BAKER & EDWARDS FINANCIAL

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NEWSLETTER - DECEMBER 2015

2015 has been a difficult year in many respects - from wars, to refugees, to a Canadian economy flirting with recession, to China's slowing growth, to floods and famines in parts of the world - it has felt like a never-ending litany of negative news. Despite this, many of you were shocked to open your September 30 statements and discover that the value of your investments had declined, further adding to the depressing story.

I expect 2016 will be a difficult year as well. I think a 6-8% return will be considered to be a good return instead of the 10% plus returns we have gotten used to since 2009. Canada will be a particularly difficult market until global growth recovers to create demand for our resources. The decline in our currency should help our exports, but we have lost so much of our manufacturing capacity that even this will be muted. Because we, as consumers, are so heavily indebted we cannot count on increased spending (as the US is) to drive returns.

With all this uncertainty, my investment recommendation is international balanced funds. These allow the managers to shift between stocks and bonds in any country in the world, and remember that they are only looking for 30-40 of the best companies in the world - out of a universe of about 48,000 stocks. If they are investing in US companies, I want them to have the ability to hedge the currency once the Canadian dollar reaches a low point - probably around 68 cents. They are looking to invest in these companies now while prices are low, and to hold onto them for 5 years or more.

If you are feeling upset by your current investment returns (or lack thereof), I urge you to set aside your emotions and take a rational look at the alternatives. If you think you can't tolerate the ups and downs of the markets, you really need to ask yourself if you can afford to be in the alternatives where you are guaranteed not to lose any money - but also not to make any money. High interest savings accounts and GICs are paying about 2%, 10-year government bonds are about 2.5%, corporate bonds are in the 5-6% range. One fund manager told us of a German pension fund that needed to invest $100 million in 10-year government bonds - in Germany he could get an interest rate of 0.31%, in Switzerland it was a negative 0.30%, in Japan a plus 0.60%, and in the US he could get 2.4%. Yes, a negative interest rate does mean that you have to pay to own the bonds – this is the price of safety! The news for next week is that the US will probably raise short term interest rates by 0.25% - but you really must doubt that they will raise them very far when they have to pay the interest on an $80 trillion debt!

The obvious role of a financial planner is to help you define your goals and to develop a plan to achieve them. This encompasses cash flow planning, debt management, risk management, education funding, retirement funding, retirement income planning, wealth management, and estate planning. Each phrase needs to be integrated with tax planning. We also need to analyze what could prevent you from reaching your goals. Your success is dependent on your earning an income so this needs to be protected.

The less obvious, but more critical role is to be your sounding board for ideas, and a counsellor to keep you on track when times are difficult – like now. Humans are not "wired" to be good investors – in fact we are quite the opposite. A whole new field of study called Behavioral Finance has developed to help understand why individual investors greatly underperform the markets. Some of the findings include: **Recency bias**- we are greatly influenced by what is personally most relevant, recent, or dramatic: **Perception bias** – we are governed by thoughts that are not borne out by the facts; **Loss aversion** – we feel a loss much more strongly than we value a gain, and fail to recognize that a temporary drop in value is not a loss unless you sell the investment; **Herd bias** – we are social animals and don't want to be different from the crowd – this leads us to buy when markets are high, and sell when they are low.

You may find this list to be useful when you are reviewing your Estate plans:

Common Estate Planning Mistakes

1. Joint accounts with beneficiaries - this is commonly done for the convenience of adult children to do your banking. Most people do not realize that this opens half of your accounts to any creditors (or ex-spouses) of your child. The other issue that leads to many family disputes is who does the money belong to on your death? If you do not specify your wishes in your Will or a letter of direction, the Courts will be forced to make an assumption as to what you wanted.
2. Beneficiary designations - when did you last check the beneficiaries who are named on your pension plans, your insurance policies, and your benefit plans?
3. Assuming you have a valid Will - if you have remarried, your previous Will is void. Your family will be treated as if you died without a Will and provincial intestacy laws will determine how your Estate is distributed - probably not even close to what you wanted.
4. Leaving large amounts to charities in your Will - while your intent is good, it may not be effective because donations can only be deducted against taxable income. You may get more mental and financial satisfaction by making the donations while you are alive to see the results. For large amounts you can set up a charitable giving fund.
5. Leaving a family cottage to all the children - while you may want to treat everyone equally, a share of the cottage may not suit everyone. Some may live too far away to use it, some may not be able to afford the upkeep. It is very important to remember that Canada Revenue Agency will deem that the cottage was sold for fair market value on the day you die, so your Estate may be in for a very large capital gains tax. Your estate planning should include a family meeting to discuss who would want the cottage, how the taxes will be paid, and how you will equalize the share everyone will get.

Another timely topic for the giving season: a recent study of people aged 18 – 34 found that 82% of them felt they lack financial knowledge and investing confidence. We are happy to work with people who want to learn so please feel free to ask them to talk to us.

We wish you all the best for the holiday season and look forward to helping you in the new year.

Bob *Tammy* *Cory*

PS: Our phone number has changed to **519-886-7882.**

PPS: Bob will be on vacation from January 6 until February 2. Cory and Tammy will be glad to help you during this time.