The Francis Forum

Create Wealth, Achieve Freedom **New Year's Edition 2014**

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INSIDE THIS ISSUE

Would you prefer to hand over control of your investment portfolio to a professional including key asset allocation decisions? Or would you rather continue with an advised portfolio where your financial advisor must consult you about significant changes and fund switches?
This is the choice many investors are facing.

There is of course another alternative: you might research the information and apportion your money across a range of securities by yourself…

For investors wanting someone else to take responsibility for their investment decisions you have the option of choosing discretionary management. A Portfolio Manager (PM) will do all the legwork for creating and maintaining a portfolio that is specifically tailored towards helping you achieve your objectives under a pre-determined risk profile. This compares to traditional financial advisors who put together 'advisory portfolios' for clients and must seek your permission when they want to make changes in the make-up of the funds even where economic and market conditions have changed significantly.

The discretionary route might also appeal to those who, perhaps, don't have the time or knowledge to run their own portfolio and are unsure how to create a balanced spread of asset classes and review them regularly. Of course, this means you have to put your faith in another person to make the investment decisions, but given investors already do this when they buy a managed fund, this might be viewed as simply one step further.

Only a select group of our Investment Advisors can offer you portfolio management services through Private Investment Management. Portfolio Managers must possess advanced investment credentials, extensive experience advising clients and substantial assets under administration.

With discretionary portfolio management, investors delegate day-to-day investment decisions, within agreed guidelines, to the professional Portfolio Manager (PM). That makes the overall portfolio management much more efficient. Since the PM is responsible for making final trading decisions, action can be taken immediately on available information without having to track down the investor for approval. In a non-discretionary structure, the advisor with 300 clients must contact each of them to get "buy" or "sell" approvals. Depending how long it takes to reach all the clients, much of the benefit of the trade may be lost during the delay. For clients in discretionary accounts, the PM can act both tactically and in a timely fashion to seize buying opportunities or sell positions.

Rebalancing in a changing market environment can be important; otherwise asset allocations can be thrown out of proportion with detrimental long-term effects. Discretionary accounts make such rebalancing much easier because PMs can pare positions or lock in profits as needed. As well, discretionary portfolio management takes emotion out of the equation. Many investors find it easy to buy positions, but difficult to sell when it's time to pull the trigger. Without a personal attachment to holdings, PMs are better equipped to take appropriate action based simply on relevant facts.

At the end of the day, investors need flexibility in their portfolios to manage volatility. Investors can gain freedom from stress with a discretionary portfolio management approach that has the flexibility to deal with market fluctuations while staying focused on long-term goals.

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

Sincerely,

Duane

A History of Capital Gains

How much tax, if any, should we pay on capital gains?

Canada's rate on capital gains varies based on your marginal tax bracket, but is 50% of your ordinary income rate. For high income Canadians who earn more than $132,406 in 2012, the top federal tax rate on capital gains, whether the property is held for a day or a decade, is 14.5%, just slightly below the general long-term U.S. federal capital gains rate. State or provincial taxes vary widely but typically increase the total combined capital gains tax rate for top income earners to 20% or slightly higher.

Recall that Canada didn't use to tax capital gains at all. The genesis of our capital gains tax began with the Carter commission report which led to the major tax reform of 1971 with the result that capital gains became taxable as of January 1, 1972.

While the Carter commission recommended full taxation of capital gains, the law, as originally introduced, only taxed 50% of capital gains. The inclusion rate was increased to 75% in 1990 and that inclusion rate stayed constant for about a decade. In February 2000, the rate was reduced down to two thirds, which lasted until October 2000, where it was dropped back to 50%, where it has remained to this day.

Some capital gains are still entirely tax-free. Consider the principal residence exemption, introduced as part of tax reform, which exempts the full gain on your residence from tax. Similarly, in 2006, the government introduced a permanent exemption from capital gains tax for donations of appreciated securities to a registered charity.

The other category of tax-free gains is in the form of the lifetime capital gains exemption. While each Canadian used to be entitled to a $100,000 lifetime exemption from capital gains tax, this general exemption, introduced by the Conservatives in 1984 lasted for only ten years, until being repealed by the Liberals in 1994.

Today, the lifetime capital gains exemption is only available to farmers, fishers or shareholders of qualified small business corporations who can avoid tax on up to $750,000 of capital gain on the sale or disposition of these properties.

So, why the favourable rate for capital gains?

While it's widely believed that the primary reason for taxing capital gains at favourable rates is to encourage individuals to take risks with their accumulated capital, thereby growing the economy in the process through job creation and a lower cost of capital, there may be far more fundamental reasons for having a preferred rate.

Consider inflation. Theoretically, the inflation component associated with a growth in an asset's value shouldn't be taxed since it doesn't truly represent an economic increase in the owner's real wealth. For example, say you buy stock which pays no dividends but is expected to grow in value by 5%. Given our ten-year average inflation rate of 2%, the real yield, pre-tax, is 3%. But our capital gains system taxes the entire 5% gain, not just the real gain of 3%, so effectively you end up paying tax on the inflation component of the stock's appreciation.

Of course the same inflation argument can be made to justify a lower rate of taxation on interest income. Prior to 1988, Canada used to exempt the first $1,000 of annual Canadian interest income from tax. Lower-income Canadians, who tend to have more of their investments in fixed income than equities, were unduly penalized by the repeal of this deduction and continue to face full taxation of interest income, with no inflationary adjustment.

Another reason to favour a lower tax rate for capital gains, particularly on common shares, has to do with the double taxation inherent with corporately-earned income. While this problem is generally solved for corporate income that is taxed inside the corporation and subsequently paid out as a dividend by way of the gross-up and dividend tax credit mechanism, it's more of an issue with corporate retained earnings.

A company that chooses to retain, rather than distribute its after-tax corporate profits to shareholders in the form of a dividend will, all things being equal, grow the value of the company by the amount of retained earnings. This increase in value would be reflected in the share price meaning that a shareholder who faced full taxation on that gain, would essentially be paying tax a second time on the same corporate earnings. Taxing such gains at 50% attempts to mitigate this double taxation.

At the end of the day, it's clear that the capital gains tax, just like any other tax on investment income, is essentially a double tax on savings, such that the choice to defer consumption to a later period in one's life is subject to tax in a way that current consumption is not. Strategic saving through an RRSP or TFSA can avoid this double tax problem altogether.

http://business.financialpost.com/2012/04/21/how-to-calculate-your-capital-gains-tax-or-not/

Investment Fees: Advice is Never Free

In one client's words, he is a "simple conservative accountant."

He holds fixed-income investments. His RRSP investments are in laddered bond ETF's and preferred shares.

"Even though it's very simple, I still use a licensed investment dealer.

Investment advisors can charge in one of three ways: by commission-based on the products sold, on an hourly rate, or lastly, on a flat fee or a fee-based on his assets.

Most choose the last option; but traditionally, Canadians have not enjoyed writing a cheque for their planning advice.

Many opt to have their financial advisors be compensated through commissions — by the sale of mutual funds, for example — so they may never receive an actual bill.

"Investment advice is never free, even if it's 'free', " warns Perry Quinton, vice-president of marketing at the Investor Education Fund.
"The costs are built in somewhere and you're going to pay them."

So how should you pay — and how much? That may depend on the amount that you have to invest.

Advisors at your bank work on a salary basis, though some make added commissions; so while there is no direct, out-of-pocket expense, fees are embedded in the investment or insurance products that you buy to implement their recommended financial plan.

"The reality in Canada is that the vast majority of financial planners hold mutual fund registrations; so their bread and butter is selling funds," Ms. Quinton says.

Turned off by Canadian mutual fund fees, which according to studies are among the highest in the world, our client opted to switch his investments from mutual funds to fixed income investments. (The so-called "invisible fees" embedded in mutual funds include management fees and operating expenses that investors don't often see because returns are reported after the fees have been collected.)

You could opt for the DIY route; investors who are more tech savvy often use discount brokers which offer online trading. "I've seen flat fees on trades ranging anywhere from $10 a trade to $100 a trade," Ms. Quinton says. The downside to this is that you must do the research, come up with your own plan, and buy and sell your investments.

As is often the case, the more money you have, the more options become available.

For those with more than $100,000, it might be time for you to consider other financial planning possibilities such as fee-based or fee-only advisors.

With fee-based payment methods, the advisor charges a fee based on your assets — a percentage of your account value or a percentage of your net worth. If your account value grows, they make more money, creating an incentive for the advisor to boost your funds.

"Some people argue: they're motivated to meet my goals with me. On the other hand, the downside some say is they get paid no matter what they do. If they have 100 to 200 clients, how can I possibly be a priority?" Ms. Quinton says.

While fees could be 2.0% or less per year on the total size of your portfolio, fees are negotiable; the bigger your pot, the less fees you will pay.

Financial planners will charge you an hourly rate or a flat fee to make you a financial plan. "The development of a comprehensive financial plan takes time and effort and an advisor who is truly doing comprehensive financial planning would never do so for anything less than $2,000," says Scott Plaskett, a certified financial planner and founder of Ironshield Planning. "You're paying for a whole year's worth of discussions and strategizing. Financial planning is a moving thing."

Fee-only planners receive 100% of their income from clients and no commissions. However, they do not implement the financial plan; you have to buy and sell your own investments.

Also both fee-only and fee-based planners may charge a quarterly or annual retainer. "The retainer model is a great model because there's full disclosure and people aren't afraid to contact their advisors," Mr. Plaskett says.

http://business.financialpost.com/2013/02/20/investment-advice-is-never-free/

Death and Taxes: Leave Your Assets to your Heirs Instead of the CRA

Unlike the U.S., Canada no longer has any form of estate or inheritance tax. Yet despite this, death can trigger a significant income tax bill that, if not properly planned for, can leave an unexpected liability when a loved one passes away. Here is what happens to your non-registered and registered assets when you die:

Non-Registered Assets

The general rule for non-registered assets is that a taxpayer is deemed to have disposed of all his or her property, such as stocks, bonds, mutual funds and real estate immediately before death at their fair market value (FMV).

When the FMV exceeds the property's adjusted cost base (ACB), the result is a capital gain, half of which is taxable to the deceased and must be reported in the deceased's final tax return, known as the "terminal return." There is an exception for the capital gain arising on the deemed disposition upon death of your principal residence, which is generally exempt.

For example, let's say you die with a portfolio worth $1,000,000 that had an ACB of $400,000. The capital gain on the deemed disposition at death would be $600,000. Since only half the gain is taxable, tax would be owing on a $300,000 taxable gain. Assuming a 45% marginal tax rate for the year of death, $135,000 of taxes would be payable on the terminal return as a result of this deemed disposition.

If you own qualified small business corporation (QSBC) shares, a qualified farm or fishing property upon death, you can claim on your terminal return any remaining lifetime capital gains exemption (currently $750,000 but rising to $800,000 in 2014) against any capital gains arising from the deemed disposition of that property.

Perhaps the best way to avoid or at least defer this deemed disposition upon death is to transfer the property to the deceased's spouse or partner, where applicable. When property is transferred in this way, the transfer can be done without triggering any immediate capital gains and the associated tax liability can be deferred until the death of the second spouse or partner (or until that spouse or partner sells the property, if earlier.)

So, continuing the example above, if you had left your portfolio to your surviving spouse, he or she would be deemed to inherit the portfolio at your original ACB of $400,000, deferring the $600,000 capital gain to the future.

Another opportunity to eliminate the tax arising from the deemed disposition at death is to consider leaving appreciated marketable securities to a registered charity through your will. The capital gains tax is completely eliminated when appreciated publicly listed shares, mutual funds or segregated funds are donated in-kind to charity.

For example, let's say Warren owned publicly traded shares that were worth $30,000 as of the date of his death and had an ACB of $6,000. If he had willed those shares to his favourite charity, the capital gains tax would be eliminated on the $24,000 accrued gain, yielding tax savings of about $5,000, assuming a marginal capital gains tax rate of approximately 20%. In addition, a charitable donation receipt for the FMV of the shares donated upon death ($30,000) would be issued which could produce a tax savings on the terminal return (or in the prior year's return) of at least 40% ($12,000), depending on his province of residence.

Registered Plans

For many Canadians, however, the largest tax liability their estate will face is the potential tax on the FMV of their RRSP or RRIF upon death. The tax rules require the FMV of the RRSP or RRIF as of the date of death to be included on the deceased's terminal tax return with tax payable at the deceased taxpayer's marginal tax rate for the year of death.
This income inclusion can be deferred if the RRSP or RRIF is left to a surviving spouse or partner, in which case tax will be payable by the survivor at his or her marginal tax rate in the year in which funds are withdrawn from the RRSP or RRIF.

Alternatively, an RRSP or RRIF may be left to a financially dependent child or grandchild and used to purchase a registered annuity that must end by the time they reache age 18. The benefit of doing this is to spread the tax on the RRSP or RRIF proceeds over several years, allowing the child or grandchild to take advantage of personal tax credits as well as graduated marginal tax rates each year until he or she reaches the age of 18. If the financially dependent child or grandchild was dependent on the deceased because of physical or mental disability, then the RRSP or RRIF proceeds can be rolled to the their own RRSP or RRIF.

http://business.financialpost.com/2013/10/25/death-and-taxes-heres-what-happens-to-your-assets-when-you-die/

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Five Practical Financial Preparations for a Long-Term Vacation

If the chilling reminder of what's in store this season has you thinking of going on an extended trip, here are five financial preparations to make before any long-term vacation**.**

1. Get travel insurance. Only half of Canadians buy medical insurance before traveling. You don't want to get caught with a $20,000 bill to treat a broken leg in the U.S. Check with your employer or your credit card company because you may have some coverage under their plans.

2. Check your home insurance policy. According to a recent survey, only 12% of Canadian snowbirds say they checked their home insurance policy to ensure their primary residence would be covered while on vacation. Often, insurance policies have specific "away" requirements, which, if not fulfilled, could void coverage if your home is left unoccupied and unattended for an extended period of time. Make sure you know what steps to take to keep your policy valid, for example arrange to have someone check your home every seven days to make sure heating is on and shut off the water supply.

While you're renting a vacation home, if you have home insurance, your contents could be covered anywhere in the world and you may have liability coverage. It's best to check your policy

3. You want your home to have that "lived-in" look while you're away. Suspend your newspaper subscription. Have someone shovel your snow. Get Canada Post to hold your mail. This service starts at $20 for the first 10 weekdays and is $8.50 for each additional week. So if you're gone for six weeks, it will cost you $54 for Canada Post to hold your mail. To save money, enlist a friend who will come by and check up on the property and collect your mail.

4. Don't forget to set up a budget before you leave. The wise thing to do would be to know how much you have to spend and try to play within your boundaries. The unwise thing to do would be to overuse your credit card and return home to a giant bill that will stress you out after a relaxing vacation.

5. Make sure that your bills get paid. A lot of bills can be paid online or prepaid with your credit card. Make a list of the bills that need to get paid and try to sort out the payment before you leave in case the sun and the beach makes you forgetful.

http://business.financialpost.com/2013/11/30/for-weekend-or-whenever-five-practical-financial-preparations-for-a-long-term-vacation

Five Costs you May Have Forgotten if you Think you Have Saved Enough for Retirement

There can be much higher costs that eviscerate your retirement nest egg than what you had originally planned for.

1. Long term care costs: You can't readily estimate what illnesses or conditions may raise your cost of living. If your assets can't cover the bills, it is worth investigating both long term care and critical illness policies. Long term expenses are not just institutional. They could include costly drugs that are not paid by provincial health care plans. It could even mean medical travel to the U.S. or other centres for treatments that require long waits in Canada. The costs could include transportation, or foreign hospitalization. Note that travel medical coverage typically excludes pre-existing conditions.

2. What it may cost to maintain your house or cottage: If you have to hire help to do the chores you used to handle, costs may skyrocket. House maintenance can be a major expense. It may be nickels and dimes when you are alive. If someone else has to do it because your health doesn't allow it, the bills can mount up, especially if maintenance was deferred in a period of illness or old age.

3. Costs of running a small businesses: If you've done it all and others who take your place will have to hire staff, tradespeople and managers, then you should make provisions in your retirement budget, or your will, which anticipate the costs. Without such attention, the asset could become a money pit that ends up requiring costly subsidies out of your pocket.

4. Inflation: Anyone who remembers the 1970s and the early 1980s when prices rose at double digit rates knows that our present rate of inflation in the low single digits may not last. Retirement budgets that get most of their cash flow from low yield Guaranteed Income Certificates and Canada Savings Bonds will lose purchasing power over time. To pace inflation, you need common stocks or other assets that can generate higher incomes over time. Otherwise, a retirement that starts out adequately funded can leave you poor after decades of inflation.

5. Money to help children or grandchildren purchase their own homes: It can come out of retirement savings or be included in your wills. It will be a gift unlikely to be forgotten, even if it is not strictly your own cost of living.

http://business.financialpost.com/2013/11/29/five-costs-you-may-have-forgotten-if-you-think-you-have-saved-enough/

Six Ways a Financial Planner Might Not Have Your Best Interests in Mind

One of the most fundamental conflicts of interest in wealth management is the simple act of charging fees. That in itself serves to lower the clients' net worth. But as the saying goes: you get what you pay for.

While some conflicts are a given, here are six others that consumers of financial products should look out for:

Sales quotas: There are many financial institutions, banks included, that have themed sales months. My favourite is VISA month. That is when your financial planner suggests out of the blue that you should consider getting a new and different VISA card. If that happened to you, chances are that this means it is VISA month, and your financial advisor has a quota on the number of new cards to sell.

Up front commissions: Any time a financial advisor is paid up front for what should be a long-term client relationship, it puts too much pressure on the up front sale, and reduces the incentive for the advisor to spend a lot of time with the client after the initial sale. In the investment industry, this can be seen by those that sell mutual funds with a deferred sales charge or DSC. Unfortunately, the entire insurance industry is based primarily on paying advisors up front, and very little ongoing. While there may be less need for significant ongoing service on insurance, the current compensation structure is why most people almost never hear from their insurance broker for years after a sale is complete.

Selling fear: While in some cases, fear is required to ensure someone begins saving more for retirement, I find that like the Scotiabank commercial, many people are richer than they think. The general message to all from the industry (based on commercials and advertising and surveys) is that you better save more for your retirement if you don't want to be destitute. I find that many people underestimate the impact of Canada Pension Plan (CPP), Old Age Security (OAS), real estate values, and inheritance, on their retirement. When properly taken into account, there is often less to fear than they think, and working with the right advisor can ensure you are fully aware of any retirement income coming your way.

Mortgage/credit life insurance: The most common of these is when someone buys a mortgage. They can also be found on many lending products like a line of credit or even credit cards. What is sold is protection for you so that you don't have to worry about your debts if you die. In reality, these very high margin products are a double win for the bank/lender. First, they make extra profits on what is usually term insurance, with a declining payout as the debt balance declines, and second, they add more protection for the lender as the debt will be paid off if something happens to you. If you are going to buy insurance, take the time to buy personal insurance from someone who is not primarily a lender, and ensure that your family is the beneficiary and not the lender.

Advisor gets paid more to sell stock funds than bond funds: Many advisors earn double the amount each year for holding a stock mutual fund as opposed to a bond mutual fund. If one of their most important jobs is to ensure that you have the right risk and growth balance in your investments, do you really want an advisor to be biased by how much they get paid? Advisors should be paid the same on stocks, bonds and cash holdings like they do in fee-based accounts. This is the only way to ensure a true and honest asset mix recommendation.

Product Bias: This can occur when an advisor only sells one financial service yet continues to provide advice on what you should do with your money. A great example is an advisor who only sells mutual funds, and so recommends against using available surpluses to pay off debts or purchase insurance.

http://business.financialpost.com/2013/11/16/six-ways-financial-planners-might-not-have-your-interests-in-mind/

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Winter Activities

The Wedding Palace Bridal Show
January 11th – 12th, 2014
http://www.weddingpalace.ca/winter-show.aspx

The Home Renovations Show
January 24th – 26th, 2014
http://www.caneastshows.ca/

Winterlude
January 31st – February 17th, 2014
http://www.pch.gc.ca/eng/1379706275276

The Ottawa Home Show
March 20th – 23rd, 2014
http://www.ottawahomeshow.com

The Ottawa Film Festival
March 22nd – 29th, 2014
http://www.offestival.com/

News

- Evening Seminar
  How your Portfolio is positioned for a Changing World
  Wednesday January 22nd, 2014
- Our annual Children's Christmas Party was held at the LoneStar Ranch on Sunday December 8th. It was again a great success and the kids had a blast.

Thanks to all of you for making 2013 a great success!
Here's to a joyous and prosperous 2014!

The Ottawa SkyHawks

For the first time in the history of our city, the people in the national capital region can now cheer for their very own pro basketball team, playing at the highest level of basketball in Canada. The Ottawa SkyHawks (part of NBL Canada) play 20 home games at the Canadian Tire Centre (formerly Scotiabank Place).

The SkyHawks' goal is to win championships and create an amazing experience for their fans. They invite you to experience the leadership of Two-Time champ Coach Kevin Keathley. You will get to experience high-flying pro basketball players like Justin Tubbs, Tirrell Baines, Mike Rose, and Jermaine Johnson bring down the roof at the CTC.

Exciting pre-shows, unique half-time shows, exceptional dance routines by the SkyGirls, and much more all packaged up in an evening of unlimited entertainment ... for as low as $13 a game (Plus venue charges and taxes).

Bring your family, your colleagues and your friends for some indoor winter fun and cheer on your local team!