

Investment Insight

For 2021: Brighter Days Ahead

The turning of a new year is synonymous with optimism and hope. After a difficult year, it may feel as though optimism is in short supply. But here are some reasons why better times may lie ahead.

While the cooler months have brought a resurgence of the virus and new shutdowns, we shouldn't overlook the potential for an economic rebound in 2021. After the spring shutdowns, Canada's economy performed better than expected. Unlike most recessions, the economic impact has been particularly uneven. Sectors that have been able to thrive during the pandemic, such as Technology, have helped to support markets. Canadian equity markets, largely influenced by the Energy and Resources sectors, have been hindered by the economic slowdown. Yet, many companies have reassessed business models and leaned operations.

Of particular interest, household incomes grew despite a contracting economy. Savings rates also increased. This has been, in part, due to significant stimulus measures. Canada has been generous and our deficit is expected to be the largest globally in 2020. Yet, with interest rates at near-zero levels, the cost of carrying this debt remains historically low.¹

The U.S. has chosen a new path forward after a highly contested presidential election, widely watched by Canadians. After an autumn of civil and social unrest, there

is hope that change will temper tensions and bring a necessary stimulus package to support Americans throughout the winter.

Most notably, we've made remarkable progress in the race to find a vaccine. This is an exceptional feat, given a typical vaccine time-to-market is 10 to 15 years; the fastest ever, the mumps vaccine, took four years.

Progress in combatting a pandemic takes time. Progress in investing may involve greater endurance. While the many ups and downs of equity markets in 2020 captured attention, they aren't the ones that matter for most longer-term investors. Assuming you can stay the course for long enough, the results can be significant. The *Rule of 72*² provides a good reminder: at an annual rate of return of five percent, an investment will double in around 14 years. For those who may not think they have the benefit of time, consider that 90 percent of renowned investor Warren Buffett's wealth was made after the age of 65.³

We expect brighter days ahead. Even the worst periods of retrenchment have been followed by new growth, economic expansion and progressing equity values. Moreover, as we saw in 2020, equity markets don't wait on the sidelines for recovery to happen. As we move into another year, keep safe, keep healthy and keep invested.

1. As a % of GDP; 2. Rule of 72: It takes approx. $72 \div (\text{rate of return})$ years for investment to double; 3. Based on shares of Berkshire Hathaway (BRK-A). 8/30/95: \$25,300; 10/30/20: \$302,500.



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To Our Clients:

The near-term outlook continues to have an air of uncertainty as we endure the winter months with an advancing virus. However, we can all take comfort in the news of promising vaccines, which brings optimism for the year ahead. Continue to look forward and don't overlook the opportunity to position your wealth for the future. As a reminder, the 2021 TFSA dollar contribution amount is \$6,000; it is also RRSP season.

While the holiday season may look different this year, we continue to be grateful for your ongoing confidence in our services and wish you the best for a safe and happy New Year.

Dilk

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Estate Planning: What Have You Told Adult Children?

In our work with clients, it isn't uncommon for us to find parents who haven't had any discussions with their adult children about their estate plans. Estate planning may be a difficult topic to approach: not many people like to talk about death, and the intensely private subject of finances can further complicate matters.

However, excessive secrecy can make a potentially difficult situation even worse. How will anyone know how to deal with your assets in the case of death? Or, in the situation where you are alive but unable to act for yourself, how can those appointed to act on your behalf ensure your wishes are carried out as intended?

The health-related consequences of the pandemic have been a stark reminder of the value in having end-of-life planning discussions with family members. It isn't necessary to divulge any detailed information about your finances or your Will in advance, but it may make sense to inform family members of your intentions.

In some cases, parents have appointed adult children as executors but haven't made them aware. Others may be aware, but have not been provided with information on where the Power of Attorney (POA), Will and other important documentation is stored. It is important for an attorney (the person appointed under a POA document^{*)} or next-of-kin to know where to find these documents in an emergency situation. This can help prevent a needless search or avoid other complications, such as incorrectly assuming a Will does not exist.

Communicating what is important to you, how you would like to be remembered and your desired legacy may also be important to



family members. Without any instruction, survivors may struggle with doubt about whether they made the right decisions. This can be especially difficult during a time of grief. Some individuals plan their funeral arrangements in advance; others may wish to make loved ones aware of causes or charities important to them. Having a dialogue with adult children may also provide an opportunity to pass along family values.

If you own a business and wish to see it continue within the family, it is important to have discussions with family members in advance. Planning today can not only provide clarity over your intention for the business' succession, but it can also help provide tax and other financial benefits down the road.

While these discussions can be difficult, having them while you are alive and well may provide comfort to you and your adult children that you continue to support them, even after you are gone.

*The name, terms and conditions of the POA document vary by province (e.g. known as a protection mandate in Quebec, whereby you can name a mandatary).

Interest Rates, Inflation and the Risk of Doing Nothing

For those of us old enough to remember, the late 1970s and early 1980s were periods rife with high inflation and interest rates. In 1981, inflation rates reached over 12 percent and the now defunct Canada Savings Bond returned 19.5 percent interest. While high interest rates meant great returns on low-risk assets like guaranteed investment certificates, it also meant unaffordable mortgages!

Since that time, it has been widely recognized that the central banks are responsible for keeping inflation in check as part of their policy objectives. For many years, the Bank of Canada and U.S. Federal Reserve (Fed) have targeted a two percent core inflation rate. Over the last decade, inflation has generally hovered close to this target, due to monetary policy actions as well as persistently low price and wage increases. It should be noted that the measure of core inflation doesn't include some of the more volatile components of our goods and services, such as food and gas — everyday costs incurred by most individuals. Many Canadians would argue that food costs have largely outpaced core inflation rates!

Today's Realities: Low Interest Rates, Low Inflation

Of course, it is unlikely that we will see the return of the inflation rates of the 1970s, but even moderate inflation can have a significant

impact over time. The chart (below) shows the erosion of purchasing power of \$100 with just moderate inflation rates.

Chart: Erosion of Purchasing Power of \$100 with Moderate Inflation

| Year | Inflation Rate | | |
|------|----------------|---------|---------|
| | 1% | 2% | 3% |
| 0 | \$100 | \$100 | \$100 |
| 10 | \$90.53 | \$82.03 | \$74.41 |
| 20 | \$81.95 | \$67.30 | \$55.37 |
| 30 | \$74.19 | \$55.21 | \$41.20 |

This should also remind us of the value of investing funds for the future. With interest rates at near-zero levels, many savings accounts yield paltry returns. Add in the subtle effects of inflation and doing nothing with your money can have its own risks.

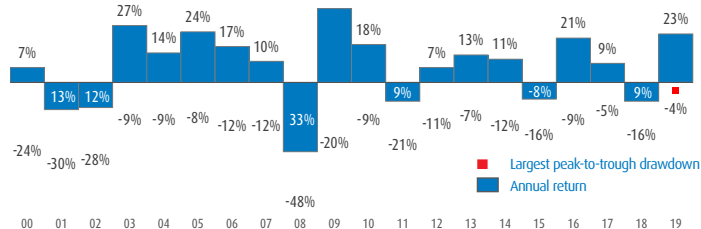
While the effects of the pandemic may have created short-term deflationary pressures, there are differing views on the longer-term path for inflation. With central banks pledging to keep interest rates low for the foreseeable future, there is the potential for rising inflation — traditional economics suggests that when rates are low and the economy grows, inflation generally increases. As well, in 2020 the Fed signaled a major shift in its approach to managing inflation, allowing it to now run above the previous two percent target to stimulate growth and tackle unemployment.

Reminders for a New Year: Building Wealth Takes Time

It may be easy to lose sight of the importance of time in building wealth. Today, the reasons are many: heightened market volatility, an increasing focus on immediacy and the influence of media in the digital age. Yet, in investing, having a longer time horizon takes advantage of the virtues of compounding, which can have a profound effect over the longer term. This also involves the difficult task of enduring inevitable short-term events, such as more unpleasant occurrences like recessions and even an unexpected pandemic. The following may help to provide some perspective:

Volatility is a Common Market Feature — The chart below shows the biggest peak-to-trough drawdowns each year for the S&P/TSX Composite Total Return Index and annual returns since 2000. In 12 of the last 20 years, there has been a double-digit, intra-year correction. Significant volatility is no stranger to the markets. Yet, in half of those years, the index finished in positive territory.

S&P/TSX Composite Total Return Index: Peak-to-Trough Drawdowns 2000 to 2019



Markets Are Cyclical: Nothing Lasts Forever — Equity and financial markets are cyclical. History shows that markets spend more time in positive than negative territory. Since 1956, there have been 13 bull and 13 bear markets. The average bull market has lasted 54 months, with an average gain of 131 percent, whereas the average bear market has lasted only 9 months, with an average loss of -27 percent.¹

Business cycles are also cyclical, typically lasting around seven years. While Canada has had seven recessions over the past 50 years, they have lasted an average of only 11 months.



Your Time Horizon May Be Longer Than You Think

— The pandemic has put pressure on many incomes, which may require some to make adjustments to retirement options or timing. But don't overlook the opportunity to make up for lost time. Just as increasing longevity requires planning, it may also allow time for recovery. Consider that an investment with a five percent compounded annual return will double in approximately 14 years. As such, a 70-year-old may still have the potential for investments to double within their lifetime,² and possibly even twice if they become a centenarian.

The Impact of Time in Investing Can Be Significant — Time can be one of the investor's greatest allies. The chart below shows the impact of time in generating retirement savings: with a longer time horizon, an investor would require a significantly lower monthly investment to yield \$1,000,000.

Chart: Monthly Investment Needed to Reach \$1M Over Time

| Years | At Average Annual Rate of Return of... | | |
|-------|--|---------|---------|
| | 4% | 5% | 6% |
| 20 | \$2,726 | \$2,433 | \$2,164 |
| 30 | \$1,441 | \$1,202 | \$996 |
| 40 | \$846 | \$655 | \$502 |


¹Assuming monthly compounding at annual rates of return. Effect of taxes, fees or inflation ignored.


Stay focused on your own investing time horizon and remember to keep time on your side.

1. S&P/TSX Composite 1/1/56 to 9/30/20; 2. Assumes average life expectancy of 83 years old.

In Short: Upcoming Changes That May Affect You


As always, change is imminent! In brief, here are some of the notable changes that have occurred in the last quarter or are upcoming:


 **Tax-Advantaged Accounts** — The **Tax-Free Savings Account (TFSA) dollar amount for 2021 is \$6,000**, with a total eligible lifetime limit of \$75,500. The **deadline for RRSP contributions for the 2020 tax year is Monday March 1, 2021**, limited to 18 percent of the previous year's earned income, to a maximum of \$27,230.

 **Income-Splitting Opportunities** — The Canada Revenue Agency (CRA) prescribed interest rate for spousal loans remains at one percent: the lowest possible rate. Making a bona-fide loan to a spouse for investment purposes is one way to split income and lower taxes, by putting family investments in the hands of a lower-income spouse. In October, the CRA confirmed that refinancing an existing prescribed rate loan at a lower rate may be done with part of the proceeds from the original loan without triggering the attribution rules.¹

 **Working from Home** — The CRA has added home office furniture to the list of expenses that employers can reimburse

tax free (up to \$500) if related to Covid-19. This was previously limited to personal computer equipment expenses. A new short-form T2200 is in the works, which is required to be completed by the employer in order for employees to deduct home office expenses.²

 **Covid-19 Benefits** — New Federal government pandemic-related benefits began in the fall, including for those who become ill or miss work to care for a sick family member. A withholding tax of 10 percent will be deducted. U.S. citizens in Canada who received U.S. Covid-related government assistance will not have to include the payments on Canadian tax returns. For detailed information: <https://canada.ca/en/services/benefits/ei/ceib-application/transition.html>

 **Legal Tender** — Bid farewell to \$1, \$2, \$25, \$500 and \$1,000 bills in circulation. As of January 1, 2021, they no longer have the official legal tender status as an approved payment of debt.

For more information on any of these changes, please call the office.

1. https://investmentexecutive.com/news/industry-news/cra-offers-flexibility-on-prescribed-rate-loans/?utm_source=newsletter&utm_medium=nl&utm_content=investmentexecutive&utm_campaign=INT-EN-All-afternoon; 2. <https://advisor.ca/tax/tax-news/cra-employers-can-now-reimburse-home-office-furniture-tax-free/>

Business Owners: Your Most Valuable Asset is You

While we may prefer to think that nothing bad will happen to us, the current pandemic is a reminder that unexpected events can sometimes occur. For many businesses, one of the most important assets is the ability of the owner to work and generate income. As such, insurance may be a worthwhile consideration to provide protection for a business owner. It can also lead to valuable tax savings opportunities. Here are some high-level considerations that may serve as a starting point for discussion.

Developing the Business

While full insurance coverage may not be affordable when first starting out, obtaining some coverage can help protect owners and their families by replacing income in the event an owner is unable to work. *Critical illness insurance* may provide protection in the event of critical illness; *term insurance* may be a comparable cost-effective solution to support family members in the event of a business owner's death.

Growing the Business

As a business becomes more established, other forms of insurance may be beneficial. *Disability insurance* may protect in the event of illness or injury, but insurers will generally require a few years of self-employed tax returns before providing coverage. *Overhead insurance* covers the cost of fixed monthly overhead expenses to keep a business running until the owner returns from a period of disability. *Key-person insurance* names the owner and other key staff as the insured, with the beneficiary as the business. *Business interruption insurance* compensates for lost income in the event of a disaster.

In the case of a partnership, insurance may also help to support a buyout agreement in the event of a partner's death. If each partner has a life insurance policy on the other, the proceeds can be used to buy out the partnership interest if something were to happen to one partner.

Insurance can also help to minimize corporate tax or maximize corporate assets. For example, owning a life insurance policy within the corporation may allow the premiums to be paid with "cheaper" corporate dollars (i.e., income subject to tax at corporate rates that are lower relative to personal tax rates). Or, if a business needs an exempt life insurance policy for key-person insurance, the policy could also be used to invest a portion of the company's excess profits on a tax-deferred basis.

Succession of the Business

Insurance can also help facilitate succession planning. Corporate-owned life insurance has the potential to provide liquidity at the time of the owner's death, which can be helpful to cover terminal tax liabilities when passing along the business. Funds may also be used as an income-replacement tool for surviving financially-dependent family members. There may also be tax benefits. At death, the par policy from participating life insurance held corporately can be distributed to the shareholder(s); anything above the adjusted cost basis is paid tax-free through the capital dividend account.

As a business owner, you are the most important asset to your business so plan ahead to protect yourself. For a more detailed discussion, please get in touch.

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