The Perspective

WORLDSOURCE FINANCIAL MANAGEMENT INC.

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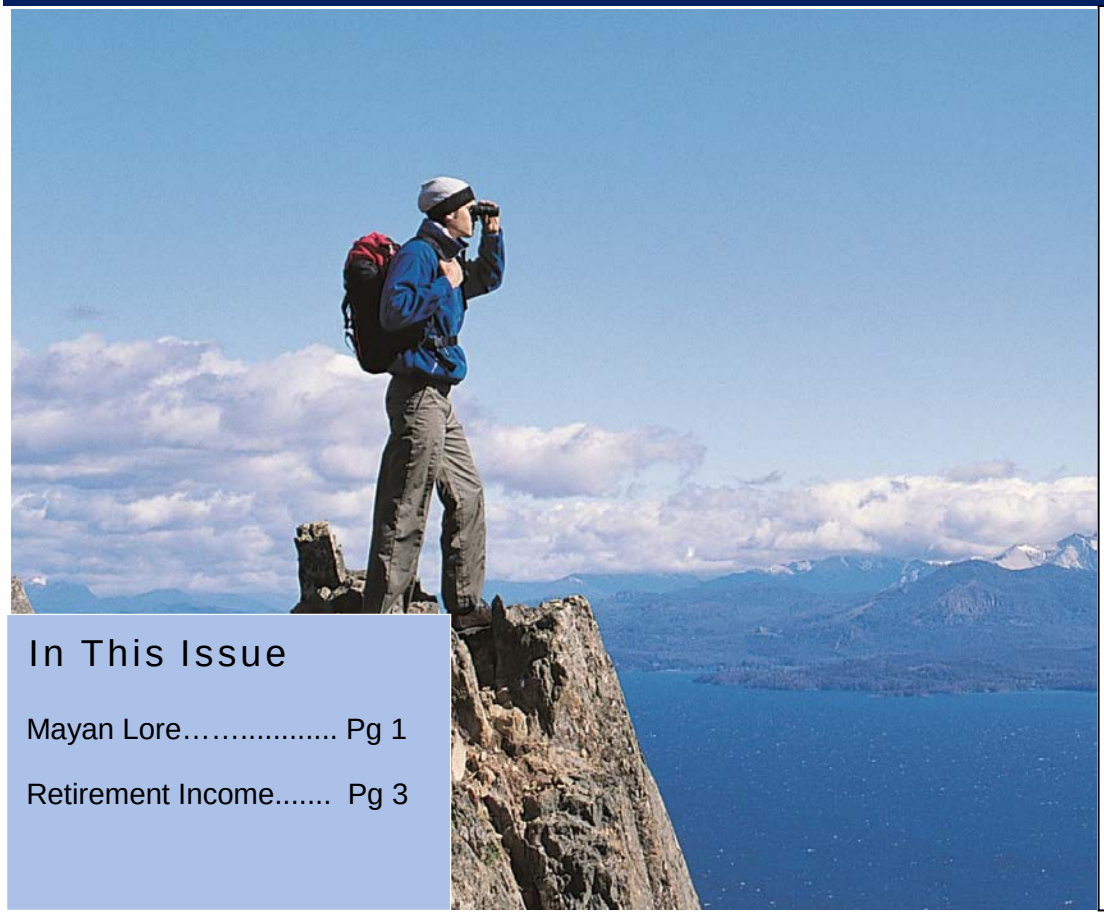

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Mayan Lore: A New Age of Policymaking

According to the Mayan calendar, the World was supposed to end on December 21, 2012. Needless to say that did not happen. Instead what we saw throughout the year was policymakers continue to reach eleventh hour deals in their ongoing efforts to stabilize and bring confidence to global economies and financial markets.

While these efforts were rewarded with fairly strong performance in most global financial markets there is still more work to do. A prime example of this occurred in the wee hours of the morning on January 1, 2013 when the US Congress approved the American Taxpayer Relief Act of 2012, the “Fiscal Cliff”: a combination of expiring tax cuts and across-the-board government spending cuts, were to come into effect on December 31, 2012. While this Act imposed tax increases on high income earners (single taxpayers earning more than $400,000 and couples earning more than $450,000 will see their tax rates increase from 35% to 39.6%) it limited the tax increases that would have negatively impacted most Americans had it not been approved. However, while the Fiscal Cliff was averted there are still approximately $1.2 trillion in automatic spending cuts (that emerged from the 2011 debt ceiling debacle), split evenly between domestic programs and defense programs that effectively were pushed back two months. As a result policymakers are once again positioned to make or break financial markets in 2013.

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While much of the world's attention has been drawn to the US over the past quarter, the past year has seen significant policy moves from the European Central Bank (ECB) that have eased funding pressures for banks as well as overstressed nations. In the first quarter, the European Central Bank's long-term refinancing operation provided more than one trillion euros to support Europe's banking system and boosted investor confidence. Later, the ECB announced a plan to buy vast amounts of government bonds to support indebted countries such as Spain and Italy.

The US Federal Reserve also made several key stimulus announcements. In mid-December, it said it would keep interest rates near zero until the US unemployment rate fell below 6.5%.

Bright signs are also emerging in Asia. In China, economic indicators have surprised to the upside and new leadership has reiterated a commitment to supporting urbanization, which implies support for continued investment in infrastructure and property. Chinese stock markets have surged upward from distressed levels in recent weeks as this fundamental turn has been recognized by investors. Another bright spot is Japan, where a landslide victory for the Liberal Democratic Party (LDP) has increased expectations for a reflationary monetary and fiscal boost, which may help finally nudge the Japanese economy out of its decades long deflationary funk.

While those who interpreted the end of the Mayan calendar as the end of the World were clearly overzealous in their doomsday predictions, the more plausible interpretation of the Mayans "end of days" scenario is that it merely marked a shifting from one era to the next.

In fact this shift may have begun well before 2012. While it has not been the cataclysmic event predicted by some, it has resulted in a shifting of attitudes, roles and perceptions. For instance, Canada and its leaders are now viewed as the standard in fiscal responsibility. In the UK, conservatives are obsessed with the financial "magic" of Canada's former Prime Minister Paul Martin, as he was largely responsible for the biggest reduction in government spending in Canada's history, when he became Finance Minister in 1993. More recently current

Bank of Canada Governor Mark Carney will become the first Non-British Governor of the Bank of England, when he assumes that role next June. More and more Canada is being looked at as a country that came out of the 2008 financial crisis relatively unscathed with a combination of good policy, a highly regulated banking system, timely central bank action, as well as some good fortune.

In 2012 Canada has cemented its image as a model for other countries to strive towards, however, this status is hard won and not to be trivialized. It takes hard work and discipline to both achieve and maintain this status not just by our leaders but also by a nation's people. And there is still more work for us to do. A recent TransUnion's quarterly analysis of national credit trends report indicated that in the last five years (between the third quarter of 2007 and the third quarter of 2012), inflation as measured by the Consumer Price Index rose nine per cent, yet total consumer debt (excluding mortgage) jumped more than 37 per cent. In 2013 one of our goals should be to improve our household balance sheets by reducing debt loads, increasing savings and educating our family members on the need to do the same. After all strong households and economies are built on these principles.

Retirement Income: **Is there a "Magic Number"?**

Canadian Prime Minister Stephen Harper spoke at the World Economic Forum on January 16, 2012, where he indicated that changes were coming to Canada's retirement income system. He stated, "Our demographics constitute a threat to the social programs and services that Canadians cherish. For this reason we will be taking measures in the coming months to ensure the sustainability of our social programs and fiscal position over the next generation."

Two months after Harper's speech, Finance Minister Jim Flaherty confirmed the age Canadians could expect to receive Old Age Security (OAS) pensions would be pushed back gradually from age 65 to 67.

This change to one of the three pillars of the Canadian retirement income system has come at a time when many of us are already concerned with investment market volatility, rising housing costs, underfunded pensions and the possibility of interest rates rising over the next few years. All of these factors have contributed to a feeling of unease amongst Canadians who are already retired, nearing retirement or beginning to contemplate their retirement date. This has been compounded by the realization that we are also living longer than past generations and as a result our savings will have to last longer.

How much do we need to retire?

While many experts have long believed that you should aim at replacing 60% to 70% of your pre-retirement income, others have recently suggested that number could be as high as 75% to 85%.

The answer to this question however is not as simple. It is dependent on many individual factors, such as the date you want to stop working, the lifestyle that you want to lead when that happens, your marital status as well as the sources of income that will be available to you in retirement and the legacy (if any) that you want to pass on.

While there is little doubt that the retirement landscape has changed, so to has our perception of what our golden years should entail. While many still envision wintering in sun and surf, most of us realize that a phased entry into retirement spent among family and friends is the more likely scenario.

What can we do to prepare for retirement?

According to many it is a matter of simply saving more and reducing debt.

This statement understates the complexity of the planning involved in determining the costs and viability of retiring. For example while some expenses such as mortgage payments, commuting costs, childcare and RSP contributions may decline, others such as health related costs may increase.

Consideration also needs to be given to the timing of when to begin government pensions such as the Canada Pension Plan (CPP). While the normal age for receiving CPP is 65, you can elect to move up this start date to as early as age 60. However, if you do so, your pension amount will be 36 % less than had you taken it at age 65. Conversely, you can also elect to delay taking CPP to as late as age 70. If you start receiving your CPP pension at the age of 70, your pension amount will be 42 % more than if you had taken it at age 65.

Thought also needs to be given to income taxes. The Canadian tax system provides seniors with several opportunities to realize tax savings. Many tax savings opportunities such as the age credit are subject to claw backs once a certain income threshold is surpassed.

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As a result tax planning opportunities such as pension income splitting with a spouse also needs to form part of the retirement income plan.

While retirement is often a date that we look forward to with much anticipation it comes with its own set of financial worries. Determining the lifestyle that we want to lead in our golden years is also largely driven by our financial capacity to meet the demands of our dreams. Both the Canadian retirement income and tax systems offer retirees flexibility, choice and opportunities to either split or share income with a spouse.

When it comes to pre-retirement planning and designing a retirement income all of these options should be explored in order to achieve a long lasting and stress free retirement lifestyle.

Pension income that qualifies for income splitting

Eligible pension income is the total of the following amounts, which also qualifies for the pension income tax credit:

- Pension income from a registered pension plan (RPP),
- Income from a Registered Income Fund (RIF) provided that the income recipient is over the age of 65
- RSP Annuity Income provided that the income recipient is over the age of 65 and the RSP has been converted to an annuity.

Income that can be shared

- Canada Pension Plan/Quebec Pension Plan (CPP/QPP).

Income that cannot be split or shared

- Old Age Security (OAS).
- Guaranteed Income Supplement (GIS).
- RSP withdrawals (not from an annuity).
- Income from a retirement compensation arrangement (RCA).