

LIVING WITH MARKET VOLATILITY

MARKET COMMENTARY

By Richard J. Wylie, CFA, Vice-President, Investment Strategy

During the financial crisis of 2008-2009, the world experienced unprecedented market volatility, and it appears that the turmoil will be around for a while. Why has the market remained so volatile? There are at least a few reasons, including investor unease about the strength of the global economy. The developed world is experiencing less than robust growth. There are concerns that China and other emerging markets, the source of much of the world's growth, may not expand as much in the medium term as previously assumed.

No discussion of the sources of today's market volatility, of course, would be complete without zeroing in on Europe's ongoing sovereign debt crisis. It is a truism that markets don't like uncertainty. Lately, investors have become more anxious about a perceived lack of resolve and speed on the part of Eurozone politicians

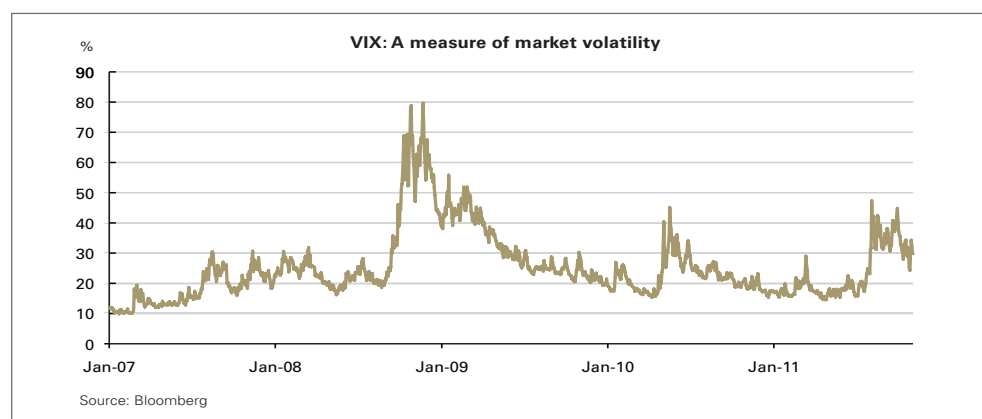
in addressing the financial crises that are centred in Greece and Italy and threaten to spread wider.

With debt issues still outstanding in Greece, Portugal, Italy, Ireland, and Spain, Europe faces a long road to sustained recovery. Complicating matters, weaker economic growth in the region will hamper efforts being made by the stronger members of the currency union. In the past, European debt problems had been dealt with and markets were able to adjust. However, those adjustments occurred in a less challenging period in which the U.S. enjoyed a stable debt environment.

One often-used measure of market volatility is the "VIX," which is shown in the chart. VIX, commonly referred to as the "investor fear gauge," is simply the ticker symbol for the Chicago Board Options Exchange

Volatility Index. The index is constructed using the prices of a wide range of options (puts and calls) on the S&P 500 Index. The pricing of these options allows a calculation of an implied volatility, producing what is viewed as traders' expectations of 30-day volatility for the market.

Despite the current uncertainty, it is important to remember that economic and political crises occur from time to time, and in the past they have eventually been sorted out. We expect the issues the world faces today to be resolved this time around too. Keep in mind that over the long term, it is company earnings that have driven stock prices – and most companies continue to earn decent profits. Also, the heightened volatility, as unsettling as it may be, will no doubt provide opportunities to buy the stocks of quality companies at attractive prices. Your advisor can help you to stick to your financial plan and to take advantage of these opportunities as the markets work their way back toward a more stable state. ■



THE BENEFICIARY LOTTERY – UNINTENDED IMPLICATIONS OF JOINT ASSETS AND BENEFICIARY DESIGNATIONS IN CERTAIN SITUATIONS

By Marla Shragge, LLB, CFP, TEP, Wealth Planning Group

A CASE STUDY

Ian and Sonia thought they had their estate plan all figured out. Both in their 60s, and married for over 20 years, they wanted to leave some assets to each other, while also providing for the two children they each had from their previous marriages.

In addition to their jointly owned properties (their home worth about \$600,000 and a commercial property valued at \$1 million), they each had retirement plans of \$400,000 and about \$15,000 in TFSAs. Ian also had non-registered investments of \$600,000, while Sonia's non-registered investments were worth \$400,000.

The initial plan

Until their recent meeting with their financial advisor, their plan was to designate their retirement plans and TFSAs to each other, and then they would each leave their remaining assets to their own children. Similarly, the surviving spouse would leave the estate just to his or her own children. But they quickly changed their estate plan following their discussions with their financial advisor, who helped them to see the unexpected implications of their initial plan.

Result of initial plan: beneficiary lottery

As their financial advisor pointed out, Ian and Sonia were basically planning for their children using a "beneficiary lottery" – that is, Ian's children would inherit either a lot more – or a lot less – than Sonia's children, depending entirely on whether Ian or Sonia died first or second. Here's how their initial plan would have played out:

If Ian died first: Since the joint properties, as well as Ian's retirement plans and TFSA, would pass directly to Sonia on Ian's death, his estate would consist only of his non-registered investments of \$600,000, so his two children would receive about \$300,000 each (ignoring taxes). This would be their entire inheritance, since the initial plan was that when Sonia later died, only her children would inherit.

If Ian died second: Ian's estate would be worth considerably more, since he would have become the sole owner of the joint properties and Sonia's retirement plans and TFSA on Sonia's death, adding about \$2 million to his own assets.

As a result, Ian's children would share about \$3 million (again ignoring taxes), so each would inherit over \$1.5 million (compared to \$300,000 if Ian died first).

If Sonia died first: Her two children would share an estate of about \$400,000 (comprised of her non-registered investments and not accounting for taxes) – and this would be their entire inheritance, based on the initial plan that only Ian's children would be sharing in Ian's estate when he later died.

If Sonia died second: In this situation, Sonia's estate would include the jointly owned properties as well as Ian's retirement plans and TFSA designated to her, so her children would share an estate of about \$2.8 million (before taxes), or about \$1.4 million each – considerably more than the \$200,000 each if she had died first.

Such a significant – and arbitrary – result would inevitably create problems among the children and was not what Ian and Sonia intended, so they immediately explored other planning options with their advisor, such as:

- Ian and Sonia both providing for the same distribution to all four children on the death of the second of them (and making a written agreement to set this out).
- Using life insurance to help equalize the distributions to the four children.
- Changing the ownership of jointly owned properties and reworking their planning to achieve what they intend.

Ian and Sonia discovered that planning in their situation was complicated, but after careful consideration, they came up with a solution that reflected their wishes and intentions.

Talk to your advisor to review your own situation and whether your planning might also need to be revised as a result of unintended implications for your beneficiaries. ■

PICTON MAHONEY UNCOVERING OPPORTUNITIES IN ASIAN STOCKS



We are pleased to highlight some of the best opportunities being discovered for United Financial's International Equity Alpha Corporate Class mandate by Portfolio Manager Michael Kuan and his team at Toronto-based Picton Mahoney Asset Management.

Q: What is your economic and market outlook for 2012?

Michael Kuan: We expect the global economy to muddle along this year, with Europe experiencing little or no growth, the U.S. growing at a low rate, and the emerging economies continuing to hum along with growth of 4% to 5%. We expect the equity markets to generate modest returns in 2012. There is a risk that if China tightens monetary policy too much, that could create an economic hard landing in a country that has been a source of much of the world's growth.

While there is a chance that Europe may experience a mild recession as a consequence of the various austerity measures in place, we believe the core countries, especially Germany, will benefit from strong export activity. There is still significant risk of policy errors in Europe, which will keep investors on edge for some time. The U.S. economy will be supported by very loose monetary policies, solid corporate balance sheets and strong free cash flow. This recovery has been muted by weak job growth, and by the deleveraging that needs to continue for some time.

Q: How has your outlook affected your positioning of this mandate?

Michael Kuan: Given the various headwinds in the world today, we have focused the portfolio on companies that are less dependent on the health of the overall economy to grow earnings. In addition, we have tilted our portfolio towards companies with strong balance sheets and transparent business models. We have minimized our exposure to companies that generate a significant portion of their revenue and earnings from continental Europe – such as European banks, domestic retailers, and unregulated utilities. Also, we are investing in companies that will benefit from rising consumption in the emerging economies.

Q: What are three of your favourite holdings?

Michael Kuan: With the highest exposure to emerging markets among all large pharmaceuticals, **Sanofi** remains committed to opportunities in China and India. We are bullish on Sanofi because it has a diversified portfolio of products, above-average expected growth and attractive valuation.

AIA Group, the former Asian business of AIG, has been operating in Asia for over 90 years, with strong exposure to the mature markets of Hong Kong and Singapore. It is leveraging its experience in those countries to grow its businesses in Thailand, Korea, Malaysia, and China. New business growth remains very strong, with premium income growing by 23% over the first half of 2011.

South Korean automaker **Kia Motors** has significantly improved its value proposition over the past few years. Its relationship with Hyundai Motor Company helped the company lower its cost base through shared platforms/components as well as improve the quality of Kia's lineup. This, combined with its position in the lower-price segment, has helped Kia to increase its share of the global passenger market from 1.5% a few years ago to 2.5% today. Kia grew earnings by 55% in 2010 and is expected to report a further 35% increase in earnings for 2011. ■

A CANDID LOOK AT MORTGAGE AND LOAN INSURANCE

By Troy Rumpel, CFP, CLU, RHU, Regional Vice-President, Estate Planning

Mortgages, loans and lines of credit are often a necessity of life. And often, as you are signing the documents, the lending institution will recommend that you also take out insurance to cover the outstanding balance, emphasizing how this would protect your family in case something happens to you. All you have to do is answer a few basic health questions and pay the premiums along with your regular monthly payments.

While it may seem fairly straightforward on the surface, mortgage or loan insurance is often misunderstood – and it is often not the best choice. Moreover, when you need to make a claim, you might be surprised to find that you are not covered.

Here are some important facts about this type of insurance. For simplicity, we will just refer to mortgage insurance, but the comments below apply equally to insurance on a loan or line of credit:

- **Your premiums.** The premiums for mortgage insurance are set based on your age when you apply and on the original amount of your mortgage. They also remain constant – so even though the mortgage balance declines over the years, you continue to pay premiums for more insurance than would be paid out.

- **Making a claim.** Coverage is not automatic when a claim is made, even if you had been paying the premiums for years. While you may have answered some basic medical questions when you applied, it is only when a claim is made that the insurance is underwritten. That is, the insurance company assesses your medical information as of the date you applied to determine your eligibility – and if there is any non-disclosure of any information, the claim will most likely be denied. It happens more often than you may believe.

Consider individual life insurance instead

In many situations, life insurance purchased through a licensed advisor can be a more effective solution:

- With an individual policy, the full amount of the death benefit is paid out, regardless of the mortgage balance at the time. This gives the beneficiary the flexibility to determine the best use of the funds. For example, it may make more sense to invest the proceeds instead of paying off an attractive low-rate mortgage.

- An individual policy is completely underwritten at the time of issue, so assuming all medical information has been fully and properly disclosed, you can rest assured that your coverage will be there when needed.
- Because individual insurance is personal, you are free to refinance your mortgage with another financial institution without having to apply for new insurance. You could also choose to keep the policy even after the mortgage is fully paid.
- The cost of an individual policy is often less than a bank's mortgage insurance.

If you want to be assured your debt obligations are covered, while maintaining the flexibility to manage your affairs in life and on death as efficiently as possible, talk to your advisor about individual insurance. ■

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