Investment Insights

Spring 2022

Maintaining Our Balance

Volatility has returned to the equity markets as central banks look to normalize their policies and, more recently, in response to the escalating Russia/Ukraine conflict. Given the relative composure of the markets' climb in 2021, we may have forgotten that volatility is a permanent fixture in the markets. On average, corrections occur around once every year, though markets were largely immune to this occurrence last year.

As we try and progress towards a "return to normal" from the pandemic, volatility should be expected. The oft-maligned "this time is different" may bear more legitimacy today. In many ways, we have been navigating uncharted waters after enduring multiple economic closures that provoked significant fiscal and monetary policies. These highly accommodative policies have helped to support economies, as well as asset prices, to see the crisis through. Central banks are now faced with the task of unwinding this support as they deal with ongoing inflationary pressures. Adding to recent concerns is the escalating situation with the Russia/Ukraine war, as the world responds to this new crisis.

These uncertainties have helped to create significant jitters in the markets. We continue to monitor the evolving geopolitical situation in Europe and the potential effects on the financial markets. Here at home, let's not forget that tightening monetary policies may be viewed as needed for the return to normal. With excess liquidity in the markets, many analysts suggest that central banks have room to hike rates without largely affecting credit conditions. Wealth is still above the levels prior to the pandemic and improving labour markets, including wage growth, are expected to support consumers. Despite high and lingering inflation, as supply chains begin to resolve themselves this is expected to help moderate inflationary pressures. Some advocate the old phrase "patience is a virtue," since we are yet to fully overcome this dominant Covid era. Yet, others wonder if the central banks have waited too long and will need to act more aggressively to temper inflation.

Volatility may feel unsettling; yet, it is the indispensable hygiene of the markets. Alongside earnings growth, it has helped to temper valuations. It has also roused some observers to suggest that this time is different. While not to diminish the significance of today's situation, history reminds us that every market period has challenges that make it difficult to assess future prospects. Taking a longer-term view shows that the markets have had remarkable resilience over time. Abandoning stocks 30 years ago would have meant missing out on significant growth — around six percent annually over three decades.* This, despite volatile periods of uncertainty including credit and debt crises, recessions, changing policies by the central banks — and even war. Einstein once suggested that progress is "like riding a bicycle. To keep your balance, you must keep moving."

*Average annual return not including dividends reinvested. S&P/TSX Composite Index 1/3/1992 – 3,495.60; 1/5/2022 – 21,335.60.

In This Issue

Weedon-Kubay Investment Group of BMO Nesbitt Burns

To Our Clients:

With the Russia/Ukraine crisis, there has been no shortage of news to test our resolve. During these difficult times, try not to be discouraged. Don't lose sight of your own wealth goals and keep time on your side. Remember that we are here to help.

This time of year, income taxes are naturally on our minds. Most of us feel we pay too much tax. There are actions we can take to help minimize these liabilities — some as simple as maximizing tax-advantaged accounts like TFSAs. This may be even more important in these times of high inflation.

We are hoping for many brighter — and smoother — days ahead.

Bruna Neil

Finding Ways to Deal With Inflation

As the theme of inflation continues to dominate the financial headlines, investors may be wondering what steps can be taken to help combat rising prices. Here are some thoughts.

Higher inflation has been more persistent than many expected, largely driven by the anomalies of the pandemic — most significantly on the supply side, due to supply chain and labour market issues still lingering from the economic shutdowns. Yet, consider also that inflationary expectations can help to drive inflation.[1]

Perhaps the most extreme case in recent times belongs to Zimbabwe. People were so accustomed to expecting higher inflation that it became somewhat self-fulfilling. In 2009, Zimbabwe's inflation rate hit 230,000,000 percent. Prices would change by the minute, but the country kept printing money. At the height of their economic problems, they issued a one hundred trillion dollar bill — the largest denominated note ever circulated. When the Zimbabwean dollar was abandoned as the official currency, the one hundred trillion dollar bill was only worth about US$0.40.[2]

Of course, we don't expect similar hyperinflation. It is likely that inflationary pressures will temper as things return to normal. However, there's little dispute that inflation is here, at least for the near term. As inflation can erode an individual's purchasing power, consider these ways to help deal with inflation:

Don't overlook the merits of being invested. History has shown that over longer time periods the return of the equity markets outperforms inflation.[3] This is a good reminder of the merits of staying invested. Now may be a great time to review your investments: do you have available contribution room in a TFSA or RRSP, or funds sitting idle that could be invested to benefit your future?

Better tax planning may help put funds back into your hands. Inflation is often referred to as the "silent tax." As such, why not consider tax planning exercises to help put funds back into your hands? It is personal income tax season — an opportunity to get organized and avoid overlooking important deductions or savings on your tax return. Tax planning should be a year-round exercise: there may be opportunities for income-splitting with a spouse, contributing to tax-advantaged accounts, or planning for a small business.

Consider a budget (or help others!). A budget may be especially helpful for those on fixed incomes, such as seniors or younger folks just starting out. It can help to provide a full picture of inflows and outflows, and determine which costs are necessary and what adjustments can be made to account for any increases from inflation. Ironically, the calculation of the official measure of inflation, the Consumer Price Index (CPI), doesn't include such items as gasoline and groceries, everyday living expenses incurred by almost everyone — and for which costs have gone up significantly.

1. www.econofact.org/thinking-can-make-it-so-the-important-role-of-inflation-expectations; 2. www.cnn.com/2016/05/06/africa/zimbabwe-trillion-dollar-note/index.html; 3. www.cnbc.com/2021/11/16/as-inflation-rises-here-are-opportunities-to-make-and-save-money-.html

Change is Imminent: Recent Tax-Related Changes

Since the start of the year, the CRA has announced changes to the tax rules. While these may not be applicable to personal income tax season, here are some of the notable changes:

Work-from-Home Tax Credit — Those who worked from home due to the pandemic are entitled to claim up to $500 of home expenses. As with the 2020 tax year, the Canada Revenue Agency (CRA) has issued a simplified Form T2200. However, the temporary flat-rate option to allow employees to claim home office expenses without having to track them has again been made available to taxpayers for both the 2021 and 2022 tax years.

Automobile Deduction Allowance — For 2022, the limit on the deduction of tax-exempt allowances paid to employees who use personal vehicles for business purposes has increased by two cents, to 61 cents per km for the first 5,000 km driven and 55 cents thereafter for all provinces. The mileage rates were last raised in 2020.

Expanded Trust Reporting: For 2022 — In the first quarter of 2022, the government confirmed that expanded annual reporting requirements for trusts, including beneficial ownership information, would not apply for the 2021 tax year. Draft legislation was introduced in February that applies to trusts with taxation years ending after Dec. 30, 2022.

A Likely Luxury Tax? — The 2021 federal budget proposed a luxury tax that did not come into effect to start 2022. The government has stated that draft legislation is expected,[1] but as of the time of writing this has yet to be introduced. The proposed levy is either 10 percent of the purchase value above a certain threshold ($100,000 for new cars and aircraft; $250,000 for boats) or 20 percent of the full value, whichever is less.

As the tax landscape continues to evolve, consider seeking the support of accounting or tax professionals to ensure your tax planning accounts for the most updated rules.

1. www.theglobeandmail.com/business/small-business/article-yacht-and-private-jet-makers-brace-for-cancelled-orders-under-liberal/

Estate Planning: Seven Questions to Ask

As you think about your estate plan, here are seven questions that can help clarify your objectives. If you already have a plan in place, these may support a review to ensure your plan reflects your current intentions.

Estate planning should be a consideration in every investor's wealth plan. We often talk about the importance of using certain tools to support the estate plan, such as Wills, power of attorney, insurance, trusts and the arrangement of the ownership* of assets. These are fundamental in helping to protect, manage and distribute assets both during your lifetime and after you are gone. However, before putting these tools in place, an important first step is to establish your estate planning objectives.

Why? We may have very unique visions for our legacy. For some, it may be to support the next generation in gaining skills or fulfilling educational goals to carry on a family business. There may be philanthropic goals that involve supporting causes that an individual believes important. Others may wish to maintain family harmony as the prime objective.

Defining Your Objectives

As you contemplate your own estate plan, consider the importance of defining your current and future objectives. Keep in mind that these often change with the passage of time and especially in light of major life events such as marriage, divorce, birth and death. As such, you may wish to revisit your objectives periodically to make sure they reflect your current thinking.

Here are seven questions to ask that may help to start the thinking process and clarify your objectives.

Estate Planning Objectives — Seven Questions:

1. What do I want my money to achieve during my life and after I am gone?
2. Will my family be able to maintain their current lifestyle if I am no longer able to contribute?
3. Who should be my primary beneficiaries? Should I appoint alternate beneficiaries in the event they predecease me?
4. How long do I intend to provide support to beneficiaries?
5. Are there significant assets that need to be addressed? If so, what is the ultimate goal for these assets? This may include a family business or vacation property, such as a cottage or cabin.
6. Will I need to structure assets to limit exposure to potential liabilities? — i.e., a beneficiary's relationship breakdown or future family controversy, or to protect against former spouses or creditors?
7. What will be my legacy? Is there a charity or cause I wish to support?

It's Never Too Early (Or, Too Late!)

There is never a better time to start planning for your legacy than the present. Consider that planning for how you will provide for the people and/or causes you care about, while balancing your own goals, can happen at any age. One of our roles is to help support your longer-term wealth goals as they relate to your estate planning objectives. We are here to work alongside estate planning specialists, so don't hesitate to call.

*In provinces, and situations, where applicable.

Adding a Layer of Protection: The Trusted Contact Person

Do you have a plan in place to support you in the event that you find yourself in a vulnerable situation? The trusted contact person (TCP) is intended to add an additional layer of protection to support the financial security of investors.

With a rise in cybercrimes and financial fraud, the trusted contact person has been introduced to help protect your financial well-being. The TCP is a person you choose, for which you have given us written consent to contact under certain circumstances, such as if there appears to be something amiss, if there is suspected financial exploitation or if there are concerns about decision making.

The TCP has no authority to make financial decisions or direct transactions and assumes no liability when it comes to your account(s). The TCP does not replace or assume the role of Trading Authority that may be authorized to an investment account. As well, the TCP is different from the Power of Attorney or Mandatary (in Quebec) roles put in place to provide support in the event of incapacity. Even if you have appointed a Power of Attorney, having a TCP adds an additional layer of protection to your account(s).

Who Should Be Appointed?

You are able to appoint anyone you wish to be your trusted contact person. It is recommended to select someone who is trusted, mature and knowledgeable about your personal situation and support network. The individual should be capable of speaking with you, and to us, about your well-being, including potentially sensitive topics such as your physical or mental health status.

If you wish to appoint more than one individual, you may consider multiple trusted contacts. Remember that the person(s) nominated as the TCP can change over time — you are able to change who you designate or revoke designations entirely at any time.

While there may not be a current need for a TCP, implementing this safeguard in advance can help to provide protection down the road. If you would like to nominate a TCP for your existing accounts, or for more information, please get in touch.

Rate Hikes – A Cause for Worry?

Central banks continue to tighten their monetary policies in the return to normal. For many months, the media has been hyping concerns over rising interest rates. As investors, should we be worried about interest rate hikes?

Here are some reasons to keep perspective in a rising rate environment:

Central banks: Good at communicating — Today, we've been given ample warning by the central banks that rates will be rising, so much of this expectation continues to be built into the markets. While we may be used to the forward guidance given by central banks, it hasn't always been this way. In the past, decisions made by central bankers were often a surprise that could rattle the markets. Consider that in the 1990s, investors used to guess what the Fed would do based on the size of then-Chair Alan Greenspan's briefcase![1] The theory: if the Fed was going to change rates, Greenspan would be carrying a lot of documents so his briefcase would be wider.

Interest rates need to normalize — Central banks have been highly accommodative for a very long time. Rates have been kept artificially low to help support economies during this challenging time. As we learn to manage the pandemic and return to normal, a natural unwinding needs to take place, which includes allowing rates to rise. However, let's not forget that even with multiple rate increases, interest rates will still continue to be very low by historical levels.

Wealth levels continue to be high — With excess liquidity in the markets, many analysts suggest that central banks can hike rates quite a bit without affecting credit conditions. Many businesses continue to be in good shape financially, with solid balance sheets and excess cash reserves, so defaults on business loans are expected to be low. Household wealth also increased at all income levels during the pandemic, and delinquency levels on consumer loans are still at record lows.[2]

Markets have historically performed well in rising rate times — Investing theory suggests that interest rates and stock prices move in opposite directions, as stock prices reflect the present value of future earnings: the higher the interest rate, the less future money is worth today. However, history has shown that markets can perform well during rising rates.[3] One market strategist determined that the S&P 500 Index returned five percent in the six months following the first rate hike of past recent cycles, despite initial volatility.[4] Other studies support positive equity market performance during rising interest rate environments (chart).

S&P 500 Performance When 10-Year Treasury Yield Rises By One Percent or More

Start	End	Starting Yield	Ending Yield	S&P 500
Jul '12	Oct '18	1.5%	3.2%	127.2%
Jun '03	May '06	3.3%	5.1%	39.1%
Oct '98	Jan '00	4.5%	6.7%	39.5%
Oct '93	Nov '94	5.3%	8.0%	2.2%
Jan '87	Oct '87	7.1%	9.5%	6.7%
May '83	Jun '84	10.4%	13.6%	−1.5%
Jun '80	Sep '81	9.8%	15.3%	11.4%

https://fortune.com/2021/03/08/stock-market-today-risks-interest-rates/

Slower economic growth — Recent economic data has been mixed to start the year, painting a slowing economic picture. Given the challenge of slower economic growth, it is likely that central bankers will be cautious in the pace of tightening, which may help to temper potential market volatility and may allow time for financial markets and economies to adjust.

1. www.money.cnn.com/1998/09/29/bizbuzz/briefcase/; 2. www.wsj.com/articles/u-s-households-took-on-1-trillion-in-new-debt-in-2021-11644342925; 3. www.bloomberg.com/news/articles/2022-01-23/u-s-stocks-historically-deliver-strong-gains-in-fed-hike-cycles; 4. ca.finance.yahoo.com/news/what-happens-to-the-stock-market-when-interest-rates-rise-115245445.html; www.forbes.com/sites/kristinmckenna/2022/01/24/how-do-stocks-perform-when-interest-rates-rise/

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