Portfolio Advisor

Wealth Management
Dominion Securities

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The Michie Wealth Management Group
RBC Dominion Securities
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Market commentary

Following a strong rebound at the beginning of the year, equity markets have shifted attention to slowing growth in the big three economies of the U.S., Europe and China, and the related downdraft in interest rates that was accompanied by an inversion of the Treasury yield curve – a cautionary signal. Markets are also contending with earnings growth and trade/tariff uncertainties.

These risks are balanced out by dovish central bank policies and signs U.S. economic growth should hold, while trends in Europe and China should stabilize/improve later this year. In our view, equity market valuations remain reasonable, with most trading near or slightly below their long-term averages. Consensus earnings estimates are also realistic. While we would maintain overall equity exposure at the "market weight" (benchmark) level in portfolios, vigilance is warranted.

Fixed income

The U.S. Federal Reserve's (the Fed's) significant policy shift in March to no fed fund rate hikes (from two) in 2019 set a new path for global central banks. Global economic weakness is driving the broad move to "easy street" and concerns are mounting as benchmark yield curves invert. The Fed projects one rate hike in 2020, but implied probabilities indicate an 80% likelihood of a rate cut by January, and market expectations predict one rate cut per year from 2019-2021.

There is the distinct possibility that rates could move lower, and we believe this makes "reinvestment risk" a potential issue for investors attracted by short-term rates equal to or exceeding long-term rates. As such, we maintain our "market weight" in fixed income, and recommend investors add duration with a focus on high-quality assets.

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

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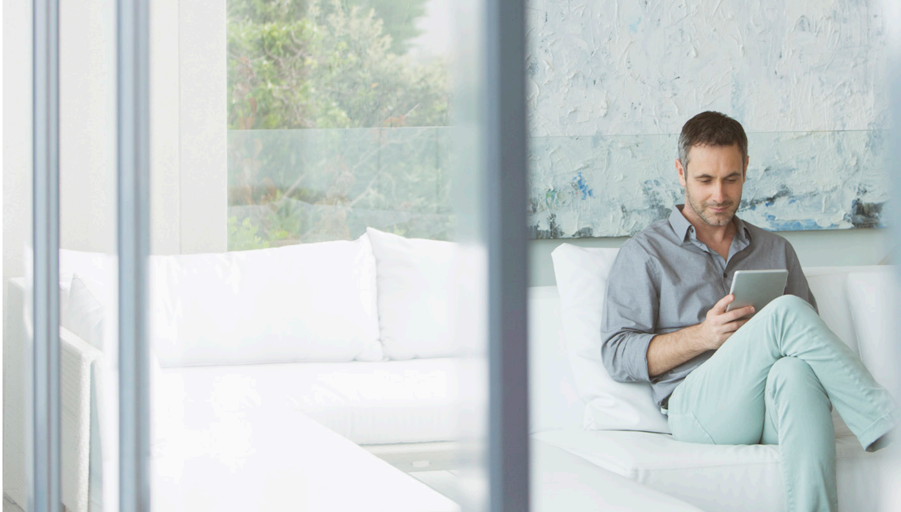
Recession-proof your portfolio with the three Rs

What do you do with your investment portfolio when you hear the infamous "R" word – recession? It's easy. Just follow the three Rs: review, rebalance and relax.



In recent months, economists have been cutting their growth forecasts for the Canadian and global economies. While evidence of a slowdown is mounting[1], it is notoriously difficult to predict – economists have failed to predict 148 of the last 150 recessions[2]. The dreaded "R-word", recession, is the economic term for two or more consecutive quarters of zero or negative economic growth (as measured by Gross Domestic Product). It is often trotted out when growth begins to moderate, but historically is rarely the outcome of such a slowdown, despite predictions to the contrary.

Recession: the nasty nine-letter word

Unfortunately, talking about a recession is one of the best ways to bring one about: hearing the "R" word, people begin to delay or abandon spending in anticipation of an economic slowdown[3]. This leads to a vicious circle: lower spending leads to lower business revenue, which leads to job losses, further worry, lower spending, more job losses and so on.

"R"-proofing your portfolio

Soaring or falling markets often generate strong emotional reactions, prompting investors to veer off course from their long-term plans. This can lead to common investment pitfalls like taking inappropriate risks, buying high and selling low, and moving to "the sidelines" (i.e. cash), thereby missing out when the markets recover.

Similarly, reacting to the "R" word by altering your investment plan is rarely the right move. Instead, investors would be well served to follow three other "R" words:

- **Review:** Wondering whether your goals are aligned with your investment portfolio's asset allocation and structure? Whether your risk tolerance is accurate? These are important questions and concerns to review with your advisor as your financial circumstances or goals change. But keep in mind that a recession is usually a short-term event, and that your investment portfolio usually reflects goals that stretch over a longer time horizon – so, changing it in response to short-term developments is rarely advisable.
- **Rebalance:** Your portfolio should be balanced in the right way to meet your goals and to reflect your appropriate risk tolerance. If your portfolio has drifted off-balance over time due to market movements or other factors, or your goals or circumstances have changed, speak to your advisor to review your portfolio to see if it needs to be rebalanced.
- **Relax:** Once you've reviewed your portfolio, and rebalanced as required, you can relax with confidence.

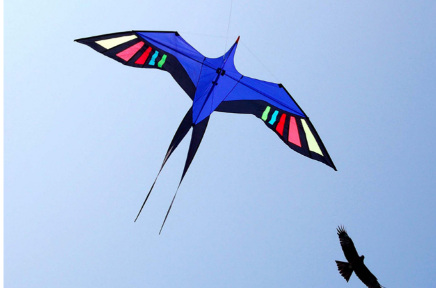
Remember, the average recession lasts six to nine months, and the impact is usually quick and transitory – making hasty, unwarranted changes to your portfolio is usually not.

To learn more, please contact us today.

[1] *Economic and Financial Market Outlook*, RBC Economics Research (March, 2019).
[2] *How Well Do Economists Forecast Recessions?*, International Monetary Fund, Zidong An; João Tovar Jalles; Prakash Loungani (March, 2018).
[3] *A reliable indicator of an imminent recession? Look to the pundits,* David Parkinson, The Globe & Mail (February, 2019).

Why pay more tax today?

For retirees, sometimes it can make sense to pay a little more tax today to pay less tax in the long run.



It's often recommended that retirees draw income from low- or non-taxable income sources first, such as Tax-Free Savings Accounts (TFSAs), and minimize withdrawals from income sources taxed at their marginal rate, such as Registered Retirement Income Funds (RRIFs).

While this is often good advice, there is no definitive withdrawal sequence that applies to everyone. As a retiree, you need to consider your personal situation, your tax rates at various times and your upcoming financial needs.

You may have a retirement income gap

Many people retire prior to their employment pension or government pension kicking in. In these "gap years" your income may be lower than it will be in the future. In this instance, it may be worthwhile to draw retirement income from your RRSP, rather than your TFSA or via the sale of securities.

By making a RRSP withdrawal during a gap year, rather than from low or non-taxable sources, you may be unnecessarily triggering taxes. However, if your tax rate today is lower than it will be after you begin receiving your pension, you could generate more after-tax dollars.

Further down the road, after you convert your RRSP to a RRIF, because you made RRSP withdrawals earlier, all else equal, your RRIF assets will be lower and therefore your mandatory RRIF withdrawals will also be lower, which can further lower your tax bill.

You may have inconsistent retirement income

Not everyone's retirement income will be as smooth as a guaranteed pension. Taking on occasional work, or starting another career in retirement can result in relatively volatile year-over-year income. While planning ahead is not always easy, if a contract is coming up "next year" or a lump sum payment for a job will soon be paid out, consider smoothing your year-over-year income by coordinating uneven employment income with investment withdrawals.

Smoothing your income can help avoid one-off years with high income generation and higher taxes. While it may mean pulling income forward and paying more tax today, in the long run it can lower your overall taxes.

Your income needs may vary from year-to-year

Drawing income from your investments is often driven by your needs (or wants), rather than solely providing steady income to cover the bills. You may be planning to buy a cottage, take a long vacation or complete a big home renovation. You might also be looking to help out your children, or make a significant charitable donation. In these instances, withdrawing the funds over multiple years, rather than in one lump sum, could help lower your taxes.

Similar to coordinating retirement employment income with investment withdrawals, smoothing your year-over-year income to fund longer-term objectives can also help save taxes.

Contact us for more information about retirement income planning.

Smooth your income and save

It may seem counter-intuitive to unnecessarily trigger taxes today by pulling income forward through the sale of an investment, an early RRSP withdrawal, or withdrawing more than the minimum from your RRIF, but for many people the payoff could be significant.

Planning ahead is not always easy, but it's the key to navigating retirement if income generation and income needs could change significantly from year-to-year. Essentially, the basic goal is to look at smoothing your income, and whether paying a little more tax today can help avoid unnecessarily high future tax bills.

Dividends by the numbers

Portfolios focused on dividend-paying equities are often looked at as purely defensive. However, over the last three decades, Canadian dividend-paying equities have offered investors a lot more than just defence.

9.2% annualized returns

Over the past 30 years, dividend payers on the S&P/TSX Composite Index (TSX) delivered an impressive 9.2% annualized rate of return, soundly outperforming the TSX itself, which delivered 6.3% annually. On the other hand, companies not paying dividends only managed annual returns of 0.3%.

20% lower volatility

When it comes to stocks, volatility can be hard to avoid. However, over the last three decades, dividend payers have shown 20% less volatility than the TSX and 45% less volatility than non-dividend payers, providing many investors with measurable relief from the ups and downs of markets.

5.3% income growth

Dividend growth on the TSX has averaged 5.3% annually since 1986, helping many income investors mitigate inflation, which averaged just 2.3% annually over the same period.

50% less tax

Death and taxes may be unavoidable, but dividend income may provide a break (from taxes). For Canadians earning a total annual income of $50,000, Canadian eligible dividends are taxed at about one-third the rate of interest or employment income. At an income of $100,000, they are taxed by about half as much.

80% pay dividends

While an equity portfolio consisting solely of dividend payers may not be appropriate for all investors, with approximately 80% of companies on both the TSX and S&P 500 paying a dividend, Canadian dividend investors can easily diversify their portfolio throughout multiple industries and across the border.

Contact us today for more information on how to incorporate dividend-paying equities into your portfolio.

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Notes: Market returns and volatility data from 1986-2017, data calculated on an equal weight basis, source: RBC Capital Markets. Dividend growth measured by subtracting S&P/TSX Composite Index annual total returns from price returns 1986-2017, source: RBC Dominion Securities Inc. Inflation data 1986-2017, source: Bank of Canada. Tax rates based on 2018 average Canadian marginal tax rates, subject to change in accordance with federal and provincial budgets, source: Royal Bank of Canada. Dividend-payers on the S&P/TSX Composite and S&P 500 as of March 2018, source: RBC Dominion Securities Inc. This information is not intended as nor does it constitute tax, legal or insurance advice. Readers should consult their own lawyer, accountant or other professional advisor when planning to implement a strategy. This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. Insurance products are offered through RBC Wealth Management Financial Services Inc. ("RBC WMFS"), a subsidiary of RBC Dominion Securities Inc.* RBC WMFS is licensed as a financial services firm in the province of Quebec. RBC Dominion Securities Inc., RBC WMFS and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund. RBC Dominion Securities Inc. and RBC WMFS are member companies of RBC Wealth Management, a business segment of Royal Bank of Canada. ® / ™ Trademark(s) of Royal Bank of Canada. Used under licence. ©2018 RBC Dominion Securities Inc. All rights reserved. 18_90083_608 (04/2018)