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By Greg Farries, BSC, The Nakamun Group, Calgary

2012 YEAREND MARKET COMMENTARY

Looking back at 2012, investors around the world remained extremely cautious. Headlines continued to be dominated by the European debt crisis, the US's inability to address its own debt issues, and China's slowing growth. In the US, housing prices and unemployment continued to be problems.

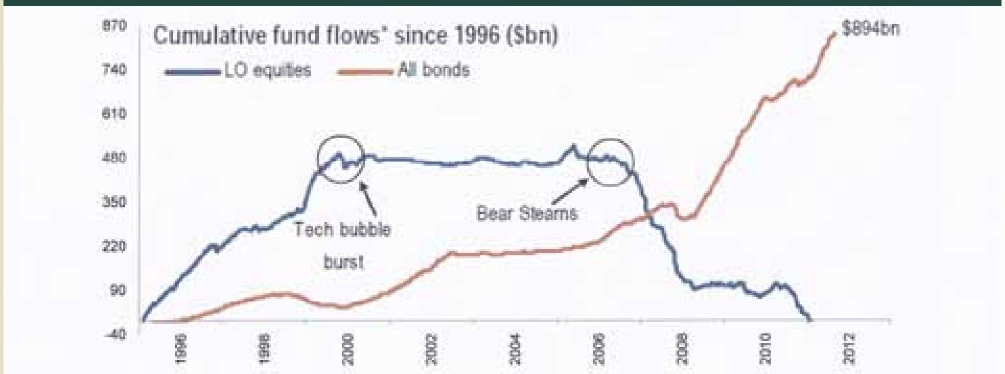
The negative headlines on top of vivid memories of the effects of the 2008/2009 financial crisis were justifiable reasons for concern.

INVESTOR REACTIONS

Investors trying to find somewhere other than equities to put their money to work, have been pouring funds into asset classes they perceive to have less risk.

As the accompanying chart shows, cash flows into "long only equities" have plummeted since 2007 and flows into bonds have skyrocketed during the same period of time. To many people, this makes sense. Since the early 1980s, when interest rates peaked, bond holders have been rewarded by earning income and gaining capital appreciation, in some cases from declining interest rates. These same investors can look back to 2000 and in

Not If but When Will Investors Fall Out of Love with Bonds?



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many cases, point to far higher returns on investments in bonds than in equities, and at far lower risk.

THE EFFECTS OF LOW INTEREST RATES

Central banks around the world have forced interest rates down to artificially low levels to try to stimulate growth. The US Federal Reserve announced that rates would not be raised until at least 2015.

We are now in an environment of negative real rates of return — after-tax rates of return on bonds or Guaranteed Investment Certificates (GICs) are less than inflation. What this means is that buying government bonds today almost guarantees loss of purchasing power, because after-tax growth on capital will struggle to keep up with inflation. This happened from 1940 to 1980, so the situation is not unprecedented. We are not suggesting for a minute, that you should not own this asset class, but you should be aware of the purchasing power risks.

Negative real rates will encourage more spending by the private sector. Low rates make housing more affordable and enable businesses to grow and hopefully, hire more people. Also, by accepting negative real rates of return, savers will carry more of the burden to assist governments in reducing their debt — when governments lower interest rates, in effect, they reduce the cost of their own debt, but at the same time, reduce everyone else's purchasing power.

EFFECTS OF THE US ELECTION

The 2012 US election resulted in President Obama being re-elected, the Republicans remaining in control of the House, and the Democrats remaining in control of the Senate. This status quo escalated fears of the "fiscal cliff" materializing and increased uncertainty for investments.

US politicians failing to agree on how to reduce their debt created the "fiscal cliff". Since they couldn't agree, they pushed the problem down the road by saying if there is no agreement by the end of 2012, they would allow all the Bush-era tax cuts to expire and legislate significant spending cuts. The net effect, without some kind of modification, is that they would actually be legislating a recession.

LOOKING FORWARD

Looking forward to 2013, there is still much uncertainty in key markets, and with the expectation of weak global growth, many investors will likely continue to be cautious.

However, not all is doom and gloom.

The US has recapitalized their banking system, a cornerstone to improving their economy. Evidence is mounting that the housing market is finally starting to recover. Corporate balance sheets have never looked better.

Europe is in the midst of a de-leveraging process that will take years, but in 2012, the European Union countries finally gave their central bank the tools to deal with the problems, by giving the bank the power to buy the debt of struggling countries. The Europeans are also just starting to recapitalize their banking system. Hiccups along the way are still inevitable, but now the Europeans, at least, have the ability to deal with these obstacles.

Late in 2012, China's economy started to stabilize, which will be positive for global growth, particularly in commodities.

The biggest challenges will likely be driven by politics and policy decisions during the next year. The framework for recovery appears to have been put in place, but good policy decisions by politicians will be required along the way to avert another crisis. The private sector has yet to indicate willingness to pick up the slack when central banks start to withdraw their stimuli and begin to repair balance sheets.

CHOOSING NOT TO BE AN EXECUTOR

By Floyd Murphy, CFP, CLU, CHFC, The Nakamun Group, Vancouver

Whether you have accepted in advance or discover after an individual passes away that you have been named an executor, you can choose to decline. Just some of the reasons you might not want to serve as executor include:

- You might be in poor health, in the midst of a family crisis, or simply too busy to take on the additional responsibilities
- Significant disputes might be occurring in the deceased's family, including a recent separation
- The affairs of the deceased might be excessively complex, with assets in many jurisdictions, business interests, etc.
- Serious creditor issues or a shortage of funds to pay the bills

Even if you have agreed, you are not obliged to serve as an executor. However, once the individual dies, you must decide quickly. If you choose not to be an executor, you must file a formal notice (in British Columbia the form is called "Renunciation of Probate") that you have not done any work on the estate and you will not be acting as executor. The "back-up" executor would then serve, but if that individual declines as well, and/or there is no other back-up, someone else can apply to the Probate Court to act as "Administrator", and in some cases, the estate is referred to the Public Trustee.

FINANCIAL ADVANTAGES
OF GROWING OLD TOGETHER

By R.A. (Bob) Challis, CFP, RHU, TEP, The Nakamun Group, Winnipeg

Canada's Income Tax Act, while often maligned, provides significant advantages to retirees, not only because of basic personal exemptions and graduated taxation rates, but also because of age and pension credits. These provisions, coupled with income security programs such as Canada Pension Plan (CPP) and Old Age Security (OAS) currently deliver about $36,600 per year to retired couples entitled to full benefits. Of this amount, just $1,550 income tax is payable (Manitoba 2012 rates). This leaves total spendable income from Government plans of around $35,000 annually, while both spouses are alive.

Actuaries tell us that in today's economy, a 65-year-old male would need about $276,000 to assure an $18,300 annual income for the duration of his life, while a 65-year-old female would need about $301,000. Mathematically, $577,000 is the "value" of a couple's combined CPP/OAS benefit at age 65.

HOWEVER…

Both spouses must live to their respective life expectancy, or longer, to realize the full value of the Government benefits. If one spouse dies early, the CPP/OAS income stream attached to the deceased person simply stops and household income becomes subject to higher tax. Unless the possibility of one spouse's premature death is addressed, the economic reality of the survivor will change, for the worse.

When one spouse dies, a full set of income tax deductions disappears, pension and age credits are halved, and pension income splitting is no longer available. A much higher pre-tax income becomes necessary to support the same level of after-tax spendable income.

EXAMPLE

A couple, both aged 65 with $500,000 in RRSP/RRIF (split equally) and each entitled to full CPP/OAS benefits, could plan for combined after-tax income of $50,000 in retirement. This income includes government benefits and RRIF withdrawals. Ignoring inflation and yield, if both retirees live to their life expectancies, they have sufficient savings.

However, if the male passes away at age 66 and the after-tax income need remains at $50,000, the surviving widow will run out of savings at about age 76, fully 10 years before her life expectancy! Alternatively, she would have to live with only $34,300 after-tax per year.

MINIMIZE "HUMAN CAPITAL" LOSSES

One solution is to purchase permanent life insurance, while the couple is insurable and the premiums are affordable, in order to minimize "Human Capital" losses and address the income needs of the surviving spouse.

TALK TO YOUR NAKAMUN ADVISOR

In future articles, we will look at other aspects of the intrinsic, yet very real economic worth of a person's "Human Capital" during and after their lifetime. In the interim, please speak with your Nakamun Advisor for more details on how to alleviate the potential adverse impact on your spouse's income security, should you die prematurely.

US CITIZENS AND GREEN CARD HOLDERS MUST FILE US TAX RETURNS

By Floyd Murphy, CFP, CLU, CHFC, The Nakamun Group, Vancouver

US Citizens and anyone with a valid US Green Card living in Canada must still file a US tax return, whether or not they have earned income in the States. This is a US tax law and anyone who is required to and doesn't file a US income tax return, could face serious consequences.

If you are a US Citizen or Canadian with a Green Card and have not filed the necessary tax forms, we urge you to contact your Nakamun Advisor to discuss the actions you should consider.

CPP QUANDARIES

By Garry Keiller, The Nakamun Group, Edmonton

Changes to the Canada Pension Plan (CPP) that came into effect on January 1, 2012 have made calculations and decisions regarding when to start collecting retirement benefits more complex than ever, particularly for those between the ages of 60 and 70.

In this and subsequent articles, we will illustrate, through examples, the importance of carefully reviewing your options before making any decisions about CPP benefits.

SURVIVOR BENEFITS

A surviving spouse or common-law partner may be eligible for survivor CPP benefits, however the combined retirement and survivor benefits cannot exceed the maximum retirement pension, which is currently $987 per month. If the surviving spouse is not receiving other CPP benefits, the survivor benefit is 60 percent of the deceased's retirement pension.

Consider the following couple:

- **BOB** — Is 60 years old, has contributed to CPP during employment years, and qualifies for maximum retirement benefit at age 65

  Is planning to continue working for the next five years

  Is considering starting to collect CPP now, even though the early retirement discount is 0.6 percent for each month between ages 60 and 65

  Has sufficient RRSP contribution room to shelter CPP income
- **ALICE** — Is 59 years old, has contributed to CPP during employment years and qualifies for maximum retirement benefit at age 65

SCENARIO A — Fast forward to when Alice is 65 and Bob is 66:

Both Alice and Bob waited until age 65 to start receiving maximum CPP retirement benefits. Bob dies during the year after he started collecting benefits. Alice will receive no surviving spouse benefit because she is already receiving the maximum CPP retirement benefit.

SCENARIO B — Fast forward to when Alice is 65 and Bob is 66:

Bob started collecting CPP at age 60, elected no withholding tax at source, and contributed the full amount each month to his RRSP, which had sufficient contribution room. He earned 1.65 percent in a daily-interest RRSP and after five years, had approximately $43,000. When Bob dies, at age 66, his RRSP transfers tax sheltered to Alice.

From age 60 to 65, Bob continued to work and was required, under the new CPP rules, to contribute 4.95 percent of his salary. His employer was required to match that amount and the total contributed funds purchased a Post-Retirement Benefit, which boosted Bob's CPP retirement income.

BEFORE YOU MAKE CPP DECISIONS...

As you can see, decisions regarding your CPP benefits can have a significant financial impact and you should, before making your decisions, talk to your Nakamun Advisor, who can explain the implications of the options.

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