

Investment Outlook

An exclusive quarterly report from TD Waterhouse® Private Investment Counsel Inc.¹

Spring 2009

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Searching for a market bottom: Are we there yet?

BY ROBERT J. GORMAN, CFA, CHIEF PORTFOLIO STRATEGIST, TD WATERHOUSE

Parents know all too well the plaintive cries that emanate from the back seat of the family car on road trips of any significant length. Soon after the initial excitement has worn off, the younger set begins to wonder aloud when they will be reaching the family's destination.

Investors today are wondering the same thing. After enduring a sharp market downturn that has cut stock market values in half, downcast investors are wondering when they will start to recover lost ground in their portfolios. In short, are we there yet?

The cycle of investor sentiment

Canadian investors have just experienced one of the worst six-month periods on record. Commencing in September 2008, the Canadian stock market sold off sharply, as did other markets around the world. This reflected a rapid worsening of the credit crisis, brought about in part by the bankruptcy of Lehman Brothers and, in Canada's case, a fast drop in the prices of many commodities that we produce.

The current year has not seen much improvement. After a bounce in December and early January — reflecting positive sentiment surrounding the impending inauguration of Barack Obama — equity markets retreated past the lows seen last November. Meanwhile, what began as a financial crisis has backed up into the real economy, with the fourth quarter of 2008 recording a sharp contraction in both the Canadian and American economies. We look



The stock market looks ahead, caring much more about what will happen than what has happened.

for continued economic weakness in the next few quarters.

Not surprisingly, many investors who have grown weary of seeing their investments decline have thrown in the towel and decided to get out of the stock market at whatever price. This behaviour is often referred to in market parlance as “capitulation” (see diagram, “The cycle of investor sentiment,” on Page 2). We saw signs of this late last year, when mutual fund redemptions spiked, reflecting very negative investor sentiment that comes when investors are feeling most pessimistic. This represented classic retail investor behaviour, as mutual fund investors commonly buy equity funds as the market peaks and sell as the market bottoms.

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Are we there yet?

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Today, investor sentiment lies somewhere between despondency and depression. While Canadians are well aware that a portfolio comprising solely Treasury Bills or Guaranteed Investment Certificates (GICs) is not likely to meet their retirement needs or protect them from the ravages of inflation and taxation, they ruefully observe that, of late, such holdings seem the better to possess. What to do?

Impairment of capital — temporary or permanent?

In market downturns, such as that we are experiencing, there are two categories of investors: those whose portfolios are temporarily impaired and those whose portfolios are permanently affected. This is an especially important distinction for those who are retired or are approaching retirement, and who nervously ponder whether their funds will meet their future needs.

Those temporarily impaired are invested in high-calibre businesses — share prices of which have been marked down because of the effects of an economic slowdown. These prices should ultimately recover to reflect normalized earnings and are the sort of holdings within your portfolios.

Investors permanently scarred by a bear market tend to be those who,

during the preceding strong market, bought into a concept that proved invalid. For example, when the technology sector peaked in 2000, some investors rushed into Internet stocks, in the mistaken belief that they could only go up. This proved incorrect, as Internet stocks crashed and many never recovered.

In the current cycle, the permanently impaired are likely to be those who invested in high-cost junior oil producers based on the imminent prospect of US\$200 oil per barrel. Those companies' share values have been crushed, and many are not likely to survive to see a price of US\$200 per barrel of crude. This is decidedly *not* how we have invested on your behalf.

Looking ahead

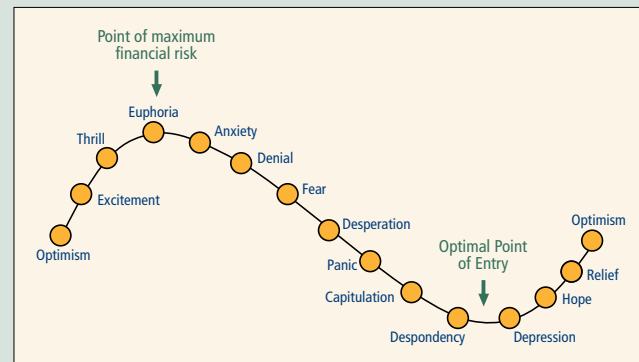
The stock market looks ahead, caring much more about what will happen than what has happened. Market bottoms cannot be pinpointed and we do not know with certainty that we are "there" yet. At some point,

though, the market will begin to look to the economic recovery ahead and commence what is likely to be a four-to five-year recovery of its own.

So, while temporarily impaired, your portfolio of high-quality issues should return to prices more in line with your future needs. This notwithstanding, if market turbulence has you re-thinking your risk tolerance, or objectives for your portfolio, this is a good time to speak with your Private Investment Counsel Portfolio Manager. In the meantime, many of the stocks held in your portfolios feature dividends that are currently higher than fixed-income yields, meaning you are being paid to wait, pending higher share prices. ■

The cycle of investor sentiment

Today, investor sentiment lies between despondency and depression.



Source: Westcore Funds/Denver Investment Advisor LLC

Current Private Investment Counsel strategy

Portfolio weighting

- Modest overweight in equities
- Slight underweight in bonds, with a somewhat shorter term than benchmarks
- Overweight corporate bonds, where mandates permit
- Overweight European industrial stocks and underweight financials within international equities

Percentage return for indices

(For the period December 15, 2008 – March 15, 2009)

DEX Universe Bond Index	+2.9%
S&P/TSX Composite Index	-0.8%
S&P 500 Index	-9.7%
MSCI EAFE Index*	-16.5%

* Morgan Stanley Capital International Europe, Australasia and Far East Index

Is your retirement savings plan on track?

BY CHARLEY TSAI, VICE-PRESIDENT WEALTH PLANNING SUPPORT, TD WATERHOUSE CANADA INC.

With the S&P/TSX Composite Index as of March 2009 almost 50% off its peak level in June 2008, investors, especially those planning to retire in the next five years and those who have recently retired, are understandably concerned as to how the recent market downturn will affect their retirement. Some may even be tempted to respond by making drastic changes to their retirement portfolios. Here are some effective approaches.

Review your plan

While it is natural to be worried in the face of market fluctuations, it is important to remember that peace of mind is often achieved by having a viable financial and retirement plan that takes into account your investment objectives and risk tolerance level, and following that plan with discipline.

A solid plan provides you with a financial roadmap, making it easier to stay focused and keep things in perspective rather than allowing yourself to be distracted by the “noise” in the markets. During these uncertain times, you may wish to contact your Private Investment Counsel Portfolio Manager to review your plan to ensure that you are still on track.

Determine income sources

It is important to remember that your investment assets are not your only source of retirement income. Most Canadians are entitled to a variety of pension incomes.

If you have lived and worked in Canada for most of your life, you will likely be eligible for payments under Old Age Security (OAS) and the Canada or Quebec Pension Plan (CPP/QPP). This income is indexed to inflation; as a result, it supplies a source of guaranteed retirement income that is unaffected by market volatility and keeps up with purchasing power. In addition, if you belong to a defined benefit pension plan, you have an additional fixed source of retirement income. Some defined benefit pension plans are also fully or partially indexed to inflation.

If having regular, secure income is important to you, you may consider converting part of your investment assets into a guaranteed income stream through a fixed or variable annuity. This way you can achieve peace of mind knowing that you have a guaranteed income for life. This may also leave you with less investment assets available for emergency use or for your estate.

Maximize after-tax income

Once you have a good idea of your fixed sources of income, you will know how much income you need to generate from your investment assets.

One way to make your investments “go further” is to increase your rate of return, but this is unlikely to be a viable solution if you are already retired or plan to retire in the next few years. This is be-

cause, to increase your return potential, you need to take on more risk.

A more workable strategy is to maximize your after-tax income. This entails investing in a tax-efficient manner and taking full advantage of all the tax breaks available to you.

Here are some suggestions:

- ▶ Allocate your investments among your Retirement Savings Plan (RSP)/Retirement Income Fund (RIF), Tax-Free Savings Account (TFSA), and non-registered portfolios with a view to sheltering your interest income from tax (in RSP/RIF and TFSA) and taking full advantage of the dividend tax credit and lower capital gains tax rate (in non-registered portfolios).
- ▶ Minimize total household taxes by splitting income with a lower-income spouse by jointly electing to split pension income, sharing CPP, and giving your spouse funds to deposit into his or her TFSA.

Your Private Investment Counsel Portfolio Manager can help ensure that your investments are allocated to provide you with the income you require in a tax-effective manner. ■

Financial care for busy lives

The demands on our time in today's busy world can seem unceasing. Many of us are balancing a career, caring for aging parents, travelling for business and pleasure, and trying to stay physically active. When you add financial affairs to the mix, it can seem overwhelming.

If you find yourself in this position, you might benefit from **Financial Care and Management** offered by TD Waterhouse Private Trust.² This service takes care of your or a family member's day-to-day finances — everything from managing investments, paying bills, and preparing tax returns to more complex tax and estate planning issues.

To learn more, speak to your Private Investment Counsel Portfolio Manager.

Investing for growth with a TFSA

The role of the new Tax-Free Savings Account (TFSA) in helping to build savings has received some worthy attention — often focused on savings. However, the TFSA can be a smart way to invest for growth using stocks, bonds, equity mutual funds, and other managed products.

You pay no tax on the investment growth in your TFSA and you can withdraw the money tax-free at any time for any purpose.

For more information on how best to use the TFSA for your situation, speak to your Private Investment Counsel Portfolio Manager.

Leave a tax-efficient legacy for your heirs

Like many of us, you may have a financial plan that includes an element of savings that you never plan to spend. You may already have taken care of your retirement income needs and have also invested money that you intend to leave to those you care about most. However, this plan's success is largely based on the investments' rate of return. If these investments are non-registered, the higher the return, the more tax you pay. This means your estate may end up smaller than anticipated because your non-registered investment income is taxable, and your estate will be faced with settlement fees and other expenses.

A solution to meet your needs

How can you ensure that you pay less tax now and provide a larger legacy for your heirs? One solution may be to invest the funds using a financial planning strategy known as the Personal Asset Transfer Plan. This strategy is a preferred alternative that offers a simple, sensible way to potentially maximize your estate by using tax-exempt life insurance that can provide:

- ▶ A large, immediate estate value;
- ▶ Tax-sheltered growth of your investments;
- ▶ A tax-free benefit to your heirs;
- ▶ Reduced estate settlement costs, if you've named a beneficiary;
- ▶ Potential for creditor protection; and
- ▶ Liquidity, if you require it.

Benefiting from life insurance

The Personal Asset Transfer Plan moves savings from a tax-exposed investment to a tax-exempt life insurance policy. The life insurance policy provides immediate life insurance protection and an investment within the policy that accumulates on a tax-deferred basis, so your heirs will receive the proceeds tax-free. By utilizing this financial planning strategy, you can potentially increase the size of your estate, and also reduce the amount of tax you pay.

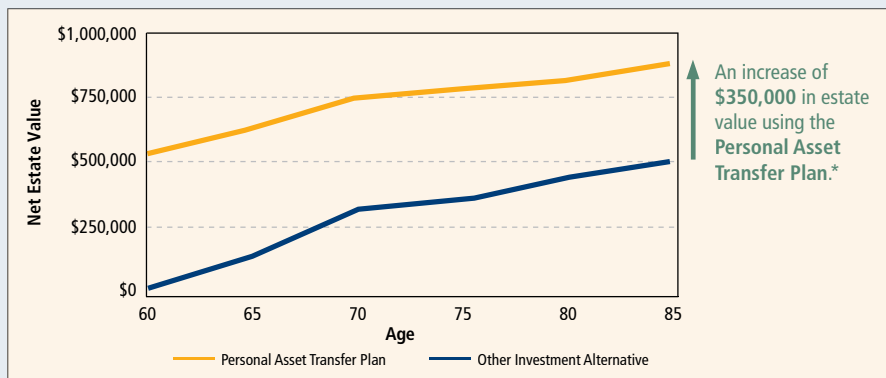
Shifting assets

Let's say that Mary, a retired 60-year-old, plans to shift \$25,000 per year over the next 10 years from

her non-registered investments into a \$500,000 universal life insurance policy. Now, Mary has \$500,000 of life insurance available for her estate, and by the time she turns 85, the net estate value will have increased to more than \$845,000. With this simple shift, Mary will be able to leave \$350,000 more than if she maintained her current investment strategy (see "Paying less tax leaves more for your beneficiaries," below).*

Your Portfolio Manager can work with an Insurance and Estate Planning Specialist to help you maximize the benefits of the Personal Asset Transfer Plan and a wide range of other wealth protection strategies. ■

Paying less tax leaves more for your beneficiaries



* Assuming a personal tax rate of 45%, 6% investment return on alternative strategy and Manulife Innovision universal life policy. The people and situations identified in this article are fictional. This example is intended to assist customers in identifying their needs. While assumptions and values used for this example were reasonable at the time the example was prepared, using tax laws in effect at that time, they are for illustration purposes only. The circumstances emphasize the attributes of the products and strategies being described. Clients should seek qualified professional accounting, tax or legal advice before proceeding on any course of action. All insurance products and services are offered by life licensed agents of TD Waterhouse Insurance Services Inc., a member of TD Bank Financial Group.

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