Issue 171– Jan. / Feb. 2016

C.E. VANDENBERG & ASSOCIATES INC.

FINANCIAL PLANNING— INSURANCE— WEALTH MANAGEMENT

ATTENTIVE - ATTUNE - ATTAIN™

WE WILL LISTEN CAREFULLY

TO WHAT YOU ARE SAYING

AND BE ATTENTIVE TO YOUR DESIRES

AS WELL AS YOUR FEARS

SO TOGETHER WE CAN BUILD

AND ENJOY

A HARMONIOUS

AND RESPONSIVE RELATIONSHIP

IN ATTAINING YOUR LIFE'S DREAMS

AND THROUGH THAT

WE WILL BE ATTAINING OURS.

Carey

WWW.CAREYVANDENBERG.COM

CAREY@CAREYVANDENBERG.COM

LOCAL 604 541 2690

TOLL FREE 1 866 274 1222

FAX 1 888 551 9202

mutual gains™

published bi-monthly since 1987

Time Of Digestion Before The Long Earnings Cycle

We have seen a virtually uninterrupted move up in equity prices since mid-2011. That was until this past summer when things started to soften. No sooner did the streamers and X & O's subside during the first hours of 2016 did a measurably more pessimistic feeling kick in on major equity markets around the world. "What's up with that?"

It's simple really. We're about "mid-cycle" as far as "beginning to end" economic cycles go and at mid cycle there is a digestion process. This is when there is an initial modest decline (which we have seen) and then we get in a place where markets as a whole bounce up and down for a while within a range. The slight difference with the current mid cycle phase today from others is the pull down coming from China's slowing economy and how virtually all other economies are still dragging. This is contrary to the push up happening in the US's warming economy. The nervousness of this "pull and push" and what that means really seemed to kick in on January 1st. It will soon end.

After we get through this "mid cycle pause", we enter the earnings driven cycle, when share prices go up because company earnings are rising. This normally lasts another few years. With so much slack in the world's economic system today however, the earnings cycle's upward trend could be longer than in past cycle, possibly much longer, because the only country that is really showing any kind of economic strength now is the US.

Today, there really aren't any excesses in the system. Inflation is low, there are historically high levels of cash held by people all around the world and valuations for companies in aggregate are in the "historically average" zone while many are down right cheap. These characteristics wouldn't be there if we were set for a large decline.

The earnings driven part of the market moves up for the longest period of time. As I said before, this could continue for much longer than normal, as in several years rather than just a few. Unfortunately, most people will miss out on the majority of those gains. Where we are today will prove to have been an opportune time to invest cash. Investment managers I use have been buying aggressively recently. It may feel uncomfortable over the next several weeks or couple of months but you will be well rewarded if you invest cash today rather than wait. I've seen it time and time again for 28 years running.

I mentioned that there were no excesses in the system. We'll that isn't quite true. The only real excess today is the excess caution felt by so many.

Diversified Portfolio Or Rental Income?

I commonly come across a new client having the idea of creating a portfolio of revenue property to produce retirement income. This sounds like a nice idea in theory but you generally can't get the same income on rental property as you can from a diversified portfolio.

The after expense costs of rental income will be in the 1—2% range if you want it to be fully managed, much like you would an investment portfolio. That includes your costs of maintenance / strata fees, property taxes, property management, replacing things that wear out etc. Underestimating these expenses is very common which leaves you with less retirement income and more expenses than you expected.

Based on long term returns, a balanced investment portfolio is shown to be able to payout 4% from your portfolio (indexed for inflation) for 30 to 35 years after all expenses. As well, there are portfolio structures that have guarantees on what percentage it will pay out to you for a fixed period ie 20 years. You also have more flexibility in that you can draw it down quicker by increasing the amount you want as income during your retirement. In other words, if you want 6% of your portfolio paid out to you, it can be set up as such. Of course, the money won't last as long however, it could still last well beyond your lifetime. Because of the ability to increase the income coming to you from your portfolio, you would have enjoyed your retirement with the highest income possible.

3 Spousal RRSP Strategies

Spousal RRSP's used to be used to split income between spouses at retirement. This was done when one spouse earned substantially more than the other and come retirement, the overall tax by the couple would be higher than if they didn't use a Spousal RRSP. That is the reason they were originally instituted. This all changed in 2007 when the government allowed retirement income to be split equally among spouses apart from using a Spousal RRSP.

This change did make the Spousal RRSP less useful however, it didn't render it obsolete. A Spousal RRSP still has some very effective uses that that can help you within a relatively short period of time. Here are the 3 biggest:

Home Buyers Plan— With a Spousal RRSP, you can double your down payment for your first home when accessing it from your RRSP's. Of course you can do this when each of you has their own RRSP however, if one is earning significantly more, it could make sense to do 1 regular RRSP and 1 Spousal RRSP. There could be an extra several thousand dollars in tax savings if done this way (see Income Tax Deductions on page 3 to get a better understanding of why I say this).

Lifelong Learning Plan— You can contribute to your RRSP's and take money out tax free to fund future education for yourself. The same contribution and withdrawal strategy applies here as I mentioned with the Home Buyers Plan. Using a Spousal RRSP and regular RRSP combo, you could be saving a lot more tax money (again, see Income Tax... pg 3).

Contribute and Withdraw— This may seem sacrilegious to many in financial circles however, if done in the context of a broader financial plan, this can work very effectively. Here, the higher income earner contributes to the lower income earner's Spousal RRSP with up to $4,400 in tax savings on $10,000. In 3 years, if the lower income earner has no income, you can withdraw the money out of the Spousal RRSP and it be tax free when the dust settles. This does use up useful contribution room which is why I said, only in the context of a broader financial plan, is it worth looking at.

How To Unchain Your Pension Money

When you leave a job, you may have a pension plan in place. Just because your pension gives you options on how much you will get per month, you don't have to just accept one of those options. You often have the ability to transfer the "commuted value" of the pension plan to a "Locked In Retirement Account" or LIRA. This could mean transferring thousands, if not hundreds of thousands of dollars, to a LIRA that is in your name. It can make sense to do this when:

⇒ You haven't worked there very long

⇒ Your family has a history of living very long lives

⇒ You see your current health as being below average

⇒ You are not married

To understand why you would do this, you have to be aware of how much money is invested on your behalf within your pension plan. The monthly income that is being promised you has to come from somewhere and where it is coming from is a pool of money that is set aside to do just that. That dollar figure is the "commuted value". That is your money.

What happens if you retire but don't live a long life and you are single? Let's say you have received $5,000 /month for 5 years when your commuted value upon retirement was $600,000. The remaining amount, including the interest, dividends and capital gains your money has earned over that time, could be closer to $800,000 yet you were only paid out $300,000. That remainder stays in the pension plan to help pay other pension plan members pensions. You were short changed.

Doing a calculation on what makes the most sense should be done on any pension plan and more so, on the 4 scenarios I pointed out at the beginning of this article. Not doing so could mean hundreds of thousands slipping through cracks.

6 Financial Rules Of Thumb— More Myths Than Realty

Your retirement income needs to be 70% of your working income— Each on of us is different, making this rule of thumb-wrong most of the time. I have seen anywhere from 25% to 140% after projections are done.

An emergency fund must equal 6 months of income— What a waste of resources, having many thousands of dollars sitting in an account that earns you next to nothing. The best way to deal with potential emergencies is with an available line of credit (having life, disability and critical illness insurance in place will take care of the rest).

Don't invest more than 5% of your savings in any 1 stock or bond— This is actually an excellent benchmark. Many of the investment managers I use for clients will have a portfolio of at least 20 different investments since that minimum amount of diversification can cover off the most important risks for loss. Betting the farm so to speak on a particular investment or catostrophic outcome is simply foolish. That is a bet much like whether you should take another card in Black Jack.

The % of your portfolio in conservative investments (bonds etc) should = your age— This may feel good but it reduces the income you can draw from your portfolio. A 50 year old with 50% in bonds? This makes no sense whatsoever.

Do an RESP first then contribute to your RRSP— The argument for this is that education costs come before retirement so save for that first. It should be the other way around. As you get closer to retirement, you have a very limited ways to make up a shortfall. Your children can go into debt and have years upon years to pay off student loans. No, that isn't ideal however, you being behind the 8 ball at retirement is more damaging. As well, you are only getting 20% from the government with an RESP. An RRSP contribution can save you up to 45.8% in tax.

Life insurance only needs to cover your mortgage— Yes, a mortgage payment can be a big expense particularly if you haven't lived in your home that long however, mortgage payments can only be 33% of income anyway which makes it very clear that most of your expenses are not related to your mortgage. Life insurance needs are family case specific.

Financial planning is a combo of chess and art. If you come across advice that has more myth than reality as I've listed above, I'd say that the person suggesting this isn't really thinking through the ramifications when followed though with.

RRSP Contribution Or Mortgage Paydown?

This has to be the most common "either or" question in financial planning. Should I pay down my mortgage or contribute to an RRSP?

For the last several years, the most often than not right answer to this is to make an RRSP contribution. This is because, with interest rates so low, you can probably get a higher return on your RRSP than you can save on interest costs by paying down your mortgage. Do I pay down a mortgage that is costing me 2.7% / year when I can earn 5% or more on a long term basis on my RRSP contribution? The math and answer is that simple.

Also, with an RRSP contribution you can save up to $45.8% in tax, which puts more in your pocket. When you pay down your mortgage by $10,000, you have simply moved $10,000 from cash to $10,000 to reducing debt. However, when you make an RRSP contribution, your net worth can increase by up to $4,580 because now, you have an extra $4,580 in cash. Use THAT to paydown your mortgage. Doing that every year will increase your net worth quicker than if simply paying down your mortgage.

That is the simple math however, not all financial planning decisions are made on math alone. Comfort is another factor.

Why Income Tax Deductions Are So Lucrative

The percentage of income tax you pay is less than the percentage you can save from a tax deduction. In other words, you may pay an "average" tax rate of 30% however, when you make an RRSP contribution you can save up to 45.8% in tax. Why is that? The reason is in the way you are charged income tax and it is the reason tax deductions can be so powerful.

The table on the right shows how we are taxed. Canada, like most counties, have a "progressive tax" system. It simple means that as your income goes up, you pay more tax. That increase doesn't go down to the first dollar you earn however. If for example, you are earning exactly $44,701 / year you pay $6,945 in income taxes. That is an average tax rate of 15.54% because you are paying income tax in 2 different bands, 0 and 20.06%. When you get a $1,000 raise, that $1,000 is all taxed at 29.7%. This is why, often when you see your paycheque after a raise, you realize that you aren't that much better than you were before the raise.

This is where a tax deduction comes in. The most popular of those is in making an RRSP contribution. As an example, if you earn $172,000, you can make a $20,000 RRSP contribution you will save $9,160 in tax (45.8%) despite your average tax rate being only 32.16%.

Taxable Income	Tax Rate
$0–$9,947	0%
$9,948–$37,606	20.06%
$37,870–$44,701	22.70%
$44,702–$75,740	29.70%
$75,741–$86,958	32.50%
$86,959–$89,402	34.29%
$89,403–$105,592	38.29%
$105,593–$138,586	40.70%
$138,587–$151,050	43.70%
$151,051+	45.80%

Tech Gems— OneTab

I use 3 different browsers on my office PC and my Surface. I often have several tabs open at any given time. If you have ever kept adding tabs to an open browser you soon realize that this can cause problems. Of course, you don't want to close any of your open tabs because you have them open to make them easily accessible. One solution would be to bookmark them but that is cumbersome and you probably only want them open for the time being. OneTab is the solution and is available for Firefox and Chrome. You simply download the add-in into your browser. Anytime you have a bunch of tabs open, click on the OneTab icon and it shoehorns all your tabs into 1 tab. Click on that tab and you will see a list of the tabs you previously had open. Click on 1 from within this list and it re-opens that 1 tab. Try it. You'll like it.

Hhhhhmmm……

Sir John Templeton, the famous value investor, at the beginning of his career, bought every stock on the New York Stock Exchange that was less than $1 / share. He did that when WWI started, a scary time to invest. Initial investment was $10,400 for a portfolio of 100 companies which by 1943 was worth over $40,000. He always said, "The time of maximum pessimism is the best time to buy, and the time of maximum optimism is the best time to sell." Money Report, Dec. 2015

A market correction is defined as a 10% drop from a recent peak. Stock market corrections have historically happened every 18 months. The last time we had a correction was August 2015, but that was the first in nearly four years, an unusually long gap (which is why it feels more unsettling). Advisor.ca, Feb. 2016

"In today's market, if you raise your dividend, investors are happy, period -- even if it's not the right thing for the business long-term." "The highest-yielding stocks are disproportionately expensive relative to their lower-yielding peers." Stephen Groff, Portfolio Manager & Principal, Cambridge Global Advisors, May 2015

The rise of passive investment (ETF's / index investing) appears to be adding to the volatility. Passive investments tend to follow trends and accentuate movements. As more of the trading is dominated by unthinking money, short term price movements become exaggerated. In this environment, judgement, focus and deep understanding of a company are critical to getting it right in the long run. Jim Young, Portfolio Manager, Invesco

The market has valued Amazon at US$325 billion which dwarfs that of Wal-Mart Stores Inc., priced at US$200 billion. Despite that dominance, Amazon's actual profits are tiny in comparison. Financial Post, Jan. 2016

Real returns (return after inflation and income tax) on chequing and savings accounts as well as, GIC's and Canada Savings Bonds are currently negative. In other words, every month you hold a bank deposit you are worse off than the month before because prices of food, clothing, car expenses, etc. are going up faster.

Car registrations have been steadily increasing for the past 2 years especially in the UK, Spain and Italy. Germany has the lowest unemployment it has ever seen. Capital Group conference call, Dec. 2015

Apple sold 74.8 million iPhones for the last 3 months of 2015. This is up just 1% from the same quarter a year ago, marking the slowest increase in sales for the device since it was introduced in 2007. USA Today, Jan. 2016

Merchandise return rates for online purchases average about 30% versus 9% at bricks and mortar stores. We have seen these differences before, with paper catalogs. Online selling is the 21st century's "catalog". Financial Post, Jan. 2015

For every $1 Americans spent for items online this year, Amazon captured 51 cents. Financial Post, Jan. 2015

Canada used to have more automobile assembly lines than Michigan. Now we have less than Mexico. Today though, Canada has the 3rd largest aerospace business sector in the world. Investment Executive, Nov. 2015

Debt reduction is like trying to improve your physical fitness. Small habit changes add up to great changes over time.

A consumer proposal is an alternative to personal bankruptcy. You could be paying less of your debt over time but you don't give up any of your assets. Advisor.ca Feb. 2016

A killer earthquake along Cascadia, a fault line which runs from Cape Mendocino, California, to Vancouver Island is 72 years overdue. Dailymail.co.uk, Jan. 2016

Canadian vs U.S. pricing on printer ink cartridges: Canadian price at Staples = $64.81. US price is $29.32. Converted to Cdn $'s = $39.93. That is 38.3% cheaper for exactly the same thing.

Carey

PS. Questions, comments? I'd love to hear them. carey@careyvandenberg.com or 604 541 2690