

Portfolio Advisor



Wealth Management
Dominion Securities

July 2019

Market commentary

So goes the economy, so goes the equity market. This is our long-standing investment philosophy, and it comes in handy now as multiple uncertainties within and outside of financial markets vie for investors' attention. Amidst the noise, we remain focused on U.S. and global economic momentum. They have slowed, validating the range-bound pattern most markets have delivered for many months, but we are not yet seeing signs that a recession is imminent.



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Until recession risks escalate, we believe equities deserve the benefit of the doubt and recommend holding global equity exposure at the long-term strategic recommended level, which equates to a “market weight” or benchmark position. While we think it’s too early to become overtly defensive by trimming equities below that level, it is prudent to upgrade the quality of holdings.

Fixed income

The U.S. Federal Reserve (the “Fed”) is poised to begin reducing interest rates in the coming months, and, in our opinion, a 0.5% cut will occur at the Fed’s July meeting. And as the Fed moves to preempt potential economic weakness, we believe an additional 0.25% cut is likely this fall. Other major central banks are likely to follow suit with “dovish” policies (i.e., lower

interest rates to encourage economic growth). Sovereign yields in Europe and Japan have fallen deeper into negative territory, and the 10-year Treasury yield has slipped below 2%. We feel easier Fed policy, ongoing trade uncertainty, and slow growth mean the Treasury yield has settled into a 1.75%–2.00% range.

We maintain our Market Weight positioning in global fixed income, and even with the feeding frenzy for yield across all fixed-income sectors, we continue to recommend investors upgrade to higher-quality corporate bonds as we approach the later stages of the credit cycle.

To learn more, please ask us for the latest issue of *Global Insight*.

RBC Wealth Management
Global Portfolio Advisory Group

Fortifying your portfolio

As the longest bull market in history ages, and the economy shows signs of being in the late-cycle stage of its life, many investors are wondering if it's time to take a more defensive stance in their portfolios.



Since the post-Financial Crisis bottom in March of 2009, the benchmark S&P 500 Index has soared, delivering a more than 350% return for investors*. And, during most of the past decade, Canadians have enjoyed a recession-free economic expansion. In short, it's been a decade of wealth creation the likes of which most of us have never seen.

When volatility struck markets last fall, many investors began to wonder if the “bull of all bulls” was finally ready to head out to pasture. Indeed, many of the commonly accepted indicators of an aging economic cycle, from soaring equity market prices and rising volatility, to strong employment, GDP growth and disappearing economic slack, are evident. More market volatility and a potential economic slowdown could be in the offing as we progress to, and through, the end-of-cycle economic stage.

Ready for a siege: building up your portfolio's parapets

No economic outlook is a certainty, and making wholesale changes to your portfolio in anticipation of potential economic or market conditions is rarely

advisable. Usually, the only reason to make significant changes to your portfolio is if your life circumstances change. However, there are strategies to shore up your defences if your portfolio looks to be under siege:

Duration

Shorten the duration (i.e., a measure of the sensitivity of the price of a bond to a change in interest rates) of your economically sensitive, corporate fixed-income holdings; maintain the duration of your sovereign debt holdings to take advantage of their hedging effects in volatile times.

Quality

Ensure your portfolio contains quality, blue-chip equities (i.e., reasonable price-earnings ratios, strong balance sheets, high earnings quality, etc.), while remaining mindful of valuations. Look internationally to economies earlier in the cycle than Canada and the U.S. to find better performing markets when domestic markets are challenged. On the fixed-income side, focus on higher-rated corporate and government bonds.

Dividend payers

Long-term, consistent dividend-payers with a track record of increasing those payouts make for an excellent “defensive wall” when markets become challenged to generate capital returns, with the added bonus of allowing you to reinvest the cash flow into under-priced assets.

Defensive sectors

Consider shifting equity holdings to more defensive sectors that tend to fare better during times of economic stress and have a low correlation to the economic growth cycle, including Consumer Staples and Utilities, which benefit from consistent and largely unchanging demand regardless of economic conditions.

Strong walls to stand on guard for thee

We continually monitor market and economic conditions, and will make appropriate recommendations or changes to your portfolio to reflect evolving opportunities and challenges. Using strategic walls, a well-fortified portfolio that reflects your investment objectives and your established risk tolerance will help you ride out all market and economic circumstances.

For more information, or to determine if any of the strategies discussed here are appropriate for you, please, contact us.

*From March, 2009 to May, 2019. Includes reinvested dividends. Return in local currency. Source: RBC Global Asset Management.

The Canadian (Pipe?) Dream

In this land, there are few limits to what you can achieve – that’s the Canadian Dream. At least, that’s what it was before mounting student debt and delayed life goals turned it into more of a pipe dream for many young Canadians. Fortunately, education planning can help.

In the past, the “life script” generally went like this: graduate, get a job, buy a house, start a family. But with 67%¹ of new post-secondary graduates now entering the workforce burdened with debt, these important life events are being delayed.

However, if they desire a higher income to help achieve their Canadian Dream, young Canadians need an university education, even if that means delaying important life goals. According to a Statistics Canada study² that followed a group of Canadian youth from the early 1990s, women with a bachelor’s degree earned \$442,000 more in average cumulative earnings through their thirties and forties as compared to women with a high school diploma. For men, the difference was \$700,000.

Keeping the dream alive

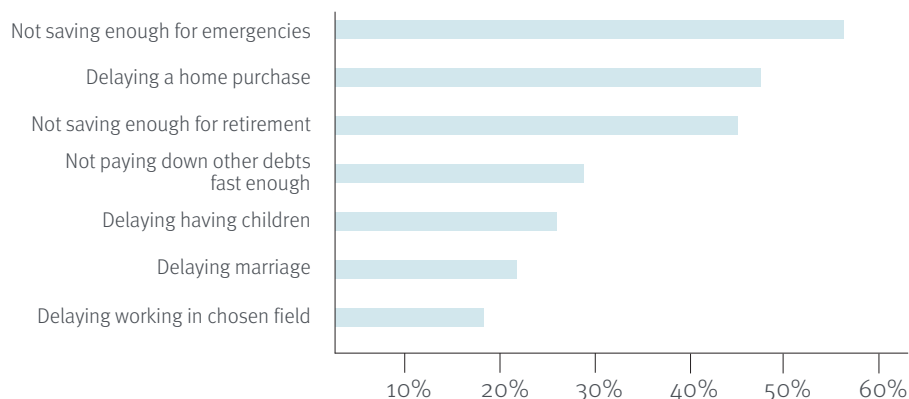
Family has a key role to play in helping young Canadians afford the \$19,498.75 average annual cost of one full-year of study³. And, fortunately, there are several strategies to help families fund education costs for younger family members. The key is to start early.

Registered Education Savings Plans (RESPs)

An RESP is a tax-deferred savings plan designed to allow you (the

Life goals impacted due to student debt

% of university graduate survey respondents



Source: Ipsos on behalf on BDO, RBC Economic Research, September 2017

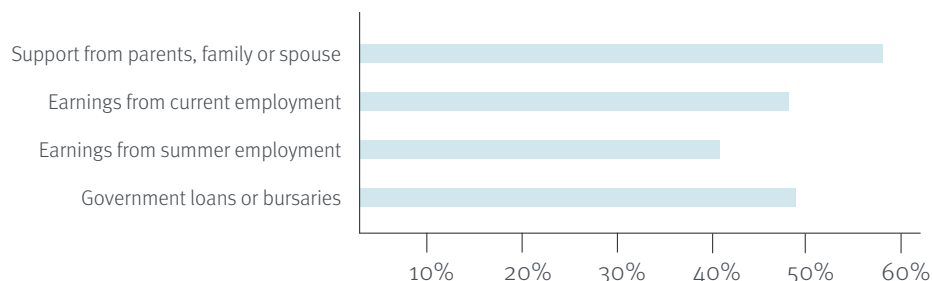
subscriber or contributor) to save for a beneficiary’s post-secondary education. All the interest, dividends, capital gains and government incentives in the plan grow on a tax-deferred basis. Also, the federal government matches a portion of your contributions. No matter what your family income, the government pays a basic Canada Education Savings Grant (CESG) of 20% on the first \$2,500 of annual contributions to a maximum annual CESG of \$500 for each beneficiary. The lifetime limit is \$7,200 per beneficiary.

Living trusts

A living trust (or *inter-vivos* trust) can

be created during your lifetime and can be a powerful tool, depending on your circumstances, as it can allow you to dictate how much you give, to whom, and for what. For example, say you want to financially support grandchildren’s post-secondary costs to alleviate the burden of debt post-graduation. You can set up a living trust with the terms drawn up according to your wishes, which may be that the assets are to be used exclusively for funding educational pursuits. When your grandchildren receive their grants, any capital appreciation or other income earned in the trust will be taxed in their hands, which presumably would be at a much lower tax bracket.

How students fund post-secondary education



Source: Maclean’s, Canadian University Survey Consortium, April 2018.

To learn more, please contact us today.

Notes:

¹Ipsos (for BDO and RBC Economic Research), Three in Four (77%) Canadian Graduates Under 40 Regret Taking on Student Debt (September 2017).

²Statistics Canada and RBC Economics, The Cost of Credentials (June 2018).

³Maclean’s, The cost of a Canadian university education in six charts (April, 2018).

ABCs of ETFs

Exchange-Traded Funds (ETFs) have exploded in popularity over the last five years, with investors holding US\$4.7 trillion in 6,483 different ETF products globally (as of Dec. 31, 2018). But what are ETFs – and why are they so appealing to investors?

Canadian solution, global phenomenon

First introduced in Canada in 1990, ETFs offered investors a new choice similar to mutual funds, but with some key differences (see chart). Originally, ETFs largely focused on providing exposure to broad indexes – in other words, they offered investors exposure to the returns of an underlying index like Canada's main equity index, the S&P/TSX Composite, or the U.S.'s S&P 500 Index. Gradually, they gave investors exposure to more specific indexes like the S&P/TSX 60 Index, as well as bond composite indexes. More recently, ETFs have begun to offer different investment styles – active or passive, growth or value – and have expanded to include almost every market in the world. In short, there are few markets, asset types or investment styles that are not covered by one ETF or another. For small minimum purchase amounts and relatively low purchase prices and management fees, ETFs offer a tremendous range of choices for investors.

The world at your fingertips

The key advantages that ETFs can offer include:

- **Diversification:** ETFs can be used to build a well-diversified portfolio – or complement an existing portfolio – by providing exposure to various asset classes, investing styles and geographic regions, while maintaining the investor's risk-appropriate strategic asset allocation.

Mutual funds and ETFs: similar, yet different

	Mutual fund	ETF
Overview	Professionally managed investment fund that pools investor capital to invest in various securities	Investment fund holding basket of securities that usually tracks an underlying index, e.g. TSX
How to buy	Directly from manufacturer or via a distributor	On exchanges such as the TSX
Valuation	End of day	Varies moment-to-moment during exchange trading hours
Management style	Mostly active, but sometimes passive	Mostly passive, but increasingly both active and passive
Transparency of holdings	Typically published quarterly with 30-day lag	Fund holdings published daily
Dividends	Paid out to investors or re-invested into new units	Generally distributed to investor's account

- **Global access and reach:** Achieving appropriate exposure to global markets – fixed income, equity or commodity – for a Canadian-based investor through direct purchases of assets in those markets can be costly and inefficient, if not outright impossible. ETFs can offer that exposure cheaply and efficiently, and generate investment opportunities that may otherwise be inaccessible to an individual investor.
- **Targeted exposure:** Whether it is a specific industry or sector, bond maturity range or niche markets, ETFs can provide investors with specific – but still diversified – exposure relatively easily and cheaply versus trying to purchase the underlying assets individually to do the same.
- **Achieving specific portfolio goals:** ETFs can offer investors “one-stop shopping” to meet specific portfolio goals – such as cash-flow generation, tax efficiency or reduced volatility.

With their growing popularity, ETFs may turn out to be Canada's most successful export, while providing its investors and their portfolios with a world of choice and flexibility.

[Please contact us to learn more.](#)

Give back – and give more for less while you're at it

A regular Canadian's guide to making a bigger charitable difference.

A masterpiece of French Gothic architecture, the Notre Dame Cathedral was the most visited historical monument in Paris, France. Yet when it went up in flames in April 2019, 859 years after its 100-year construction, people all over the world took to social media to criticize the philanthropists who donated US\$1 billion towards its restoration in just two days.

What about climate change, or the rising Ebola death toll in the Congo? Indeed, there's never been any shortage of important causes to care about, and it's not just billionaires with a love for French Gothic who can make a difference. How can regular Canadians like you make your donations go further?

Donating cash vs. donating shares

Marginal tax rate: 50%*
Donation tax credit: 46%**

	Sell shares and donate cash	Donate shares directly
Future market value of donation (a)	\$20,000	\$20,000
Adjusted cost base	\$10,000	\$10,000
Capital gain	\$10,000	\$10,000
Taxable capital gain	\$5,000	\$0
Tax on capital gain (\$5,000 x 50%) (b)	\$2,500	\$0
Donation tax credit (\$20,000 x 46%) (c)	\$9,200	\$9,200
Total cost of donation = (a) + (b) – (c)	\$13,300	\$10,800

Net tax savings from donating shares: \$2,500 (\$13,300 – \$10,800), assuming that donations of \$200 have already been made.

*Assumes the person has taxable income below the top bracket and donations in excess of \$200.

**Assumes the person is also entitled to a combined federal and provincial donation tax credit at a rate of 46%.

Claim your federal and provincial tax credits

With some planning, tax savings can fund close to 50% of your gift in some provinces and territories. For donations over \$200, the provincial tax credit is usually equal to the highest marginal tax rate – but this amount varies by province. The federal tax credit your donation attracts depends on a few factors, like your marginal tax rate and the amount of your donation. To ensure you take advantage of these credits, discuss your charitable giving with your tax advisor.

Set up a charitable gift fund

With a charitable gift fund, you can support charitable causes that are important to you, while receiving

potentially significant tax advantages. To set up your own fund, you need to make an initial irrevocable contribution beginning at \$25,000, then you can make additional contributions of \$250 or more at any time. You can invest the contributions in a way that reflects your individual philanthropic objectives, and recommend grants from the fund to qualified charitable donees whenever you wish. You receive tax receipts for your contributions, which can potentially enable you to give more. To determine if a charitable gift fund is right for you, please contact us.

Consider donating securities, not cash

You normally pay tax on a portion of capital gains triggered by the sale of a stock or bond, but this tax rate is reduced to 0% when you instead donate the securities directly in kind to a qualified donee.

This is no exhaustive list and, for a thorough and personalized assessment of your charitable capabilities, you'll want to review your giving strategy with your professional advisors. Even a short review and action plan can help ensure your generosity creates the outcomes you've envisioned.

To learn more, please contact us today.

Portfolio, sweet portfolio

Many Canadians are counting on their “home, sweet home” to help fund their retirement years. But it’s also important to consider your investment portfolio.

A tale of five cities (and an equity market)

The S&P/TSX Composite Total Return Index vs. select Canadian real estate markets

Based on an initial \$300,000 investment with no leverage over the past 25 years

Market	End value	Rate of return
S&P/TSX Composite Total Return Index	\$2,410,431	8.3%
Toronto	\$1,170,577	5.4%
Vancouver	\$1,125,502	5.2%
Montreal*	\$1,021,881	4.8%
Calgary	\$983,057	4.7%
National avg.	\$931,739	4.5%
Halifax	\$831,220	4.0%

Sources: All data as of December 31, 2018. Housing price data compiled by RBC Global Asset Management Inc. from Canadian Real Estate Association (CREA). Source of the S&P/TSX Composite Total Return Index is RBC Global Asset Management Inc. All returns are annualized, and where applicable, compounded assuming reinvestment of all distributions. *Please note that data for the Montreal market is not seasonally adjusted.

Despite soaring home prices over the last few decades, many Canadians might be surprised to learn that, over the last 25 years, the average long-term growth of home prices in the country’s major markets has been far less than the growth of the country’s leading equity market index. That’s not an argument against home ownership. Instead, it serves as a good reminder that diversifying your investments to ensure you take advantage of the long-term growth potential of equities is a smart way to get you “home, sweet home” to your retirement goals.

A house is a home, not (just) an investment

For most Canadians, a home is the single largest and most significant purchase they will ever make in their lives. In doing so, they leverage their often small amount of equity (usually as little as 5% to 25% of the purchase

price) and cover the rest by taking out a mortgage from the bank.

Of course, that’s one of the most significant and wonderful aspects of home ownership: you can enjoy the purchase immediately, while paying the cost of it over a very long period of time, often as long as 25 years. From Day 1, you can take advantage of the leverage of paying only a fraction of the cost to live in a property that can be worth as much as 20 times that down payment. And, each mortgage payment you make builds your equity, taking you one step closer to full ownership.

The unloved but (hopefully) appreciated investment portfolio

Unlike a home, an investment portfolio doesn’t allow us to enjoy the experience of bringing our first child home to it; of watching the height measurements of our kids grow ever higher on the

kitchen wall; or, to remember the many anniversaries and birthdays we’ve shared with our families and friends over the years in it.

Without an emotional attachment and real enjoyment being derived from it, we tend not to love or care about our portfolios in the same way. But if we can’t exactly love them, we can – and should – nonetheless appreciate them for the wealth that they can create for us, wealth that ultimately works to support the achievement of our goals. Because, despite our widespread belief that our home values grow faster than our investments, as the chart to the left shows, the equity market’s long-term return significantly outpaces that of homes in all major markets across the country – in some cases as much as doubling it.

Foundations of wealth

Your principal residence is where your heart is – but shouldn’t necessarily be seen as your sole “principle” investment. Seeing your home this way can ignore significant risks, including the high costs of ownership (e.g., financing, taxes, upkeep and repairs). As well, a home is an illiquid asset, which can represent a real risk if you need to remove your equity at a certain time. Equities, while historically providing stronger long-term returns, also have their own associated risks and costs which need to be considered, including volatility. But, when taken together, the virtual “bricks and mortar” of your investment portfolio can work together with the actual bricks and mortar of your home to build the foundations of your wealth.

To learn more, please contact us today.



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