The Francis Forum

Create Wealth, Achieve Freedom

Summer Edition 2013

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INSIDE THIS ISSUE

Are We in a Bull Market or a Bear Market? And Should You Care?

The financial and popular media is fascinated with labeling markets as bulls or bears as if that somehow describes what is happening to your stocks.

It is true that market risk – the danger that a declining overall market may affect your stock – is real. However, investors who work with advisors know the difference between a general market decline and something wrong with their stock.

Some High and Some Low

Look at any bear market and even at its lowest point you will find stocks that do quite well. Similarly, in any bull market there are stocks that do poorly.

A rising or ebbing tide does not necessarily raise or lower all the stocks in a market.

When the overall market is declining or rising significantly, the intelligent investor has a real advantage over the person who has invested on a whim.

If you know the company behind the stock, you will be able to judge whether the stock's price decline is simply a reflection of the market's general pessimism or a signal that something is fundamentally wrong with the company.

Decisions

Armed with this knowledge, you can then decide whether to:

- Sit tight and let the market work through its problems
- Take advantage of the price decline and add to your holdings if you believe nothing has fundamentally changed with the company
- Sell before the loss becomes worse

Whatever your decision, you are armed with information to make an intelligent decision.

In a bull market, your stock may take off with the market, which is not necessarily a bad thing. However, you may be concerned that the stock will become highly overpriced and will suffer a significant drop when the bull market ends.

Options

Here are some options:

- You could sit tight and let the market work through its problems
- You could sell some of the shares and buy back the stock when the price falls back to reasonable levels
- You could sell all of the shares for a profit

You can protect yourself in several ways from the danger that a bull market has overpriced a stock so badly that it might fall below its true value.

Whatever course of action or inaction you choose, the intelligent investor always works from a position of knowledge. If you know the company and its industry, you won't have to worry about whether it's a bull or bear market.

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

Sincerely,

Duane

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Have We Given Up on Retirement Saving?

Is it over? Has the love affair with the RRSP soured as Canadians turn their attention to fighting ballooning debt? Do they prefer the odds of the housing market to the paltry returns they have seen since the financial crisis?

Sure RRSPs are a great way to defer taxes, but is our financial literacy sound enough to make sure we make the most of that advantage? Is saving taking a back seat to the prevailing advice to pare down debt before interest rates rise?

The RRSP was first introduced in 1957 as the government's plan to help us save for our own retirement and supplement the Canada Pension Plan but today the overwhelming majority of Canadians fail to make full use of the fact they can contribute up to 18% of their previous year's earned income.

The latest information from Statistics Canada going back to 2011 shows only about six million Canadians made an RRSP contribution. The amount of unused RRSP contribution room is now more than $500-billion.

So even as income security provided by private pension plans declines and the age to collect old age security will be increasing for many now in the workforce, we are saving less, not more.

The key debate this year seems to be whether to pay down debt or make that RRSP contribution. Household debt to income — all debt divided by after-tax income — reached a record 164.6% in the last quarter.

Canadians listed paying that down as their No. 1 priority for 2013 in a Canadian Imperial Bank of Commerce survey.

The survey found 17% listed reducing debt as their top financial priority while only 7% picked retirement planning. Two years ago, retirement planning was listed by 13% as a top priority.

Credit card debt has a high interest rate by its very nature and it's unlikely no matter how well you do in your RRSP or TFSA you'll beat the rate on your debt.

Convincing consumers to save can be a tough sell, given the poor performance of many investments. Returns, regardless of the type of investor you are, for the last decade or so have not been fun.
Besides, investors may wonder, who needs a retirement plan if you have a house that has doubled in value over the last decade?

Then there's the tax-free savings account — now five years old and eligible for $25,500 in contributions over that period — a far more flexible vehicle for depositing and withdrawing money.

Are RRSPs relevant? Yes, in the sense that people need to save for retirement and generally we are falling further behind. Income security is not as great as it used to be. We need to actually save more and for most middle and upper income Canadians, RRSPs are still the way to save.

Still, our saving rate has slowed. A Toronto-Dominion Bank study released this week found 15% of Canadians will spend five years or less saving for retirement even though 69% of retirees wished they had saved for 25 years.

Canadians just don't seem to have any money. A poll from the Bank of Nova Scotia released Tuesday found 64% of Canadians cited affordability as a barrier to investing, up from 59% a year earlier.

The TD poll found many working Canadians have come to grips with the new reality, with 36% planning to work until after 65. Another 16% of Canadians plan to work into their 70s.

There remains a fundamental problem with the RRSP — namely many people seem oblivious to the fact the money will eventually be taxed. People are not investing as much as they think. If you take $1,000, and keep the math simple and use an outdated 50% tax bracket, that $1,000 needs to become $2,000 in the RRSP!

What often happens is people will put $1,000 in their RRSP and just spend the $500 refund. What that does is turn $1,000 of after-tax money into $1,000 of before-tax money because your refund is blown and now you have money sitting in an RRSP that has yet to be taxed.

It's easy to see where some people might be spending potential savings. Housing. There are intellectual reasons why savings should be dropping since housing has become so expensive, that most have to pour all the money into their mortgage.

Perhaps that's why Canadians view their principal residence as a key component of their retirement. A Bank of Montreal survey last year found 41% of Canadians are counting on their home value to bridge any retirement shortfall.

http://business.financialpost.com/2013/01/16/have-we-given-up-on-retirement-saving/

Are You Sure You Can Put That in Your TFSA?

There's a difference between what you should put in your Tax Free Savings Account (TFSA) versus what you can legally hold in this relatively new savings vehicle.

Contrary to popular belief, the TFSA is not merely a savings account, as its name seems to suggest, but rather can be used as vehicle to hold all kinds of qualified investments, similar to an RRSP or RRIF.

The options for TFSA investment are virtually endless: from cash and GICs, to stocks and bonds, along with mutual funds and ETFs.

But the rules concerning qualified investments can be complex and detailed, especially when your investment is something other than a plain vanilla, blue chip Canadian stock. Take the controversy that arose online last month of a TFSA that had grown to over $172,000 by investing in shares of Fannie Mae, the U.S. housing lender that has been placed into the conservatorship of the Federal Housing Finance Agency.

While common shares generally qualify for investment in a TSFA, the rules themselves are quite technical. The Income Tax Act states that in order for a stock to be a qualified investment for a TFSA, it generally must be listed on a designated stock exchange.

The Department of Finance maintains a list on its website of designated exchanges, which includes 41 exchanges in 28 countries, ranging from the U.S. NASDAQ to Israel's Tel Aviv Exchange. The list includes most Canadian and U.S. stock exchanges but Over-the-Counter Facilities such as the NASDAQ OTC Bulletin Board facility and the Canadian OTC Automated Trading System are not on the list.

Fannie Mae, which used to be traded on both the New York Stock Exchange and the Chicago Stock Exchange, was delisted in June 2010 and began trading on the OTC Bulletin Board, which is not a designated exchange; however, because it also listed on the Stuttgart Stock Exchange in Germany, it appears its shares do qualify for investment by TFSAs, regardless of which exchange the shares are purchased through.

Interestingly, there is a special rule that applies to Canadian public companies that have been delisted. Shares of Canadian listed corporations which are subsequently moved to over-the-counter status continue to be qualified investments for a TFSA and other registered plans. But this rule doesn't apply to U.S. or other foreign stocks.

The consequences of investing in a non-qualified investment inside your TFSA can be quite severe. First of all, there is an automatic penalty of 50% of the fair market value of the non-qualified investment in the year it is purchased by the TFSA. Fortunately, as long as you can demonstrate that it was purchased inadvertently, this penalty can be refunded in the year the non-qualified investment is disposed of by the TFSA.

But the real problem is that the TFSA itself must pay tax, at the top marginal tax rate, on any income or capital gains earned from the non-qualified investment. To make matters worse, the capital gain is taxed in full, and not at the normal 50% inclusion rate.

http://business.financialpost.com/2013/06/22/are-you-sure-you-can-invest-that-in-your-tfsa/?__lsa=d47f-f0f7

Sometimes it Pays to Challenge the CRA

If you filed your 2012 tax return late and you owed money, you're probably in no hurry to receive your Notice of Assessment from the Canada Revenue Agency, showing the amount of your late-filing penalty and arrears interest owing.

But if you feel that you've been unjustly charged a penalty or interest due to circumstances beyond your control, you should consider applying to the CRA under the "fairness provisions" for some relief.

The fairness legislation, introduced in 1991, gives the CRA the discretion to cancel or waive either all or a portion of any interest or penalties (but not the actual tax) payable.

But trying to argue that the "dog ate my tax return" may not be enough. For the fairness provisions to apply, the penalties and interest must have generally resulted from circumstances beyond your control. Examples of "extraordinary circumstances" may include: natural disasters such as a flood or fire, a serious illness or accident or serious emotional or mental distress such as a death in the family.

If your request for interest or penalty relief is initially turned down by the CRA, you can request that your case be reviewed a second time by the director of your tax centre or district office.

If it's again denied, you can apply to the Federal Court for a judicial review. While the Federal Court does not have the discretion to directly reverse the CRA's decision, it will determine whether, in the court's opinion, the CRA has "exercised its discretion in a reasonable and fair manner." If the court finds that the CRA did not properly exercise such discretion, it will refer the request once again back to the CRA for reconsideration.

http://business.financialpost.com/2013/05/25/sometimes-it-pays-to-challenge-the-cra/

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Does Investment Conservatism Pay Off?

Since the 2008 market meltdown, many individual investors have stayed away from equities, which is a shame since they would have recovered all their losses had they simply held on and waited for a recovery.

For those of us who still believe in equities, the question is: What should you do with your equity holdings as you get closer to retirement? After all, you don't want a bear market in stocks to ravage your RRSP balance just as you are about to retire, so perhaps it is prudent to start shifting to fixed-income investments a few years beforehand.

A little conservatism when investing one's retirement savings might seem like a good thing, but it is eye opening to learn just how much it costs you in terms of lost opportunity. An analysis of stock and bond returns over the past half-century shows conservatism has rarely paid off.

Using actual equity and bond returns since 1963, I compared two scenarios involving people saving for retirement through RRSPs.

In what I call the 60/40 scenario, they invest 60% of their RRSP in an equity fund (Canadian and U.S. stocks) and 40% in a bond fund (long-term government bonds) right up until retirement. This is the more aggressive investment strategy.

In the 30/70 scenario, they reduce their equity weighting to 30% five years before retirement to protect against a market correction. The other 70% is invested in a bond fund. I calculated the final RRSP balance under these two scenarios for each year from 1967 to 2012.

Before we get to the results, let's consider the theory.

One would expect the 30/70 scenario would do a little worse than the 60/40 scenario on average, because equities outperform bonds in the long run but also entail more risk.

On the other hand, 30/70 should reduce the chances of a catastrophic loss in the event of a stock market crash. You can think of it as an insurance policy. The only question is whether the trade-off is fair.

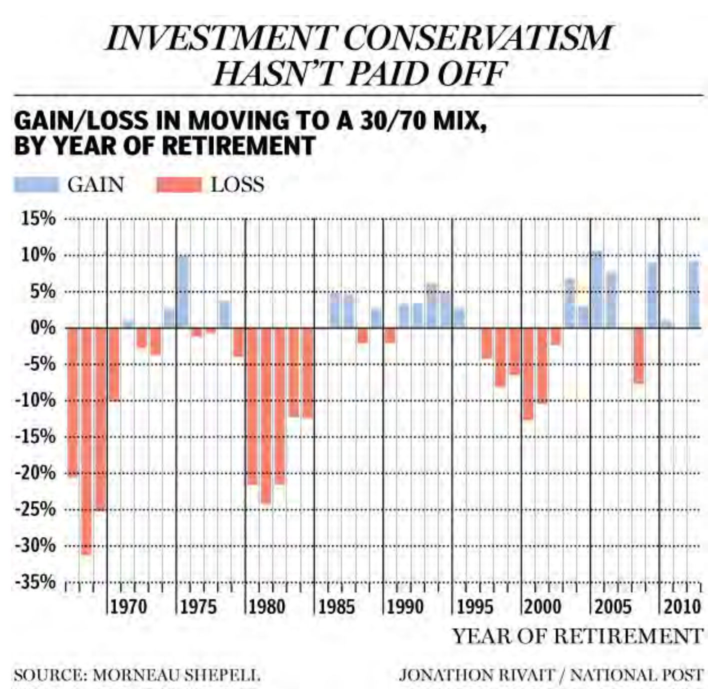
It turns out the cost of that insurance is rather high. Compared with the 60/40 scenario, the final RRSP balance under the 30/70 split was 4.5% lower on average, which is significant. Assuming an RRSP balance of $250,000, that translates into a loss of $11,250, which means you're paying heavily to reduce your downside risk. What's worse, the final RRSP balance under 30/70 in some years was lower by as much as 30%.

One possible response is to swallow hard and remind yourself that insurance is expensive, but it is important to avoid a catastrophic result. As an actuary, I would be the first to agree, but how catastrophic would the result have been in the past 50 years?

Glancing at the accompanying chart, the worst case seems to occur in 2005, when 30/70 would have produced an RRSP balance that was 10.6% higher than 60/40. That is because one would have held only 30% in equities in 2001 and 2002, a period that became known as the "perfect storm."

While equities didn't do as well, 60/40 still produced an average annual return of 4.6% in the five years leading up to 2005. If the point of adopting a 30/70 mix was to avoid a catastrophic result, it didn't happen.

The worst five-year period for 60/40 in the past 50 years was the one ending in 1974, when the average annual return was 1.1% (net of a 1% investment management fee), although in real terms it was worse than that since inflation averaged 6.5% a year.
Hence, the 60/40 portfolio would have fallen by 25% in real terms over five years. This is arguably catastrophic. The trouble is that a 30/70 portfolio would have lost 15% in real terms, so the costly insurance didn't provide much protection.



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Where does that leave us? No one wants to save their entire career and then see their RRSP portfolio decimated by a market crash just before retirement, but, if history is any indicator, this fear is not a good reason to avoid equities in your RRSP, even near retirement.

The odds are you will do well having 60% or even more of your portfolio invested in equities. There are no guarantees, of course, and every so often your exposure to equities will hurt you.

You can shift to a more conservative asset mix, such as the 30/70 scenario, but this is a costly strategy and even when you really need the protection, it's unlikely to be much better than 60/40.

Of course, you could avoid equities altogether in the years leading up to retirement, but the opportunity cost would be even greater than under 30/70. Risks can be mitigated, but they cannot be avoided without creating an even worse problem.

If you have other sources of retirement income and are not relying too heavily on your RRSP holdings, my suggestion is to maintain your equity weighting at 60% or even higher, assuming you can still sleep at night if the markets do fall.

I strongly suggest investing in a reputable equity fund with a low management expense ratio rather than choosing your own stocks. If you are truly risk averse, lighten your equity weighting but keep in mind that this has been a losing strategy in most years with only minimal effectiveness as a hedge.

There's one caveat: If you decide to invest in something other than equities, avoid long-term bonds for the foreseeable future, especially government bonds. It is a matter of when, not if, interest rates will start rising, and long-term bonds will suffer significant capital losses when they do.

http://business.financialpost.com/2013/05/31/does-investment-conservatism-pay-off/

Graduated Tax System for Testamentary Trusts Likely On The Way Out

The Federal Government formally launched a consultation paper that will likely lead to the elimination of the graduated tax rate system for testamentary trusts and estates. The proposed measures, which were first foreshadowed in the 2013 federal budget, would come into play starting in 2016 and would effectively abolish a common estate planning technique used by wealthy Canadians to reduce tax on the investment income earned from their assets, by their beneficiaries, for years after their death.

A testamentary trust is a type of legal arrangement in which one person, typically known as the estate trustee, holds and manages the deceased's property for the benefit of someone else, known as the beneficiary. A testamentary trust also includes an estate, which arises upon death and generally lasts until the executor distributes the assets to the beneficiaries who are inheriting under the will of the deceased.

For tax purposes, both trusts and estates are considered to be individuals and must file returns which require them to pay tax on any taxable income that is not paid to the trust's beneficiaries.

The graduated tax rates currently applicable for testamentary trusts and estates are in sharp contrast to the tax rate applicable to income earned in an inter-vivos trust, meaning a trust set up while you are alive. Inter-vivos trusts, sometimes known as family trusts, pay tax on income at the highest marginal tax rate acting as a disincentive to use these trusts for tax planning purposes.

Allowing testamentary trusts to pay tax at graduated rates effectively allows the beneficiaries of those trusts, whether it be the surviving spouse or partner, children or grandchildren, to access more than one set of graduated rates – their own and the testamentary trust's.

The tax savings can exceed $20,000 annually, depending on the province, when income is taxed in a testamentary trust instead of perhaps in the hands of a high income beneficiary had they inherited the funds directly and subsequently invested them.

Specifically, the government listed the use of multiple testamentary trusts, tax-motivated delays in completing the administration of estates, and avoidance of the Old Age Security clawback as offensive testamentary trust planning which "raise questions of fairness, and negatively affect government tax revenues."

As a result, the government proposes to change the tax law such to apply flat top-rate taxation to testamentary trusts created by wills as well as to estates "after a reasonable period of administration" of 36 months.

http://business.financialpost.com/2013/06/08/graduated-tax-system-for-testamentary-trusts-likely-on-the-way-out/

Rest Assured: Segmented Sleep

Bad sleepers rarely hear good news. Insomniacs often read about the latest ways our nighttime pacing is believed to be wrecking our health. Or we are treated to recycled and often unrealistic advice about how to shift around our routines to encourage sounder sleep. We can feel guilty if we find ourselves unable to follow it.

So curiosity was piqued when a recent BBC online story, "The myth of the eight-hour sleep," shone a light on a growing body of research suggesting that "segmented sleep" is perfectly normal. It appears that in centuries past, and in pre-industrial societies, bedtime has meant falling asleep once, then waking for a while, and then going back to bed for a "second sleep."

Historians are arguing that everyone used to spend the night that way. For those who wake up in the middle of the night, this could be liberating news.

Before artificial lighting "colonized" the darkness, a nightly wakeful interlude was expected. Lighting and caffeinated beverages promoted active, chatty evenings. This, historians believe, pushed back the Western world's bedtime. The modern ideal of a continuous eight-hour slumber was born.

But prior to that, the idea of a "first" and "second" sleep was apparently routine.

This was the insight of A. Roger Ekirch, a professor of history at Virginia Tech. In his 2005 book *At Day's Close*, he argued that: "Until the close of the early modern era [roughly the year 1800], Western Europeans on most evenings experienced two major sleeps bridged by an hour or more of quiet wakefulness." This period was known as the "watch" or "watching."

Segmented sleep, "also seems to appear in societies that don't have a lot of access to artificial light. … I think it's a natural feature of human evolution to break any long, dark period up into two sleeps."

Take the Trumai, an indigenous people in Brazil. They used to get up in the middle of the night to socialize and flirt by the fireside, smoke, or go fishing. The introduction of electricity to their society put an end to their midnight wanderings. Similar behaviour has been documented in other cultures.

If biphasic slumber is common, could it be the "correct" way to sleep? That is, did evolution design us for two four-hour chunks of rest? What is ideal, anyway?

It appears we do fall into a segmented sleep pattern when coffee and electricity are confiscated from us. The BBC noted a 1990s experiment by the psychiatrist Thomas Wehr, in which subjects were enveloped in profound darkness for 14 hours every night for a month. Over time, they drifted into a biphasic pattern. This was a sign, it has been suggested, that segmented sleep has a prehistoric pedigree.

Could it be that we're genetically determined to sleep this way? The most important thing to remember is that in 2012, the world does not operate the way it did. It's all well and good to say that in the past people had biphasic sleeps, but the question is, what's the relevance today? In this day and age, when people have to go to work in the morning and at home at night, we don't have a lot of choice. We really only have the nighttime to rest.

Yet, it may be worthwhile giving the two-sleep pattern a trial run — or at least stop feeling guilty about mid-night sleeplessness. You might feel relieved when you hear there is historical evidence that may support there's nothing wrong with that.

Maybe even enough to rest a little easier.

http://life.nationalpost.com/2012/07/16/rest-assured-theres-nothing-wrong-with-segmented-sleep/

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Summer Activities

RBC Royal Bank Bluesfest
July 4 – 14, 2013
http://ottawabluesfest.ca/

HOPE Volleyball Summerfest
July 13th, 2013
http://www.hopehelps.com/

The Ottawa Lebanese Festival
July 17 – 21, 2013
http://www.ottawalebanesefestival.com/

The Ottawa Folk Festival
September 6 – 9, 2013
http://www.ottawafolk.org/

Ottawa Fashion Week
September 28 – October 2, 2013
http://eng.ottawafashionweek.ca/

News

Welcome to Mandeville Private Client

As you are now well aware, the move from Manulife Securities to Mandeville Private Client is transitioning very smoothly. This change was driven predominantly by client feedback over the past few years and included numerous features and benefits of continuing with me as your advisor at Mandeville Private Client. The new dealer is very client-focused and intent on providing a superior platform that exceeds your investment needs. We will continue to offer all other services as before (tax preparation, financial plans, Insurance/estate planning etc) through the branch.

At this point we have submitted transfer documents for 90% of our clients and we are in the final stages of this transition. In August, we will be verifying all account holdings and will be back to normal business practices. On that point, I want to say thank you for the overwhelming support you have given to this initiative. It is greatly appreciated.

Should you have any questions, please let us know. We are all here to help.

Ottawa International Busker Festival – August 2- 4, 2013

Ottawa's annual Busker Festival (aka Buskerfest) takes place from August 2-4, 2013 on the Sparks Street Mall in downtown Ottawa. There are over 40 performances daily, with entertainers from across Canada and around the world.

The festival takes place along Ottawa's Sparks Street pedestrian mall between Elgin Street and Kent Street. Shows start daily at 11:00am. Make sure you bring some loonies & toonies for the performers!

There are set performance times for certain locations, but there will also be unscheduled performances popping up along the street and in surrounding areas.

Road Closures

- Thursday & Friday, 6pm-12am: Metcalfe Street closed between Sparks & Wellington.
- Saturday, Sunday & Monday, 10am-12am: Metcalfe Street and O'Connor Street closed between Sparks & Wellington.

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