

Investment Insights

The Volatility Quotient

Autumn 2024

“Volatility is the price of admission.”

It may seem like a distant memory, but the first half of 2024 went down as one of the calmest in history for equity markets. By the end of June, the S&P 500 had made headlines for going 377 days without a selloff greater than 2 percent — the longest stretch since the financial crisis. The CBOE Volatility Index (VIX) fell to its lowest level since November 2020.

Yet, the pendulum can quickly swing. When the Bank of Japan surprised the markets with a rate hike at the end of July, volatility returned. While central banks globally were raising rates to fight inflation in 2022 and 2023, Japan had been the exception. As a result, the Japanese yen became the currency of choice for carry-trade investors, who borrowed low-interest-rate yen to invest in assets denominated in higher-interest-rate currencies. At the end of these trades, investors converted funds back into yen to repay the loans. It's a leveraged strategy that has been likened to *“picking up pennies in front of a steamroller”* due to its considerable risks. Indeed, the yen's rapid appreciation in August, triggered by the rate hike and other factors, led to significant losses in carry positions, prompting the Nikkei to experience its worst day since Black Monday in October 1987. North American markets jittered, and the VIX spiked to its third-highest level since its inception.

As one market strategist then noted: *“Markets are feeling like...a market.”* Seasoned investors accept volatility as a necessary part of the investing journey, facilitating the risk-return tradeoff. Without volatility, there wouldn't be the potential for higher returns. Market corrections are also needed for the healthy functioning of markets, helping to reduce excesses that can build up over time. This may be particularly relevant for the S&P 500, which has posted double-digit returns in both 2022 and 2023, as well as record highs in the first half of 2024 that came with conspicuously little volatility.

Yet, volatility is an inherent part of the markets and should be expected. A look back at the S&P/TSX Composite since 1985 provides some reminders (with similar outcomes for the S&P 500):¹

- A 5 percent drawdown is almost guaranteed each year, occurring 95 percent of the time;
- Double-digit drawdowns of more than 10 percent happened 56 percent of the time;
- Despite positive annual returns over 70 percent of the time, the average intra-year drawdown has been -15 percent. The market declines even when it rises (see page 3).

As investors, we should be prepared for both possibilities: significant gains and potential declines in the markets. Indeed, *“volatility is the price of admission.”* While a renewed sense of uncertainty emerged alongside the volatility, the near-term outlook hasn't dramatically changed: global inflation continues to fall, labour markets, while slowing, remain stable on an absolute basis and financial conditions remain relatively loose. In these times, it's important not to let short-term fluctuations disrupt long-term financial plans. Consider the merits of having a solid investment plan — and sticking to it.

1. Based on S&P/TSX Composite Index daily data from 12/31/1984 to 7/31/2024.

In This Issue

RESP Withdrawal Questions Answered ... 2

RRIF “In-Kind” Withdrawals ... 3

Donations & Changes to the Tax Rules ... 2

U.S. Election: Investing Perspectives ... 4



Doug Jones Terri Szego Richard Lawrence

To Our Clients:

It's set to be a busy fall for many of us: kids back at school, work schedules returning to normal and election fever south of the border!

The return of shorter days is a reminder that there are just a few months remaining in 2024. Before then, certain actions can support your 2024 tax position, such as contributing to tax-advantaged accounts, tax-loss selling or charitable donations. Please let us know how we can provide support. Given the increase in the capital gains inclusion rate this year, tax planning has never been more important.

As we enjoy the 'bounties' of autumn, we wish you a season filled with happiness and prosperity. Here's to warm markets for the cooler days ahead.

Doug, Terri and Richard

Your RESP Withdrawal Questions Answered

With kids now back to school, there have been a fair number of Registered Education Savings Plan (RESP) queries.

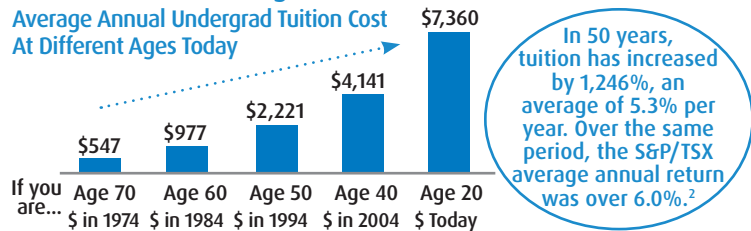
It's also a reminder to those with young (grand)children that it may be an opportune time to contribute to the RESP. For those looking to access funds, here are answers to your questions about withdrawals:

1. How much of my RESP withdrawal is subject to tax? It's important to distinguish between the two types of RESP withdrawals for educational purposes. The educational assistance payment (EAP) consists of any income earned or grants accumulated in the plan and is taxable in the hands of the beneficiary/child attending a qualifying educational program. The post-secondary education (PSE) payment represents funds that the subscriber contributed to the plan and is not subject to tax. When you withdraw from the RESP, you need to specify the type of withdrawal you wish to make. Please call the office if you need help with identifying each component.

2. What are the key considerations for a withdrawal strategy? Students often don't have significant income, so it generally makes sense to exhaust EAPs first, when a beneficiary has a lower marginal tax rate. If they are in a higher tax bracket (due to scholarships or part-time work) and expect lower income in future school years, it may make sense to wait. If the RESP is large, consider spreading EAPs over several years to reduce the potential tax liability that may be incurred in any one year. This is because a student can potentially take advantage of several tax credits to offset EAP income: The basic personal amount for the 2024 tax year is \$15,705. Assuming a federal tuition tax credit of \$7,360, federal tax credits would total \$23,065, meaning that a student with no other income in the year could potentially receive \$23,065 of EAPs in 2024 and pay no tax.

3. Should RESP withdrawal timing be driven by equity market performance? During volatile market times, it may be prudent to

How Has the Cost of Higher Education Grown Over Time?¹ Average Annual Undergrad Tuition Cost At Different Ages Today



wait for investment values to rebound since there's no limit on EAP withdrawals after the first 13 weeks of full-time enrollment. However, other considerations may impact the decision. Keep in mind that the basic personal amount is a non-refundable tax credit, so it must be used in the current tax year. The tuition credit can be carried forward. However, if the student has other income, a larger EAP may put the student into a higher marginal tax bracket. Worse still, if you delay withdrawals and the student ends up dropping out of school, any remaining income/grant money may be taxable to you, the subscriber, and subject to an additional penalty tax.

4. What if the beneficiary doesn't attend post-secondary school? While original contributions (PSEs) can be withdrawn without tax consequences, any grants and income earned inside the plan may be subject to repayment and tax penalties. There may be an opportunity to transfer eligible funds to a sibling's RESP, or income (as an 'accumulated income payment') to a subscriber's Registered Retirement Savings Plan (RRSP), subject to available contribution room, up to a maximum of \$50,000. Remember also that the RESP can stay open for up to 36 years in the event a beneficiary has a change of heart and decides to pursue post-secondary education.

As you plan your RESP withdrawals, please call with questions. The RESP continues to be a valuable tool to plan for post-secondary education.

1. Assumes enrollment at age 20; 2. S&P/TSX at 31/12/73, 1,193.56; 30/07/24, 22,824.7.

Recent Changes to Tax Rules: Donations Still Make Sense

With changes to the tax rules in 2024, the donation of appreciated securities may still make good sense.

The final months of the year bring forth the season of giving, with Thanksgiving and December in sight. If you plan to take equity gains and face the prospect of a substantial capital gains tax liability, why not consider doing good while saving tax at the same time?

It's never pleasant to see asset values reduced by taxes, especially when realized gains over \$250,000 per year are taxed at a 2/3 inclusion rate instead of the 1/2 rate.* By donating appreciated shares "in kind," you will receive a donation receipt for the gross value of shares and will not be subject to the capital gains tax liability. Shares must be donated — do not sell them first and donate the proceeds, as part of the tax benefit will be lost.

Consider also that if your estate plan involves giving to charity, you may receive greater tax benefits by making gifts annually to use donation credits and reduce a tax liability, instead of having a large donation credit at death that may not be fully used.**

For high-income earners subject to the alternative minimum tax (AMT), the rules surrounding donations were amended for 2024.

Alongside an increasing AMT tax rate to 20.5 percent (from 15 percent) and an exemption base to \$173,000 (from \$40,000), only 80 percent of the donation tax credit can be deducted (down from 100 percent, but more than the proposed 50 percent) to reduce AMT payable. Now, 30 percent of capital gains on the donation of qualifying securities are included in the AMT base (from 0 percent), which may lead to tax consequences for large donations. As such, plan ahead.

If you plan to donate appreciated shares, be sure to give enough time before year end. The donation must be received by the charity before the calendar year end for it to apply to your 2024 personal income taxes, and time is often needed to settle the transaction. Please call for assistance.

*At the time of writing, the implementation bill has not achieved royal assent. **There may be flexibility if the estate is a "Graduated Rate Estate."



RRIF “In-Kind” Withdrawals & Other Withdrawal Practices

As we are now in the final months of the year, many retirees plan to take RRIF withdrawals. Don't forget that an “in-kind” withdrawal can satisfy part or all of the minimum requirement.

A common assumption is that investments held in a Registered Retirement Income Fund (RRIF) must be sold. Instead, you may consider an in-kind withdrawal, which involves transferring investments directly to a non-registered account. The fair market value (FMV) of the investment at the time of the transfer will be considered taxable income and the adjusted cost base (ACB) of the transferred investment will become the FMV at that time. For example, for an in-kind withdrawal and transfer of 100 shares of XYZ stock trading at \$50, the RRIF withdrawal will be valued at the FMV of the shares, which is \$5,000 (100 X \$50).^{*} This amount will be added to your taxable income. Keep in mind that if this value is greater than the minimum withdrawal requirement, the excess amount will be subject to withholding tax.

As you think about your RRIF withdrawal strategy, consider planning ahead. Here are four withdrawal practices that may require forethought:

1. Wait to allow greater potential tax-deferred compounding.

Making required withdrawals closer to year end may allow for greater potential tax-deferred compounding within the plan. For those converting their RRSP to a RRIF at age 71, mandatory withdrawals aren't required until the year after the plan is opened, which may allow for

greater growth in the plan.

2. Vary RRIF withdrawals with your tax bracket.

For years in which you may be in a lower income tax bracket, consider the opportunity to make withdrawals greater than the minimum requirement to take advantage of your lower tax rate (but don't forget the withholding tax).

3. Convert a small portion of your RRSP to a RRIF before age 71.

The pension income tax credit generally begins at age 65, so this may be one way to take advantage of this non-refundable credit. You may also be able to split pension income with a spouse/partner, which can reduce taxes or improve access to income-tested government benefits.

4. Use a younger spouse's age to determine the minimum.

A younger spouse's age can minimize withdrawal amounts and maximize flexibility since you can always withdraw more than the required minimum if you need it (subject to withholding tax). However, remember that you must elect to use a spouse's age when first setting up the RRIF.

^{*}The ACB of the transferred shares will now be \$5,000, regardless of the price paid when originally acquired. When transferred in-kind to a non-registered account, the ACB will be used when shares are eventually sold to calculate the capital gain/loss.



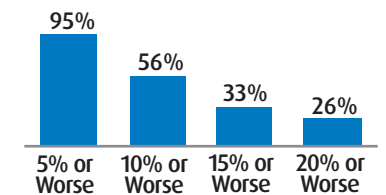
Two Graphics: Perspectives on Market Volatility

Significant volatility is no stranger to the markets. These two graphics highlight the regularity of the ups and downs.

Volatility is a common feature of the equity markets. Declines of at least 5 percent occur almost every year; corrections of 10 percent or more happen in about 6 out of 10 years; and drops of 15 percent or more occur one-third of the time (graph, top right). Even in years when the S&P/TSX Composite Index has posted strong performance, there have been significant intra-year price drawdowns. Since 2005, the average intra-year drawdown has been -15 percent, yet the S&P/TSX has returned an average of

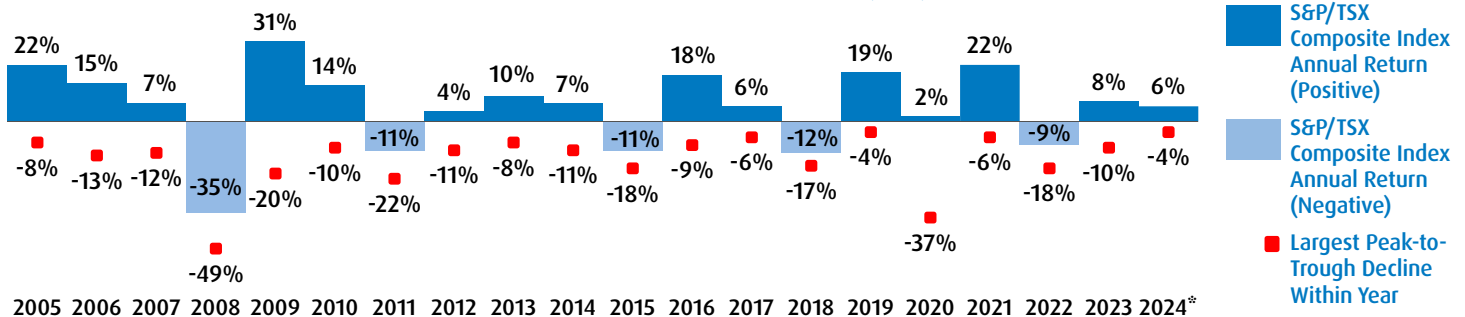
around 6 percent during this time (graph below). Successful investing involves preparing for both significant gains and potential declines that come with volatility. While it's never easy to see portfolio values decline during volatile times, have the patience to see these periods through.

% of Years with Drawdowns, S&P/TSX Composite, 1985 to 2023



S&P/TSX Composite Index, 1/1/85 to 12/31/23.

S&P/TSX Composite Annual Returns & Intra-Year Drawdowns, 2005 to 2024 (July)



Source: S&P/TSX Composite Index 1/1/2005 to 7/31/2024. ^{*}2024 represents data for the partial year to 7/31/2024.

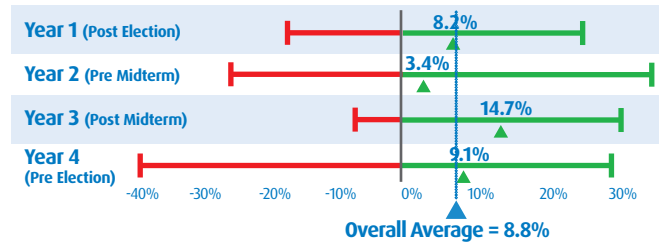
U.S. Election Fever: Investing Perspectives

Politics and money are never far apart. Election years are often fuelled by uncertainty about future policies, regulatory shifts and the potential impact on markets and economies.

This year's U.S. election has been no exception. While public policy can indeed influence specific industries, sectors and even the broader economic and social climate, the actual impact of the election may have less significance to the markets than many investors might expect. Here are three perspectives to consider:

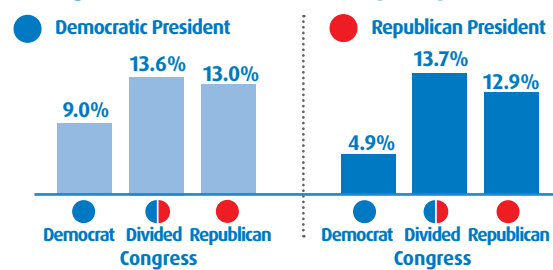
1. Election year returns are similar to non-election years. Historical data shows that, since 1850, the annual compound return for a balanced 60/40 stock/bond portfolio invested in U.S. markets is similar in both election and non-election years. Election years (41 periods) have returned an average annual return of 8.7 percent, compared to 7.7 percent in non-election years (122 periods).¹ Similarly, since 1950, the S&P 500 Index has averaged a return of 9.1 percent in an election year ("Year 4," chart right), not significantly differing from the overall average of 8.8 percent. Interestingly, the 12 months preceding an election have exhibited the widest range of market outcomes compared to other times in the election cycle.

S&P 500 Index Return Ranges by Election Years Since 1950²



2. Markets are non-partisan. A common misconception is that one political party is better for market returns. However, historical data does not support this theory (chart, right). The S&P 500 has historically averaged positive returns under every partisan combination. Moreover, a divided government has been correlated with stronger market returns; some suggest that government gridlock may create less policy uncertainty.

Average Annual S&P 500 Returns By Party Control



3. There are few consistent outcomes for sector returns in election years.² While many investors are watching carefully to see how potential policy changes may impact the industries, sectors or even a company's performance, consider that making changes to an investment strategy at this point comes with risks. Campaign promises do not always result in policy changes. Consider also that the success of policies depends on a variety of factors, including the composition of Congress and the Senate, economic and social conditions, and many others.

The Bottom Line? Presidential election years often generate significant headlines, sometimes causing market volatility or tempting investors to adjust their investing programs. Yet, it's important to distinguish between short-term noise and longer-term outcomes. As these perspectives highlight, the actual impact of an election may have less significance to the markets than many investors assume. Perhaps this is good food for thought for those of us nervously watching the outcome this November!

1. <https://investor.vanguard.com/investor-resources-education/article/presidential-elections-matter-but-not-so-much-when-it-comes-to-your-investments>; 2. <https://fidelity.com/learning-center/trading-investing/election-market-impact>



L to R: Hailey Friedrichsen, Glen Breglia, Hill Su, Ann McCarron, Mario Glavas, Bianca Creanga

Ann is a Senior Investment Associate bringing over 25 years of experience in coordinating and communicating investment ideas to clients. Hill is a Wealth Associate and holds a CPA, CA, CFA & CFP. He is an expert in wealth planning for high-net-worth clients. Glen, Mario, Bianca and Hailey are responsible for the administrative aspects of your account. For general inquiries, please call them directly.

Ann McCarron: 416-359-7668
Hill Su: 416-359-7608
Glen Breglia: 416-359-7049
Mario Glavas: 416-359-4008
Bianca Creanga: 416-359-7069
Hailey Friedrichsen: 416-359-4064

Terri A. Szego, MBA, CFA
Senior Portfolio Manager,
Senior Investment Advisor,
Senior Wealth Advisor
416-359-7677

Douglas M. Jones, CIM
Senior Portfolio Manager,
Senior Investment Advisor,
Senior Wealth Advisor
416-359-7667

Richard Lawrence, CFA
Portfolio Manager,
Senior Investment Advisor
416-359-5377

BMO Nesbitt Burns Inc.
One First Canadian Place
P.O. Box 150, 40th Floor
Toronto, Ontario M5X 1H3
Toll Free: 1-800-227-9842
Fax: 416-359-7669
www.szegojoneslawrence.com



Szego Jones Lawrence
Wealth Management
BMO Nesbitt Burns

BMO Private Wealth is a brand name for a business group consisting of Bank of Montreal and certain of its affiliates in providing private wealth management products and services. Not all products and services are offered by all legal entities within BMO Private Wealth. Banking services are offered through Bank of Montreal. Investment management, wealth planning, tax planning, and philanthropy planning services are offered through BMO Nesbitt Burns Inc. and BMO Private Investment Counsel Inc. Estate, trust, and custodial services are offered through BMO Trust Company. Insurance services and products are offered through BMO Estate Insurance Advisory Services Inc., a wholly-owned subsidiary of BMO Nesbitt Burns Inc. BMO Private Wealth legal entities do not offer tax advice. If you are already a client of BMO Nesbitt Burns Inc., please contact your Investment Advisor for more information. BMO Nesbitt Burns Inc. is a Member - Canadian Investor Protection Fund and is a Member of Canadian Investment Regulatory Organization. BMO Trust Company and BMO Bank of Montreal are Members of CDIC.

"BMO (M-bar roundel symbol)" is a registered trademark of Bank of Montreal, used under licence.

BMO Private Wealth provides this publication for informational purposes only and it is not and should not be construed as professional advice to any individual. This newsletter was produced by J. Hirasawa & Associates, an independent third party for the individual Investment Advisor noted. While every effort is made to ensure that the contents have been compiled or derived from sources believed to be reliable and contain information and opinions which are accurate and complete, the author does not accept responsibility or liability resulting from the information or content provided. The information contained in this publication is based on material believed to be reliable at the time of publication, but BMO Private Wealth cannot guarantee the information is accurate or complete. Individuals should contact their BMO representative for professional advice regarding their personal circumstances and/or financial position. The comments included in this publication are not intended to be a definitive analysis of tax applicability or trust and estates law. The comments are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances.