Portfolio Advisor

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RBC Dominion Securities

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Market commentary

Equity markets are still grappling with issues that have lingered since the correction began in February, including trade disputes, the flat Treasury yield curve, Chinese deleveraging, and European political uncertainties. While most markets have held up relatively well, China's Shanghai Composite Index slipped into bear market territory in June.

One thing is apparent: the world's largest economy shows no signs of buckling. Sturdy U.S. economic growth should support global growth and equity prices during this consolidation period. We expect strong corporate earnings to power developed markets higher by year's end. However, their trajectories could be more volatile and shallower than during the double-digit annual return runs of 2016 and 2017. We would maintain a slight overweight position in global equities.

Fixed income

Central bankers are paying more attention to trade developments, according to several of their comments at last month's European Central Bank Forum. Although these concerns haven't risen to the point where central bankers are including them in their economic outlooks, the bankers noted that escalating trade tensions could negatively impact business confidence and economic growth. For now, these concerns are unlikely to derail current monetary policy plans to gradually dial back stimulus.

The heightened attention to conditions that arise in the latter part of an economic cycle—rising interest rates, flattening yield curves, and high corporate debt levels—leave many investors overly cautious, in our opinion. Even though we maintain our underweight to fixed income, investors should not ignore selective opportunities in credit and/or strategic yield curve positioning.

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

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Global Portfolio Advisory Group

Wealth and inflation... what's the relation?

Imagine needing a wheelbarrow of cash to buy a loaf of bread. That was the scene in 1919-1923 Weimar Germany because of hyperinflation, to the tune of 21% ... daily. While that's an extreme case, inflation is an important concern for Canadian investors, especially as it's been creeping up recently and is now over 2%.

What's inflation?

Inflation is a sustained increase in prices for goods and services that erodes your purchasing power. It's the reason penny candies don't actually cost a penny. When the supply of goods and services is low, as in the case of a natural disaster or a conflict, supplies become scarce, and consumers are willing to pay more for them. When demand is high for goods and services, as in the case of rising wages or income tax cuts, prices rise. Face the perfect storm of falling supply and rising demand, and the Bank of Canada might bring back the thousand-dollar bill.

How does it affect investors?

When the inflationary tide is rising, you want your portfolio to rise with it. Unfortunately, traditional fixed-income products act more like anchors in an inflationary environment. Bonds, GICs and the like can play an important role in your portfolio because of their low volatility and predictable income, but they are vulnerable to rising prices. Say you've locked into a bond that provides a monthly payment of $500 for the next 20 years. After only five years at an annual inflation rate of 7%, the purchasing power of $500 would be closer to $356.

Fortunately, there are assets that, as a rule, fare better in times of high inflation. Here are some ways to inflation-proof your portfolio that, depending on your situation, may be right for you:

- **Commodities such as gold, oil, copper, wheat, etc.:** Gold has traditionally been seen as a store of value during inflationary times, with its relative rarity yet broad acceptance as an unofficial currency underpinning its value. And, the world relies on fuel and food; thus, there will always be a demand for some commodities, no matter the cost. You can gain exposure in your portfolio through shares, futures contracts or Exchange-Traded Funds (ETFs).
- **Real Return Bonds (RRBs):** The value of existing fixed-rate bonds dives in times of high inflation. However, Real Return Bond payments are inflation-indexed – when inflation rises, so do RRB payments.
- **Indexed life annuities:** A life annuity is a contract that binds an issuer to deliver a steady stream of income payments that last an entire lifetime in return for a lump sum deposit. Under an indexed option, your payments may be indexed each year to a cost of living index so you don't lose your purchasing power.
- **Shares of essential services companies:** Generally, inflation raises companies' costs faster than companies can pass the price increases off onto consumers. That said, some industries can increase their prices faster than others, such as utilities and consumer staples.
- **Real Estate Income Trusts (REITs):** Mark Twain had biting wit as well as prudent hedging advice: "Buy land, they're not making it anymore." You can gain exposure by investing in REITs, which own various income-producing properties.

Prudence pays

Over the past 40 years, the Bank of Canada has helped keep inflation at 1-3%. But before that, there was a time when it spiked to over 12.5%. It's important to consider the risks of inflation as they can be curbed with the right plan and a diversified portfolio.

For more information about inflation-proofing your portfolio, please contact us today.

The right assets in the right accounts

What to put in your RRSP, TFSA and non-registered accounts

You wouldn't put regular gas in a BMW 7 series, so why are you filling your TFSA with inferior fuel? Certain accounts seem tailor-made for particular assets. Get the combination right, and you can have your account running at peak tax-efficiency.

	Consider:	Generally, avoid:
Registered Retirement Savings Plan (RRSP)	**Canadian or U.S. interest** – bonds, GICs, T-bills, etc. that pay interest income (fully taxable outside a registered account). The U.S. generally does not withhold tax on interest payments to Canada. **U.S. corporate dividends** – U.S. dividends received into an RRSP from U.S. corporations are exempt from U.S. withholding tax under the tax treaty between the U.S. and Canada. U.S. dividends are fully taxed like interest when held outside a registered account.	**Foreign interest** – there is likely withholding tax on interest received from countries other than Canada or the U.S. **Canadian corporate dividends** – Canadian dividend tax credit can't be used resulting in additional tax if these are earned in an RRSP as the dividends are fully taxable when withdrawn from the RRSP. **Foreign (non-U.S.) corporate dividends** – there will be withholding tax on dividends which cannot be recovered through the foreign tax credit mechanism. **Capital gains** – capital gains are taxed at a preferential tax rate in a non-registered account, which is an advantage lost inside an RRSP. There is generally no withholding tax on capital gains from foreign countries.
Tax-Free Savings Account (TFSA)	**Canadian or U.S. interest** – bonds, GICs, T-bills, etc. that pay interest income (fully taxable outside a registered account). There is no withholding tax on interest paid from U.S. to Canada on most investments. **Capital Gains, domestic and foreign** – no capital gains tax when realized or when withdrawn, but also no capital loss deduction. **Canadian corporate dividends** – tax-free dividends in the TFSA vs. preferential tax in a non-registered account. While you pay less tax on Canadian dividends in a non-registered account, you would pay no tax in the TFSA.	**U.S. and foreign dividend stocks** – dividends are subject to withholding taxes, which can't be recovered with the foreign tax credit. **Foreign interest** – there could be foreign withholding taxes that cannot be recovered.
Corporate (non-registered) **account**	**Canadian dividend stocks** – preferential dividend tax treatment resulting in lower effective tax rates. **Capital growth stocks, domestic and foreign** – preferential capital gains tax when realized, capital losses can be deducted from capital gains.	**Foreign corporate stocks** – a mismatch in the corporate foreign tax credit and Canadian corporate tax regime causes foreign dividends to be taxed at much higher tax rates when they are withdrawn from the corporation than if earned personally.
Personal (non-registered) **account**	**Capital gains, domestic and foreign** – preferential capital gains tax when realized, capital losses can be deducted from capital gains. **Canadian corporate dividends** – preferential dividend tax treatment resulting in lower effective tax rates. **U.S. and foreign corporate dividends** – although foreign dividends are fully taxed like interest, foreign taxes withheld can qualify for the foreign tax credit.	**Interest** – bonds, GICs, T-bills, etc. that pay fully taxable income.

In most cases, your granny's tender words of encouragement still ring true: "It's what's inside that counts." But, so do the words she omitted: "There are exceptions to every rule." Tax-efficiency can be a consideration when selecting suitable investments for each account, but it should never be at the risk of an unbalanced portfolio. For more information, please contact us today.

* If a specific investment is not listed here, contact a qualified professional.

Oh, CRA-p!

You lift open the mailbox only to spot that dreaded brown envelope – your Notice of Assessment has arrived. As you unseal the envelope, your hands begin to tremble. Your math differs from the Canada Revenue Agency's – it's significant, and not a refund. How could this have happened?

Three common reasons for a surprise tax bill

1. **Income not taxed at source**
   If you receive income for more than one year in which an insufficient amount of tax is withheld, or none at all, the Canada Revenue Agency (CRA) could request that you start paying tax in instalments. It's most common if you receive regular rental, interest or dividend income, capital gains or self-employment income. Even Registered Retirement Income Fund (RRIF) withdrawals and certain pension payments may trigger quarterly installment payments, since tax is generally not withheld on these types of income.

You'll have three options for calculating instalment payments:

1. No-calculation (pay what the CRA asks)
2. Prior-year (your return is similar to last year but different from two years ago)
3. Current-year (your return is very different from past two years)

Determining the optimum amount requires an analysis of your cash flow situation and income forecast for the year ahead.

Consider paying what the CRA asks for in their notice to avoid possible interest and penalties from underestimating the amount of tax you will owe next year.

2. **Human error**
   The late Stephen Hawking cautioned "that Artificial Intelligence (AI) may replace humans altogether." It's a frightening thought, though if AI were to take over the burden of filing our taxes, it may not be such a bad thing. Until then, April will continue to be "tax month" and our tax returns will be prone to human error.

Here are a few common administrative mistakes that lead to reassessment:

- Missing slips (e.g. T5s and other income slips)
- Filing too early (i.e. sometimes slips haven't arrived, or other material changes come to head after you've filed that then require amendments)
- Mathematical or calculation errors

3. **Putting information on the wrong line**
   Tax filing has grown more complex over the years. A common mistake by DIY'ers is to claim an item on one line of their tax return when it should be on another. For example, when you sell real estate, you won't always realize a capital gain – sometimes it is fully taxable income, or not taxed at all. Each type of income gets reported on a different line. Deductions can be equally confusing. Take the case of an eligible severance contributed to an RRSP. If claimed properly, it will not use RRSP room. Claim the deduction on the line for a regular RRSP contribution, and you could be over contributed to your RRSP. Mistakes like this are usually simple to correct or avoid but increasingly require experienced advice to eliminate in the first place.

For more information, please contact us today.

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