

Investment Insights

S&P/TSX Composite at 1,000,000?

Spring 2024

With the S&P 500 reaching multiple new highs to start the year, some investors have expressed impatience with the lagging S&P/TSX Composite (S&P/TSX).

It's worth recalling that for much of last year, the investing world was preoccupied with the prospect of an 'imminent recession.' Yet, despite the many uncertainties, Canadian and U.S. economies have held their own quite well. Indeed, the long-awaited recession in the U.S. appears unlikely for now, with recent U.S. GDP statistics suggesting expansion. While Canadian GDP continues to be sluggish, let's not forget the central banks' objective in raising interest rates in 2022 was to slow growth to curb inflation. Economic resilience has surpassed expectations, partly due to low unemployment, which continues at relative lows. Wealth, wages and employment are higher now than they were before the pandemic.¹

As the major U.S. indices have hit new highs, when will Canada follow suit?² It was just over six years ago that renowned investor Warren Buffett made a memorable prediction worth repeating: Expect the Dow to reach one million in 100 years.³ And, perhaps the same could be said about the S&P/TSX.

At first glance, it may seem like quite the assertion, especially since the Dow hovered at a mere 100 points just 100 years ago.³ When Buffett made his prediction, the Dow had reached a level of 22,000; it had risen above the 39,000 mark on February 22. However, looking deeper into the numbers, at the time the Dow needed to compound at less than 4 percent annually to achieve Buffett's target. Today, Canada's S&P/TSX would need an annualized return of 4 percent to reach the 1,000,000 mark by 2124.

Yet, Buffett's intent wasn't to propose whether this arbitrary benchmark could be achieved. Rather, he meant to inspire confidence in future growth. History has shown that equities outperform most asset classes over the long run; not surprising since the overall growth in corporate profits has been an upward trajectory over time. This is not to suggest that short-term setbacks won't occur. These are inevitable and sometimes necessary to help reset economies or spark innovation and growth. There may be impatience with the lagging Canadian index; our stock market is generally at its best when interest rates are low, global manufacturing is robust and there's high demand for resources. But, markets and economies will ebb and flow, and we shouldn't lose sight of the growth that lies ahead.

Market strategist Ed Yardeni recently went so far as to suggest that we may be in for a repeat of the "Roaring Twenties." He believes we may be in the early stages of a productivity growth boom — a pivotal time in history due to the intersection of the availability of big data, high-powered computing and advances in artificial intelligence. Indeed, the longer-term outlook for economic growth is positive, with technology set to drive continued productivity and innovation, alongside efforts by governments to control inflation and focus on infrastructure and sustainability initiatives, just some factors that should help us prosper in North America. We can all benefit if we choose to participate, and we are here to provide wealth management ideas, strategies and support as we progress towards the 1,000,000 mark.

¹At the time of writing (early March 2024), the S&P/TSX has yet to reach a new all-time high in 2024. 1. Based on annual unemployment rates, StatsCan Table T-4-10-00020-01; 2. Dow Jones Industrial Average (Dow); <https://www.cnn.com/2017/09/21/dow-1-million-warren-buffett-says-it-can-happen.html>; 3. <https://www.fedprimerate.com/dow-jones-industrial-average-history-djia.htm>

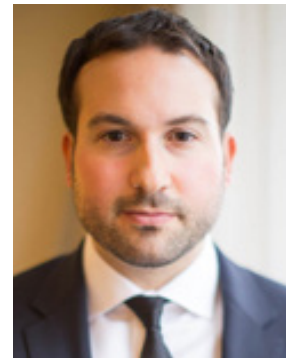
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Gary Lewin, CIM, CIWM, FCSI
Senior Wealth Advisor
Portfolio Manager
416-359-7136
gary.lewin@nbpcd.com

To Our Clients:

For most of us, personal income tax season has arrived once again. Are you taking every opportunity to legitimately reduce the taxes you pay? Don't hesitate to consult with us, especially with regard to your investment strategies, if you have any questions or are in need of ideas.

Spring is often referred to as the season of renewal. If you have friends or relatives seeking a fresh perspective on an existing portfolio or advice on a new financial situation, we would be pleased to offer our experience and support. Please feel free to share our information with them. We remain grateful to those who have made introductions and appreciate your continued trust in our services.

Wishing you a wonderful spring.

Gary

FHSA or HBP: Which Is Better?

As we enter the home-buying season, some clients have asked which plan is better for (grand)kids to purchase a first home: the First-Home Savings Account (FHSA) or Home Buyers' Plan (HBP).

While both can be valuable tools, in brief, here are some considerations:

First: An Overview of Each

The FHSA is a registered account that combines the best of the Registered Retirement Savings Plan (RRSP) and Tax-Free Savings Account (TFSA): Contributions are tax deductible (similar to the RRSP) and withdrawals are tax free (similar to the TFSA) if used to purchase a first home. Annual contributions of \$8,000, to a lifetime limit of \$40,000, can grow tax sheltered. The account can stay open for 15 years.

The HBP allows first-time buyers to tap their existing RRSP, subject to conditions, for a tax-free withdrawal of up to \$35,000. The amount must be repaid within 15 years; otherwise, it will be considered taxable income.

Simply put, the FHSA allows holders to save and grow funds to purchase a first home, whereas the HBP acts as an interest-free loan from the RRSP. The good news? They can both be used for the purchase of a new home.

Considerations: Growth, Funding, Withdrawals and Unused Amounts

Growth potential — For both the FHSA and RRSP, starting earlier allows greater time for funds to grow on a tax-deferred basis. Given the FHSA's 15-year limit, if an investor starts early and opens the account at age 18, by maximizing contributions from the outset, at a five percent annual rate of return the account could grow to over \$75,000 by age 33. By one account, this is the average age of a first-time home buyer.¹

Funding accounts — Both the RRSP and FHSA allow for tax-deductible contributions. While tax-free transfers from the RRSP are allowed to fund the FHSA, keep in mind this eliminates the important tax benefit: a transfer will not generate a tax deduction and won't reinstate RRSP contribution room.

Withdrawals — Funds can be withdrawn tax free from the FHSA for the purchase of a new home. HBP withdrawals are tax free as long as they are repaid within 15 years; otherwise, they will be considered taxable income.

Unused amounts — If you decide not to purchase a first home, unused FHSA amounts can be transferred to the RRSP. This will not affect existing RRSP contribution room, effectively increasing overall contribution room.

Which to Prioritize: FHSA or RRSP?

If funds are limited, which account should be funded first? The choice depends on different factors, including timing, savings amount and ability to repay the HBP. Yet, in many cases, prioritizing the FHSA may be beneficial.

With the FHSA, you may be able to access a greater amount for a down payment; in our example, the FHSA grows to \$75,000, while the HBP has a \$35,000 limit. There is also flexibility: If FHSA funds are unused, they can be transferred to the RRSP, increasing total RRSP contribution room. The FHSA may be more flexible for some since the HBP requires repayment within 15 years. However, this repayment is valuable as it preserves RRSP contribution room to allow for future tax-deferred growth for retirement.

The Bottom Line: Both the FHSA and RRSP's HBP are great tools to support a first-home buyer. If possible, maximize contributions to both accounts. The ability to grow funds on a tax-advantaged basis should not be overlooked!

1. <https://cdn.nar.realtor/sites/default/files/documents/2021-highlights-from-the-profile-of-home-buyers-and-sellers-11-11-2021.pdf>

In Brief: Perspectives on Diverging Economic Growth

While Canadian and U.S. economies share many similarities, there has been a recent divergence in economic growth. Why?

The divergence may be attributed to various factors. Higher interest rates have affected Canada more than the U.S., largely because we hold higher debt loads. Canada has the highest debt level of the G7 nations (chart).¹ Mortgage debt, which makes up the largest portion, renews more quickly than our U.S. counterparts, with the average Canadian mortgage term of five years, compared to the average U.S. 30-year term. Many Americans secured fixed rates during their lows, so there has been less exposure to rising debt costs. This has helped to sustain U.S. consumer spending. Consider that 68 percent of U.S. GDP is attributed to consumer spending!² As long as labour markets remain robust, consumer spending is expected to continue. Government policy has also supported the U.S. economy, as new infrastructure and clean energy projects have earmarked trillions in spending, created jobs and spurred \$640 billion in private investments.³

Are Rate Cuts Ahead?

The potential for interest rate cuts exists in both nations; however, for differing reasons. Our economic growth continues to be sluggish, so the Bank of Canada may cut rates to stimulate the economy. To start the year,

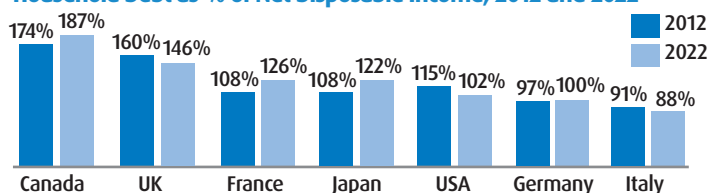
U.S. inflation fell faster than expected, yet growth remained strong. If inflation stays at low levels, the Fed may cut rates to prevent economic activity from being unnecessarily restrained.



While Canada's economic performance has lagged, the strength of our largest trading partner may provide near-term momentum. Our stock market has trailed due to its cyclical nature but is poised to benefit from interest rate stability and declining long-term rates. Higher corporate margins are possible through efficiency gains and lower input costs, particularly as inflation moderates. And, potential rate cuts may provide tailwinds to equity markets.

1. <https://financialpost.com/news/economy/families-facing-real-pressure-household-debt-levels-rise-cmhc>; 2. <https://fred.stlouisfed.org/series/DPCERE1Q156NBEA>; 3. <https://www.washingtonpost.com/business/2024/01/25/gdp-2023-economy-boom/>; 4. Source: Latest OECD data, uses 2021 data for Japan and the USA.

Household Debt as % of Net Disposable Income, 2012 and 2022⁴



Make Investments More Tax Efficient

Spring is the season when taxes are top of mind. Just as investments benefit from compounded growth over time, the tax on income and gains can accumulate to become significant.

Recall the different ways that investment income is taxed in non-registered accounts. Interest income is fully taxable at the investor's marginal rate. Capital gains are taxed at half of this rate, since only half of the capital gain is taxable. Eligible dividend income from Canadian corporations generally attracts a tax rate somewhere in between the two.

How much of a difference can this make? The table below illustrates four scenarios (A to D), each involving an investment of \$50,000 at Year 0 and an annual rate of return of 6 percent compounded over 25 years. In A and B, tax is paid each year at different rates based on the type of income earned: interest and dividends. In C, taxes are deferred so there is no annual tax, but tax is paid at year 25 when capital gains are realized. In D, there is no tax; funds grow in a TFSA. After 25 years, the difference in

How Different Taxes Can Affect After-Tax Values (Illustrative)

Year	A: Interest	B: Eligible Dividends	C: Capital Gains	D: TFSA	
	Taxed Annually	Taxed Annually	Tax Deferred	No Taxation	
	Tax Rate	50.25%	35.02%	25.13%	—
0	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
1	51,492	51,949	53,000	53,000	53,000
5	57,921	60,537	66,911	66,911	66,911
10	67,098	73,295	89,542	89,542	89,542
15	77,728	88,741	119,828	119,828	119,828
20	90,042	107,442	160,357	160,357	160,357
25	104,307	130,084	214,594	214,594	214,594
After-Tax Value	104,307	130,084	173,239	214,594	214,594
Amount Paid in Tax	54,855	43,163	41,355	—	—
Difference (% of D)	49%	61%	81%	100%	100%

Based on 6% annual growth. Tax rates are based on the average of 2023 combined federal, provincial and territorial personal marginal tax bracket at \$250,000 of ordinary income, eligible dividends or capital gains: 50.25%, 35.02% and 25.13%, respectively.

after-tax value is significant. As such, it is prudent to consider making investments more tax efficient where possible. In brief, here are some ideas:

- 1. Maximize tax-efficient accounts.** Don't overlook the benefits of tax-advantaged accounts like TFSAs and RRSPs.
- 2. Optimize asset location.** Different types of income may be taxed differently based on the type of account the income is generated from. By consolidating accounts, a comprehensive view can help to better optimize asset location across all accounts.



A Reminder: The Tax Treatment of GICs

With increased interest in Guaranteed Investment Certificates (GICs), remember that the associated tax liability must be reported on an annual basis for non-registered accounts. Many GICs are locked-in investments, meaning you can't cash them in until their maturity date. Yet, even if a GIC matures in a future tax year and interest has not yet been paid, the amount that has accrued within the tax year must be reported on a tax return. A T5 slip will be issued for amounts of \$50 or more.

- 3. Consider tax-efficient alternatives.** Some types of investments have tax-advantaged attributes. For instance, mutual funds, REITs, limited partnerships and others may provide return of capital (ROC) distributions that are not a taxable receipt. High-quality bonds trading at a discount provide income and a more favourably-taxed capital gains component.
- 4. Explore other tools.** Other tools may help defer tax, such as an Individual Pension Plan (IPP) to allow business owners/executives tax-deferred growth to build retirement income. Small business owners may consider an estate freeze when succession planning to lock in the tax liability at death based on today's business value.

You Asked: Am I Holding a Bare Trust?

Do you hold assets in an arrangement with a separate legal and beneficial owner, where the beneficial owner oversees the assets? You may be associated with a "bare trust" arrangement and have a filing requirement where you previously did not.

First, what is a bare trust? Generally, a bare trust arrangement may exist where a trustee has legal ownership of property/assets but no other duties, obligations or responsibilities with respect to the property other than to transfer under the absolute control/instructions of the beneficial owner the title to the property.¹

Here are two examples of where a bare trust arrangement may exist:

- You have been added to the property title of an elderly parent to assist with estate planning, but the parent retains beneficial ownership/control.
- As a parent, you have your name added to the title of an adult child's home to help the child qualify for financing.

Why is this important? Bare trusts are now subject to reporting requirements that changed for trusts with taxation years ending after

December 30, 2023. For most trusts, even if there is no income or activity to report, a T3 Trust Income Tax and Information Return must be filed within 90 days of the trust's tax year-end.

The good news? Since reporting requirements were expanded to include bare trusts, the CRA will provide penalty relief if a T3 return hasn't been filed by the deadline. This only applies to bare trusts for the 2023 tax year. Penalties are steep for failing to file knowingly or due to negligence — the greater of \$2,500 or five percent of the highest value of the trust property.

Since the intent of the arrangement can impact whether or not it is considered a bare trust, if you believe you may be associated with a bare trust arrangement, it's best to discuss your situation with qualified tax and legal advisors to understand if you are subject to filing obligations. For more information: <https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/new-trust-reporting-requirements-t3-filed-tax-years-ending-december-2023.html>

¹ This is the definition of a bare trust according to the CRA: <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-015/treatment-bare-trusts-under-excise-tax-act.html>

This is not intended to be a comprehensive or legal discussion of bare trusts.

Tax Benefits of a Corporate Asset Transfer Plan

This strategy has the potential to increase the after-tax transfer of corporate assets to heirs. Just how much of a difference can it make?

Many small business owners keep surplus funds within their company to take advantage of the tax deferral. However, once these funds are eventually distributed to shareholders they may be taxed; or, upon the death of the shareholder, dividends paid could be taxable to the estate. In addition, since the federal government's passive income rules took effect in 2019, earnings from passive investments within a corporation could result in a loss of the small business deduction, exposing the business to higher general income tax rates.

Is there a way to 'permanently' defer the potential taxes? For business owners looking to eventually pass along their corporate surplus to heirs, a corporate-insured asset transfer strategy may be a solution. This involves using a portion of surplus earnings to fund a corporately-owned exempt life insurance policy with a guaranteed cash value. Not only does the insurance provide protection, but there are potential tax benefits:

- **Annual tax savings** — Corporate funds that would otherwise be invested, for which annual income is subject to tax, are now used to fund a life insurance policy, where the cash value can grow on a tax-deferred basis.
- **Estate tax savings** — Upon death, the policy's proceeds, which includes the death benefit and the cash value, are generally paid tax free to the corporation. This amount, less the adjusted cost base, is credited to the Capital Dividend Account (CDA), which can be paid to the shareholders tax free.

Just how much of a difference can this make?

A Case Study: Jane Business Owner's Succession Plan

Jane is a healthy 55-year-old and successful business owner. Over the years, she's worked hard and invested surplus earnings of her company, for which annual income is subject to tax. She wishes to eventually transfer wealth to her kids and would like to minimize her corporate tax bill and maximize the wealth transfer upon her death.

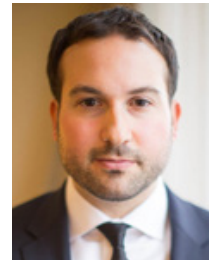
Based on planned deposits of \$20,000 for ten years, the table below shows the projected net estate values when Jane purchases life insurance to facilitate a corporate asset transfer compared to investing in a fixed-income portfolio. The difference is significant should Jane pass away at the average life expectancy.

While this case study is used for illustrative purposes only, we've supported clients in similar scenarios to use permanent life insurance to reduce taxes and maximize an asset transfer. If you are interested in learning more, please get in touch.

Projected Net Estate Value: Corporate Asset Transfer vs. Fixed-Income Investment (Illustrative)

Year	Corporate Asset Transfer						Fixed-Income Portfolio projected 5% annual rate of return	
	Cash Value	Death Benefit	Adjusted Cost Basis	CDA Credit	Tax Payable on Taxable Dividends	Estate Value (net of personal tax)	After-Tax Investment Value	Estate Value (net of personal tax)
10	231,488	731,488	185,529	545,959	(83,488)	647,999	229,669	136,327
20	319,932	819,932	124,274	695,658	(55,923)	764,009	293,996	193,406
30	362,447	862,447	0	862,447	0	862,447	376,340	266,472
40	198,155	698,155	0	698,155	0	698,155	481,747	360,003

*Assumptions: Corporate asset transfer plan using single life policy, BMO Life Dimensions (projected at a 5% annual rate of return) death benefit: sum insured plus fund value. Planned deposits: \$20,000 for ten years; face amount \$500,000. Corporate tax rate 50%; individual dividend tax rate 45%, corporate dividend tax rate 38.33%. Calculations do not reflect impact of relative values to corporation of life insurance policy (cash surrender value) or fixed-income portfolio to shareholder capital gain upon deemed disposition at death.



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Lewin Wealth Advisory Group BMO Nesbitt Burns

Gary Lewin, CIM, CIWM, FCSI
Senior Wealth Advisor
Portfolio Manager
416-359-7136
gary.lewin@nbpcd.com

David Spevick, MBA
Investment Associate
416-359-8200
david.spevick@nbpcd.com

Eysha Syeda, BSc. (Hons)
Senior Client Service Associate
416-359-5678
eysha.syeda@nbpcd.com

Catherine Keyes
Senior Client Service Associate
416-359-5678
catherine.keyes@nbpcd.com

BMO Nesbitt Burns Inc.
1 First Canadian Place
40th Floor, P.O. Box 150
Toronto, Ontario M5X 1H3
Toll Free: 1-800-263-2286
Fax: 416-359-7240
www.garylewin.ca



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