

# The Rubino Wealth Management Group's *Investment Review*



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**Rob Rubino** B.Sc. FCSI  
Ch.P. Strategic Wealth  
905-875-4871  
[rob.rubino@rbc.com](mailto:rob.rubino@rbc.com)



**Jody Coulson** B.Sc., B.Ed.  
905-875-1850  
[jody.coulson@rbc.com](mailto:jody.coulson@rbc.com)

## Portfolio Strategy

### Recommended Asset Mix

15%	Cash
25%	Fixed Income
60%	Equities

#### Equities

Contact us regarding our  
quarterly recommendations

#### Fixed Income

[Click here for our  
Highest GIC rates](#)

#### Cash

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Highest Money Market  
Rates](#)

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## OUTLOOK 2008

After climbing out from its August low and sprinting ahead following September's unexpectedly large 50-basis-point cut in the fed funds rate, the stock market plunged again in November against the backdrop of an intensifying credit crunch threatening to move beyond the commercial paper market and into the broader economy. That threat still exists and, left unchecked, presents a serious risk to the economic cycle.

We respect the stock market's message, and also that of the bond market, where a flight to quality has pushed 10-year T-bond yields down 50 basis points in the past month alone – this despite the challenge to fixed-income markets that usually comes with a falling fed funds rate. That said, we are not ready to abandon our baseline forecast of durable growth, mild inflation and low interest rates. There is simply not enough evidence that the slide into recession has begun, and less evidence that central banks are about to watch that happen without an even more aggressive response.

## CREDIT CRUNCH THREATENS...

The credit crunch remains a significant threat to the global economic expansion. The root of the problem, troubled subprime loans backed by frequently impaired borrowers and a sliding housing market, defies an easy solution.

The worst of the crisis, however, may be upon us now as the shakiest borrowers are quickly flushed out. A raft of proposals, and more that are certain to come, hold the prospect of limiting the fallout and distributing pain over a manageable time frame.

## ...BUT RISK OF RECESSION IS MILD

Falling interest rates, firm job creation and a narrowing trade gap are holding the economy on a growth track in spite of the shock. As long as a more general credit crunch is avoided, the risk of recession appears mild. We've shaved our U.S. GDP estimates to 2.5% for both 2007 and 2008. For Canada, we now look for growth averaging 2.75% into year-end 2008.

Conditions in the Eurozone are sound, and growth there is likely to hold between 2.5% and 2.75% over the forecast horizon. U.K. growth should reach 3.0% this year, but slip to 2.25% in 2008. As is frequently the case, Japan has disappointed, and we now expect growth of only 2.0% this year before a mild move up to 2.25% in 2008. Around the world, we don't expect a lot of growth, but growth nonetheless. A more aggressive approach to attacking problems in credit markets has had an impact on inflation expectations, but not much. In all regions, we forecast inflation close to the upper reach of central banks' comfort zone.

## A GRADUALIST APPROACH TO RATE CUTS

The drums are beating for interest rate cuts, and the market wants them soon. We expect the Fed and other central banks to continue with a gradualist approach, feeding in cuts only when absolutely necessary, balancing the risk flowing from the credit crunch against the potential for inflation as the pressure eases, exposing the economy to stimulative rates without much excess productive capacity. We look for at least one more 25-basis-point cut in the fed funds rate, and more if necessary.

The ECB is less likely to move on rates. We have reduced our original expectation for hikes in Japan by 25 basis points. The U.K. has the greatest scope for lower rates, and we look for the BOE to move rates down to 5.25% over the coming year.

## BOND YIELDS UNSUSTAINABLY LOW

Plunging bond yields reflect an intense shift in risk premiums. Absent recession, current levels will be difficult to sustain, especially as central banks shift their policy bias. Over the year ahead, we look for total returns either side of 0% for the world's major bond markets.

In both the U.S. and Canada, we forecast 10-year yields at the 4.75% level. We look for 10-year Eurozone yields of 4.5%, U.K. Gilt yields at 5.0% and a 2.0% yield in Japan.

## EQUITIES SHOW GOOD POTENTIAL

Equity markets lie close to or below their fair value in most of the world's major markets. Fair value is the minimum valuation level consistent with periods of durable growth, mild inflation and low interest rates.

Moreover, the record for stocks during periods following an initial cut in the fed funds rate is almost always positive. We forecast gains in the low double digits over the year ahead for the major markets.

Our regional mix is tilted toward U.S. equities as a result of both relative valuations and the emerging leadership of large cap, growth oriented stocks which dominate the U.S. list more than any other.

## A BOTTOM FOR THE U.S. DOLLAR?

A flight from risky assets has pulled most major currencies far above their purchasing power parity values. The U.S. dollar has been sold indiscriminately. It may be too early to call the end of this dollar bear market, but the risk/reward trade off for staying short the dollar against major currencies now appears very poor. The dollar-bottoming process may be quite lengthy, with peaks in individual currencies spread in time, but we expect the next 12 months to bring plenty of trading opportunities for those with a short time horizon, while those with longer time horizons should accumulate U.S. dollars on weakness.

## ASSET MIX TILTS TO STOCKS, AWAY FROM BONDS

The outlook, which seemed so clear only six months ago, is decidedly murky. We acknowledge the accumulated threats to the cycle and are keenly reviewing any developments that tilt the balance of risks. We haven't seen enough of these to join all those fleeing to safe havens. As a result, we've cut our exposure to bonds twice over the past quarter, pulling our fixed-income weight below the midpoint of its allowable range, while maintaining relatively full exposure to stocks. For a balanced global investor, we now recommend an asset mix of 62.5% equities (allowable range: 40% - 70%), 32.5% bonds (allowable range 25% - 55%) with the balance of 5% held in cash to provide some ballast to portfolios through the current volatility as well as a modest buying reserve.

## Eight critical questions every small business owner should answer

(this is the 1<sup>st</sup> in our 8 part series)

*Though most owners of a small business know the details of their operation inside and out, backwards and forwards, not all of them are aware of the tax, retirement and estate planning strategies available to them. These strategies can potentially minimize your personal and corporate taxes, increase your retirement income, provide an effective succession plan for your business and enhance your estate.*

However, every small business owner is different. As a result, a particular tax or retirement income planning strategy that may work for another business owner may not necessarily be appropriate for you. To start determining those strategies that may be appropriate, you should answer the following eight questions:

### Question #1: Have you incorporated your business?

If your business is structured as a sole proprietorship, you may be wondering if it makes sense to incorporate. A number of factors will go into making your decision, most of them tax-related. This includes weighing the potential loss of personal tax deductions available to sole proprietorships versus the corporate income-splitting opportunities available.

### Question#2: Have you discussed tax minimization strategies with your tax advisor?

If you personally own an incorporated Canadian business, there are many different tax-planning strategies that can benefit you and your family, such as paying dividends to a spouse and adult children.

### **Question #3: Do you have excess cash in your corporation?**

If so, your first step is to determine whether you have a business need for the cash. If you do, choose an appropriate investment solution based on your time horizon. If you don't need it for the business, determine the most tax-effective ways to either withdraw it or utilize it for future goals, like estate or retirement planning.

### **Question #4: What would happen to your family and your business if you passed away or became disabled today?**

Evaluate whether you have adequate insurance in the event of death or disability. Also consider your plans for passing along control and ownership of your business, including your buy-sell agreement.

### **Question #5: Do you have enough assets to meet your retirement income needs?**

Consider creating or updating your financial plan to determine if you will have adequate assets and income to meet your tax, retirement and estate planning goals.

### **Question #6: Are you aware of opportunities to increase retirement income and reduce corporate tax?**

As an owner of a corporation, you have several strategies available to you that can help you to not only reduce or defer corporate income tax but also enhance your retirement income.

### **Question #7: Do you plan on selling your business to someone outside your family?**

There are several issues to consider, including whether the purchaser is interested in buying the assets or shares of your business. If they are interested in buying the shares, you may be able to claim a capital gains exemption.

### **Question #8: Do you plan on passing your business to at least one of your children?**

There are many considerations – everything from ensuring your children have the necessary aptitude and knowledge for running the business to determining strategies to minimize taxes.

## **Strategies to Minimize Your Capital Gains Tax on the Privatization of BCE**

Prashant Patel, ASA, CFP, TEP, Wealth Management Services

*On June 30, 2007 BCE announced that the company has entered into a definitive agreement for BCE to be acquired by an investor group led by Teachers Private Capital (the private investment arm of the Ontario Teachers Pension Plan), Providence Equity Partners Inc. and Madison Dearborn Partners, LLC. As part of the transaction, the investor group will acquire all of the common shares of BCE not already owned by Teachers for a cash offer price of C\$42.75 per common share. BCE anticipates that the transaction will be completed in the first quarter of 2008.*

*Of course there has been considerable media coverage on the buyout of BCE including a number of articles in national newspapers on the large capital gain tax that shareholders will have to pay due to the cash buyout. Due to the 30% increase in the BCE share price since April 2007, most BCE common shareholders will indeed realize a large capital gain especially those shareholders that owned BCE at the time of the Nortel spin-off. However, this article will discuss a number of strategies that you can consider with your professional advisors to minimize, defer or in some cases even eliminate the capital gain taxes on the BCE buyout assuming the deal goes through with the same terms announced on June 30, 2007.*

*For investment issues related to the buyout, please refer to the Portfolio Advisory Group's article titled "Privatization of BCE – Investment Implications".*

If your BCE shares are held in a taxable account, the acquisition of BCE will result in a capital gain equal to \$42.75 multiplied by the number of BCE common shares held minus your total Adjusted Cost Base (ACB) of BCE. There is information at the end of the article related to calculating your ACB of BCE. For tax purposes, 50% of the capital gain will be taxable at your marginal tax rate. If you have held BCE for many years, your capital gain tax could be significant. The following are five tax planning strategies that you could consider with your professional advisors to minimize the tax on the capital gain (this is not an exhaustive list).

- A) Sell over two years
- B) Donate some shares in-kind
- C) Capital loss planning
- D) Capital gain splitting with spouse
- E) Investment tax shelters

For illustration purposes, we will assume the investor owns 10,000 shares of BCE at an ACB per share of \$20 per share in a personal non-registered account and their marginal tax rate is 46.4%. If you owned BCE in a corporate account then some but not all of the strategies below are also applicable however speak to your advisor for more details. RBC Dominion Securities **Bulletin** Wealth Management Strategies to Minimize Your Capital Gains Tax on the Privatization of BCE **July 19, 2007**

### A. SELL OVER TWO YEARS

Given only 50% of capital gains are taxable, the maximum personal tax you would have to pay ranges from 19.5% - 24.32% of the capital gain depending on what province you reside in.

In our example, the investor will face a capital gain of \$227,500 [(\$42.75 - \$20) x 10,000 shares]. This will result in tax payable of \$52,780 (\$227,500 x 50% x 46.4%), leaving the investor with \$374,720 of cash after taxes.

Given the deal is expected to close in early 2008, if you are not expected to be in the highest marginal tax bracket for 2007 or 2008 you could consider selling some shares in 2007 and let the remaining shares be bought out in calendar 2008. This income averaging strategy can result in some overall tax savings. However, the downside of this strategy is that the 2007 capital gains tax is payable by April 30, 2008 unless one of the other strategies discussed below are used for 2007. If you are not on instalments, allowing all the BCE shares to be bought out in 2008 results in a tax deferral as the capital gains tax is not payable until April 30, 2009.

If you are receiving Old Age Security (OAS) or other government benefits that are subject to clawback, then you should consider the impact that a taxable capital gain in 2007 and/or 2008 would have on these benefits. This could determine how much of a capital gain you realize in 2007 and 2008.

### B. DONATE SOME SHARES IN-KIND

An innovative strategy to eliminate some or all capital gain taxes on the BCE buyout is to donate some BCE shares in-kind prior to the buyout and sell the rest or let the remaining shares be bought out. This strategy is appealing since there is no capital gain related those BCE shares that are donated in-kind to a qualified charity due to recent tax law changes.

Furthermore, the donation tax credit on the shares donated can be used to minimize or eliminate the capital gain taxes on the shares sold or bought out.

Your advisor has access to a Stock Donation Calculator which calculates the exact number of BCE shares to donate such that the donation tax credit will eliminate all the capital gain taxes on the shares that are sold on the market or bought out. The following page provides a screen shot of the calculator using our investor's assumptions. In this case, the investor will have to donate 2,102 of his BCE shares in-kind either outright to a qualified charity or to his own charitable foundation (public or private) to eliminate all taxes on the remaining 7,898 that are sold or bought out. Note that the 2007 Federal Budget proposal to eliminate capital gain taxes on the donation of listed stock in-kind to a private foundation has not passed as of the date of this article.

If the investor is donating the 2,102 BCE shares to his own charitable foundation, this means that \$89,844 worth of BCE shares will fund the foundation and no taxes will be paid to the Canada Revenue Agency (CRA) on the 7,898 shares that are sold or bought out due to the \$89,844 donation tax receipt. In this case, the investor will be left with \$337,656 of cash for reinvestment.

If all the 10,000 shares were sold or bought out with no donation, the investor will pay \$52,780 of taxes to the CRA and be left with \$374,720 of cash for reinvestment. So in our example, the donation strategy results in \$37,064 (\$374,720 - \$337,656) less cash for reinvestment. As a result, the donation strategy is generally appealing for those individuals that are either already making annual donations, have thought about starting a philanthropic program or leaving a legacy or are focused on minimizing tax payable to CRA. That is under the donation strategy, the \$52,780 tax that would otherwise be payable to CRA if no donation was made plus an additional \$37,064 (total \$89,844) would now instead be directed to the investor's favorite charity or their own family foundation. Contact your advisor if you would like him/her to run the Stock Donation Calculator using your own BCE share assumptions and/or would like more information on donating BCE shares to your own family foundation.

### C. CAPITAL LOSS PLANNING

One of the most popular strategies to minimize capital gain taxes is to sell securities at a loss so that the capital loss realized can be used to reduce capital gains triggered on the BCE buyout. If the loss security sold is still favored from an investment standpoint then be careful of buying back the identical loss security within 30 days of the sale due to the superficial loss rules. These rules results in the capital loss being denied and added to the ACB of the newly purchased security.

Tax loss selling is typically done at year-end. However, if you sell your loss security at the end of 2007, you first have to use your capital losses to offset capital gains in the current year

before they can be carried back three years or carried forward. Since the BCE buyout is expected to occur in 2008, if you are doing tax loss selling in 2007 keep in mind that you may not have adequate losses to carry forward to 2008 if you realized other capital gains in 2007. Of course if you sell your BCE shares on the market in 2007, then losses incurred in 2007 can offset these capital gains.

If your spouse has unrealized capital losses but you own BCE shares with the gains, then there is an innovative strategy for your spouse to transfer his/her capital losses to you which can help reduce the capital gains on the sale or buyout of your BCE shares. If you want more details on this strategy, then speak to your advisor for a copy of the article titled "Transferring Capital Losses to Your Spouse".

#### D. CAPITAL GAIN SPLITTING WITH LOW-INCOME SPOUSE

If your spouse is in a lower tax bracket than you, then there is an income splitting strategy that can result in 25% of the capital gain on the BCE shares to be taxed in the hands of your lower income earning spouse resulting in family tax savings. This strategy involves a series of steps and must be done before the BCE buyout. Given the complexity and advanced nature of this strategy it is imperative that you speak to a qualified tax advisor before embarking on this strategy. If you want more details on this strategy including the steps involved, then speak to your advisor for a copy of the article titled "Transferring Capital Gains to Your Spouse".

#### E. INVESTMENT TAX SHELTERS

Purchasing investment tax shelters (i.e. flow through shares) is an investment and tax strategy that is considered when determining options to reduce and defer tax. In our example, the taxable capital gain on the full buyout of the BCE shares is \$113,750 [ $\$227,500 \times 50\%$ ] resulting in \$52,780 of tax payable. However, purchasing \$113,750 of investment tax shelters can potentially create a tax deduction of up to \$113,750 which can be used to offset the taxable capital gain of \$113,750 which avoids paying the \$52,780 of tax.

If the investment tax shelter is then sold in the future for sale proceeds of \$113,750, there will now be a capital gain of \$113,750 of which only 50% is taxable or \$56,875 resulting in tax payable of \$26,390. However, this tax payable is exactly 50% of the original capital gain tax payable of \$52,780. So this strategy can not only result in deferring the tax on the BCE capital gain but also reducing the ultimate tax bill by 50%. Of course when purchasing investment tax shelters the investment merits of the tax shelter need to be considered carefully due to the potentially higher risk nature of tax shelter investments. Furthermore, if a large purchase is made of tax shelters it can create an Alternative Minimum Tax (AMT) liability which can reduce or defer some of the expected tax savings. Speak to your advisor for more information on the

pros and cons of purchasing investment tax shelter to reduce and defer the tax on the BCE capital gain.

### Calculating Your Adjusted Cost Base (ACB) of BCE

In order to calculate your capital gain on the sale or buyout of BCE, your accountant and you will have to determine the ACB of BCE. There have been a couple of reorganizations that BCE has gone through over the years that impacts the ACB of BCE which we have denoted below. Note that your Book Value for BCE on your DS monthly statements has been adjusted accordingly for the transactions below unless it has been flagged with a "#" symbol that indicates that part or all of the book value was provided by you.

The following are some points to keep in mind when calculating your ACB of BCE:

- If you are reinvesting your dividends of BCE to buy more BCE shares, then the dividends add to your ACB.
- If you owned BCE on May 1, 2000 when Nortel was spun-off, then 30.79% of your total BCE ACB on May 1, 2000 was allocated to BCE and the remaining 69.21% was allocated to Nortel.
- If you owned BCE on July 10, 2006 and you held more than 150 shares of BCE, then you would have exchanged each of your BCE shares for 0.915 BCE shares and the total ACB of BCE would have been reduced by the Fair Market Value of any Bell Aliant Regional Communications (BARC) income fund units you received.
- If you owned 150 or less shares of BCE on July 10, 2006, then you would have exchanged each of your BCE shares for 0.915 shares of BCE but you would not have received any BARC units.

If you have any questions or require clarification on any of the issues discussed in this article, do not hesitate to discuss these with your advisor.

**Note: The above information is based on the tax law in effect as of the date of this article. The article is for informational purposes only and should not be construed as offering tax or legal advice. Individuals should consult with a qualified tax and legal advisor before taking any action based upon the information contained in this article.**

## Trend & Cycle

Date: January 1, 2008	Long Term: (6-18 mths)	MidTerm: (5-10 wks)	Comments:
TSX 60:	↘	↘	• long term problem forming, spring rally may suggest a selling opportunity
Dow Jones Industrials:	↘	↘	• intermediate rally may begin soon
90 Day Interest Rates:	↘	↘	• short term rates continue to fall
5 Yr Interest Rates:	↘	↘	• rate approaching lows
30 Yr Interest Rates:	↘	↘	• rate approaching lows
Gold:	↗	↗	• a significant correction will present a buying opportunity
Canadian Dollar:	↘	↗	• CDN\$ is flat to down in the future
<b>LEGEND</b>	↘ ↗ bottom forming	↗ buy	↗ ↘ top forming
			↘ sell



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Please visit our website

[www.robrubino.com](http://www.robrubino.com)

### Contact us at:

[rob.rubino@rbc.com](mailto:rob.rubino@rbc.com)

905-875-4871

or

[jody.coulson@rbc.com](mailto:jody.coulson@rbc.com)

905-875-1850

1-800-567-5615

Fax 905-875-4035

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