal retirement age (at the time about 12 years out) there was an income gap if her partner died prior to fully funding his Pension Plan.

While we agreed insurance was a responsible solution, Mr. Smart was feeling very healthy and was in no way interested in paying term insurance premiums for something he felt would never be utilized. Further, he claimed, they had "mortgage insurance" which he felt was more than enough, since it would pay off the debt in the unlikely event he meets his maker before the mortgage was paid off.

Through dialogue, projections and some persuasion, Mr. Smart ultimately agreed additional coverage was warranted and signed a $300,000 term life insurance policy with Canada Life, who had offered the lowest premium of the numerous insurers approached. While I recommended a higher amount to allow cancellation of the mortgage insurance (see why below) and provide an additional buffer, this was not accepted as necessary by Mr. Smart.

As a smoker, his premium was "rated", which meant he was asked to pay a higher premium for his $300,000 life insurance policy to reflect the risks associated with smoking. To his credit, three years later Mr. Smart quit smoking and after 12 months of abstinence, we applied for a reduced premium. His premium was subsequently lowered to his surprise and pleasure! A year later Mr. Smart was unfortunately diagnosed with a serious illness - leukemia. Sadly, and most regrettably, he passed away earlier this year after a valiant multi-year struggle - yet at peace knowing his wife was financially secure.

Canada Life paid out the life insurance ($300,000) within two weeks of submitting the claim. This money has since been invested to maximize Ms. Smart's Tax Free Savings Account (TFSA) with the remainder funding a non-registered "cash" account help supplement the projected shortfall in retirement income in the years ahead.

While maintaining capital, it will provide approximately $1,000 per month of tax-efficient income (more if capital is slowly encroached over the next 25 years) and will make the difference between simply existing and living well in retirement.

The TFSA can be used to fund a car in the future or emergency home repairs etc. Ms. Smart can also afford some non-discretionary expense - a health club membership, replacing furniture when needed, a trip to visit her children and grand-children, perhaps escaping winter for a few weeks, etc. It provides some additional financial backing, confidence and support at a vulnerable time and throughout the years ahead.

On the other hand, the mortgage insurance has yet to be paid! This is because unlike a private policy (like Mr. Smart's term life insurance) which is *underwritten at time of application*/*underwriting*, mortgage insurance is underwritten at *time of claim*. This means that nearly six months later, the bank insurer is still looking at any pre-existing illness/reason to *deny* the claim for Mr. Smart and withhold payment.

A death claim from an insurance contract underwritten at time of application/underwriting can only be denied in the first two years due to misleading information or suicide. Once the two-year contestability time has passed, the contract is guaranteed and renewable <u>regardless</u> of any future illness contracted; such as cancer, heart disease, Parkinson's etc. You pay your pre-set premiums as laid out at time of purchase and you are insured - period!

With mortgage insurance, there is no underwriting at time of application except some simple questions to exclude the worst candidates or risks. As such, it is only at time of claim that the mortgage insurer begins to investigate if you took up smoking, had a pre-existing illness, participated in hang-gliding or any other reason to deny a claim.

While we remain hopeful Ms. Smart will soon have her mortgage paid off, this worry and risk could have been avoided with a private insurance policy. The premium for a $300,000 mortgage insurance policy is <u>fixed</u> – meaning the customer pays the same premium *throughout the entire term* of the mortgage *even though they are paying down the mortgage* and reducing the amount received in event of claim. With mortgage insurance, if the mortgage debt is only $150,000 at time of claim…then you only receive $150,000 - not the original $300,000 even though your premium payments have remained constant based on $300,000! This means the risk to the lender decreases as you pay down your mortgage - but you still pay the same premium cost! To add further insult to injury, the claim, if paid, is paid *directly to the bank* which removes any financial planning opportunities/flexibility.

Key take away; Use insurance to offset retirement income risks as the Smart's did. Mortality tables affect us all – none of us is invincible regardless of age and current health. Allow us to properly assess your insurance needs through a "needs analysis" especially if you have others dependent on your income. Avoid any form of bank mortgage insurance if you qualify for the proper coverage – privately owned life insurance that will often cost less and guarantees the original sum insured with no fuss on payment at the time of claim.

A Cottage Agreement can Save the Family Headaches

There's a family I know who have a story they'd like to share. Eric, Ben and Emma are siblings who inherited their father's cottage four years ago when he passed away. They all love spending time at the cottage, and love one another – most of the time. Still, they can drive one another crazy. "Tim, I love my sister," Eric said, "but when we're at the cottage together, she plays the bagpipes all day long. Supposedly it's good for her asthma. It drives me nuts."

If you own a cottage and are thinking of leaving the property to your heirs one day, there's no guarantee that they'll be able to share the place successfully. But you can stack the odds in favour of a happy co-ownership through use of one terrific tool: A Cottage Agreement.

The agreement

A Cottage Agreement is a document signed by you, and each of your heirs who will one day inherit your cottage. The agreement should be finalized after an open discussion with your heirs so that they provide input into its creation. What's the purpose of a Cottage Agreement? To provide a clear understanding of how the finances, usage, upkeep and decisions around the cottage will work when you're gone. The agreement will also spell out how disputes will be resolved, when (not if) they arise.

As the current owner of the cottage, you might want to pass ownership to the kids during your lifetime, but retain certain rights related to the property – such as the right to continue using the cottage. A Cottage Agreement should spell out these rights.

Sure, a little moral suasion may be enough to keep harmony in the family while you're around, but even the most loving families can face stresses related to a shared property if there's no clear understanding around key issues.

The issues

When heirs are going to share the cottage, the following issues should be discussed, with answers baked into your Cottage Agreement.

Use of the cottage. Will all the kids be allowed to use the cottage all the time? This will require that they be willing to stay with one another (and may require Eric to be respectful of Emma's bagpipe asthma treatments). Or will each have exclusive use at certain times? How do you allocate these times?

Guests at the cottage. Are heirs allowed to bring guests to the cottage, or will it be family only? Further, can an heir rent the cottage during his or her exclusive time, or is renting prohibited?

Sharing the costs. How will your heirs split the costs of upkeep? Should the costs simply be split evenly? Should it be based on who can afford to pay? Should it be in proportion to use of the cottage? Will you leave a "cottage fund" in trust for the heirs to help cover some of the costs? Perhaps your heirs should set aside money annually to create a "reserve fund" to pay for larger repairs when they become necessary.

Managing the money. Once everyone agrees on how to pay for things, who will make sure suppliers are paid? Someone has to collect the money, pay the utility bills, property taxes and insurance premiums, among other things.

Labour at the cottage. There's plenty of work to do at the cottage. Who is going to open and close the cottage if required? Who will cut the grass, rake the beachfront, put the dock in the water, prune the trees and hedges, clean out the shed, and more?

Rules at the cottage. I've seen many cottage heirs squabble over the mess left behind by a sibling, leaving the boat without gas, leaving rotting food in the fridge and other minor inconveniences. Preparing some "Rules of Use" to accompany a Cottage Agreement is a good idea.

Succession of the cottage. Will each have the right to leave his or her share to a spouse (who may remarry later), or should the share go to the kids of a deceased owner? Heirs may need a way out of cottage ownership if necessary. Should each have a right to sell his or her share, perhaps giving the others a right of first refusal to buy?

Decisions about the cottage. How will your heirs arrive at agreement on matters related to the cottage? Should a majority rule on minor issues? Will certain decisions (such as selling, or making major improvements) require unanimity? How about mediation if they can't agree?

https://www.theglobeandmail.com/globe-investor/personal-finance/taxes/a-cottage-agreement-can-save-the-family-headaches/article35181869/

When to Start CPP

What would you rather have: a bag of money with $20,000 in it or a bag with $25,000? It seems like a silly question but the debate about when to start CPP pension boils down to a question just like it. Is it better to start CPP at 60 or 65 or even 70? The usual answer from industry experts tends to be the highly unsatisfactory “it depends.” Fortunately, actuarial science gives us the tools to do better. This article may be the one and only time you will see a definitive answer to this question though we do admit it depends on one’s earnings history.

To wait or not to wait: this question makes sense, of course, only if you have a choice. If you retire at 60 with little money saved away, you will absolutely need to start your CPP payments immediately. What makes a choice possible is having a six-figure nest-egg to tide you over until you choose to start your CPP pension.

Few people appreciate how punitive it is to start CPP early, or how beneficial it can be to defer it beyond age 65. Data from government sources reveals a great propensity to begin CPP benefits as soon as one is eligible — which is at age 60. In 2015, 42 per cent of Canadians who began CPP benefits were 60 years old. A mere 6 per cent postponed the first payment beyond age 65.

The rules for computing CPP pensions are complicated, especially because of the dropout provisions, the combination rules for survivor pensions after 65 and changes in the average national wage. Rather than reciting these rules, let us consider an example.

Jacques is a pending retiree who just turned 60 years old. He is married and has made the maximum CPP contributions since he was 23. He has accumulated enough in his RRSPs that he doesn’t have to begin his CPP immediately. Instead, he can draw down his savings until age 70.

Jacques is not troubled by this option since he is determined to start his CPP pension when it will give him the greatest overall value.
In 2017, Jacques’ CPP pension at 60 would be $713 month. This is calculated as the maximum pension less a reduction of 36 per cent.

With inflation at 2.2 per cent a year, the monthly payments will gradually climb to $886 by the time he hits 70. If he holds off on collecting CPP until 70, the monthly pension at 70 will be about $2,056! (This assumes wage inflation beats price inflation by 1 per cent a year.)

Comparing an indexed pension of $713 from age 60 to a pension of $2,056 from 70 is hard. It is a little bit like handicapping the race between the tortoise and the hare. Almost everyone roots for the hare (which means taking the $713 a month from age 60) but who wins in the long run?

Fortunately, actuarial science comes to the rescue. Actuaries try to take everything into account when assessing the present value of a pension: the probability of death on a year by year basis up to age 115, changes in the dropout provision as the starting age changes, survivor benefits, future inflation and most important, the appropriate discount rate. We used 1 per cent as the real discount rate (after inflation). This is a risk-free rate and though it sounds low, it is a little higher than the current yields on real-return bonds.

And the result? The actuarial present value of Jacques’ CPP benefit if he commenced it at age 60 is $205,000. The corresponding value if he starts CPP at 70 is $277,000. And no, we didn’t hand Warren Beatty the wrong card. Starting CPP at age 70 is the clear winner. By postponing his CPP to age 70 instead of 60, Jacques can increase the value of his benefit by 35 per cent.

Why are Canadians the beneficiaries of such government largesse? The answer lies in that all-important discount rate. From the government’s perspective, the choice between a starting age of 60 or 70 is more or less cost-neutral but that is because they use a real discount rate of 4 per cent to compare the options instead of 1 per cent. This doesn’t make 4 per cent the right choice for you though because you cannot earn 4 per cent after inflation without taking big risks.

Let us generalize the result to the extent we can. If Jacques were not married, the difference is almost as great — the value of his CPP benefit from age 70 would still be significantly greater than starting it at 60.
If Jacques started working at age 26, the CPP pension starting at 70 is still worth more, though the difference shrinks to 24 per cent. For the individual in this case, the true difference in value can be more than 24 per cent. That is because the CPP pension is virtually guaranteed; having more retirement income coming from a guaranteed source like CPP reduces both your investment and your longevity risk.

There are situations where the excess value at 70 is even smaller; for instance, if you have a spotty contributory record or a shorter than average life span. Most people though, benefit from deferral.

http://business.financialpost.com/personal-finance/this-retirement-decision-could-be-worth-72000-but-few-canadians-take-advantage-of-it

How to Prepare for Higher Interest Rates

The Bank of Canada has begun the process of slapping Canadians back to reality on interest rates.

Economic growth is picking up and the central bank made it clear earlier this week that it's looking at whether to raise rates. CIBC Economics sees the bank raising rates by a total 0.5 of a percentage point in the first six months of 2018, or a bit sooner.

We've had speculation, off and on, about higher borrowing costs in the past decade or so and rates stayed low. Today, risks to the economic outlook include a correction in the housing market, high household debt levels and weak wage growth. But the U.S. economy has been strong enough lately for rates to start rising, and it looks like Canada could follow the same pattern if our overall economic picture continues to improve.

In any case, preparing for higher interest rates is like starting to exercise more. You'll end up in better shape. Here are six things you can do to get ready for higher rates on mortgages, lines of credit, car loans and more, and a few additional points for savers and investors.

1. Check when your mortgage renews
Find out whether your renewal date is in the next six months or so and see if it's possible to renew early. Some lenders will let you renew several months before the actual renewal date – the question is whether they offer you a decent rate. If not, talk to other lenders about what they can offer if you transfer to them on renewal.

2. Go with a fixed rate mortgage
Most people are already doing this, but there is a group of home owners who rightly point out that variable rate mortgages have been a long-term money saver. Looking forward, a fixed rate mortgage offers two layers of protection. One, your payments are set for the term of your mortgage. Two, you eliminate the stress of worrying about rising rates. Remember, variable-rate mortgages adjust as interest rates change. If you already have a variable-rate mortgage, think about locking into a fixed-rate loan.

3. Consider a lump-sum mortgage prepayment
Lowering your principal today means less to finance at a higher rate in the future. Even if rates don't rise, you'll save on interest costs over the long term.

mortgage rate if you're buying a home
Lenders will hold rates for as long as 90 or 120 days. It's a no-brainer to get a commitment on today's rates, even if you're only half serious about buying.

5. Start chipping away at your line of credit balance
The federal Financial Consumer Agency of Canada says 25 per cent of people with lines of credit are making the minimum payment every month, often just interest. Forty per cent do not make regular payments to lower their loan balance. In a higher rate world, those habits for managing a line of credit will keep you indebted indefinitely. Start regularly paying principal down now, while your interest costs are still low.

6. Cool it on the car buying
Low rates have fed a multi-year surge in car sales and allowed people to get into more expensive vehicles. Even with low rates, data from J.D. Power shows the average monthly loan payment was above $600 in April, and a stunning 52 per cent of new vehicle loans had terms of seven years and longer. There's a recklessness shown in these numbers. Car loans should be five years, max. Buy cheaper vehicles to make that happen.

And, three points for investors and savers:

-Watch for better rates on savings
If and when the Bank of Canada starts raising rates, make sure the bank or credit union where you have your high rate savings account reacts by bumping up your return. If not, find a more competitive bank.

-Be cautious with long term bonds and bond funds.
Returns from long-term bonds have been fabulous in recent years because of the declining interest rate trend. But rising rates would hit long-term bonds the hardest. Stay with bonds maturing in five years or less, or use a short-term bond fund.

-Brace yourself for some dividend stocks to struggle
Utility, pipeline and telecom stocks may wilt somewhat as rates rise, and real estate investment trusts might do so as well. If your goal is to generate dividend income, ignore the price decline.

https://www.theglobeandmail.com/globe-investor/personal-finance/household-finances/how-borrowers-savers-and-investors-can-prepare-for-higher-interest-rates/article35296641/

Technology: What is Bitcoin?

Bitcoin is a form of digital currency, created and held electronically. No one controls it. Bitcoins aren't printed, like dollars or euros – they're produced by people, and increasingly businesses, running computers all around the world, using software that solves mathematical problems.
It's the first example of a growing category of money known as cryptocurrency.

What makes it different from normal currencies?
Bitcoin can be used to buy things electronically. In that sense, it's like conventional dollars, euros, or yen, which are also traded digitally. However, bitcoin's most important characteristic, and the thing that makes it different to conventional money, is that it is decentralized. No single institution controls the bitcoin network. This puts some people at ease, because it means that a large bank can't control their money.

Who created it?
A software developer called Satoshi Nakamoto proposed bitcoin, which was an electronic payment system based on mathematical proof. The idea was to produce a currency independent of any central authority, transferable electronically, more or less instantly, with very low transaction fees.

Who prints it?
No one. This currency isn't physically printed in the shadows by a central bank, unaccountable to the population, and making its own rules. Those banks can simply produce more money to cover the national debt, thus devaluing their currency.

Instead, bitcoin is created digitally, by a community of people that anyone can join. Bitcoins are 'mined', using computing power in a distributed network.

This network also processes transactions made with the virtual currency, effectively making bitcoin its own payment network.
So you can't churn out unlimited bitcoins?

Conventional currency has been based on gold or silver. Theoretically, you knew that if you handed over a dollar at the bank, you could get some gold back (although this didn't actually work in practice). But bitcoin isn't based on gold; it's based on mathematics.

Around the world, people are using software programs that follow a mathematical formula to produce bitcoins. The mathematical formula is freely available, so that anyone can check it.

The software is also open source, meaning that anyone can look at it to make sure that it does what it is supposed to.

What are its characteristics?
Bitcoin has several important features that set it apart from government-backed currencies.

1. It's decentralized. The bitcoin network isn't controlled by one central authority. Every machine that mines bitcoin and processes transactions makes up a part of the network, and the machines work together. That means that, in theory, one central authority can't tinker with monetary policy and cause a meltdown – or simply decide to take people's bitcoins away from them, as the Central European Bank decided to do in Cyprus in early 2013. And if some part of the network goes offline for some reason, the money keeps on flowing.

2. It's easy to set up. Conventional banks make you jump through hoops simply to open a bank account. Setting up merchant accounts for payment is another Kafkaesque task, beset by bureaucracy. However, you can set up a bitcoin address in seconds, no questions asked, and with no fees payable.

3. It's anonymous. Well, kind of. Users can hold multiple bitcoin addresses, and they aren't linked to names, addresses, or other personally identifying information. However…

4. It's completely transparent. …bitcoin stores details of every single transaction that ever happened in the network in a huge version of a general ledger, called the blockchain. The blockchain tells all.

If you have a publicly used bitcoin address, anyone can tell how many bitcoins are stored at that address. They just don't know that it's yours. There are measures that people can take to make their activities more opaque on the bitcoin network, though, such as not using the same bitcoin addresses consistently, and not transferring lots of bitcoin to a single address.

5. Transaction fees are miniscule. Your bank may charge you a £10 fee for international transfers. Bitcoin doesn't.

6. It's fast. You can send money anywhere and it will arrive minutes later, as soon as the bitcoin network processes the payment.

7. It's non-repudiable. When your bitcoins are sent, there's no getting them back, unless the recipient returns them to you. They're gone forever.

So, bitcoin has a lot going for it, in theory. But how does it work, in practice? Read more to find out how bitcoins are mined, what happens when a bitcoin transaction occurs, and how the network keeps track of everything.

http://www.coindesk.com/information/what-is-bitcoin/

Summer Activities

Canadian Track and Field Championships
July 6th – 9th
http://athletics.ca/#sthash.fHOSt3cT.dpbs

H.O.P.E. Volleyball Summerfest
July 15th
http://www.hopehelps.com/

RBC Bluesfest
July 6th – 16th
http://www.ottawabluesfest.ca/

Casino Du Lac-Leamy Sound of Light
August 5th – 19th
http://www.feux.qc.ca/

Capital Pride Festival
August 21st – 27th
http://ottawacapitalpride.ca/

Upcoming Events:

We typically don't have any scheduled events or seminars during the summer months.

Check back with us for our first scheduled Client Seminar in September.

As always, we welcome any suggestions you may have.

Sky Lounge

Heighten your senses at Sky Lounge, an exclusive culinary flight of fancy that will take you 150 feet in the air to discover Ottawa's fine dining like never before.

Treat yourself to Andaz Feast+Revel's Chef Stephen La Salle and his team's appetizing creations — while enjoying a spectacular view of the nation's capital.

Two different culinary journeys will excite your taste buds, each showcasing great Canadian food products, locally sourced, prepared with a dash of subtle creative nuances and flavours.

From July 7th to 22nd