Market Snapshot – May 2015

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GIVING THE TAX MAN WHAT HE DESERVES. AND NOT A PENNY MORE.

JAMES GAUTHIER

Tax season has come and gone, and while many advisors are not involved directly in the preparation of client tax statements, advisors are in a position to have a significant influence over client tax circumstances. Ensuring clients are in a position to maximize their after tax savings is one of the most fundamentally important roles a good advisor should be playing.

We could write volumes about what can be done to ensure maximum tax efficiency, but let's review some of the basic considerations, discussion points and solutions that advisors should be going through with all clients.

The points that follow may seem rudimentary, but ensuring the basics are in place is the most important step in ensuring client tax planning needs are on the right track.

TFSA Contributions

Canadian taxpayers don't have many freebies at their disposal. The TFSA may be one of them. The 2015 Federal Budget brought the annual contribution limit to $10,000, effective January 1, 2015. So anyone who already contributed the previous maximum of $5,500 is free to top that off. This is not a dedicated-TFSA piece, but there is plenty of content out there about the benefits of this savings vehicle. Wherever possible, it makes sense for most clients to maximize their TFSA contributions, and it often makes sense for clients to move money into a TFSA before making RRSP contributions. After all, it's tough to get more tax efficient than "tax free".

RRSP Contributions

Again, a ton of content on the benefits and ideal uses of RRSPs is available online, but most clients who are in a positon to maximize TFSA and RRSP contributions should do so.

Corporate Class Funds

Corporate class funds offer tax advantages that are not available through funds structured as trusts. The primary benefits include tax deferred switching from one class of fund to another within the same corporation and a minimization of taxable distributions. Note that the mechanics of the corporate structure means there are limited fixed income options, most large fund companies have corporate class equivalents of the bulk of the equity products in their lineups and pricing is the same, typically, as the trust versions. The level of assets within corporate class funds in general indicate to us that these products are underutilized, but wise advisors are already using these tools in client accounts.

T-Series

Most major fund companies offer versions of their funds that pay out monthly distributions of varying magnitudes (collectively, T-Series funds). These payments allow for a certain amount of cash flow certainty for clients, and the distributions themselves are classified as return of capital (ROC) payments, meaning they are not taxable. Tax is deferred until fund units are sold, or the investor's capital is depleted. The adjusted cost base is lowered by the amount of ROC and any capital gain (or loss) is realized when the investment is sold.

Understanding the Different Tax Rates Applicable to Income, Capital Gains and Dividends

Canadian income tax rules apply different tax rates to income from different sources. Provincial tax rules ensure that the rate applied to each income source differs from province to province. Across all jurisdictions, ordinary income is hit with the highest tax rate. We believe the old rule stating that bonds should be held in registered accounts (or TFSAs) and stocks should be held in non-registered accounts is outmoded. For example, if a client holds a bond yielding 2% and a stock yielding 4%, it might make sense to hold the stock in a registered account and the bond in an open account. Understanding individual client circumstances is crucial when deciding where to hold particular assets, but holding them in the right place can be an aid in maximizing tax efficiency.

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Minimizing Capital Gains Distributions Through Low Turnover Mutual Funds/ETFs

After a six year bull run for equity markets around the globe, there aren't a lot of capital loss carry-forwards to go around. Therefore, funds crystalizing gains in their investment portfolios are more likely to be in a position to pay distributions out to investors. The rule of thumb is that the lower the turnover level of a fund, the more tax efficient it will be.

Deductibility of Interest on Borrowing Used for Generating Income

The general rule is that interest expense is deductible for income tax purposes if the borrowed funds are used to earn income and certain other conditions are met. We are not using this space to endorse the use of leverage in client accounts, but for situations where leverage is utilized, be sure clients take advantage of the deductibility of the interest charges.

Tax Loss Selling

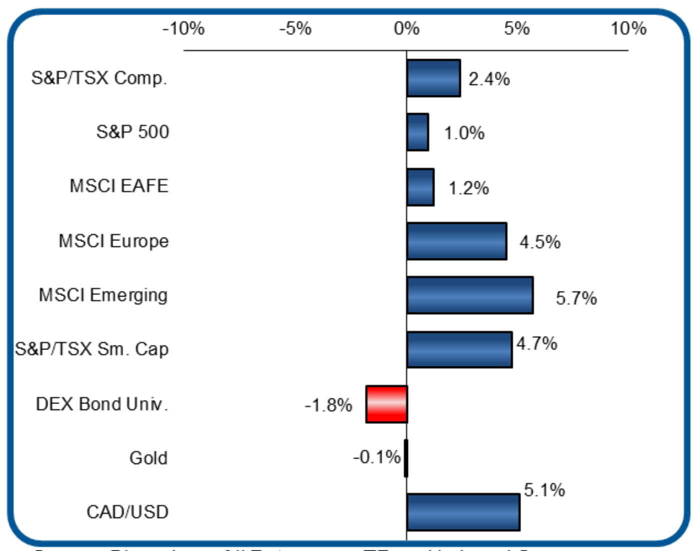
This is something that should be saved for year end, but where and individual owns investments with accrued losses, he or she may consider selling these investments before the end of the year in order to offset any capital gains realized during the year. Make sure clients wait 30 days before repurchasing any investment in order to avoid superficial loss rules.

MONTHLY OVERVIEW

Equity prices in Canada were higher, on average, during April as a rebound in energy prices stoked investor interest in the sector. The S&P/TSX Composite Index advanced 2.4% on the month. April was also a strong month for the mining and precious metals areas. Results for global equity markets were mixed, but a stronger loonie on the back of improving commodity prices meant negative results for most of the broad-based indices, from the perspective of a Canadian investor. Rising bond yields knocked the broader Canadian investment grade bond index lower for the second month in a row.

The U.S. dollar has lost some altitude recently, in response to the lacklustre U.S. economic conditions at the start of this year. Expectations for the Fed's first rate hike have been 'pushed out' to later this year, and the magnitude and frequency of subsequent tightening efforts have also been reduced. With oil prices on the mend, many commodity-sensitive currencies – including the Canadian dollar and the Mexican peso – have strengthened vis-à-vis the greenback. However, there remains considerable volatility in the outlook for currencies. Evidence of a stronger U.S. economic rebound would reinforce a monetary policy divergence, lead to higher U.S. borrowing costs, and a renewed strengthening in the U.S. dollar.

1 MONTH RETURNS



Source: Bloomberg, All Returns are TR and in Local Currency

Speaking of improving oil prices, spot WTI prices surged 24% higher in U.S. dollar terms, as traders began expecting oil production levels to show sizable declines following several weeks of decreases in the number of U.S. rigs actively drilling for oil. The price jump marked the biggest monthly gain for the commodity since May 2009. Gold prices were flat in April, despite the weakness in the greenback during the month.

MARKET OUTLOOK

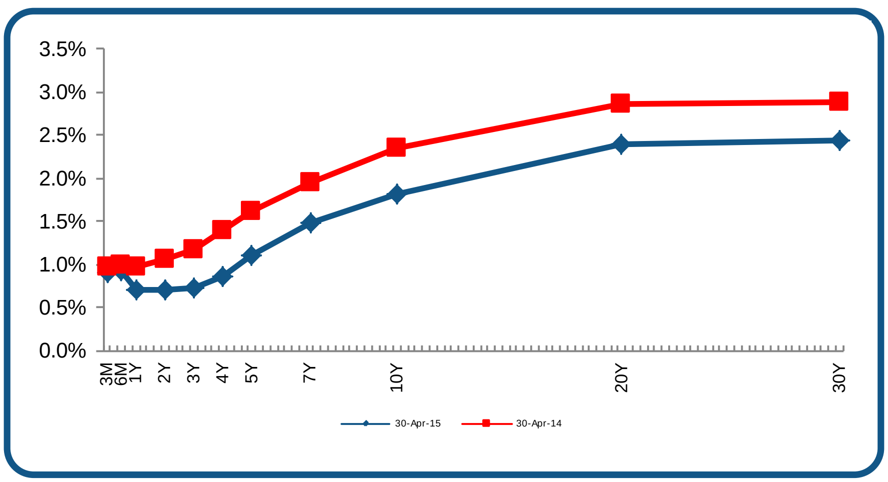
Scotiabank Economics continues to believe that an improving global growth profile will emerge through the balance of the year and into 2016. This is based upon expectations that the combination of low borrowing costs, low gasoline prices, significant currency relief for many countries, the rising trend in stock market valuations, increased infrastructure spending in a number of jurisdictions, and a stronger trend in U.S. output will provide sufficient stimulus to kick-start growth.

Monthly Market Statistics: April 2015

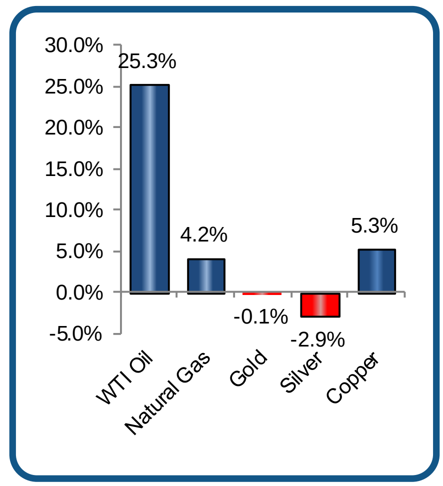
Total Return Index Returns (Annualized After One Year)

	Local Currency Returns							Canadian Dollar Returns						
	1M	3M	6M	YTD	1YR	3YR	5YR	1M	3M	6M	YTD	1YR	3YR	5YR
TSX Composite	2.4%	4.5%	5.7%	5.1%	6.9%	10.7%	7.6%	2.4%	4.5%	5.7%	5.1%	6.9%	10.7%	7.6%
S&P 500	1.0%	5.1%	4.4%	1.9%	13.0%	16.7%	14.3%	-3.7%	-0.2%	11.9%	6.1%	24.8%	24.9%	18.4%
MSCI EAFE	1.2%	9.0%	14.7%	12.3%	18.7%	18.7%	10.1%	-0.7%	3.4%	14.8%	13.8%	12.7%	19.5%	11.7%
MSCI World	1.1%	6.7%	8.5%	6.2%	15.0%	17.2%	12.1%	-2.3%	1.5%	13.0%	9.2%	19.2%	22.1%	15.0%
MSCI Pacific	2.7%	10.9%	15.9%	12.5%	29.1%	22.5%	10.6%	-1.1%	4.6%	16.2%	16.3%	24.1%	18.1%	10.7%
MSCI Emerging	5.7%	9.4%	9.4%	10.9%	17.8%	9.0%	7.1%	2.7%	4.1%	11.5%	14.7%	19.4%	10.8%	7.0%
TSX Small Cap	4.7%	4.0%	4.0%	4.5%	-9.1%	1.7%	2.2%	4.7%	4.0%	4.0%	4.5%	-9.1%	1.7%	2.2%
Global Small Cap	-0.2%	7.3%	9.7%	6.7%	13.1%	17.7%	13.0%	-3.7%	2.1%	14.4%	9.9%	17.8%	22.5%	15.8%
CDA Bond Uni.	-1.4%	-1.8%	4.9%	2.7%	8.2%	4.6%	5.8%	-1.4%	-1.8%	4.9%	2.7%	8.2%	4.6%	5.8%
CDA 1-5 Yr Bond	-0.4%	-0.6%	2.1%	1.4%	3.2%	2.8%	3.3%	-0.4%	-0.6%	2.1%	1.4%	3.2%	2.8%	3.3%

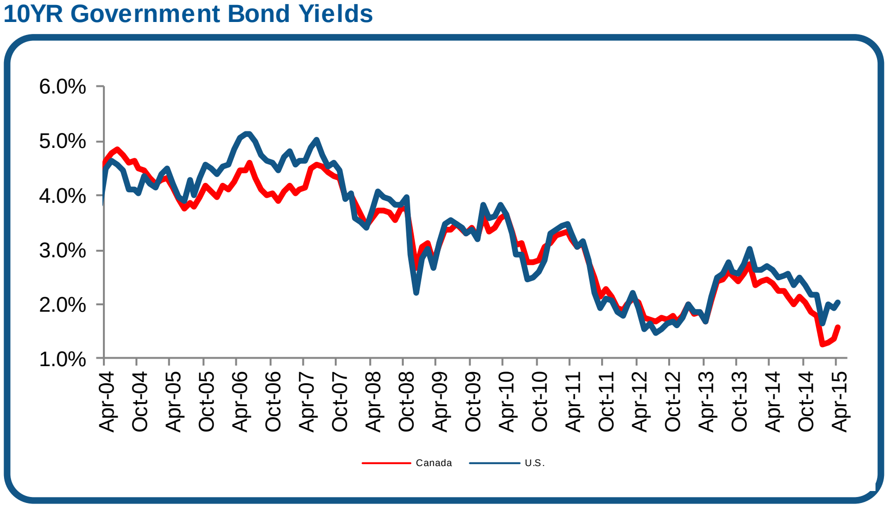
Canadian Yield Curve



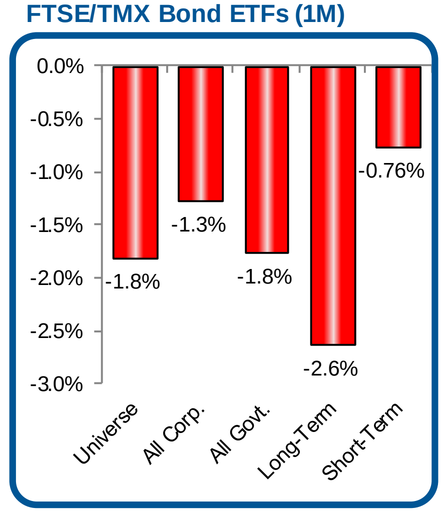
Commodities Performance (1M)



10YR Government Bond Yields



FTSE/TMX Bond ETFs (1M)



Source: Bloomberg, iShares.ca

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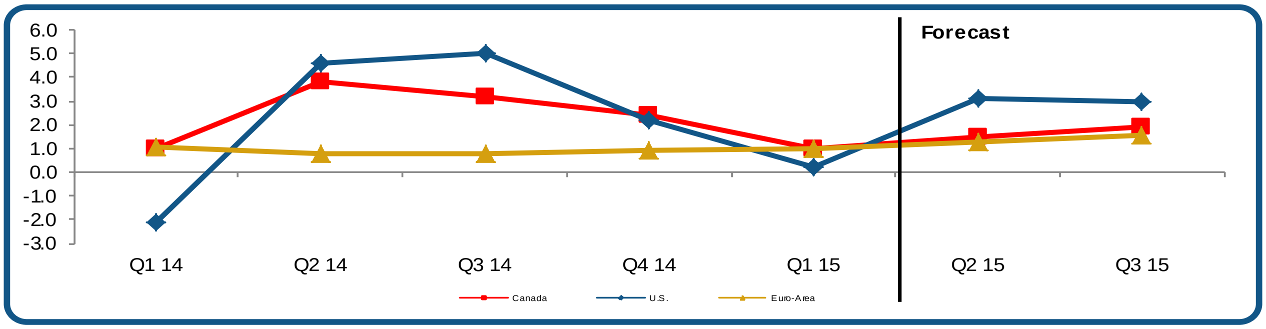
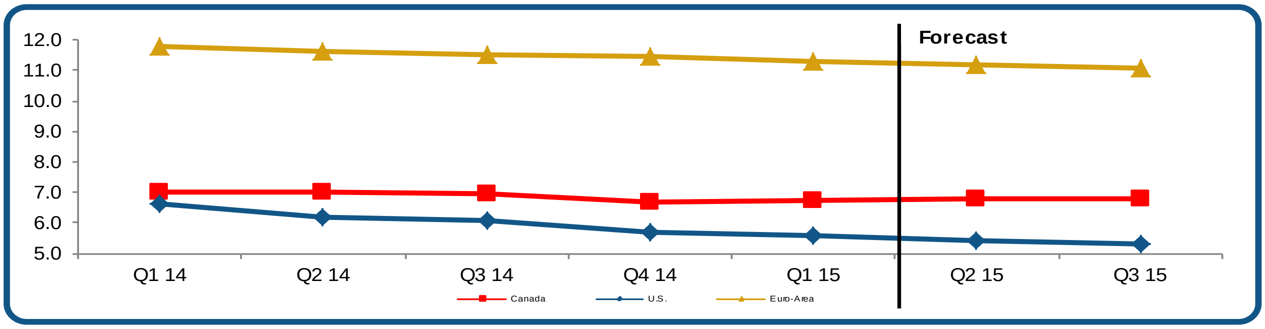
Economic Statistics

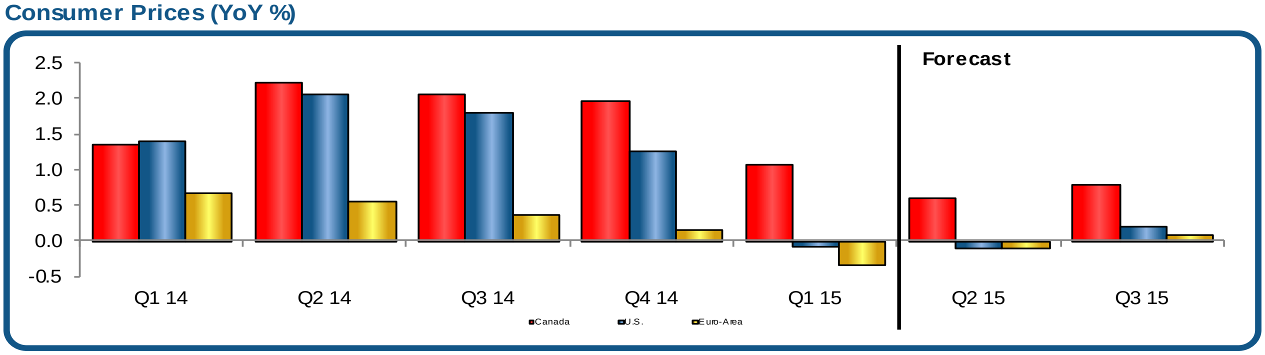
Real GDP (%)



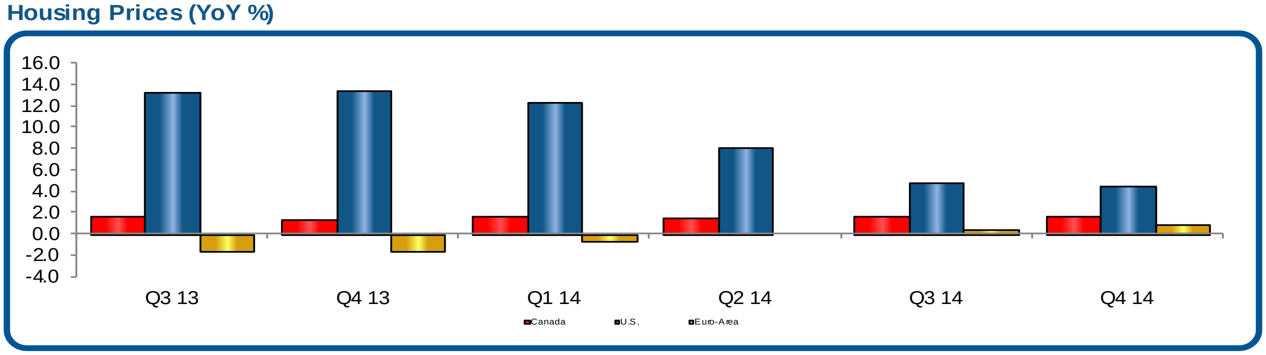
Unemployment Rate (%)



Consumer Prices (YoY %)



Housing Prices (YoY %)



Source: Bloomberg

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