RBC Dominion Securities Inc.

Cooper Wealth Management

Wealth Management
Dominion Securities

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"'The time has come', the Walrus said, 'to talk of many things…'"
– Lewis Carroll, The Walrus and the Carpenter

Our annual investment review and outlook

Annual forecasts often sound like nonsense in the fullness of time, but as Mr. Carroll showed us, a little nonsense can be entertaining, so here we go.

We will begin with a discussion of the United States, the source of many positives, but also much nonsense this year. President Trump's first year in office has been unpredictable but the Republicans appear to be getting their legislative agenda together. We expect the initial passage of tax reform legislation by the end of the year, but it will take much longer for both legislative houses to hammer out the final details. This will be the major order of business to start 2018. This legislation must be passed by November 2018, or the Republicans risk losing control of the House and the Senate in the mid-term elections. This will take the focus off the ongoing NAFTA trade talks with Canada and Mexico, which are off to a poor start. It has been estimated that a cancellation of the deal could reduce Canadian and U.S. GDP between 0.5-0.9%. Hopefully, everyone involved has seen the mess the U.K. is in as a result of the Brexit Vote and don't want that repeated here.

The President has also appointed a new chairman of the U.S. Federal Reserve, who has indicated he will continue to slowly normalize interest rates. The Fed is anticipating three further rate increases in 2018, which should also keep the U.S. dollar strong. These interest rate increases have raised short-term interest rates, but the 10-year U.S. Treasury Bond has remained in a trading range with an upper limit of 2.40%, just below the 2.43% level of November 2015 when the rate increases started. With the European Union and Japan still engaged in quantitative easing and pouring more liquidity into the global system, we expect U.S. long-term interest rates to stay right where they are, to a ceiling of 2.75%. This has led to worry among market participants that a flat yield could trigger a U.S. recession, as banks grow more reluctant to lend as the yield curve gets flatter. However, we believe a flat yield curve might just be the hangover cure the fixed-income market needs after the excesses of quantitative easing. Here is our view: since 2008, U.S. GDP has been slow and steady at around 1.5% on average, with both U.S. consumers and corporations building their cash reserves. Basically,

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Our annual investment review ...
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We are adjusting our portfolios to add more of a growth bias, focusing on large capitalization companies that have stronger market leadership ...

any growth was being funded from cash flow alone and debt became a bad word. Now, with the U.S. Federal Reserve determined to raise rates, we believe U.S. major corporations will want to start putting excess capital to work, locking in expansion and/or acquisition plans before the cost of borrowing becomes more expensive. The faster this happens, the faster the excess liquidity in the global financial system gets absorbed. Only when this liquidity is removed can global interest rates begin to move higher. However, we do see this as a multi-year process, as we don't expect Japan or the European Union to stop printing money any time soon.

This means the global equity markets should continue to be positive next year. In 2017, growth stocks dominated the markets, while higher dividend, defensive stocks lagged behind. In the U.S., where growth sectors like technology dominate more of the market, the stock indexes were sharply higher, while in Canada, with its much higher resource base and higher percentage of defensive names making up the TSX, performance lagged, with the notable exception of the Big 6 Banks. The Canadian market has started to rebound since September and we expect that to continue into the New Year.

How high the Canadian market goes will also depend on oil prices. Oil has risen to approximately $57 per barrel, as OPEC cuts have actually been enforced, exploration budgets remain low and the global surplus has begun to shrink. Saudi Arabia has kept OPEC in line and extended production cuts through 2018. They are determined to raise the global oil price, so they can get top dollar when they sell a portion of Saudi Aramco, the state oil company. However, low-cost U.S. state oil producers may use the opportunity to bring more production online to take market share from OPEC. The other factor has been the unseasonably warm winter so far this year. While the forecast is for much colder temperatures to come, a milder winter in the North America will keep oil and gas demand lower. We remain underweight on the TSX in oil and gas until the situation has greater clarity and price increases look sustainable. We believe oil will remain range bound with an upper limit of $65 until these issues are further clarified.

We are adjusting our portfolios to add more of a growth bias, focusing on large capitalization companies that have stronger market leadership such as Dollarama. We have lowered our Consumer Staples holdings by selling solid but slower growth name such as Loblaw's and Metro. We are also adding some European exposure through the use of the Capital International Global Equity Fund for low-cost but broad diversification, as well as Novo Nordisk, the world leader in insulin production. We are continuing with our covered call strategy to generate cash flows but will be using some longer-dated options to open more premium and give stocks more room to run up in price.

In conclusion, we expect 2018 to be a solid year for equities. Hopefully, with as little nonsense as possible. All the best to you and your families for the holiday season and the New Year. Thank you for the opportunity to be of service to you.

Yours Truly,

Walter Harmidarow & the Cooper Wealth Management team at RBC Dominion Securities

PS: We are moving to new offices on the 16th floor. Our mailing address and phone numbers will remain the same. If you get the chance, give us a call and come by for a visit.

What is the best way to handle inheritance?

The topic of inheritance is one that often doesn't receive the attention or planning it requires from both those who are passing down wealth and those who are receiving it. In fact, statistics indicate that many high-net-worth families are unsuccessful in transferring assets, which often stems from a lack of communication and planning beforehand at the family level to determine values and how those values may be carried on via inheritances. Unfortunately, this leaves some individuals unprepared or caught by surprise in receiving an inheritance, which often goes hand-in-hand with funds then not being utilized in the most beneficial way. Beyond potential financial repercussions, lack of planning around inheritance may also be the source of great family tension. And while it's understandable that the emotional stakes are naturally higher when dealing with assets within a family, the best way to approach this is with proactive communication among all family members in forming plans that are in line with family goals and values.

To examine two different scenarios among the receiving generation for utilizing inheritance, let's revisit our couples. Nisha and Betty went to school together, graduated together, and got married around the same time. Both families have been endowed a large sum of money through inheritance. Although the couples are all successful professionals, are embarking on the next stages of their lives together, and have had similar experiences thus far, that does not necessarily mean they will make the same decisions in regards to inheritance.

Prem and Nisha

- Inheritance: $1 million from Prem's mother
- Family circumstances: Two children who play hockey and attend private school.
- They are familiar with the burdens of student loans and debt, as Nisha had insisted on footing some of her educational bill when she attended medical school, wanting to take on more financial independence and responsibility from her family.
- Family values/plans: All family members agreed that education was of high priority.
- Decision: Prem and Nisha do not want their children to have to worry about the costs of higher education or student loans. They will loan the funds to a family trust in benefit for their children's education costs.

Tim and Betty

- Inheritance: $1 million from Betty's favourite aunt
- Family circumstances: Two minor children who are enrolled in a number of extracurricular activities and who attend a private school.
- Family values/plans: Values at the family level had not been discussed and no plans had been put in place. They were surprised to receive the funds.
- Decision: They will place the inheritance funds into their non-registered account.

Prem and Nisha

The couple meets with their advisors and discusses their recent inheritance and the importance of ensuring their children's education costs, and only their educational costs, would be covered with this sum of money. Their advisors inform them they can establish a family trust for the children's education at the current 1 percent CRA prescribed loan rate, and that they would be able to income split with their children. They are further advised that once the trust is established and Prem has loaned $1 million to the trust at the CRA prescribed interest rate, all of the investment income (interest, dividends and capital gains) earned would be taxable to the children. For that to happen, the trust must pay the loan interest to Prem annually, which he would include in his income.

By establishing a family trust, the couple may save approximately $225,000 in taxes (see table 1 on page 4).

This amount of savings is based on the fact that the couple will be paying for their children's education and extracurriculars with the trust income and therefore awarded the tax benefits. Furthermore, Prem and Nisha are able to call back the $1 million loan should they ever require the funds, or they may choose to forgive it on their death. They are comfortable knowing that they are not simply cutting a $1 million cheque for their children, but are rather loaning the funds, thereby never losing access to the inheritance.

Tim and Betty

Tim and Betty were caught off-guard in receiving the inheritance and had no plans in place. Without seeking any advice, they opt to place the funds in their non-registered account, and then simply cut cheques for their children's expenses. All income from investing the inheritance is taxed in Betty's hands, at the top marginal rate, and no income splitting has been established. By year 10, Betty will have paid approximately $146,000 in taxes. If she and Tim had instead placed her inheritance in a trust like Prem and Nisha did, she would have paid approximately 66 percent less in taxes over the 10-year period, allowing her to save $97,295.

The big picture

Given the fact that approximately $30 trillion in assets will be transferred from Baby Boomers to Generation X and Millennial heirs over the next three to four decades — marking the largest wealth transfer in history — the importance of carrying out the process of inheritance appropriately, effectively and wisely among family members absolutely cannot be understated.

Intergenerational wealth transfer is a major consideration and one that needs to be approached with not only an understanding about the importance of open and ongoing communication, but also a firm knowledge of the impact, and potential implications, of the related financial decisions — among both generations involved.

In the following section, we progress towards the retirement phase, examining a variety of aspects, questions and decisions individuals face regarding income and financial situation as they finalize their retirement plans and shift into this stage of life.

Table 1

Assumptions for Prem and Nisha	Assumptions for Tim and Betty
• $1 million portfolio • Annual rate of return: 6% • Prem's tax rate: 49.5% • Two beneficiaries (if the child's taxable income is below basic exemption, there will be zero income taxes payable) • Basic Personal Exemption: $10,000 (this amount varies by province)	• $1 million portfolio • Annual rate of return: 6% • Betty's tax rate: 49.5% • Two beneficiaries (if the child's taxable income is below basic exemption, there will be zero income taxes payable) • Basic Personal Exemption: $10,000 (this amount varies by province)

	Prem and Nisha	Tim and Betty
	Inheritance loaned at 1% to family trust	Inheritance held in Betty's personal account
Investment income (interest, dividends, capital gains)	$60,000	$60,000
Tax payable in year one	$4,950	$13,439
Tax payable by children	–	–

When you compare taxes payable in year 1, Prem and Nisha will experience a savings of $8,489 over Tim and Betty.

Over 10 years, that savings will grow to $97,295 for Prem and Nisha over Tim and Betty; and over 20 years, that translates to a savings of $225,650 for Prem and Nisha through choosing the family trust option.

Learn more at our new website

For detailed reports on topics like family and business wealth management, private invesetment management, estate planning and more, visit the "Client Resources" page on our website.

Please contact us

For assistance in planning or acting on any of the ideas shared in this article, please reach out to us and we will have our team, including our in-house financial planner, Anne McDougall, CFP, arrange a meeting to discuss how we can best serve your family's needs. Once again, thank you for your support and we look forward to serving your future investment needs at Cooper Wealth Management of RBC Dominion Securities.