RBC Dominion Securities Inc.

# Portfolio Advisor

Wealth Management
Dominion Securities

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## Market commentary

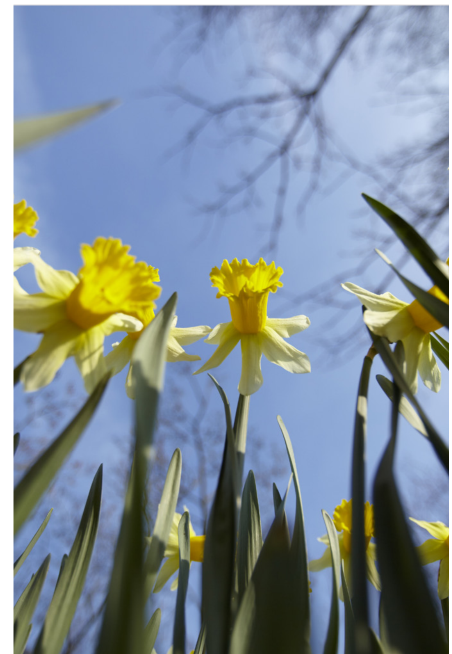
The MSCI World Index surged 5.9% in Q1 even though most markets came off the boil in March. It was the fourth straight quarter of gains and the strongest quarterly performance for developed markets in more than three years. Equities have been energized by improved earnings prospects worldwide and better economic data in the U.S., Europe, and China.

Following such a strong run, periods of consolidation, or even a pullback, can't be ruled out. Nevertheless, we anticipate this bull market, which began in 2009, can persist so long as the U.S. and global economies avoid a recession. We recommend investors hold a moderate Overweight position in global equities. Among regions, we continue to favor the U.S. We have downgraded Canada to Market Weight from Overweight as the risk-reward balance has shifted.

### Fixed income

Despite improved global economic trends and moderately higher Federal Reserve rate hike expectations, government bond yields in North America, the U.K., and Europe could be range-bound for the foreseeable future. Global GDP is unlikely to reach "breakout" speed in the near term, and we doubt U.S. fiscal policy, the French elections, and Brexit developments will jolt yields. Also, the upward pressure on yields brought about by higher inflation may have run its course for the time being.

Corporate credit continues to be our favorite segment of the fixed income market, but investors should be patient regarding entry points as there are fewer opportunities currently. Yield spreads are very narrow, especially in North America. Investors would be best served by adhering to a "quality is king" strategy.



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

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# Stay calm and invest on

In stormy markets, keeping a sense of perspective can help you stay on track to reaching your long-term goals, like retirement or a legacy for your family's future.

When the markets are particularly volatile, there's a natural tendency for investors to move into safer investments, hoping to avoid further losses, and wait until the markets recover. But unfortunately it's nearly impossible to predict when the markets will recover. As a result, investors may miss out on the eventual recovery, which can negatively affect their long-term investment goals. As the chart at right shows, the investor who stays invested tends to do better than the investor who bails out and misses even some of the recovery.

## Avoid market timing

Some investors try to improve their returns attempting to "time" the market – selling right before the markets go down, then buying right before they go up again. In theory, this sounds great. But in practice, it rarely works, simply because it's so difficult to predict when the markets will go up or down. Unfortunately, that doesn't stop investors from trying, which is why the "average investor" tends to underperform virtually every asset class.

## Maintain your sense of perspective

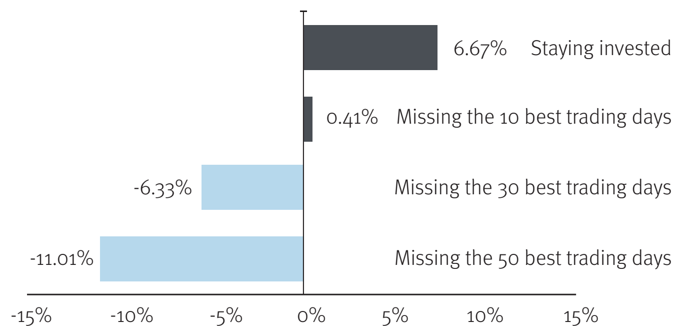
Unquestionably, stock market downturns can be painful, especially when you're in the middle of one. It's not always easy, but it's important to remember that downturns have happened before – and will happen again – and that historically the markets have always recovered and reached new highs, as the table below shows.

## Reassess your comfort level with risk

It's one thing to say you are comfortable with a higher level of risk when the markets are only going up, and another thing when the markets are volatile. If you are finding it difficult to sleep at night because of market volatility, then it might be time to consider how much risk you are truly comfortable taking with your investments.

### Why it's best to stay invested

Missing just the 10 best days in the market over the past 10 years would have reduced returns significantly.




Source: RBC Dominion Securities.
Based on annualized returns of the S&P/TSX Composite Index for 10 years ending July 2015.

### Market recoveries following major downturns (S&P/TSX)

| Year (event) | Return | Return in the following year | Average return over next 5 years |
|---|---|---|---|
| 1974 (oil embargo) | -25.0% | +18.5% | +22.3% |
| 1981 (double-digit inflation) | -10.2% | +5.5% | +13.7% |
| 1990 (Gulf war) | -14.8% | +12.9% | +10.8% |
| 2002 ("Tech wreck") | -12.4% | +26.7% | +18.3% |
| 2008 ("Subprime crisis") | -35.03% | +30.7% | +8.7% |

Source: Based on the returns of the S&P/TSX Composite Total Return Index.

# Creating a comfortable retirement

You've spent time building enough income to retire on, and are embarking on this new stage of your life

These considerations can help you maximize your retirement income and enjoy the fruits of your labour.

- **Order your sources of retirement income.** At the time you retire, your tax rate is generally higher than later in retirement when you have less taxable income. Generally, if you're in a higher tax bracket, it makes sense to begin withdrawing lesser-taxed assets before those that trigger greater taxes. For example, income drawn from your RRIF is fully taxable at your marginal rate, while capital gains and eligible dividends drawn from your regular non-registered account receive favourable tax treatment. As a result, it may make sense to draw more income from your non-registered accounts first, and draw only the minimum required amount from your RRIF. That way, you allow more of your RRIF assets to continue growing on a tax-deferred basis, and you may be in a lower tax bracket when you eventually start making larger RRIF withdrawals (which are fully taxable at your marginal rate).

Being "retirement ready" isn't just about the numbers – it's a state of mind.

- **Make arrangements for RRIF income payments.** When you convert your RRSP to a RRIF, you must receive at least a minimum payment from the plan each year. But if you don't yet need this income, you can contribute it to your TFSA so that it can continue to grow tax-free. If you have a spouse younger than you, you may choose to base your minimum annual RRIF withdrawal on your spouse's age in order to minimize the amount of the annual withdrawal, thereby keeping more assets in your RRIF to grow tax-deferred.

- **Find your balance.** Whether it's to continue earning some extra money for retirement, or to simply ease in to the next stage of life, many people become semi-retirees before they become retirees. Think about whether you want to transition into retirement gradually instead of all at once, for example by consulting, working part-time or training your successor.

- **Think beyond the money.** Your financial well-being is important, but so is your mental and physical well-being. People who are active in their communities have higher self-esteem, a brighter outlook on life and better health, according to a 2008 Statistics Canada study. As you near retirement, think about what you'd like to accomplish with your time – perhaps volunteer at a local organization or on a Board of Directors, or support a charity that's close to your heart.

**If you have questions about your retirement, contact us today to discuss.**

## Get ready to retire

- **Determine your employer pension options.** Ask your employer about your pension options on retirement, including the option to transfer the value of your pension to a locked-in RRSP. Consider whether it is possible to split your pension payments with a lower income spouse.

- **Apply for Canada Pension Plan (CPP) or Quebec Pension Plan (QPP) benefits.** Avoid delays by filing for CPP or QPP benefits at least six months before you are eligible to receive them. If your spouse is also eligible, consider applying for CPP/QPP "sharing" to reduce your total tax burden.

- **Review your asset allocation.** Speak to us about tailoring your registered and non-registered investments to your retirement income needs. As you make the transition into retirement, you will probably want to move from a more growth-based investment approach to one that preserves your capital and enhances your income.

# The power of dividends

Dividends are income distributions from a company to its shareholders. But how powerful is the power of dividends in your portfolio?

Income-focused investors often look to dividend-paying stocks – typically large-cap companies that are less volatile – as a source of stability and income and as a way to diversify their portfolios. Although companies are not obligated to pay dividends to investors, most continue to do so.

Some investors see dividend payments as a signal of the company's confidence in its future earning power, particularly in tenuous markets. They can also help to mitigate stock market downturns.

## The long-term advantages

Many stocks make automatic Dividend Reinvestment Plans (DRIPs) available, through which investors can reinvest their dividends for future growth (and more dividends) instead of spending them. These reinvested dividends can compound into significant returns over the long term.

In the United States, dividends have represented a significant portion of total returns for the S&P/TSX Composite Total Return Index, representing over 30% of the average annual total return (RBC Global Asset Management, September 2015).

Suppose you invest $100 initially, and an additional $75 per quarter, at an anticipated stock price appreciation of 7% and an anticipated dividend yield of 2%. In 20 years, you would have invested a total of $6,025 and reinvested dividends of $2,324.88 for a total cost basis of $8,349.88. Your capital gain would be $8,166.42 – and your total value would be $16,516.29!

## Dividend tax advantages

Dividends received from Canadian corporations are effectively taxed at a lower rate than interest income, due to the dividend tax credit that is applied to the federal and provincial tax payable. This tax credit is meant to recognize that the Canadian corporation paying the dividends has already paid tax on its earnings, which are now being distributed to its investors. Dividends from foreign corporations do not receive the same dividend tax credit, and are taxed at a higher rate than those of Canadian corporations.

For example, if you earn more than $132,000 in annual taxable income, and receive $1,000 in dividend income from a Canadian company, you keep approximately $735 after federal and provincial taxes – less the dividend tax credit. By comparison, $1,000 in interest income will net about $555 after taxes – the same for $1,000 in foreign dividend income, because it is not subject to the tax credit for Canadian corporations, and is taxed at a higher rate.

**When considered in light of total returns and tax advantages, dividend-paying stocks may be an attractive option. If you think it's time to talk about the power of dividends, please contact us today.**

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