The Dream Achiever

DD HUMES

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"Experience is not what happens to you; it's what you do with what happens to you."

~ Aldous Huxley

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Seeing red? We are here for you

Happy New Year! Last year our December newsletter talked about how there was a synchronized global upturn with all major markets contributing to some solid returns with hardly any volatility; but this year the fourth quarter was more of a severely volatile synchronized downwards movement appearing like a red sunset on the longest bull market in history.

The final quarter of 2018 was not a good one for equity markets. Investors have had to contend with rising US central bank interest rates, a sharp slowdown in Eurozone business confidence, weaker Chinese growth, and rising geopolitical concerns (including Brexit, Italian politics and the ongoing trade conflict between the US and China). This all proved an indigestible cocktail for investors. On the plus side, over the quarter as a whole, government bonds at least lived up to their traditional role as the defensive part of a well balanced portfolio.

In 2018 there were not many places to hide from the declines. The Canadian TSX composite was dragged down by plunging energy prices, weakness in materials, and financial services finished the year with a drop of -10.1% in the quarter resulting in an annual return of -8.9%. The American S&P 500 was down -13.5% finishing the year down -4.48%, MSCI World Index ($USD), which measures equity results in 23 developed markets around the world, was down -13.3% for an annual return of -8.2%, and FTSE Canadian Bond Index was up 2.78% for an annual return if 2.42%.* The CAD$ fell -5.5% in the quarter versus the USD$ to finish the year down -7.4%.

Central banks in North America continued to gradually raise interest rates in the fourth quarter. The Bank of Canada raised rates 0.25% on October 24th to 1.75% while the US Fed raised their rate by 0.25% on December 19th to 2.5%. Ten-year U.S. and Canada government bond yields rose and peaked early in the fourth quarter, but fell through November and December to end lower for the year when Jerome Powell softened the line on interest rate rises saying they were currently just below neutral.

Regardless of the cause, there is no doubt that **market turbulence can be unsettling for investors**, and the volatile 2018 performance was particularly surprising following 2017's steadiness. The reality is that downside market volatility is normal. In most years the S&P 500 will experience several days in which the value of the index drops by 2% or more. In this context, 2017 was an outlier with no such days. Last year the S&P 500 registered 15 days with losses of 2% or more, returning the level of volatility for the index to a more "normal" range. The fact is, market volatility is not always a bad thing. Professional money managers often welcome market declines as a necessary ingredient for positive returns as it creates opportunities to add to existing positions or buy higher-quality businesses at reduced prices. In 2017, asset prices remained elevated, providing few opportunities to shop for "bargains."

It is nearly impossible to predict when market swings will occur so trying to time when to sell and then reinvest has proven to generally detract from returns, often missing the best upside days and underperform those who stay invested. In 2019 we see global growth slowing and downside risks increasing in the later stages of an economic cycle. Nevertheless, developed economies are expected to grow throughout the coming year and inflation remains moderate. Global interest rates are low by historical standards, allowing corporations the flexibility to strengthen their balance sheets and invest in the future of their businesses. We are hopeful that some of the trade issues will also continue to get ironed out. These conditions suggest a cautiously optimistic outlook for markets in 2019.

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Market Overview Continued

Our advice is to stay diversified and invest for the long term. It can be difficult to set aside short-term distractions and maintain a long-term perspective when negative headlines dominate as they have in recent weeks. But looking back over the longer term, the most recent market decline can be seen as a setback in a strong run upward. From its lows reached following the financial crisis in March 2009 to the end of last year, for example, the S&P 500 was still up more than 270%.

We believe that the most important action to take as an investor is to create a sound, diversified investment plan that takes your time horizon and tolerance for risk into account, and then to stick to that plan through periods of short-term volatility. Those of you who are withdrawing from your accounts, your **"cash wedge"** acts as a buffer towards these downward market movements. Asset classes do not typically perform in a correlated fashion, so diversification can help to insulate your portfolio from the highs and lows, and provide a smoother experience over time.

In closing, we appreciate the opportunity of working with you as your financial advisor. It is during these turbulent times that working with a professional can add the most value by keeping investors on track. We are here for you if you have any questions or concerns about your investments or if your personal circumstances have changed. It is when you see red that focusing on your plan is most important.

New Year Planning items

- **RRSP Contribution Deadline:** For the 2018 tax year you need to contribute before March 1, 2019. The maximum room for 2018 is $26,230. If you want to get started on your 2019 contributions, the maximum limit is $26,500. You may need to adjust your automatic savings plans for the coming year accordingly.
- **Registered Education Savings plan (RESP) contributions:** Quebec beneficiaries get the added 10% QESI grant from the provincial government increasing the overall grant to 30%! 2019 room now available.
- **Tax Free Savings Account (TFSA):** A new $6000 of room available since January 1, 2019. Total room since 2009 is $63,500.
- **Conversion to RRIF account:** Those of you who turn 71 years of age in 2019 (born in 1948) will need to convert their RRSPs into RRIF accounts before calendar year end. We will be in contact to assist you on how to get that done.
- **$2K pension deduction:** Those who turn age 65 in 2019 or older and not already receiving recognized pension income.

The Planning Corner – Changes to CPP & QPP

As of January 1st you may notice that your QPP and CPP deductions have increased on your pay slips. (I guess the other news of interest would be that the EI and QPIP contributions have been reduced slightly). With regards to the **CPP** (all provinces other than Quebec) the employee and employer contribution rates will increase from 4.95% to 5.1%. The plan enhancements are meant to increase the coverage of MPE from 25% to 33% for the work earnings you receive after 2019. It will now also have an increased disability pension and survivor's pension. The contribution rates will continue to be phased in over 7 years and the by 2023 the employee/employer contribution rate will be 5.95% on amounts between $3500 and the earnings limit.

In 2024 and 2025 a higher earnings limit will be introduced allowing for an additional portion of your earnings to be invested in the CPP based on two earnings limits. There will be a "**first earnings ceiling**" (estimated to be $69,700 in 2025) with a continued base rate and a "**second earnings ceiling**" (estimated to be $79,400 in 2025) with a reduced contribution rate. (For more information visit Canada.ca)

In the case of the **QPP** there are similar changes with an increase to the rate on the base plan where the employee and employer contributions have increased from 5.4% to 5.55% on earnings between $3500 (the basic exemption) and the QPP maximum pensionable earnings (MPE - $57,400 in 2019). As always, the self-employed worker would pay the entire amount. There is now also **a new additional plan** where contributions will be paid by employees and employers according to a rate that will gradually increase from 2019 to 2023. In addition, as of 2024 new contributions will be added to the portion of earnings between the MPE and the new pensionable earnings ceiling, which will be 107% of the MPE as of 2024 and 114% of the MPE as of 2025.

The increases are all meant to be to the advantage of future retirees by adding more financial security in retirement. There will be higher benefits in the event of death or disability. It will increase the required savings into a guaranteed retirement plan to help with a higher percentage of guaranteed income replacement. It also will allow those who earn more than the MPE to benefit from more coverage due to the increase in the MPE calculation. You can read more about these changes on the Retraite Quebec web site.

*Source: Morningstar Canada