Investment Insights

Time: The Great Equalizer

Autumn 2023

You've likely heard reminiscent tales from older generations who "*walked uphill both ways to school.*" Life back then was tough. But, there has also been a growing sentiment that today's generation, with its unique set of challenges, may have it harder.

For many years, it was claimed that Millennials (born between 1980 and 1994) were the first generation worse off than their parents financially. Faced with a surge in housing prices, coupled with escalating education costs and a challenging economy, things didn't seem particularly bright for the Millennials just a decade ago. However, recent statistics suggest a contrasting narrative.

As the Millennials have begun turning 43 this year, purportedly the average age when we "stop feeling young," they have outpaced previous generations. Millennial household income now surpasses that of prior generations at the same age: $9,000 more than the median GenX (1965 to 1979) household income and $10,000 more than the Boomers (1946 to 1964), in 2019 dollars. And contrary to the belief that high home prices have put ownership out of reach, the Millennials are only slightly behind: 48 percent owned a home as 25-to-39-year-olds, compared with 50 percent of Boomers.[1] The future may not look so bleak, after all. As they enter their peak earning years, Millennials will continue to support the economy, including in investing. Today, Millennials hold just 2.3 percent of total U.S. stock and funds,[2] a trend that is likely to change as their wealth grows.

Every generation has faced, and overcome, distinct challenges. Back in 1993, GenX was entering a tough job market, with "dire predictions" about their economic future. Some may remember this as the year the Blue Jays would take their second consecutive World Series win, yet it is less memorable for being a period of economic strife. Canada was recovering from a recession described as "the deepest since the Great Depression." Unemployment climbed to over 11 percent after interest rates were aggressively raised to fight inflation. Canada's future economic prospects seemed bleak. With soaring debt, an editorial in 1995 referred to "Bankrupt Canada" as "an honourary member of the Third World."[3] Yet, the years that would follow presented a striking contrast. Canada would achieve budget surpluses to end the 1990s (a concept unfamiliar to many today!) and GDP growth would notably surge.

Time can be the great equalizer. Economic cycles come full circle, and the rebound of the 1990s — and the Millennials — serves as a reminder of the inherent value of time. This, too, has lessons for wealth building. Investing $100,000 in the S&P/TSX Composite Index during the uncertain days of 1993 would have grown to $628,274 today, or $1,318,766 with dividends reinvested.[4] However, participating in this growth required having confidence in the prospect of better days ahead. Investing in the safety of a GIC over the same period would have yielded around $228,000.[5] Much of long-term investing success may rely on accepting and preparing for this inevitable cyclicality.

As one market strategist reminds us: "*A good bet in economics: the past wasn't as good as you remember, the present isn't as bad as you think, and the future will be better than you anticipate.*"[6]

1. www.theatlantic.com/magazine/archive/2023/05/millennial-generation-financial-issues-income-homeowners/673485/; 2. U.S. Federal Reserve, "*Distribution of Household Wealth in the U.S. Since 1989*," Q1 2023; 3. www.reuters.com/article/us-crisis-timeline-idUSTRE7AK0FF20111121; 4. S&P/TSX Composite and Total Return Indices, 01/29/93 to 1/31/23 (3,305.47 to 20,767.40; 6,124.83 to 80,772.20); 5. 1-year T-Bill rate, '93 to '22; 6. http://collabfund.com/blog/everything-is-cyclical/

In This Issue

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To Our Clients:

It's remarkable how the economic landscape can quickly change. Just six months ago, there were fears of U.S. banking crisis contagion; at the time of writing, the S&P/TSX Composite has risen 12 percent from its October '22 trough. Interest rates appear to be peaking, inflation is subsiding and GDP growth, while finally slowing, has largely exceeded expectations. Often, one of the more difficult parts of investing is having the conviction to stick to your plan during rapidly changing times.

Autumn is the season of change and a reminder that time has a way of altering most things. Our financial obligations and goals may also change as time passes. If a review is in order, or if there are investing actions you need to take in the final months of the year, please get in touch. During this Thanksgiving season and beyond, wishing you an abundance of health and happiness.

The RESP: A Potential Tool for Legacy Planning?

Investing in education has its benefits: better labour market prospects, reduced unemployment and higher earnings over a working life — the latest studies suggest the potential for annual earnings that are 47 to 58 percent higher.[1]

It is, therefore, not surprising that many grandparents who are legacy planning wish to help younger generations fund the cost of education. When it comes to the Registered Education Savings Plan (RESP), while it is possible for grandparents to set up (as "subscriber") the RESP for the benefit of grandchildren (as "beneficiary"), there may be limitations. Here are three considerations and some tips to potentially avoid complications:

1. What if the child decides not to pursue post-secondary education? While it may be possible to transfer up to $50,000 of accumulated income in the RESP to a subscriber's RRSP, having a grandparent as the subscriber often means a greater chance that they will be over the age of 71 and no longer hold the RRSP. In this case, there are likely to be tax implications. **Tip:** One option may be for grandparents to set up a family plan, as there can be a greater number of beneficiaries (such as a grandchild's siblings or cousins) under the same plan. If one or more beneficiaries decide not to pursue a qualifying education, the plan's assets can be used by other beneficiaries. Another option is to gift funds to the parents to contribute.

2. What if you move from Canada? If a retiree decides to retire outside of Canada and is the RESP subscriber, there may be tax implications. For instance, with a move to the U.S., while the RESP would continue to be tax exempt in Canada, the U.S. Internal Revenue Service doesn't recognize the tax-deferred status of the RESP and it would be considered a foreign trust. As such, annual income earned in the RESP plus annual grants received would be taxable to the subscriber on a U.S. tax return. **Tip:** In this case, it may be wise to transfer the RESP to a new RESP with a different subscriber, but the same beneficiary, before leaving Canada.

3. What happens if you pass away? Many people believe that RESPs are treated similarly to RRSPs and pass outside the subscriber's estate upon death; however, this isn't the case. Generally, if there is no surviving joint subscriber or alternative plan in place, the RESP assets would become part of the deceased subscriber's estate (i.e., the plan would collapse, with tax implications for income and grants received) and the value will belong to the beneficiaries of the estate. These estate beneficiaries may not be the same as the RESP beneficiary. **Tip:** In these circumstances, if you wish to maintain the RESP's original intent, it is important to provide clear direction within the Will as the RESP subscriber.

1. www12.statcan.gc.ca/census-recensement/2016/as-sa/98-200-x/2016024/98-200-x2016024-eng.cfm

Recent RESP Changes

Planning a first withdrawal from the RESP? The federal budget increased the limit on allowable educational assistance payments (EAPs) from $5,000 to $8,000 in the first 13-week period for full-time programs.

Opening the RESP? The rules now permit divorced/separated parents to open joint RESPs for children or move an existing joint RESP to another promoter.

Rebalancing a Portfolio May Provide Other Benefits

Rebalancing a portfolio involves adjusting the allocation of assets to bring it back in line with your original investment strategy. This is done to ensure that the portfolio remains consistent with the intended risk and return profile over time.

Why do we rebalance? If diversification and asset allocation are to work properly, we need to regularly review and rebalance your portfolio from time to time. This is because, over time, your asset mix may have drifted away from your targets. For example, a period of strong growth in one industry or sector may be a signal that some funds should be redeployed to another area to get you back in balance. No matter how promising the outlook of any company, industry or asset class, maintaining appropriate balance according to your risk levels should be a high priority, which may mean pruning or other adjustments.

Here are some thoughts on how an approach to rebalancing a portfolio may also provide other benefits:

Deploy capital — It's not always necessary to sell in order to get your portfolio back in balance. Sometimes you can do an effective job over time by investing new cash flow into asset classes that are now underweight. This approach not only brings the added discipline of focusing on potentially undervalued sectors or asset classes for new investment ideas, but may also align with the goal of buying low and selling high.

Match gains with losses — Where a review suggests it would be prudent to sell part of an overweight position, remember that any gains realized outside a registered plan will be subject to capital gains tax. To help minimize the tax liability, there may be an opportunity to consider selling securities with losing positions to offset these gains. (If you want to retain the position, consider buying back the security after the 30-day waiting period under the superficial loss rules.) Or, if you have a previous net capital loss, it can be carried forward to the current tax year to offset capital gains. Remember that within a registered plan, such as the RRSP or RRIF, there will be no tax implications when securities are traded as long as the funds stay within the plan. As such, asset location may be an important consideration when rebalancing to manage the potential tax implications.

Charitable giving — Consider the opportunity to "do good" by donating winning holdings to a charity instead of selling them directly to benefit from the tax opportunity. Gifting publicly-traded securities with accrued capital gains to a registered charity not only entitles you to a tax receipt for its fair market value, but also eliminates the associated capital gains tax.

These are just a handful of considerations for investors as we consider portfolio rebalancing. If you have questions about this, or other portfolio management practices, please call the office.

Estate Planning & Contesting a Will

Earlier this year, the headlines featured a high-profile estate planning conflict over Elvis Presley's daughter's Will. Over the summer, the children of Aretha Franklin, who passed away in 2018, also contested her Will.

This has prompted some to ask, just how easy is it to contest a Will? Generally, there are very specific legal grounds for which a Will can be challenged — it can't be for reasons such as a beneficiary feeling they are being unfairly treated. These may include "testamentary" capacity, such as when the person who created the Will (the "testator") did not have the mental capacity to understand the implications of their Will when they created it; for instance, if they were suffering from a mental disorder, such as dementia, that could affect their judgment. There may also be reasonable grounds if the Will was not properly executed or proper legal steps weren't taken to make the Will valid, as in the case where the testator signed the Will in the presence of two witnesses, but the witnesses failed to sign it. In some provinces, the witnesses cannot be beneficiaries of the Will, as one example. Another common reason for challenging a Will is due to "undue influence" if it can be shown that the testator was coerced into changing their Will. Depending on the province, there may also be grounds to challenge a Will if there is no provision made in the Will for dependents or a spouse.

In Canada, there is often a limitation period in which a Will can be challenged, sometimes limited to a period from the date the potential challenger became aware of their case.* It can become a costly and time-consuming process, and one likely to create further emotional conflict.

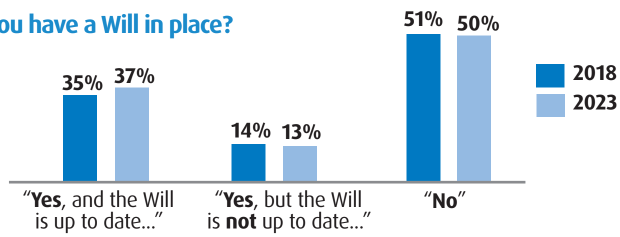
This serves as a reminder of the significance of carefully constructing estate planning documents to ensure our intentions are carried out as planned, while also reducing the chances of future conflict or disputes. This includes drafting a Will while in good health, making sure the document is legally executed and periodically revisiting it to account for any changes to circumstances or wishes. As always, please seek the support of a lawyer and estate planning specialist.

*Each province/territory has its own rules.

Are Your Estate Planning Documents in Order?

One of the positive outcomes of the pandemic was that an increasing number of Canadians appeared to be influenced into preparing estate planning documents.[1] However, a recent *Angus Reid* poll suggests this may not be the case: the figures are nearly identical to those before the pandemic hit.[2]

Do you have a Will in place?



How about you? If the answer is "no," why not get your Will in shape before year end? For an introduction to a specialist, please call the office.

1. www.newswire.ca/news-releases/pandemic-influenced-canadians-to-prepare-estate-planning-documents-832378633.html; 2. https://angusreid.org/canada-will-testament-intestate-dying-without-will/

A Closer Look: How Have Education & Housing Costs Changed?

"Let me tell you about how it was back in my day..."

Over a decade ago, an article published in *The Globe & Mail* looked at the costs of education and the housing market back in the 1980s to answer the question: Do young adults have it harder today? The conclusion: "*Back in my day, economically speaking, life was easier.*"[1]

When comparing the costs in both of these areas, one could argue that the same can be said in 2023. The chart (right) shows just how difficult it is for first-time home buyers today compared to back then. While mortgage rates are much cheaper — we may forget the double-digit rates of 1984! — the skyrocketing cost of the average home has more than offset this decline.

Yet, it's not all that bad. As the economy continues to show resilience, today's low unemployment rate means that there are significant opportunities for younger people to continue building wealth. In fact, a more highly-educated younger population, alongside record participation by women in the workforce, has enabled the younger generation to amass greater wealth than prior generations, as discussed on page 1, and this is only expected to continue through their peak earning years. Despite the challenges of higher costs, there are many reasons to believe the future continues to look bright!

1. www.theglobeandmail.com/globe-investor/personal-finance/2012-vs-1984-young-adults-really-do-have-it-harder-today/article4105604/

Education & Housing Costs vs. Family Income, 1984, 2012 and Today

	1984	2012	Today	% Change from 1984
Undergrad Tuition Cost (A)	$977	$5,313	$7,076	+624%
Average Home Cost (B)	$76,214	$369,677	$709,218	+831%
Median Family Income (C)	$48,500	$71,700	$104,350*	+115%
Price-to-Income Ratio	1.57	5.16	6.80	+333%
5-yr. Fixed Rate Mortgage	14.96%	4.23%	5.51%	–63%
Monthly Mortgage Payment 25-Yr. (D)	$711	$1,493	$3,249	+357%
Payment-to-Income Ratio	18%	25%	37%	+106%
Lifetime Interest Cost	$156,034	$170,704	$443,041	+184%
Unemployment Rate	12%	7.2%	5.5%	–54%

A: StatsCan Table: 37-10-0150-01; B: CREA national average selling price in July 2023. C: https://www.statista.com/statistics/484881/median-family-income-for-couple-families-in-canada/; D. Based on a 25% down payment; *2020 data; Average of https://www.ratehub.ca/best-mortgage-rates/5-year/fixed at 08/12/23; Source: "2012 vs 1984: Yes, Young Adults Do Have It Harder Today," R. Carrick. Globe & Mail, 8 May 2012, B12.

Tapping the Bank of Mom & Dad

$10 Billion: According to one estimate, that's how much parents gave kids in 2021 to fund a down payment on a home.[1] How is the high cost of home ownership putting a burden on parents?[2]

- 47% are providing room and board at home
- 41% assisted with down payments
- 34% used retirement savings to help adult kids
- 32% believe their adult children may never become financially independent

How are you tending to your financial future?

1. www.theglobeandmail.com/investing/personal-finance/article-parents-gave-their-adult-kids-more-than-10-billion-to-buy-houses-in/; 2. www.theglobeandmail.com/investing/personal-finance/young-money/article-nine-in-10-parents-are-helping-their-adult-kids-financially-heres-how/

Discounted Bonds: A Tax-Efficient Alternative

This may be a tax-efficient alternative to GICs that appeals to investors.

With rapid rate increases, there has understandably been more interest in low-risk, fixed income investments like Guaranteed Investment Certificates (GICs). However, with the unprecedented bond market volatility, many quality bonds are trading at discounts to their par values. These discounted bonds can offer a tax-efficient alternative to GICs from a risk perspective, but may provide greater after-tax return potential. This is because when a GIC is held in a non-registered account, any income earned will be fully taxable at the investor's marginal rate — compared to capital gains and dividend income, which generally receive more favourable tax treatment. A discounted bond has a portion of the total return taxed at lower capital gains rates.

GICs pay a guaranteed return, expressed as an interest rate paid on the amount invested, which is taxable as interest income in a non-registered account. Since they aren't tradeable assets, they don't vary in price. At maturity, the original investment, including interest, is returned to the investor. Bonds, on the other hand, generally pay a coupon, or an annual interest rate (sometimes paid semi-annually), which is taxable as interest income. The coupon rate is expressed as a percentage of the bond's "face value" — the amount paid to the bondholder at maturity. Over the life of the bond, a bond's price can vary as interest rates change.

Take, for example, a 2-year, $1,000 bond issued with a 4 percent annual coupon rate, or a $40 coupon amount. Let's say that interest rates rise for comparable bonds in the next month to 6 percent, so these bonds now offer a coupon amount of $60. As such, the bond that pays the coupon of $40 will need to fall in price so that its coupon and eventual face value paid at maturity ($1,000) will be equivalent to the new 6 percent yield. So, the bond's price would fall to $966. When a bond is sold for less than its face value, it is termed a "discounted bond." Conversely, if interest rates fall and become lower than the bond's coupon rate, the bond will be sold at a "premium" (or above par).

Example: Discounted Bond vs. GIC

	Bond	GIC
Term (Years)	2	2
Yield-to-Maturity	6%	6%
Principal Invested	$966	$1,000
Coupon Rate	4%	6%
Sale Price at Maturity	$1,000	$1,000
Coupon Payment	$40	$60
Price/Roll Yield	$20	—
Annual Before-Tax Yield	6%	6%
Tax* on Income (50.25%)	$20.10	$30.15
Tax* on Capital Gains (25.13%)	$5.03	—
Total Tax Paid	$25.13	$30.15
Annual Net Income After Tax	$34.87	$29.85
Annual After-Tax Returns	**3.487%**	**2.985%**

*Tax rates are based on the average 2023 combined federal, provincial and territorial marginal tax rates for $250,000 of ordinary income and will vary by individual income level and province of residence.

Discounted Bonds: The Tax Advantage

What makes a discounted bond attractive from a tax perspective? Bonds generally mature at par, which is $1,000 in the example above. With the discounted bond, the return achieved from the discounted price paid, or $966, and its original par value, or $1,000, would be treated as a capital gain for tax purposes. The coupon amount would still be taxed as interest income. However, since a portion of the total return generated by the discounted bond is taxed at a lower capital gains tax rate, this makes the discounted bond more tax-efficient than a comparable GIC with returns fully taxable as interest income. The chart, intended to be illustrative, shows this scenario and the difference in after-tax returns.

In some cases, even if the GIC has a higher pre-tax expected return than the discounted bond, the after-tax returns of the discounted bond may be notably higher. In addition to the tax advantage, many quality bonds are more liquid than GICs. As well, in a situation where future interest rates decline, there may be an opportunity for investors to realize gains before the bond reaches maturity. Since many quality bonds currently trade at a discount, investors may be able to find appropriate portfolio additions that meet their risk tolerance while offering higher after-tax returns than GICs. To learn more, please feel free to call the office.

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