Investment Insight

Balancing Risk and Return

Summer 2021

There is an old saying in the investment industry: "Don't confuse brains with a bull market." The inference, of course, is that it's easy to feel confident when markets are rising. The challenges emerge when the markets change their course, as they always do.

Buoyant equity markets can also give confidence for individuals to take greater risks. Often, stronger markets help to drive new innovation, which can create further challenges in assessing risks as expectations are largely driven by hope and uncertainty about the future. When rapid change leads to quick profits, it can encourage risk-taking behaviour and create froth in the markets.

Today is no exception. In May, the cryptocurrency Dogecoin, a joke between two engineers named after a Shiba Inu "doge meme,"[1] became the fourth most valuable digital currency after gaining over 14,000 percent this year. It was much to the surprise of its cofounder, who reportedly created it in "a few hours" and sold his holdings in 2015.[2] Similarly, SPAC issuances have surged, prompting regulators to issue warnings. SPACs sell shares with the objective of buying a private company and taking it public. They are known as "blank cheque" companies for a reason: they have no operating business and often no stated acquisition targets. With their rise, and increasing endorsements by celebrities, investors have been warned not to be "lured into participating in a risky investment."[3]

It's easy to get caught up in the excitement — we'd all like to ride the next superstar investment to financial freedom. We may also feel that we aren't successful investors unless we are in the middle of the action. But, too much enthusiasm for what appears to be a good opportunity can often prove unsustainable; the warning signs sometimes only apparent to the astute.

Some of the most successful investors are able to ignore the noise when they make investment decisions. They follow the specific rules established to control risk within a portfolio. While such an approach will not produce the results that make overnight headlines, it provides a good litmus test to avoid being carried away by the enthusiasm of the moment.

As we look ahead, we've needed greater endurance than other nations in the return to normalcy. With strengthening commodity prices, the reopening of some global markets and increasing inflationary pressures, the investing landscape looks a lot different than just one year ago. Considerations of risk, value, quality, diversification, tax and personal objectives continue to be as important today as ever. The changing times are precisely when trusted advisors can provide thoughtful evaluation and scrutiny in investment choices. And, for investors, remembering the elements of risk control — that balance risk and return — can go a long way in helping to achieve our financial goals.

1. en.wikipedia.org/wiki/Doge_(meme); 2. markets.businessinsider.com/currencies/news/dogecoin-price-rally-eclipses-xrp-4th-largest-crypto-doge-2021-5-1030391242; 3. sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert

In This Issue

Quinn+Cardy Wealth Management
BMO Nesbitt Burns

Jelena Milivojevic, Geoffrey Cardy, Meredith Roberts, Joe Quinn

To Our Clients:

A recent article in the *Wall Street Journal* shared some fitting advice from endurance athletes. It suggested that those who endure adversity can emerge stronger and more resilient in what is termed "post-traumatic growth." We have required a particular amount of endurance in Canada. With the warm weather, and increasing vaccination rates, there is hope that we are emerging from the worst of the pandemic, and perhaps stronger. We hope that you will find time for some well-deserved relaxation and fun this summer.

We also remain available to help family or friends. Whether it is a fresh opinion on an existing portfolio or advice relating to a new situation, we are here to assist.

Tax Planning: A Spousal Rollover May Not Always Make Sense

Having a surviving spouse may provide flexibility for capital property or property held in a registered plan upon your death. This is because the Income Tax Act permits the use of a spousal rollover.[1] Yet, there are reasons why it may not always make sense.

Under a spousal rollover, such property can be transferred to a surviving spouse and any associated capital gains or registered plan income will be deferred until the spouse disposes of, or is deemed to have disposed of, those assets, or withdraws assets (in the case of a registered plan). Using the spousal rollover has become a conventional and almost automatic strategy for many estate plans.

However, in some cases, there may be reasons why it may not make sense. Why? While deferring taxes is often beneficial, it can also result in unintended consequences. Take, for example, a situation in which a surviving spouse ends up with a very high income due to the rollover of their deceased spouse's Registered Retirement Income Fund (RRIF) to their own RRIF. This increases their minimum annual withdrawal requirements. With this higher income, the spouse is now subject to the Old Age Security (OAS) clawback and a higher marginal rate of taxation.

Given a reduced OAS benefit and higher annual taxes, some forward planning could potentially have reduced the overall lifetime tax-related burden. It may have been better for the deceased spouse to have bled down their RRIF in the years in which they had a lower marginal tax rate. Or, it may have made sense for the RRIF to be partially converted to cash upon death, with only a portion transferred to the surviving spouse.

Electing to Not Use the Spousal Rollover

Be aware that an automatic rollover of capital property occurs, for tax purposes, upon the death of the first spouse. As such, an election will need to be made to not use the spousal rollover on a property-by-property basis. Here are some other situations in which electing to not use the spousal rollover may make sense:

- The deceased's marginal tax rate is low on the date-of-death return.
- The deceased has capital losses carried forward from previous years that can be used to offset realized capital gains.
- The deceased owns qualified small business corporation shares with unrealized capital gains or an unused lifetime capital gains exemption.
- The deceased has property with an accrued loss, which may be used to offset accrued capital gains on other properties.

Having flexibility in tax planning by using, or not using, the spousal rollover may have its benefits. Please seek the advice of a tax-planning expert as you plan ahead for your particular situation.

1. For tax purposes, a person is generally deemed to have disposed of capital property at fair market value immediately before death. Even though there may not have been an actual sale, there may be associated gains/losses realized for tax purposes. Also, unless a rollover is available, the fair market value of a registered plan is included in the deceased's income in the year of death. A spousal rollover is available where property is transferred to a surviving spouse/common-law partner.

Estate Planning: The Importance of End-of-Life Discussions

The ongoing pandemic reminds us of the importance of having end-of-life planning discussions with loved ones.

Discussing end-of-life wishes is important, not only to provide comfort to loved ones that the right decisions will be made, but also to help avoid potential complications such as family disputes down the road. If you haven't had these conversations with elderly parents or adult children, here are three questions to start the dialogue:

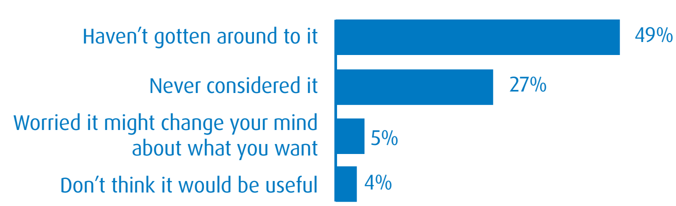
Who do you wish to make decisions on your behalf if you are unable? It is important to identify trusted individual(s) to make decisions the way you wish and on your behalf before a situation arises. The person(s) should be made aware of their role, as well as the preferences for your care.

In a medical crisis, what type of treatment do you want, or not want? Some people may have strong feelings about different types of medical treatment. Have you considered how invasive you want medical care to be, such as being kept alive on a respirator, including a breathing machine or ventilator? If you are in pain and can't make clear decisions, are you comfortable with high doses of painkillers? Your preferences may depend on the amount of time that passes for treatment — if it is temporary, or should the situation persist over the longer term.

What are your preferences for quality of life and types of care? Quality of life preferences can be very personal — some may be fine with having help getting dressed or bathed, but not with being tube-fed to stay alive. It may be important for individuals to live independently within their own home. Others may be comfortable in assisted care, such as in a hospice or palliative care facility.

Perhaps one of the more positive outcomes of the pandemic will be that it helps to facilitate discussions between loved ones. Having a conversation is the first step. Documenting these wishes as part of a broader estate plan is also important. If you are looking for resources to help support these difficult conversations, please call.

***The Economist* Magazine: End-of-Life Survey**
Reasons for Not Having End-of-Life Wishes Documented



Source: Kaiser Family Foundation, 2017. "Other" reasons represent the remaining 15%.

Federal Budget 2021: How It May Affect You

In April, the federal government released its first federal budget in two years. Here are some of the ways it may affect you.*

Perhaps most notably, the federal government expects to continue its significant spending — over $101 billion for the next three years — to support strong economic recovery in the fight against Covid-19. It extended various emergency benefits, resulting in a record deficit and significantly higher projected debt for the foreseeable future.

Some would argue that the excessive spending has Canada wading into "Modern Monetary Theory" (MMT) waters. MMT suggests that federal government spending shouldn't be constrained by its revenues, which are largely created through taxation. It suggests that countries that issue their own fiat currency should determine what their requirements are and spend accordingly, not worrying about running larger deficits as long as inflation is under control. Given the pledged spending, it may seem as if Canada is embracing this new way of economic thinking. And we're not the only ones. Many governments have followed suit, with an estimated US$12 trillion spent globally in just the first 8 months of the pandemic.[1]

While the future economic consequences are yet to be seen, the injection of significant liquidity into the economy appears to be having inflationary effects. We see increasing commodity prices (lumber prices have tripled this year!) and steepening grocery bills, as just some examples.

Beyond the spending spree, the budget had no changes to personal or corporate income tax rates. Here are four ways you may be impacted:

For Seniors: Extending Benefits — Seniors who are 75 years or older as of June, 2022 will receive a one-time Old Age Security (OAS) payment of $500 by this August. For this cohort, monthly OAS payments will increase by 10 percent beginning in July, 2022. If you aren't in need of these funds, consider investing them. If you haven't maxed out contributions, a Tax-Free Savings Account is a great way to potentially grow funds on a tax-free basis.

For Investors: Potential Opportunities? — The federal government has pledged $8.8 billion over five years to support a greener future. Of particular note, the budget indicated the objective of raising $5 billion by issuing green bonds. Proceeds will be used to finance green projects, including infrastructure, cleantech and nature conservation. According to the budget, the presence of government-backed bonds may support more mature investors who are "looking for a green portfolio but also need to manage their investment risk."[2]

For High-Net-Worth Spenders: A Luxury Tax — If you're considering the purchase of a luxury vehicle in the near future, you may want to do so by December 31, 2021. As of January 1, 2022, sales of cars and personal aircraft with a retail price of over $100,000, as well as boats priced over $250,000, will incur a new tax. It will be calculated at the lesser of 20 percent of the value above those thresholds, or 10 percent of the full value of the vehicle.

For Business Owners: Accounting for Capital Assets — If you operate a Canadian-controlled private corporation, the business will now be able to purchase up to $1.5 million of certain capital assets and fully expense these in the year they become available for use. This includes eligible assets purchased on or after April 19, 2021 and before 2024. There may be tax benefits achieved by immediately expensing certain assets; however, please consult a tax professional as it relates to your particular situation.

For greater detail on all of the initiatives proposed, see the Government of Canada website: budget.gc.ca/2021/home-accueil-en.html

1. theglobeandmail.com/business/article-whatever-we-may-think-of-modern-monetary-theory-its-day-in-the-sun-has/; 2. Budget 2021: A Recovery Plan for Jobs, Growth and Resilience, Government of Canada, page 166. *At the time of writing, the budget proposals had not been passed into law.

The Profound Impact of Time on Investing

> "Greatness is not in where we stand, but in what direction we are moving. We must sail sometimes with the wind, and sometimes against it — but sail we must, and not drift, nor lie at anchor." — Oliver Wendell Holmes

Procrastination can be one of our greatest enemies in the quest for wealth creation and, ironically, it's one that is within our power to defeat. If you have (grand)children learning about finances, the accompanying chart may be a worthwhile share. It shows the impact that starting early can have in building wealth down the road.

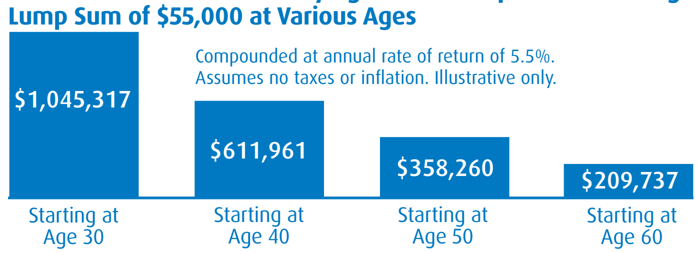
How about you? Do you have funds sitting idle that can be put to work for your future? The latest data shows that the average unused Tax-Free Savings Account (TFSA) cumulative contribution room is around $34,000 per person. At last count, total Canadian cumulative unused Registered Retirement Savings Plan (RRSP) room was in excess of one trillion dollars!

Does any of this unused contribution room belong to you? You can check your available contribution room on your Canada Revenue Agency online account, "My Account," under "RRSP and TFSA" details.*

The best investment opportunity is valueless unless we actually make use of it. Put time on your side and keep your money working for you.

*CRA data may not be fully updated depending on what time of the year it is accessed.
1. At 12/31/18. financialpost.com/personal-finance/taxes/new-data-from-cra-shows-canadians-have-nearly-300-billion-reasons-to-love-their-tfsas; 2. Statistics Canada, CANSIM Table 111-0040, 2018.

How Much Could You Have By Age 85? The Impact of Investing a Lump Sum of $55,000 at Various Ages



Revisiting the Four Percent Rule

How much can I spend in retirement so that I don't outlast my money? This is one of the more common questions we hear as we help clients to plan ahead.

This question spawned the birth of the "four percent rule," which has become a commonly used rule of thumb within financial planning circles. It's a simple way to think about retirement withdrawals. By adding all of your investments, you can withdraw four percent of the total during the first year of retirement. In subsequent years, you adjust this amount for inflation. This provides a good proxy for not outliving your money, assuming a 30-year retirement.

The "rule" has been around since 1994 when rocket-scientist-turned-financial-advisor Bill Bengen took on the task of determining a safe withdrawal rate to protect investors from running short of funds in retirement. Bengen's model assumed that there would be no severe market downturns and the investor would rely upon a predictable, steady stream of income. Here are some of his original findings:[1]

- The "absolutely safe" withdrawal rate based on historical market returns was three percent. A portfolio would not be fully drawn down in less than 50 years.
- A four percent withdrawal rate never resulted in a portfolio being exhausted in less than 33 years.
- The "worst-case" for a 4.25 percent withdrawal rate was a portfolio that lasted 28 years.
- While the model was based on a 50/50 stock/bond portfolio, Bengen suggested allocating a greater proportion to equities, between 50 and 75 percent.

Chart: A Lot Has Changed Since 1994

	1994	2021
10-Year Govt. of Canada Marketable Bonds Rate (A)	8.63%	1.90%
25-Year Historical Rate of Inflation (B)	5.7%	2.2%
5-Year Avg. Residential Mortgage Rate (C)	7.89%	3.26%
Cost of 1L Whole Milk (D)	1.36	1.51
Cost of Eggs (doz. lg.) (E)	1.49	3.77
Price of Gas (reg. unleaded)/L (F)	0.52	1.25

A: Bank of Canada; 150.statcan.gc.ca/n1/pub/11-210-x/2010000/t098-eng.htm (v122487); B: awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/; C: Bank of Canada; 150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3410014501; D: fraserinstitute.org/sites/default/files/PerfectFoodinaPerfectMess.pdf; E: archive.macleans.ca/article/1994/1/24/the-cost-of-feeding-canada; D, E, F: 150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000201; F: 150.statcan.gc.ca/n1/pub/57-601-x/2010004/t182-eng.htm

Of course, like most generalizations, Bengen's simple rule of thumb might not fit every investor's situation. After all, retirement spending isn't necessarily constant from year to year. Some retirees have greater expenditures earlier in retirement as they may opt to enjoy their healthy years travelling the world or engaging in other costly pursuits; others may be confronted with high healthcare or caregiving expenditures as they age. The rule was also based on a suggested portfolio composition, as well as historical returns, that were relevant in 1994. Things looked a lot different back then. Treasury yields hovered around 8 percent; today, they are closer to 2 percent. Historical inflation at that time was around 5.7 percent for the previous 25 years; today, the 25-year rate averages around 2.2 percent (see chart).

The Rule, Revisited for 2021

Given that much has changed over 27 years, you may wonder if the rule has also changed. According to Bengen — yes — and his conclusion may be surprising. He recently suggested that if he were to update the model, he would actually recommend a higher withdrawal rate: "5.25 or even 5.5 percent, which is going to enrage people even more because it's higher...but that's what history has demonstrated."[2]

Having this rule of thumb can be helpful to act as a general guide. However, one of our main roles is to support a planning process for our clients that takes individual circumstances into account and makes course adjustments as life transpires. The ultimate goal? To help ensure that you can look ahead to a comfortable retirement for many years to come.

1,2. awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/

With the compliments of...

Joe Quinn
Vice President, Portfolio Manager
416-359-5812
joe.quinn@nbpcd.com

Geoffrey Cardy
Vice President, Portfolio Manager
416-359-5599
geoffrey.cardy@nbpcd.com

Meredith Roberts
Associate Investment Advisor
416-359-4797
meredith.roberts@nbpcd.com

Jelena Milivojevic
Administrative Assistant
416-359-4456
jelena.milivojevic@nbpcd.com

BMO Nesbitt Burns Inc.
1 First Canadian Place
38th Floor, P.O. Box 150
Toronto, Ontario M5X 1H3
Toll Free: 1-800-263-2286
Fax: 416-359-5346
www.quinncardy.com

BMO Private Wealth

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