The Financial Corner with Joanne Vesprini

Sintra Portugal

A quarterly newsletter filled with practical wealth management advice to help understand various aspects of financial well-being.

Fall 2017

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- Canadian Dollar Outlook
- Four psychological pitfalls of investing – and how to avoid them
- Tax Planning Basics

My thoughts,

As the seasons change I find lots of people take stock of the year so far and start to plan for the upcoming New Year.

As the days get shorter I find myself reflecting on the year; did I see what I hoped to see? Did I spend time with family and friends? Did I get things done that I hoped to? Is there anything I want to do before the end of the year? Am I checking things off my bucket list or will I run out of time?

I think the same can be done with your portfolio. What has happened so far this year and how does that fit into your long term plan? When it comes to your portfolio ask yourself, what is the money for? When & how do you want to use the money? What is important for you to have in your life? Money to travel? Time with family & friends? Volunteering? Yoga or tennis or bridge or meditation? Perhaps a comfortable lifestyle and a legacy?

Once you know what you want to do, you can determine how much money is needed annually to make that happen. Using this information in a retirement plan will then provide guidance on how your portfolio should be constructed.

It's never too late or too early to plan. The peace of mind is worth the effort.

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1-3 Month Outlook – No rest for the BoC

Although USD/CAD underwent a correction to 1.2778 in the first half of August, the rally was short-lived and the pair ended the month closer to 1.2500 as key data releases continued to point to above potential growth. June retail sales registered their fourth consecutive monthly gain, with volumes running at a 7.8%y/y clip – the largest y/y increase since at least 2004. Moreover, the 4.5%q/q annualized print for Q2 GDP was not only above the Bank's 3.0% projection in the July MPR but the expansion was also broad-based and resulted in the fourth consecutive quarter of above potential growth (Figure 1). This prompted the BoC to raise rates by 25 bp at their September 6 meeting, taking the market by surprise as it had only attached ~30% probability to such a move. The Bank's actions indicate that they are very focused on the amount of slack in the economy and that their projections in the upcoming October MPR will show that the economy may be near full capacity in Q4. While they indicated that further rate moves are not "pre-determined" and that they will be guided by incoming economic data and financial market developments, the current momentum has caused us to raise our 2017 growth forecast to 3.1% from 2.6%, with 2018 growth expected to moderate to a slightly above potential 2.2% pace. As such, we look for the BoC to hike again at their October meeting before pausing through Q1 of next year. While this should keep USD/CAD near 1.21 to end Q3, we do see the scope for a correction toward 1.24 to end the year as we expect the Fed to raise rates by 25 bp in December and this outcome is currently underpriced in the market. Risks emanating from NAFTA renegotiations may also come to the fore into year end.

6-12 Month Outlook – Nuanced rate differentials

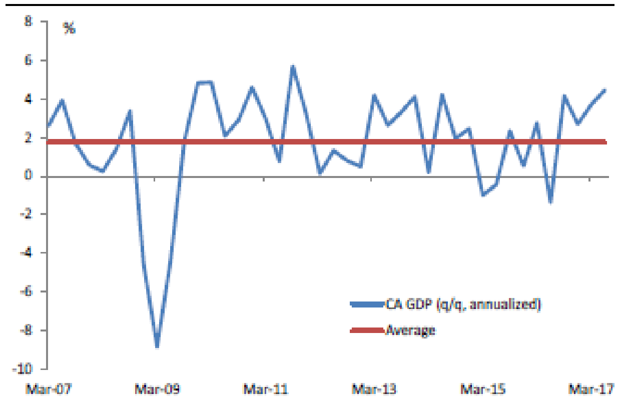
Interest rate differentials remain a key driver of our forecast profile in 2018, with USD/CAD expected to peak at 1.27 in Q1 as the Fed hikes again while the BoC holds steady. With the BoC expected to match the Fed with 25 bp moves from Q2 through Q4, rate differentials will remain relatively stable and cause USD/CAD to trade with a neutral profile around 1.26. Inflation will be a key consideration through 2018 as well, with the BoC looking for core inflation to move back toward their 2% target in the middle of the year (Figure 2). The lack of a sustained move higher in inflation would represent a key risk to interest rate expectations.

Indicators

	Current (Previous)*
Official cash rate	**1.00% (0.75%)**
Trend interest rates 10y average	1.10%
Bias in interest rate market	Higher
Core CPI Inflation (Trim) %Y/Y July (June)	**1.3% (1.2%)**
CPI inflation target range %Y/Y	1-3%
Budget balance % GDP FY16 (FY15)	**-0.1% (0.1%)**
Budget balance target % GDP	Balanced over the business cycle
GDP Growth %Q/Q saar Q2 (Q1)	**4.5% (3.7%)**
Trend GDP %Q/Q	1.72%
Purchasing Power Parity Value Jul	**1.2405**
Spot end-Aug	1.2481
PPP Valuation	USD/CAD is slightly overvalued
Current account balance % GDP Q2 (Q1)	**-2.9% (-3.0%)**
Trend current account balance % GDP	-2.39%
Moody's Foreign Currency Rating	**Aaa**
Outlook	Stable

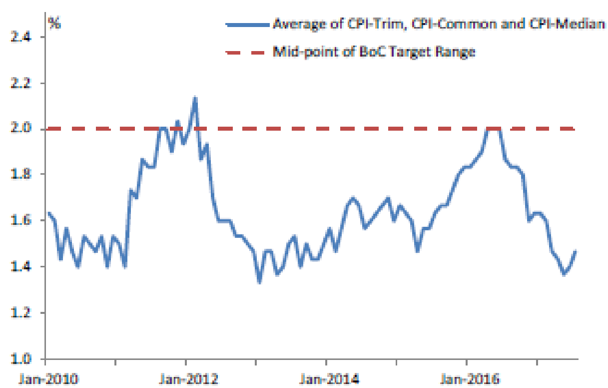
* Current is latest month, quarter or year

1. Strong rebound in GDP growth since Q2 2016



Source: Bloomberg, RBC Capital Markets

2. Core inflation measures attempting to stabilize



Source: Bank of Canada, Haver Analytics, RBC Capital Markets

Forecasts

	2017				2018			
	Q1	Q2	Q3f	Q4f	Q1f	Q2f	Q3f	Q4f
USD/CAD	1.33	1.30	1.21	1.24	1.27	1.26	1.26	1.26
EUR/CAD	1.42	1.48	1.40	1.39	1.38	1.34	1.36	1.41
CAD/JPY	83.7	86.7	88.4	83.1	78.7	81.0	82.5	84.1

Source: RBC Capital Markets estimates

Four psychological pitfalls of investing – and how to avoid them

Do you get anxious when the stock markets are volatile? Or do you feel optimistic that everything will turn out fine? Both reactions – natural parts of your psychological makeup – can actually impede your progress towards your investment goals.

The good news is that you can gain some control over your psychological responses – unlike the financial markets. Following are seven psychological pitfalls of investing – and how you can avoid them.

1. Overconfidence

Another powerful psychological bias is overconfidence. Just as people tend to be overly optimistic about the probability of positive results, they also tend to be overconfident about their own talents. Some investors think that they can "outsmart the market" – and even control largely unpredictable events such as stock market volatility.

This leads to one of the most common pitfalls of investing – market timing. Confident in their own abilities, many investors try to time the market so that they always buy low and sell high – despite the fact that not even the most accomplished professional investors can do this consistently.

Recognizing this tendency towards overconfidence is the first step towards dealing with it. Try to be honest about your abilities, and if you find yourself falling into traps such as market timing, take a step back and rethink your approach.

2. Hindsight

Hindsight is the tendency to believe that after something has happened, you knew all along that it would – even though you didn't. This tendency can lead you to believe that events are far more predictable than they really are, raising unrealistic expectations about how well your investments will perform and your advisor's ability to foretell the future, among other things. If you find yourself confidently declaring that you "knew it all along" ask yourself whether you really did. As with optimism and over confidence, you may have to consciously compensate for hindsight.

3. Obsession

Do you follow the performance of your investments minute-by-minute on TV or the Internet? Do you dwell on short-term changes in the market value of your investments? Do you fixate on the negative performance of a single investment, even when your overall portfolio is doing well? These can all be signs of obsessive behaviour commonly displayed by investors.

Take a step back and look at the big picture. Are you on track to achieving your longer-term goals? Are you comfortable with the level of investment risk in your portfolio? If not, you may have to make adjustments to stop obsessing about short-term events.

4. Herd instinct

When we see other people doing something, we have a natural tendency to think that it must be a good thing and we should do it too. This "herd instinct" is often behind sharp ups and downs in the financial markets. When other people are buying, propelling the market upwards, we buy too, sending the market even higher. Similarly, when other people sell in a panic, sending the market downwards, we sell too, fueling the decline. Unfortunately, this often results in buying at the height of the market euphoria, or selling close to the depths of the panic. Instead of following the herd, follow a disciplined investment strategy based on logic and reason.

Successful investing over the long term is less about how the markets are doing than how we react to what the markets are doing. Unfortunately, many of our natural psychological reactions – like denial, panic or greed – can impede our long-term success.

We make a living by what we get, but we make a life by what we give ~ Winston Churchill

Tax Planning Basics

Continued from our earlier newsletters where we looked at how different sources of income are taxed; in this issue we will continue to look at tax planning basics, this time focusing on capital gains/losses and after tax returns…

Taxable capital gains / net capital losses

You will realize a capital gain when you sell an asset and the proceeds exceed the cost base of the asset. A capital gain can be further reduced by any fees you incur to sell the asset (e.g. transaction fees or commissions). You will realize a capital loss when you sell an asset and the proceeds are less than the cost base of the asset. Your capital loss can become larger if you incurred fees to sell the asset. You must report capital gains on your tax return in the year they are realized. If you realized capital losses in the year, you must use these losses to reduce capital gains that you realized in the same year. If you did not reduce your capital gains to zero after subtracting your losses, you will report 50% of the balance on your tax return as a taxable capital gain. You pay tax on this amount at your marginal tax rate the year. If your losses for the year are greater than your gains, you will add 50% of the losses to your net capital loss pool. You can use the losses in this pool to reduce any taxable capital gains reported in any of the three previous calendar years, or carry them to future years to reduce any taxable capital gains you may realize in future years.

After-tax return on various types of revenue

The following chart shows how interest, dividends and capital gains compare on an after-tax basis when you invest $1,000. The chart assumes you pay tax at the highest marginal tax rates in effect in 2016, depending on the province where you live. Tables showing this information for those with different marginal tax rates by province can be found as an appendix to this article.

	Interest	Non-Eligible Dividends	Eligible Dividends	Capital Gains
Alberta	520	598	683	760
British Columbia	523	594	687	762
Manitoba	496	543	622	748
New Brunswick	467	542	658	734
NL&Labrador	502	581	595	751
Nova Scotia	460	530	584	730
Nunavut	555	636	669	778
NWT	530	643	717	765
Ontario	465	547	607	732
PEI	486	561	658	743
Quebec	467	562	602	733
Saskatchewan	520	601	697	760
Yukon	520	598	752	760

Source: RBC Wealth Management. Calculated based on federal and provincial legislation and legislative proposals, 2016.

A goal without a plan is a wish ~ Antoine de Saint-Exupery