Investment Insights

Summer 2022

Bull and Bear: Tortoise or Hare?

In strong markets and times of turbulence, like we have been experiencing today, are you inclined to be a tortoise or a hare?

Keeping expectations on an even keel is not an easy task given the continuing volatility. Coming into this year, it was expected that central banks would tighten their monetary policy. Yet, it was also anticipated that inflation would substantially ease — and it hasn't. New inflationary headwinds, including those emerging from the war in Europe and the Covid lockdowns in China, have led to a more aggressive response by central banks, which some believe will put undue pressure on already slowing economies. The changing expectations have been a key driver of more recent volatility.

While the doomsday prognostications echoed by the media have helped to feed this volatility, let's not forget that we are emerging from a time in which record government stimulus supported markets and economies, so a period of adjustment can be expected. Company earnings that thrived over these times must adjust as consumption patterns balance towards a post-pandemic world. While high inflation has been more than transitory, consider that it's not likely to be permanent. We've also experienced similar challenges before: significant inflation, tightening monetary policies and war. Over the past 50 years:

- Annual inflation exceeded five percent in 13 of those years.[1]
- The market fell 40 percent of the time and lost a quarter of its value at least seven times.[2]
- There were eight bear markets lasting a total of 77 months.[2]
- We had six recessions, cumulatively lasting almost six years.[3]

Yet, by zooming out, we are reminded that equity markets, as measured by the S&P/TSX Composite Index, returned over six percent on an annualized basis, and this doesn't include reinvested dividends.[2]

It is therefore not surprising that amidst the volatility, renowned investor Warren Buffett has been adding to his portfolio, reportedly his largest purchases since 2008. Buffett recognizes that the long-term trend of the equity markets has been up. His investment thesis seeks to buy quality companies at reasonable prices and hold them forever. He recognizes that markets, as well as economies, progress over time and investors benefit from the investment, innovation and growth of participating companies.

At his shareholder meeting in May, Buffett used a farm analogy to remind investors that patience remains one of the keys to generating future wealth. He said that too many wrongly think they can become rich by speculation, by "inserting yourself in the system." On a farm, "they don't sit there and, 15 times a day, get quotes to make calls and puts. They go about making the farm worth more money over time."

Buffett's words are worth reflection — reminiscent of the old Aesop's fable, in which the slow-but-steady tortoise perseveres to overcome the speedy-but-inconsistent hare. Building wealth takes time and inevitably involves both ups and downs in the markets. While it may be difficult to see beyond today, this period of market volatility and economic uncertainty will eventually pass. Keep your eyes on the horizon and try not to overlook the value of patience in achieving your longer-term goals.

1. www.inflation.eu; 2. Measured by months; S&P/TSX Composite Index 12/31/71 to 12/31/21; 3. Data from cdhowe.org.

Scott Kok, Garett Surcon, Tim Mahoney

To Our Clients:

As Investment Advisors, we have managed through challenging economic periods and market pullbacks before. This issue of our newsletter provides some perspectives on navigating these difficult times. As always, please remember that we are here to help.

This period of economic uncertainty is expected to continue, but eventually the pendulum will swing back again. It may be difficult not to focus on the pessimism of today, but having a view for the longer term can help provide perspective. Longer-term investing involves enduring the inevitable cycles, entrusting that your wealth plan has been put in place to benefit your future.

With summer's arrival, may you find time to enjoy many leisurely pursuits for the days ahead.

In This Issue

BMO | Private Wealth

Estate Planning: Preserving Family Harmony

Your estate plan should be about more than just managing assets. It can also include strategies for preserving family values and relationships.

Even the most harmonious of families can undergo bitter disputes when dealing with the distribution of assets within an estate. However, the time you invest in planning can help to leave a lasting legacy of family harmony. Here are some thoughts:

1. Keep documents up-to-date — Consider reviewing your estate plan periodically to ensure it reflects your current thinking and to avoid future conflict. If you have a Will in place, how old is it? Perhaps this may be a good time for a thorough review of your estate planning documents, especially if circumstances have changed. Equally important: reviewing your designated beneficiaries, where applicable. Many investors fail to revisit these designations to account for major life changes, such as marriage, divorce or the birth of a child.

2. Rely on professional support — Improper documentation or vague instruction can lead to misunderstanding and conflict, and even escalate to a costly court battle. While you are able to create estate planning documents on your own, such as by using an online Will service, even if the document is valid, do you fully understand the family and succession laws of your province or income tax and investment rules? These can change over time and should be evaluated against your estate plan. With the rise in blended families, balancing competing interests from children, stepchildren and a new spouse may be challenging. The support of estate planning professionals can help ensure assets are distributed as intended.

3. Communicate — Sharing your intentions with beneficiaries can help manage expectations and prevent future conflict. While the topic of death is not always easily broached, consider communicating with loved ones while you are alive about your estate. In-depth details do not have to be provided, but high-level conversations can be beneficial to avoid future surprises. These conversations can also help you understand the wishes of loved ones for when you are gone, including for items of sentimental value, which can commonly become the centre of conflict.

4. Understand the implications of joint ownership with children — Joint ownership* is sometimes used to simplify the transfer of assets on death. In certain jurisdictions, it is used to minimize probate fees. Yet, it has the potential to lead to complications, often relating to estate equalization. It is a common cause of stressful lawsuits that will easily surpass the cost of probate — perhaps the exact situation you were trying to avoid in the first place! There may also be unintended consequences, such as tax implications or exposing assets to potential creditors.

5. Consider the support of a professional executor — It may be money well spent to consider a corporate executor. This can help to preserve impartiality if you have children you were considering appointing as estate executor(s). More important, it can help take the burden off of loved ones during what is often an emotionally difficult time.

Please seek the support of estate planning specialists for your situation.

*Not applicable in the province of Quebec.

You Asked: The Registered Retirement Income Fund (RRIF)

If you are approaching retirement, chances are you've considered opening a RRIF. As you plan ahead, here are some unconventional questions asked about the RRIF.

Q: Can I open the RRIF earlier than age 71?

A: Yes. While the Registered Retirement Savings Plan (RRSP) matures by the end of the calendar year in which the holder turns age 71 and is often converted to a RRIF at that time, you are able to open the RRIF earlier. Some may decide to do an early conversion if they retire early, take a sabbatical or have an extended leave from work, since the loss of income means they will be in a lower tax bracket or they may need funds.

Minimum withdrawal payments will still be required in the calendar year following the year that the RRIF account was opened, calculated using a "prescribed factor" based on age. If you've converted your RRSP to the RRIF earlier than age 71 and realize that it's no longer to your benefit, you are able to convert it back. For example, if you retire early but then return to work, it may be beneficial to resume the RRSP.

Q: Can I hold the RRSP and RRIF at the same time?

A: Yes. There may be instances in which you want both. If you want to generate pension income to take advantage of the federal pension income tax credit, you could consider opening a small RRIF at the age of 65. At the same time, you could continue operating your RRSP to benefit from ongoing tax deductions from your contributions. Consider also that, for tax purposes, you can notionally split up to 50 percent of your eligible pension income (which includes RRIF income from age 65) with a spouse (common-law partner).

Q: Are there ways to minimize my RRIF prescribed withdrawals?

A: Yes. If you have a younger spouse, you are able to use their age as a basis for the "prescribed factor" to result in a lower minimum withdrawal rate for your RRIF. Some choose this option as a way to help preserve income-tested government benefits. However, this can only be done when first setting up the RRIF and before you have received any payments, so make sure to plan ahead.

Budget Recap, in Brief: Tempering the Hot Housing Market

In the spring, the federal government delivered its budget with few significant changes for investors: no changes to the capital gains inclusion rate or federal income tax rates. Many initiatives address the hot housing market. Here are some highlights:

Tax-Free First Home Savings Account (FHSA). The federal government proposed a new account to help Canadians save for their first home. Expected to begin in 2023, the account will have a lifetime contribution limit of $40,000, with an annual limit of $8,000. Contributions will be tax-deductible, similar to the RRSP, and withdrawals will be tax free, similar to the Tax-Free Savings Account (TFSA). When the FHSA was originally proposed in the 2021 election campaign, it came with an age limit. This was removed in the most recent budget. If this change stands, a recent article in the popular press suggests that tax-planning opportunities may be available to older Canadians by using the FHSA as a savings tool.[1] Stay tuned for updates as the rules are finalized and details become clearer.

Multigenerational Home Renovation Tax Credit. This proposed refundable tax credit offers up to $7,500 by allowing qualifying families to claim up to 15 percent of $50,000 in eligible renovation and construction costs incurred to construct a secondary suite for a senior or adult with a disability.

Residential Property Flipping Rule. Under proposed rules, property sold that is held for less than 12 months would be considered flipping and any profits would be subject to full taxation as business income (with certain exceptions). Where the new rule applies, the Principal Residence Exemption would not be available.

Small Business Deduction. Under current rules, access to the small business deduction is reduced when a Canadian-controlled private corporation has taxable capital greater than $10 million, reducing to nil with taxable capital of $15 million or more. The budget proposes to change the formula such that the small business deduction will not be reduced to nil until the corporation has taxable capital of $50 million.

Minimum Tax for High Earners. The federal government announced an intention to revisit the current Alternative Minimum Tax regime with a view to ensuring high-income earning Canadians pay a minimum level of tax. Further details are expected in the 2022 fall economic update.

At the time of writing, these proposals have not been enacted into law. For greater detail, please see the Government of Canada website: https://budget.gc.ca/2022/home-accueil-en.html

1. "Three ways to make the most of the new tax-free savings account for home buyers," Erica Alini, *The Globe and Mail*, April 30, 2022, B15.

Perspectives for Navigating Volatile Times

While it may be difficult to look beyond today, this period of market volatility and economic uncertainty will eventually pass.

As advisors, we've managed through market pullbacks and economic uncertainty before. Part of our role is to help investors navigate these challenging times. Here are three considerations:

Consider the Bigger Picture — Over shorter periods, market performance is often unpredictable. By zooming out, this perspective changes — history shows that the longer-term trend of equity markets is upward. This is generally because economies, and many businesses, grow over the long term, which manifests in earnings growth and improved returns for equity investors. We continue to advocate that investors view the markets in the context of multiple years or even decades, not weeks or months.

Stop Checking — Paying attention to the markets, or portfolio values, won't give you more control or change their outcome. Over time, they will experience both gains and declines. If the latter is a cause for concern, reduce the temptation to be constantly monitoring your portfolio and leave the day-to-day worries to those of us who are here to manage it.

Don't Make Unnecessary Changes — During market pullbacks, some investors may feel inclined to sell investments for fear of greater loss. However, this creates two issues: selling at low prices and the subsequent need to re-enter the markets. Market timing is difficult, if not impossible; one convincing reason being that the biggest up and down days have historically tended to cluster together. Selling low to buy higher is the exact opposite of the desired outcome in investing.

Adjustments may be made to help position portfolios to be more defensive during uncertain times. Quality companies with strong balance sheets, low debt and healthy cash flows are often well-placed to see through periods of uncertainty. Dividend-paying companies can help provide a steady stream of income to an investor, and many companies have a history of continuing, and even increasing, dividend payments during more difficult markets.

While the media has been busy magnifying the uncertainties and suggesting that this time is different, we are confident that better times will ensue. Periods of volatility can be anticipated as the current challenges are resolved, but rate increases, rising bond yields and more moderate equity valuations have been expected as we embark on normalizing the economy. Market pullbacks are uncomfortable, yet they remain a normal part of investing. The pendulum will swing back again.

Oh Canada! Reasons to Keep Perspective

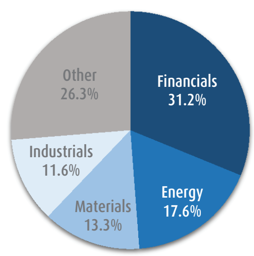
This summer marks Canada's 155th birthday. As the world continues to be out of balance and the financial markets test our resolve, perhaps this is an opportune time to step away from the headlines and focus on the many reasons to be grateful to be in Canada.

We are a nation of peace, prosperity and resilience, considered to have a stable economy and a strong quality of life. Despite our small stature by population — Canada represents just 0.48 percent of the total world's population — we rank as the 10th largest economy by GDP (2021).[1] We have one of the highest life expectancies, in part due to our universal healthcare system. And, we consistently rank as one of the best countries in which to live globally when measured by quality of life, freedom, education and health.[2]

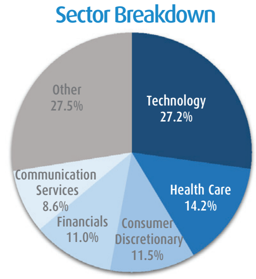
We are relatively insulated from many of the current challenges that face other nations. The ongoing war in Ukraine should be a reminder that even basic necessities like food, shelter, health and safety are luxuries to those in need. With energy production again in the spotlight as a matter of national security, we are fortunate to have access to all major sources of energy. Beyond energy, we are a nation rich in resources, including uranium, zinc, potash, nickel and titanium. Notably, we are ranked fourth in the world for countries rich in natural resources, behind Russia, the U.S. and Saudi Arabia. We are also the fifth largest exporter of agricultural and food products in the world.[3]

For investors, the Canadian equity market composition may be well-positioned to face the challenges of today. It may be comparatively more tolerant to inflationary environments due to greater exposure to financials, resources, materials and industrials sectors. At the time of writing, while markets have experienced broad-based declines, the S&P/TSX Composite Index has performed better than its U.S. counterpart. Regardless, as history shows, investors should remember that over the long term, equity market returns have generally outperformed inflation and continued their upward climb. This is also why diversification is important. No sector — or even asset class or geographical market — will perform at the top each year. Diversification can provide the opportunity to participate in the upside of the best performers each year.

Canada: S&P/TSX Composite Index Sector Breakdown



U.S.: S&P 500 Index Sector Breakdown



Sector breakdown at 4/29/22, S&P Global Factsheets.

While there has been a lot of talk about economic growth being hindered by tightening monetary policy, there may be factors to support our resilience. Canada's expansion is expected to outpace the growth of other advanced economies this year, in part because the impact of the European crisis will be tempered by our commodities sector. This may be reflected in our economic performance to start the year: Q1 2022 GDP grew at a rate of 3.1 percent in Canada, whereas it contracted in the U.S.[4] Also supportive for growth — our labour market continues to be strong, and our population continues to grow at a faster rate than our peers; the fastest of the Group of Seven (G7) advanced countries, at 5.2 percent over the past five years.[5]

Without a doubt, there are many challenges ahead; however, there are many reasons to keep perspective. We hope that you can take some time to enjoy the summer and celebrate living in our wonderful nation!

1. worldpopulationreview.com/countries/countries-by-gdp; www.worldometers.info; 2. www.newswire.ca/news-releases/canada-is-the-no-1-country-in-the-world-according-to-the-2021-best-countries-report-867033906.html; 3. www150.statcan.gc.ca/n1/daily-quotidien/211101/dq211101a-eng.htm; www.statista.com/statistics/748223/leading-countries-based-on-natural-resource-value/; 4. www.bloomberg.com/news/articles/2022-04-29/canada-extends-growth-streak-as-first-quarter-tops-expectations; 5. www.cbc.ca/news/politics/census-2021-release-population-cities-1.6344179

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