

Investment Insights

Harness the Power of Time

Winter 2024

It has been said that “one of the most important variables for how you’ll do as an investor is how long you can stay invested.” As we look ahead to another year, don’t overlook the profound impact of compounding — and time — on investing success.

According to statistics, the U.S. is home to around 750 billionaires. Yet, one fund manager believes this number should be higher. Why? If \$72,000 had been invested 100 years ago in the S&P 500 and left untouched, it would be worth over \$1 billion today.¹ What happened to all the could-have-been billionaires? In short, he suggests that investor behaviour disrupts the opportunity for compounded growth.

One of the challenges lies in its delayed impact. Compounding demands patience, which can be difficult for even the most disciplined individuals. This is because initial gains appear small at the onset and moderate in the middle, but significant outcomes are only realized in the latter part of the investment journey. Consider the investment of \$72,000 made 100 years ago. Based on the average annual S&P 500 return over this time, after a full decade, it would have grown to \$172,000. Even after two decades, it would be worth \$455,000, or just 0.046 percent of one billion. Surpassing the million-dollar mark would take three decades. Yet, remarkably, after 76 years the investment would exceed \$100 million and, after a century, reach the billion-dollar milestone. This highlights the profound impact of compounding over time — let’s not forget this all started with just \$72,000.

Adding to the challenge is that compounding often demands seemingly counter-intuitive behaviour. In investing, while the focus is often on average returns over a period of time, in reality, an ‘average’ year rarely generates an average return — market returns can vary wildly from one year to the next. During heightened uncertainty, periods of downward volatility may prompt investors to react. We all know the oft-counterproductive behaviours, such as trying to sell before a market downturn or, worse still, abandoning stocks during a downturn, which deprives the investor of the ability to eventually recover. These appear to be intuitive actions in the face of uncertainty.

It’s worth a reminder: the world has always been uncertain. Today is no exception. We face continued uncertainties around debt and deleverage, deglobalization, slower growth and higher interest rates, to name a handful. Yet, we’ve overcome these and many other challenges before: recessions, financial crises, inflation, stagflation — and even wars — the returns of the past 100 years include all of these adverse events. While they can derail the markets for temporary periods, it is investor reactions to these events that can derail compounding.

As an advisor, I am focused on managing portfolios to navigate the challenges that come with the changing times. As investors, don’t overlook the importance of a commitment to the longer term. Let time in the markets be one of your keys to success.

1. Estimate based on S&P Index Total Returns (dividends reinvested) from 1928. Annualized return: 10.2%. Prior to 1957, the S&P 500 was the S&P 90. Robert Shiller database: <http://www.econ.yale.edu/~shiller/data.htm>

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To My Clients:

The year that has passed serves as a reminder that things can often unfold much differently than predicted. Despite historic rate hikes, economies were comparatively resilient. In Q3, U.S. GDP was the highest seen in years. Canada was challenged by slow growth, but let’s not forget this was the central bank’s intention in raising rates. The good news is that we may now be on the other side of the aggressive hikes.

Looking ahead, it’s RRSP season, a reminder of the importance of building wealth for tomorrow. After a bumpy year, valuations and dividend yields in Canada may offer opportunities worth considering. Now is the time to tend to your future.

As I continue to navigate the changing times, I remain grateful for your ongoing confidence in my services. May 2024 bring good health, peace and prosperity.

Charlene Morris

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The TFSA: For Younger Folks, \$1.7M is Within Reach

How much do we need in retirement savings? Many Canadians believe this figure is \$1.7 million.¹ While it may seem lofty, consider it is within reach for many younger folks today.

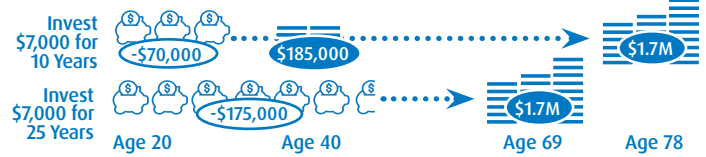
With a bit of discipline, a consistent savings and investing program that relies on relatively modest contributions could progress toward achieving this retirement goal. In a Tax-Free Savings Account (TFSA), assuming annual contributions of \$7,000, or \$584 per month, and an annual rate of return of 6 percent, consider that:

- Starting at age 20, contributing for just 10 years, the TFSA will grow to \$1.7 million by age 78. However, if funds are withdrawn at age 40, the TFSA will be worth only \$185,000 (see diagram, top right).
- Contributing for 25 years, the TFSA will grow to \$1.7 million by age 69.
- Starting late? Investing a lump sum of \$95,000 today, you'll need to contribute \$7,000 for 36 years to achieve \$1.7 million.

For those of us who may not have the luxury of time, don't overlook TFSA benefits beyond the opportunity to grow funds on a tax-free basis:

Approaching Retirement — If you are in a lower tax bracket now than you anticipate in the future, you can draw down Registered Retirement Savings Plan/Registered Retirement Income Fund (RRSP/RRIF) funds (be aware of withholding taxes) and contribute them to a TFSA (subject to available room). Funds can grow in the TFSA and serve as a future tax-free source of income to supplement/replace RRIF withdrawals or other taxable income sources later in retirement. At death, residual TFSA amounts can pass to heirs tax free. In contrast, residual RRSP/RRIF values at death are generally taxable as income to an estate.

Growth of the TFSA Over Time With a 6% Annual Rate of Return



In Retirement — The TFSA may help to enhance retirement income or cash flow. Withdrawals from the TFSA are not taxable and therefore do not affect income-tested benefits such as Old Age Security (OAS). The TFSA can supplement cash flow if a retiree chooses to defer OAS or Canada/Quebec Pension Plan (CPP/QPP) benefits. It may also support tax planning. If generating RRIF income will push you into a higher tax bracket, you may be able to minimize tax by withdrawing only the required RRIF amount and using TFSA withdrawals to supplement income. On the other hand, if your marginal tax rate is lower than you expect in the future or at death, a “meltdown strategy” (see previous point) may help reduce lifetime taxes.

Estate Planning While Alive — The TFSA may offer an opportunity for a tax-efficient, albeit gradual, transfer of wealth to adult (grand)children while alive. By gifting funds to contribute to their own TFSAs, these assets can grow tax sheltered over time. As with any gift, while you will lose control over the funds, you can reduce the value of your own estate by the amount gifted, ultimately reducing potential tax implications upon death.

1. <https://www.theglobeandmail.com/business/article-canadians-now-expect-to-need-17-million-in-savings-in-order-to-retire/>

2024 TFSA Annual Dollar Limit: \$7,000

This is the second consecutive year that the annual limit has increased by \$500 due to adjustments for inflation, bringing the eligible lifetime contribution amount to \$95,000. [Have you fully contributed?](#)

CPP/QPP Reforms: In 2024, Expect to Pay More

CPP/QPP* reforms are expected to make meaningful changes to future benefits. If you earn employment income, you may have noticed more of your paycheque going towards CPP/QPP. In 2024, higher-income earners can expect to pay even more.

Why the reforms? CPP/QPP reforms were put in place to address the decline in workplace pension plans. CPP/QPP was amended in two ways: i) increasing the income replacement level to 33.33 percent from 25 percent of eligible earnings, and ii) increasing the upper limit for eligible earnings. The first phase began in 2019, gradually increasing the contribution rate by one percentage point from 2019 to 2023 on earnings between \$3,500 and the maximum pensionable earnings (MPE) limit. The second phase begins on January 1, 2024, and will affect higher-income earners. Employees and employers will each be required to contribute an additional four percent on earnings between the MPE and a new ceiling. Based on the 2024 MPE of \$68,500, the new ceiling will be \$73,200 in 2024 and \$78,000 in 2025.¹

What is the potential impact? Under the old rules, those who retired at age 65 in 2023 could receive a maximum annual CPP/QPP benefit of around \$15,460.² With the enhanced benefit, this would increase to

\$23,490³ or by almost 52 percent. Consider also that this doesn't account for the 0.7 percent per month enhancement for those who wait to collect benefits after age 65, which further increases

the benefit. Fewer than one percent of retirees wait, despite studies showing that deferring to the age of 70 may be one of the more financially prudent decisions if you live beyond average life expectancy.⁴

While these reforms are expected to materially increase benefits, keep in mind that it will take time before the full impact is realized. Those retiring in the near term will see only modest enhancements since benefits are generally based on an average of the best 40 years of earnings.

For details, please see: <https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-enhancement.html> and https://www.rrq.gov.qc.ca/en/programmes/regime_rentes/Pages/regime-supplementaire.aspx
*Canada/Quebec Pension Plan; 1. For 2024, 107% of MPE; for 2025, 114% of MPE; 2. For Q1 2023, \$1,306.57 under old regime less \$18.24 enhanced benefit = \$1,288.33. www.advisor.ca/tax/tax-strategies/what-clients-should-know-about-the-cpp-reforms/; www.canada.ca/en/revenue-agency/news/2023/05/the-canada-pension-plan-enhancement-businesses-individuals-and-self-employed-what-it-means-for-you.html; 3. www.rrq.gov.qc.ca/en/programmes/regime_rentes/Pages/regime-supplementaire.aspx; 4. www.ipcanada.ca/docs/default-source/default-document-library/tpw/globe-article-delay-cpp.pdf



RRSPs & RRIFs: Be Aware of Taxable Withdrawals

With the growing cost of living, there may be a temptation to access funds from plans like the RRSP or RRIF. Yet, early withdrawals may be costly.

First, consider that any withdrawal is subject to tax and must be reported as income on a tax return. For the RRSP, and amounts above the required minimum withdrawal for the RRIF, there is also an immediate withholding tax. If you are accessing funds to pay down short-term debt, you may end up paying more tax on the withdrawal than you'll save in interest costs. Second, market volatility has put many asset values under pressure. Keeping funds in the plan can be beneficial as asset prices recover.

The RRSP: Additional Implications of Taxable Withdrawals

For those saving for retirement, consider that early RRSP withdrawals may have additional implications. If your current income is higher today than in the future, you may be paying higher taxes today. You will forgo the opportunity for continued tax-deferred compounding, perhaps the most beneficial aspect of the RRSP: A 35-year-old who withdraws \$18,000 from the RRSP will have around \$100,000 less in retirement savings by age 65, at an annual return of 6 percent. In addition, once you make a withdrawal, you won't be able to get back the valuable contribution room, unlike other options such as the TFSA where the contribution room resets itself at the start of the year. If funds are needed, the Home Buyers' Plan or Lifelong Learning Plan, subject to conditions, may allow for tax-free withdrawals and recontribution. For more information, please contact the office.

RRIF Withdrawals: Ways to Minimize the Impact

For those who have entered retirement, allowing funds to remain in the RRIF may be challenging given the minimum withdrawal requirement.

However, there may be ways to minimize the impact:

Make withdrawals at the end of the year — This may allow greater time for asset values to recover. Consider also that making withdrawals at the end of each year, instead of the beginning, allows for a longer period for potential growth within the plan.

Make an "in-kind" withdrawal — If you aren't in need of funds, with an "in-kind" withdrawal for the required amount you will continue to own the security. While the fair market value at the time of withdrawal will be considered income on a tax return, if transferred to a TFSA (subject to available room), future gains will not be subject to tax.

Split RRIF income with a spouse — RRIF income qualifies as eligible pension income for pension income splitting. If you have a lower-income spouse and you're 65 or older, you can split up to 50 percent of your RRIF income to reduce your combined tax bill.

If you are turning age 71 in 2024, here are additional options...

Make the first withdrawal next year — You aren't required to make a withdrawal in the year that the RRIF is opened. You can wait until the end of 2025, the year in which you turn 72, to make the first withdrawal.

Base withdrawals on a younger spouse's age — If you have a younger spouse, use their age to result in a lower minimum withdrawal rate. Note: This can only be done when first setting up the RRIF, so plan ahead.

RRSP Deadline: February 29, 2024, for the 2023 tax year.

Turning 71 in 2024? You must collapse your RRSP before year end. Please call the office to discuss options.



Investing Resolutions: Why Not Check Your Portfolio Less Often?

Think kids are getting too much screen time? There's another demographic struggling to put down their devices: Baby Boomers. As one man put it: "My 75-year-old dad's phone may as well be an implant; he lives with it like a teenager!"¹

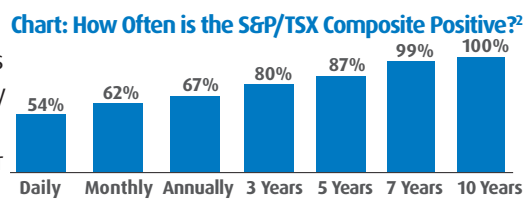
This has implications for our investing ways. With easy access, we may all be guilty of checking investment accounts too frequently. For 2024, why not resolve to check your portfolio less frequently? Here are three reasons why:

1. The more you check, the greater likelihood of negative performance.

History shows that by checking the stock market daily, the chances of seeing a negative return are 46 percent. Yet, this reduces to 0 percent for 10-year rolling monthly returns. As the chart reminds us, the longer you extend your time horizon, the better the chances of seeing positive returns.

2. Emotions can impact our investing decisions. Behavioural finance suggests we feel losses twice as acutely as we feel gains of a similar size. *Myopic loss aversion* occurs when we react hastily to avoid these losses, making decisions that may not be in our longer-term best interests. Yet, an

important variable for investing success is how long you stay invested. As Warren Buffett's late partner Charlie Munger often said: "The big money is not in the buying or selling, but in the waiting."²



3. Investing often involves patience. After the last bear market — the shortest ever at a mere 33 days during the pandemic — we may have been conditioned to believe that markets quickly rebound. Yet, enduring down market periods can take time. Consider the S&P 500 Index: Over the past 50 years, there have been six bear markets that lasted on average 15 months from peak to trough. In order to regain those losses, it took an average of 30 additional months. While difficult to remember in down times, markets are cyclical and history reminds us that they've recovered to reach new highs.

For 2024, consider focusing on other important things and leave the day-to-day portfolio focus to those who are here to manage it.

1. www.washingtonpost.com/technology/2022/11/12/boomers-screen-time/; 2. S&P/TSX Composite Index. "Daily" returns, 1/1/80 to 5/1/23. For all others, rolling monthly returns, 1/1/70 to 5/1/23.

Interest Rates: Higher for Longer?

If higher rates are here for longer, how will this impact the equity markets?

Since the summer, bond yields have risen rapidly. In April, the U.S. 10-year Treasury yield hovered around 3.3 percent; by October, it touched 5 percent for the first time in 16 years. This is a substantial increase in just six months. Many market observers suggest this indicates that the bond market has accepted that interest rates will be kept higher for longer.

Stronger labour markets and resilient economies have put upward pressure on inflation. The central banks have been using interest rates as the main tool to temper inflation, signalling they intend to keep rates at sustained levels as long as the economic data is robust. Of course, should there be an economic downturn, there is room to lower rates to stimulate growth.

Higher rates have been bad news for borrowers — the rapid rise has been particularly difficult for those holding larger debt positions like mortgages. However, the positive news for investors is that the income component of ‘fixed income’ is back: Yields that shrunk to historical lows have risen to heights not seen in decades.

If interest rates continue at higher levels, how will this impact the equity markets? First, it’s worth remembering that both the economy and the equity markets have been remarkably resilient given the speed and magnitude of the rate hikes since early 2022. One market analyst recently looked at the performance of the S&P 500 Index at different interest rate and inflation levels and it may provide some perspective. The best future returns have come after periods of very low and very high starting interest rates, as measured by 10-year Treasury bond yields. The average 10-year yield since 1926 is 4.8 percent, similar to where we are today. With inflation, the best future returns have come after periods of very high starting inflation levels; the average inflation rate since 1926 being around 3 percent.

Why is this the case? Consider that during this time we’ve only had one period of extremely high interest rates and two very high inflationary periods (post-war 1940s and the 1970s), but each of these was followed by significant bull markets. Periods viewed as historical outliers may be “scary while you’re living through them but also tend to produce excellent entry points into the market.” Comparatively, in a more “normal” economic environment, forward returns may appear muted because economies generally expand more gradually, with less interruption, alongside stock prices. Also worth remembering: Changes to rates and inflation may create market volatility in the short run, but consider the 10- and 20-year returns in the charts above — a longer time horizon can yield impressive results. Time continues to be the investor’s great ally.

1. <https://awealthofcommonsense.com/2023/10/higher-for-longer-vs-the-stock-market/>

S&P 500 Returns Based on Starting Interest Rates Since 1926¹

| Starting Yield | +1 Year | +5 Years | +10 Years | +20 Years |
|----------------|---------|----------|-----------|-----------|
| 0 to 2% | 15.4% | 103.6% | 260.0% | 1,452.7% |
| 2 to 4% | 13.6% | 75.2% | 213.7% | 835.3% |
| 4 to 6% | 6.3% | 34.7% | 77.2% | 420.7% |
| 6 to 8% | 9.9% | 69.3% | 175.6 | 766.2% |
| 8% or more | 17.6% | 110.6% | 353.9% | 1,249.3% |

S&P 500 Returns Based on Starting Inflation Rates Since 1926¹

| Starting Inflation | +1 Year | +5 Years | +10 Years | +20 Years |
|--------------------|---------|----------|-----------|-----------|
| <0% | 16.3% | 61.4% | 149.5% | 656.6% |
| 0 to 2% | 13.4% | 64.3% | 159.4% | 583.7% |
| 2 to 4% | 12.8% | 35.0% | 172.1% | 650.4% |
| 4 to 6% | 4.3% | 60.1% | 235.1% | 774.7% |
| 6 to 8% | 11.3% | 96.7% | 319.3% | 1,418.5% |
| 8% or more | 13.1% | 107.9% | 346.3% | 1,648.4% |

With the compliments of...



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