The Financial Corner with Joanne Vesprini

A quarterly newsletter filled with practical wealth management advice that covers various aspects of financial well-being.

Spring 2018

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My thoughts,

This past quarter has had a fair share of volatile issues and lots of change. Italy formed a coalition government, Spain elected a new Prime Minister, interest rates increased in several countries and trade tariffs were implemented between the US and a number of countries.

In Canada NAFTA negotiations remain an ongoing saga, higher mortgage rates and stress tests on uninsured mortgages continue to have a cooling effect on the Toronto housing market while the foreign buyer's tax appears to have done the same for the Vancouver market and areas of Vancouver Island. With oil prices remaining in the high $60's the domestic energy sector has outperformed the S&P/TSX Composite since the end of March.

In the US the Fed raised interest rates in March and again in June with two more likely to happen before the end of the year. The Fed is striving for a more normalized rate structure after a decade of unprecedented monetary easing.

The US economy remains fundamentally strong with low unemployment, strength in manufacturing and non-manufacturing and increasing exports.

Concerns continue with the US and trade tensions with China, Mexico, Canada and the European Union and then with the complex relations with North Korea and Russia. The risks also continue from concerns with rising inflation and a flattening yield curve.

So the positives and negatives result in a steady stream of bull and bear outlooks. The back and forth that we have seen so far this year is most likely to continue for the balance of the year.

As long as you are invested for the mid to long term with good diversification your portfolio should withstand and recover from this type of market fluctuations and should allow you to relax and enjoy the summer!

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U.S. economy: The worry list

By Kelly Bogdanova – San Francisco Portfolio Analyst, US Equities

One of our mantras has been "to stay vigilant," so we look at a few nagging question marks hanging over the U.S. economy. While we think the business cycle has further to go, markets could be choppy at times as they work through these issues.

Why is growth still sluggish? Q1 GDP growth of 2.3% was well below the 3.1% average of the prior three quarters and nearly equivalent to the subpar trend that has persisted throughout this unusually weak recovery period. The largest tax cut package of all time was supposed to boost the economy. What happened?

The economic benefits of tax cuts and other fiscal stimulus typically don't materialize right away. They usually take at least a couple of quarters to kick in. There are anecdotal signs growth could accelerate in the second half of the year, if not sooner. Two examples: During Q1 earnings conference calls, we detected a pickup in small and medium-size business momentum, and homebuilders indicated new home purchases have been brisk despite the rise in mortgage rates.

Could inflation become a problem? This is certainly a risk the bond market has been focused on, as has the stock market, to a lesser extent. First off, a disclaimer. When we talk about "rising inflation," we're not talking about 1970s- or early 1980s-style runaway, high inflation. We think inflation will rise further, probably moderately beyond the Federal Reserve's 2% core inflation target (excludes volatile food and energy prices). Wages are moving up, as are prices of commodities that are used as inputs for industrial products.

The natural process of inflation rising back toward more normal levels after a lengthy period of ultralow inflation will likely unfold. This would be positive, not negative, in our view. One of our favorite inflation indicators, the New York Fed's Underlying Inflation Gauge, is pointing toward higher inflation. We think the Fed will allow core inflation to drift moderately beyond its 2% target. But if inflation seems headed well beyond that level, look for the Fed to actively intervene with additional rate hikes. The uncertainty surrounding inflation's ultimate stopping point could put financial markets on their heels at times.

Are you concerned about tariffs? Sentiment surveys, including those conducted by RBC Capital Markets, indicate the Trump administration's tariff policies have the business sector and institutional investors on edge. It's unclear how far the administration would go to implement a protectionist agenda and how trading partners would retaliate. We are concerned because tariffs normally bring negative economic implications with them, but the global economy is sturdy enough to absorb modest trade spats and targeted tariffs, in our view. We don't think this will metastasize into an all-out trade war. That being said, trade risks are difficult to model and have the potential to become more intense in the coming year. For more about this topic, see our article, *The year of the tariff*.

What about the flat yield curve—is a recession coming? When the spread between short- and long-term Treasury yields is narrow, like now, it doesn't necessarily mean a recession is imminent. The yield curve can stay flat for a long time, sometimes years, like in the 1990s. The difference between 10-year and 2-year yields was only 35 basis points (bps), on average, from 1995–1999, and the curve even dipped slightly into negative territory for a brief time before clearly inverting in 2000 (see lower chart). By comparison, the yield curve is currently at 46 bps. During the flat period in the 1990s, GDP grew at a strong 4.2% average rate and never fell into negative territory. Despite this period, flat yield curves are often accompanied by subpar GDP growth.

Inverted, or negative, yield curves are another matter entirely. When the difference between 10- and 2-year yields turns negative, it is typically a sign a recession is coming in the next six or 12 months, as the lower chart illustrates. Inversions matter most, and are the biggest threats to stock market performance because history shows that when a recession hits, corporate earnings plunge, and the equity bull market morphs into a bear market. The key takeaway is that an inverted yield curve usually gives investors time to become defensive because a recession doesn't automatically happen right away. One of our mantras has been "to stay vigilant" when it comes to market risks, so this "worry list" is important to contemplate. We think the business cycle has further to go and the U.S. economy can keep growing for the next 12 months, at least. But growth could be uneven or subpar, and the issues above could linger as headwinds for financial markets.

Multiple Wills Strategy

As part of your estate planning, you may look for ways to reduce or avoid taxes payable on your death, including probate taxes. There may be several strategies available to you. The use of multiple Wills is one such strategy that you may wish to consider.

Probate taxes: When you pass away, your executor (or liquidator in Quebec) may be required to obtain a grant of probate in order to be able to fully administer your estate. Probate is an administrative procedure to validate a Will and confirm the authority of the executor named in the Will to act on behalf of the estate. Your executor's authority is not derived from the probate process but from the Will itself. Third parties, however, may require probate in order to release your assets to your executor or change the legal ownership of property, such as securities or real estate. Most provinces charge a tax when your Will is probated. Probate taxes range from a nominal or low flat fee in some provinces to a percentage of the fair market value of the estate assets. In Quebec, a Notarial Will does not require probate.

The multiple Wills strategy

In an effort to reduce or avoid probate taxes, some estate planners advocate the use of multiple Wills. Historically, multiple Wills were used primarily to deal with assets held in different jurisdictions or where you wanted different executors to deal with different assets. Now multiple Wills are also being used in some provinces as a means of minimizing probate taxes.

The multiple Wills strategy involves segregating your assets so that different assets are subject to different Wills. For example, a "primary" Will may deal with assets that require probate in that jurisdiction, such as bank accounts, investment portfolios, and real estate. A "secondary" Will may hold the remaining assets that do not require probate, such as privately held shares or personal effects, such as antiques, art and jewelry.

Where this strategy is available, your executor has the choice to probate any of your Wills and probate taxes would only apply to the assets included in the Will being probated. By separating assets that may require probate from those that do not, you may therefore avoid paying probate on those assets that do not otherwise require probate.

Multiple Wills may also be structured based upon jurisdiction, to take advantage of lower or nominal probate taxes in different jurisdictions, such as Quebec and Alberta. For example, an Ontario resident who wishes to take advantage of the multiple Wills strategy may have an "Ontario" Will to deal with real property located in Ontario and a "Quebec" Will to deal with other property situated in Quebec. As well, multiple Wills may be used to simplify estate administration when assets are held in multiple jurisdictions.

In the right circumstances, multiple Wills can significantly reduce the probate taxes that the estate would otherwise pay. Whether or not multiple Wills should be used depends upon your intentions, the nature of the assets held, where they are held, the value of the assets and the corresponding anticipated savings in probate taxes that follow from the implementation of this strategy.

Implementation of the multiple Wills Strategy

While this strategy may be appealing, its successful implementation can be thwarted by improper drafting and execution of the Wills. Care must be taken by you and your professional advisors to ensure that common pitfalls are avoided. For example:

- The execution (signing) of one Will should not have the effect of revoking the other. The Wills should be carefully worded so that the intention for multiple Wills to co-exist is clear;
- Each Will should clearly identify the property it is dealing with to avoid situations where multiple Wills deal with the same property in different ways or where more than one executor is appointed with authority over the same property; and
- The Wills should identify which assets are to be used to pay debts and expenses of the estate, as well as legacies. Otherwise, there may be difficulties in the administration of the estate, particularly if there are different beneficiaries under each Will.

Multiple Wills Continued

Circumstances where a secondary Will might require probate

There are a few scenarios where a secondary Will might require probate: These include:

- If one of your Wills is contested by beneficiaries or other interested parties
- If third parties are unable to effect a change of ownership of assets dealt with in a secondary Will
- If the Will does not provide for an outright distribution of the deceased's assets but rather requires ongoing administration. Such may be the case where the Will creates trusts. A financial institution may be unable to open an estate or testamentary trust account without a probated Will because of the potential unlimited liability to which it may be exposed. A financial institution may be held liable if it negotiates a cheque payable to the estate or trust where the Will presented may not be the last Will of the deceased or if it is not a valid Will and the executor does not have the legal authority to act on behalf of the estate. This issue should be considered and discussed with your financial institution as well as your estate planning lawyer at the time of drafting your secondary Will
- If an asset which requires probate is included in your Secondary Will.

If there is a concern that one of these issues may arise, it may not be worthwhile implementing the multiple Will strategy.

Benefits of obtaining probate

Although certain assets may not require probate to change ownership and thus can be dealt with in a secondary Will, it may still be beneficial to obtain probate. The benefits of obtaining probate include:

Probate starts the clock on claims that can be made against the estate – certain claims that may be brought against an estate may be time limited. Depending on applicable law, the limitation period may run from the date of the grant of probate. Without the grant of probate, the limitation period may never expire.

Protection for the executor – if an executor administers an estate pursuant to a Will that has not been probated, and the Will is later found to be invalid, the executor may be personally liable to the proper beneficiaries.

Protection for third parties – probate provides third parties, such as banks and brokerage firms, with confirmation that they are dealing with the person who is legally authorized to act on behalf of the deceased's estate. It protects them from future claims that the deceased's assets were transferred to the wrong person.

For more information on the multiple Wills strategy and whether it should be implemented as part of your overall estate plans, you are advised to consult with a qualified legal advisor.