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GIVING IT ALL AWAY

Charitable giving often arises from a desire to give back, help others and do good. Donations can be in the form of cash, securities, RRSPs, RRIFs, life insurance as well as real estate. In addition to the feel good aspects of helping your fellow man, there are several interesting tax incentives worth considering.

Charitable Donation Tax Credit
Making a donation of cash or a security results in a charitable tax receipt. This can reduce the donor's tax bill through the charitable donation tax credit. The maximum amount of donations that an individual can claim on his/her tax return in a given year is 75% of income. Donations that cannot be used in the current year can be carried forward for five years.

In the case where the donation is done by an estate (of a deceased person through the will), the maximum amount of donations that can be claimed is 100% of income in the year of passing, as well as in the previous year.

Many investors with large unrealized capital gains in securities who are considering making a charitable donation may well consider donating an appreciated security in lieu of cash.

Consider the significant tax advantages in example below, which highlights an important point: whether you donate cash or a security, you will receive a tax receipt for the full value of the donation regardless of the tax treatment of the capital gain.

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Benefits of Donating Appreciated Securities vs. Cash Donation

	Sell Security & Donate Cash	Donate Security
Capital gain on sale	50,000	50,000
Taxable portion of capital gain	25,000	0
Income tax payable*	12,500	0
Deductible amount of donation	50,000	50,000
Tax savings from donation*	25,000	25,000
Net tax savings	12,500	25,000
Net after-tax cost to donor	**37,500**	**25,000**

*Assumes 50% combined Federal/Provincial tax rate for individuals with taxable income of 220K or more.

Let's connect

Al Rizk, BBA, CIM
Portfolio Manager
Tel: 514-286-7242
al.rizk@nbpcd.com

Mark A. Stairs, B.Eng., CFA
Portfolio Manager
Tel: 514-286-7334
mark.stairs@nbpcd.com

RS Wealth Management
BMO Nesbitt Burns
3200 - 1501 McGill College Ave.
Montreal, Quebec, H3A 3M8

FIXED INCOME: Sex, Lies and Videotape

Admittedly, there is probably less sex going on in the back rooms of the Federal Reserve than there is at Grey-Sloan Memorial Hospital. However, there is no shortage of top Fed officials being 'caught on video insider trading' their personal accounts during the early and dramatic market days of the COVID crisis.

More accurately, the Fed's most senior officials were caught *front running*—strategically positioning their personal portfolios before—-Federal Open Market Committee (FOMC) meetings at which hugely important, market moving decisions were made. Indeed, sitting board members, Boston Fed President Eric Rosengren, Dallas Fed President Robert Kaplan and later, none other than Vice-Chair Richard Clarida would all be publicly 'busted' for trading their own accounts. All maintain that they did not violate formal ethics rules, however, it appears that they all skated very close to the line, making for very poor optics. All would resign from their posts shortly after being outed: what a disgrace!

This follows an equally disgraceful 2011 expose done by CBS' 60 Minutes on the insider trading activities of numerous member of congress. Again the mechanics are the same, congressional members sitting on important legislative committees positioned their portfolios either to benefit from or avoid losses as a result of pending laws they saw coming down the pipe.

It is preposterous that any of these influential people should be allowed to trade their own accounts! It tests the limits of credulity that all sitting FOMC board members, members of congress and other highly influential members of government are not required to have all their investments managed for them via a blind trust, for as long as they hold their position. It should be a pre-condition of employment and violations punishable by immediate dismissal, heavy fines and criminal prosecution.

If there are any questions remaining about whether true free-market capitalism is dead; that all we have left is a bare husk of self-serving government officials, there only to line their own pockets at the expense of society, then the above should cast out any remaining doubt. All we have now is a kleptocracy driven by crony-capitalism, regulatory capture and increasing monopolism.

And Now for the Lies

When it comes to policy makers, I have always adhered to the adage *'ignore what they say, but rather watch what they do'*, in other words, talk is cheap.

In late 2020 and into early 2021, as the monthly inflation figures were ramping-up in the US, Federal Reserve officials were out and about giving public assurances that due to base effects from the abnormally low inflation numbers recorded during the early months of COVID, we would see a rapid peak and decline in CPI numbers during the first half of 2021: there was no need to raise rates or otherwise panic, as this inflation would, in Chairman Powell's own words, *'be transitory'*. Of course transitory can have several definitions given that CPI is a rate-of-change function rather than an absolute price level. Remember that a 7% CPI rate takes an index from 100 to 107, so even if the CPI moderates the following year to 3%, thus indicating a falling rate-of-change, the price level still increases from 107 to 110. The accrued increases in our cost of living accumulates, so unless we have actual deflation for a time, the price level continues to increase.

Initially this transitory narrative was, I believe, purposefully left open to interpretation, but because Fed officials told us that we would soon return to pre-COVID levels of inflation, there was an implied notion that the price level would also fall back to pre-COVID levels, suggesting a period of actual deflation following the current spike in CPI. None of us should have been willing to drink that cool-aid, realizing that their public rhetoric was meant to be obfuscatory and that no such thing would happen.

Then when inflation figures continued to accelerate into Q3, the excuse became COVID related supply chain bottle necks, which would also soon pass. At no point did Fed officials suggest that their record breaking increase in the money supply, averaging 20%+ on a monthly basis since April of 2020, might have had anything to do with skyrocketing goods demand and rising prices! Funny that for such educated folks, it never occurred to them that locking down the economy would result in fewer goods being produced while simultaneously goosing the money supply, would lead to Milton Friedman's classic monetary phenomenon of '*too many dollars, chasing too few goods'* and thus rising prices. Finally in Q4, Chairman Powell, in public testimony, had to admit that the Fed needed to drop the use of the word *transitory* and that *'inflation was proving to be stickier and remarkably more persistent than anticipated'.*

I think it is clear that Fed officials have spent all of 2021 willfully lying to us about inflation. As I write in January 2022, they have yet to take any real action to protect us from this scourge. Shockingly, the Fed Funds Rate remains at zero and the Federal Reserve continues to print and pump tens of billions of dollars into the system every month via QE (its bond purchasing program), albeit at a slower pace than before; hardly an aggressive stance towards fighting rampant inflation of 7%, the highest CPI reading since 1982! Despite the fact that I do expect CPI to moderate somewhat in 2022, barring an outright deflationary bust, I just can't see a return to pre-COVID levels of 1-2% CPI any time soon, as Fed officials would like us to believe. Fed officials have explicitly told us they plan to raise rates to 1% by the end of 2022 and to 2% by the end of 2023: what a joke. Real rates have never been so deeply negative, nor has the Fed ever been so far behind the inflation curve. Hang on to your precious metals just-in-case and avoid bonds at all costs, these liars are attempting to inflated away your wealth.

Central bankers are not your friend. Sincerely, Mark.

STOCK TALK: No Safe Assets

In my year-end reports I highlighted that there are no longer any truly safe assets (gov. guaranteed bonds and bank GICs/term deposits) for investors to hide in, something that we've all taken for granted in the past whenever we felt that risky assets (stocks and real estate) appeared richly priced and susceptible to a steeper than average market correction (i.e. real estate in 2008-09, stocks in 2000-02 and stocks again in 2008-09). Historically, your portfolio manager could rebalance your asset mix after a good run in riskier assets, in favour of safer assets. That option is long gone and untenable (due to deeply negative real rates on bonds/GICs) thanks to a decade of radical central bank policy.

Things Just Got a Whole Tougher in 2021
The conundrum of safe asset allocation and maintenance of a traditional 40/60 balanced portfolio just got a whole lot more difficult in 2021, if not outright impossible, with the re-emergence of meaningful inflation. Comparatively, in 2020 Canadian CPI was a very modest 0.7%, so hiding in short-term GICs yielding 2.5-3.0% provided you with a decent real-return. While hoarding cash cost you a only a small amount in real terms, but provided you with comfort and flexibility in what was a highly uncertain year. Indeed, early in 2020, with the onset of COVID and markets plunging 33% from their January peak, free-falling for five straight weeks, cash was definitely *King*. Enter early 2021, inflation was then sporting a 3 handle and looking like it had momentum, despite the Fed's 'transitory' assurances and a market booming from a gusher of government money, cash suddenly became *Trash*. Cash became the proverbial hot potato that no investor wanted to hold given soaring stock prices and CPI accelerating towards 7% south of the border and 5% at home. Despite a strong 2021 for stocks and whatever reservations investors might have about inflated stock or real estate prices heading into 2022, nobody can afford the cost of a truly defensive posture of sitting on hoards of cash earning nothing, while inflation rips higher. Of course, therein lies the critical asset allocation dilemma and the miserable corner we have all been forced into by repressive central bank policy and profligate government spending. Regardless of age, this corner continues to force us all to <u>tolerate more risk than we would prefer or alternatively, face the scourge of deeply negative real rates that erodes our purchasing power.</u>

Almost Always a Relative Exercise for Humans
Human decision making is almost always a relative process. Do I risk a fatal car collision driving to the grocery store today because the fridge is bare versus starving to death if I stay at home? After all, tens of thousands of people die every year in motor vehicle accidents. This relative decision making is equally true for investment management. While cash might be trash in an inflationary environment, losing 7% to inflation might be better than losing 40% in a bear market for stocks. <u>A big problem arises when there are no good or clear-cut alternatives, all trade-offs seem unattractive or feel like half measures</u>, as is the case with my cash vs stocks example above.

These Are Our Choices, There Are No Others
Most of the time investors perceive a vast ocean of infinite investment alternatives when it comes to personal finance and the broader markets. However, nothing could be further from the truth. Simply put, we have four choices as investors: CASH, BONDS, STOCKS, REAL ESTATE. You could, and I do, add precious metals as a unique fifth asset class. However, no matter how creative Wall Street gets at repackaging these four basic asset classes into all kinds of convoluted paper products, usually with hidden fees and special guarantees to lure you in, we must accept that there are still only four asset classes in which to invest and <u>no matter how much lipstick Wall Street puts on its packaged pigs, they're nothing more than derivatives of the same four basic asset classes and not safe, liquid income solutions.</u>

Admitting You Have a Problem is the First Step
So once we admit that there are no magic bullets, card caring portfolio management wizards with crystal balls, or secret rarely talked about, safe secure asset classes only available to the select few, we can begin an attempt to tackle the impossible dilemma we all find ourselves in.

- Cash pays nothing and inflation is rising, so hoarding a lot of cash, at first glance doesn't seem viable.
- Bonds pay next to nothing and risk significant capital depreciation in a rising rate environment and/or inflationary surge, holding more cash instead of bonds looks better.
- Real estate offers some measure of inflation protection. The rising cost of new home construction tends to lift the price of existing homes. The flip side, is that real estate purchases tend to be done with a lot of borrowed money, this could be problematic. Furthermore, valuations are at historic highs in almost every major city around the globe as measured by the Disposable-Household-Income-to-Median-Home-Price ratio.
- Stocks while historically overvalued south of the border, international stocks, including emerging markets look much more reasonably priced, as do value stocks vs. growth stocks, as do dividend payers vs non-dividend payers. The divide between value and growth has never been wider, as a result of the market's enthusiasm for 'growth' over the past decade.
- Finally, commodities which have only perked up in the last year, remain undervalued in my opinion and well below their previous cycle highs.

Best bets going forward? Underweight expensive tech, even the high quality names, focus on value stocks, non-US stocks, avoid bonds at all costs, hold more cash despite the rising cost of doing so, consider cash's positive impact on your psyche in a vicious market decline and more importantly, the optionality it provides you (your manager) to act on bargains. Overweight inflation sensitive hard assets such as real estate and commodity producers, think metals and energy. Already early in the new year value and commodity stocks are way outperforming as rapacious growth investors takes it on the chin. Also, gold may ultimately prove to be the last truly safe asset in a big crisis.

2022 promises to be an exciting, if not terrifying year.
Sincerely, Mark.

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Donor Advised Fund

Donors may wish to approach charitable giving in a more structured manner. Larger gifts (i.e. $100,000 and more) can be used to establish a fund from which grants are made to charitable organizations. A Donor Advised Fund is a separately managed account within a public foundation. The donor will receive a tax credit in the year of the donation. The funds are invested, and in subsequent years grants are made to qualifying charities from the fund on either an ad hoc or recurring basis and can be adjusted or changed, providing flexibility. The donor controls who receives the grants, with the administration of the grants provided by the foundation.

Private Foundations

Private foundations are generally established as a trust or a not for profit corporation with the sole purpose of charitable giving. Generally, the donor and the donor's family are trustees or directors of the foundation. It can be named after the donor or the donor's family, creating a legacy in perpetuity that endures well beyond the founder's death. In addition, foundations provide donors with tremendous flexibility and allow for a more strategic and long-term approach. The tax receipt is given for the fair market value of the donation at the time of gifting to the foundation. By law, the foundation is required to distribute 3.5% of the assets annually. Generally, the account is managed so as to generate at least this much per annum, hence allowing the foundation to exist indefinitely.

The creation of a foundation can often coincide with the sale of a business or taxable capital property. The sale can produce a substantial tax liability, as well as significant cash proceeds, hence establishing a foundation can be timely. While there are no hard rules, foundations are usually created with at least one million dollars.

Gifting Through Life Insurance

Another strategy is to use life insurance to fund a gifting strategy. There are two approaches to consider. The first is to purchase a policy and assign ownership to a specific charity. The donor makes the premium payments through the assigned charity. The premium payments are considered donations and the insured receives a deduction on his/her tax return. During the life of the insured the charity receives no benefit. However, upon the insured's death, the charity receives the death benefit which will most likely be far greater than if the annual premium payments were made as cash donations. At the insured's death there are no tax benefits to the estate as all deductions were related only to premium payments during the life of the insured.

The second approach to gifting through insurance is to retain ownership of the policy and name a charity as beneficiary. In this case, the premium payments are not deductible. However, at death the lump sum is paid out to the charity and the resulting tax credit can be used to reduce taxes payable by the estate. This strategy can be especially beneficial for estates with large tax liabilities and limited liquid resources. An alternative to this strategy is naming the estate as beneficiary of the policy and through a bequest in the will, gifting the proceeds to the charity.

Another potentially interesting strategy involving life insurance is making regular cash donations to a charity and using the tax refund to pay the premiums on an insurance policy with both the estate and the charity as beneficiaries. This way, the charity clearly benefits from the cash donations in addition to part of the death benefit, while the estate could recoup the donations made through the death benefit.

RRSPs and RRIFs

At death, unless transferred to a spouse, the balance of an RRSP or RRIF is treated as ordinary income resulting in a potentially substantial tax bill. Designating the proceeds of these accounts to a charity upon death will qualify for the charitable donation tax credit helping to offset income.

Final Thought

In this article, I have tried to introduce the subject of philanthropy and charitable giving, along with some basic strategies. I believe it can be deeply rewarding and meaningful to contemplate the positive effects of charitable giving during one's lifetime and beyond. In addition, adding a philanthropic component to your tax and estate planning can result in significant tax savings while addressing your desire to leave a lasting legacy.

Sincerely, Al.

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