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Client Letter – Autumn 2012

Cliff Hanger

Now that the American elections have passed without the landscape changing much at all, we turn our sights to the end of the year and the dreaded “fiscal cliff”. For those who have not been following the story, this term, though used in certain circles some time ago, is credited to none other than the Chairman of the U.S. Federal Reserve Board, Ben Bernanke. The “Fed” is the outfit who help to dictate interest rate and monetary policies.

The “cliff” is an automatic increase in income and payroll taxes juxtaposed on a reduction in all sorts of government expenditures, come January 1st, 2013. Between the two, it potentially represents a whopping \$600 to \$800 Billion reduction to the American economy. These “automatic” increases/decreases were negotiated back in the summer of 2011. You might recall that the self imposed limitations on U.S. Federal debt had eclipsed \$15 Trillion and at one point, due to the stalemate between the politicians, it appeared that federal government cheques for all sorts of things would cease. Before the clock could strike midnight, the Democrats and Republicans brokered a deal that would further kick the can down the road to a later date; that date, January 1st 2013, is at our doorstep and without another swift kick, the deal will be enacted.

The former Chairman of the Fed, Alan Greenspan, has opined that this may not be a bad thing after all. Many of you know that I was very critical of the former Chairman for not deflating all sorts of financial bubbles along the way. He rather would deal with the bubble after it has burst; God forbid, he certainly wouldn’t want to supply the prick responsible for ending the party. But in this case I agree somewhat with Easy Al. Perhaps it’s time that the leaders of the largest economy get on with the job of truly dealing with its massive government debt. Another punt would propagate an even bigger bubble with consequences likely more dire than swallowing the big one now.

I know it's a massive undertaking but enough's enough. Our friends to the south may want to take a page out of our fiscal playbook. If they want the wealthier to pay more, a value added tax scheme, similar to ours, may go a long way to appeasing both political parties while raising tax revenue that could reduce the deficit. A rebate mechanism could assuage the cost to the poor while the wealthier would incur greater taxes when they convert their cash into creature comforts. Moreover, an overhaul of their legal system which promotes frivolous lawsuits is long overdue. And the really big gorillas in the room are the outdated entitlement plans that don't adequately address the increased lifespan 21st century humans enjoy and the associated expense incurred by Social Security, Medicare, Medicaid and the prescription drug plans. There is an enormous amount of work that needs to be done; but as my former Branch Manager Keith Baechler use to always tell me, "The best way to eat an elephant is one bite at a time."

Implications for Canada

If the Democrats and Republicans can't come to a different arrangement than the current self imposed "cliff", then it will cause a drag on the Canadian economy too. The U.S. is our largest trade partner and we are not an island. Commodities would be the likely suspect to come under pressure and perhaps our currency too. It's not a bad event for people or companies who have a competitive advantage with a lesser valued currency. Exporters and people who derive their incomes from the States get a raise in pay as the Canadian dollar declines while importers and snowbirds get clipped. Clarity as to what the tax changes and budget cuts would be, however, may offer some relief as at least the markets would know what we're dealing with. I still think there will be some sort of deal negotiated prior to years' end, defraying some of the immediate costs that would likely otherwise be incurred.

I still believe that with interest rates as low as they are, it's prudent to diversify into companies that pay dividends. The dividend yields are, in a lot of cases, much higher than what we can find in the government bonds and guaranteed investment certificates. Granted, yes, common shares will go up and down in value but many have a history of increasing their dividends and values tend to climb over long periods of time. So fear not, it's life, and owning solid companies isn't speculating.

Good News on Tax Free Savings Accounts

Recently the Canadian government announced that the annual maximum contribution level has increased to \$5,500 from \$5,000. It's hard to believe but we are now entering the 5th year of this wonderful savings vehicle. Although you don't get a tax break when you invest the money, your investment gains and redemptions are free of tax. Being that contribution room is cumulative, for those who haven't taken advantage of TFSAs yet, the maximum contribution room would be \$25,500 come January the 1st of 2013.

Year End Tax Planning

Most of my clients have given us an email address for periodic communication and we sent out an article on year end tax planning. If you're still on "snail mail" and would like to get a hard copy of the article, please feel free to give us a call and we'll forward it along to you. Things don't change very much from year to year so it may be a handy reference guide each year.

How Lucky We Are

This year I had an opportunity to travel to Europe as friends of mine were getting married in Albania. It's a country coming out of communism not all that long ago. The old part of its capital, Tirana, looked like there was never a building code and pedestrians have to be mindful of the traffic as cars seem to speed up as they approach you. Houses are built one floor at a time; it's the strangest thing to see stairwells that go to nothing but sky. Most people are poor and have simple lifestyles.

While I was there, I met a man who lives in Greece where unemployment is soaring and there is economic depression. Ironically, he had left Albania twenty some years ago in search of a better life for him and his family and now he's trying to come back to Albania.

"How fortunate we are", I thought to myself. We live in one of the greatest places in the world. We live in a democracy where we have the opportunity to pursue our passions, exercise freedom of religion and speech and in Essex County we are relatively free from natural disasters. There is so much to be thankful for.

So with gratitude as a backdrop heading into this holiday season I thought I'd leave you with a quote by Yevgeny Yevtushenko, a Russian poet and author that was included in Marc Faber's monthly newsletter. It's particularly appropriate as I will be heading to Moscow and then on to Ufa Russia for the World Junior Hockey Championship.

"All values in this world are more or less questionable, but the most important thing in life is human kindness."

Please have a healthy, happy and safe Holiday season. On behalf of myself, Erin Hooper and the rest of the crew here at RBC Wealth Management thank you for your continuing support.

Sincerely,

John Davies, CFP
Investment Advisor

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