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- INVESTMENT -
INSIGHT

WINTER 2021

The Year Ahead: A Time for Optimism

Happy New Year! As we face the winter months with new lockdowns and a seemingly relentless virus, there are many reasons to maintain optimism for the year ahead. After a year filled with significant disruption, a return to normalcy is largely expected in 2021: for many, the hope of maskless days, gatherings with family and friends and, perhaps, even travel.

Driving this hope is the progress we've made in vaccine development, which has been nothing short of remarkable. A typical vaccine time-to-market is 10 to 15 years; the fastest until now — the mumps vaccine — took four years. With multiple vaccines now active less than a year into the pandemic, this is an exceptional feat.

Even after enduring a pandemic year filled with adversity and challenges, there were bright spots to build optimism for the year ahead. Unlike previous recessions, the economic effects of Covid-19 have been uneven and concentrated to certain sectors. This has resulted in a relatively weak multiplier effect for the overall economy, which should help to support the eventual recovery. Sectors that have thrived, such as technology, helped to drive equity markets in 2020. Canadian equity markets, largely influenced by the energy and resources sectors, were hindered by lower demand due to the slowdown. However, there is renewed optimism that the vaccine rollout will help to lift global fuel demand.

We have also shown significant resilience. After the spring shutdowns, Canada's economy rebounded better than expected as restrictions were relaxed. Employment levels grew faster than anticipated, as did consumer spending. The housing market continued to perform well. More notably, Canada's household incomes grew at a time when the economy contracted. Savings rates also increased.[1] Many financial institutions that set aside significant loan loss provisions in anticipation of mortgage or credit defaults reduced these reserves in the latter part of the year.

One must not overlook the significance of government stimulus efforts in preventing greater economic adversity. This support has been very generous, with Canada having the largest stimulus deficit of any nation globally in 2020.[2] While there are likely to be future consequences, the good news is that the current cost of carrying debt remains low due to near-zero interest rates. In the 1990s, more than 35 percent of government revenue went to pay interest costs on federal debt. Today this percentage hovers in the single digits.[3]

While there is optimism that change is imminent as we work towards erradicating the virus, south of the border the U.S. has chosen a change in direction. Given considerable and continuing social unrest, there is hope that the new presidential leadership will help to temper tensions and allow the world's largest economy to move towards recovery with confidence.

Progress in combatting a pandemic takes time. Yet, as we saw in 2020, equity markets don't wait on the sidelines for recovery to happen. They are, after all, forward looking in nature. Perhaps this is an admirable quality to uphold as we look forward to the year ahead.

1. https://www150.statcan.gc.ca/n1/daily-quotidien/200828/t005a-eng.htm; 2. As a % of GDP; 3. "The Bearable Lightness of Canada's Debt Burden", Globe & Mail, 10/30/20, p. B6.

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INCOME-SPLITTING STRATEGIES

An Opportune Time: The Spousal Loan Strategy

As you look to the year ahead, consider the opportunity to save taxes through income splitting. Making a bona-fide loan to a spouse for investment purposes is one way to put family investments in the hands of a lower-income spouse. With the prescribed rate currently at its lowest level possible, this may be an opportune time to split income with a spouse by use of a loan.

Why is a spousal loan required? Generally, you achieve no tax advantage if you were to simply give funds to a lower-income spouse to invest. This is because the Canada Revenue Agency (CRA) attributes any investment income earned on these funds back to the higher-income spouse, as if earned by that spouse, and it is taxable at the spouse's higher marginal tax rate. This is known as the "attribution rules."

A spousal loan must be documented and interest must be paid by the borrowing spouse at the CRA prescribed rate. Any interest for the year must be paid no later than January 30 after the year-end. Failure to do so means the attribution rules will apply, and any returns on the investment will be taxable in the hands of the higher-income spouse. Interest costs will be taxable income to the spouse loaning the money and may be deductible to the lower-income spouse.

The lower the prescribed rate relative to the return on investments, the greater the opportunity to benefit from such a strategy. The current prescribed interest rate is one percent, the lowest possible rate (please see CRA website for quarterly changes[1]).

Muddy Waters: The TFSA

An exception to the attribution rules applies to the Tax-Free Savings Account (TFSA). While the Income Tax Act prohibits anyone other than the TFSA holder from making contributions, it does not prevent an individual from gifting assets to a lower-income spouse who then contributes that gift to his/her own TFSA.

However, the attribution rules may apply when money gifted and then contributed to a TFSA is subsequently withdrawn. If a higher-income spouse gifted funds to a lower-income spouse and these funds were contributed to a TFSA, if any withdrawn funds were then reinvested in a non-TFSA, the future income and/or capital gains earned from that gift may be taxable to the original high-income spouse.[2]

1. https://canada.ca/en/revenue-agency/services/tax/prescribed-interest-rates.html; 2. See CRA technical interpretation #2010-0354491E5.

PLANNING FOR RETIREMENT

RRSP Time Again: Action Items to Consider

Registered Retirement Savings Plan (RRSP) season is here again. Times have changed since the introduction of the RRSP in 1957: back then, contributions were limited to 10 percent of the previous year's income to a maximum of $2,500. Today, the RRSP has grown to be an excellent way to take advantage of tax-deferred investment growth.

Have you been using the RRSP to its fullest? Perhaps a quick check up is in order and here are some ideas:

Make a Contribution — Have you maximized your RRSP contribution? The last day to make contributions for the 2020 tax year is March 1, 2021. Contribution limits are 18 percent of your previous year's earned income, to a maximum of $27,230 for the 2020 tax year, less any pension adjustment or past service pension adjustment, plus unused contribution room carried forward.

Update Beneficiary Designations — The start of the year may be a good time to review your designations and ensure that they are updated in the plan documentation (Note: in Quebec, this designation must be made in your Will). Understand that there may be tax consequences to your estate depending upon who has been named as beneficiary(ies). There may also be special considerations to address when designating a minor child (which vary depending on provincial/territorial laws), an individual with a disability (including the use of Registered Disability Savings Plans) or non-residents.

Consider a Spousal RRSP — There may be opportunities to split income through the use of a spousal RRSP (or common-law partner (CLP)). Remember that the total amount you can deduct for contributions you make to your RRSP and your spousal/CLP RRSP cannot be more than your RRSP deduction limit.

Help Children to Open an RRSP — If you have children or grandchildren who have a part-time job, they may benefit by holding an RRSP. Often, when earned income is less than the basic personal tax amount, an income tax return is not filed. However, by not reporting this income, the opportunity to generate RRSP contribution room is foregone. As such, the chance to compound savings for additional years on a tax-deferred basis or reduce future personal income tax liabilities through annual tax deductions is also lost. Remember that even if a child does not contribute in the current year, the unused RRSP contribution room carries forward.

Some of these actions may benefit from the support of a professional tax advisor. Call for assistance with any RRSP matters.

Contribute to Tax-Advantaged Accounts

Deadline for RRSP Contributions for the 2020 Tax Year: Monday March 1, 2021, limited to 18 percent of the previous year's earned income, to a maximum of $27,230.

TFSA Annual Dollar Amount for 2021: $6,000, making the total eligible lifetime Tax-Free Savings Account limit $75,500.

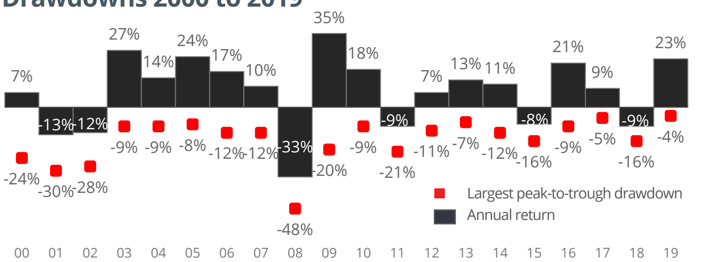
INVESTING PERSPECTIVES

Building Wealth Takes Time

It may be easy to lose sight of the importance of time in building wealth. Today, the reasons are many: heightened market volatility, an increasing focus on immediacy and the influence of media in the digital age. Yet, in investing, having a longer time horizon takes advantage of the virtues of compounding, which can have a profound effect over the longer term. This also involves the difficult task of enduring inevitable short-term events, such as more unpleasant occurrences like recessions and even an unexpected pandemic. The following may help to provide perspective:

Volatility: A Common Market Feature — The chart shows the biggest peak-to-trough drawdowns each year for the S&P/TSX Composite Total Return Index and annual returns since 2000. In 12 of the last 20 years, there has been a double-digit, intra-year correction. Significant volatility is no stranger to the markets. Yet, in half of those years, the index finished in positive territory.

S&P/TSX Composite Total Return Index: Peak-to-Trough Drawdowns 2000 to 2019



Markets Are Cyclical: Nothing Lasts Forever — Equity and financial markets are cyclical. History shows that markets spend more time in positive than negative territory. Since 1956, there have been 13 bull and 13 bear markets. The average bull market has lasted 54 months, with an average gain of 131 percent, whereas the average bear market has lasted only 9 months, with an average loss of -27 percent.[1] Business cycles are also cyclical, typically lasting around seven years. While Canada has had seven recessions over the past 50 years, they have lasted an average of only 11 months.

Your Time Horizon May Be Longer Than You Think — The pandemic has put pressure on many incomes, which may require some to make adjustments to retirement options or timing. But don't overlook the opportunity to make up for lost time. Just as increasing longevity requires planning, it may also allow time for recovery. Consider that an investment with a five percent compounded annual return will double in approximately 14 years. As such, a 70-year-old may still have the potential for investments to double within their lifetime[2] and possibly even twice if they become a centenarian.

The Impact of Time Can Be Significant — Time can be one of the investor's greatest allies. The chart shows the impact of time in generating retirement savings: with a longer time horizon, an investor requires a significantly lower monthly investment to yield $1,000,000.

Chart: Monthly Amount Needed to Reach $1M Over Time

	Average Annual Rate of Return		
Years	4%	5%	6%
20	$2,726	$2,433	$2,164
30	$1,441	$1,202	$996
40	$846	$655	$502

*Compounded monthly at annual return rates shown. Effect of taxes and fees ignored.

Stay focused on your own investing time horizon and remember to keep time on your side.

1. S&P/TSX Composite 1/1/56 to 9/30/20; 2. Assumes average life expectancy of 83 years old.

FROM THE WORLD'S GREATEST INVESTORS

For the Year Ahead: Words of Wisdom

While the winter months have been challenging due to lockdowns and an advancing virus, continue to look forward to the better times ahead. Here are some thoughts from the world's greatest investors on persevering through difficult times:

> ***"To be an investor, you must be a believer in a better tomorrow."***
> — Benjamin Graham

History reminds us that, in the short run, life is full of setbacks. The pandemic has been no exception. History also shows that over the long run, we have continued to advance and progress. Even the worst periods of retrenchment have been followed by new growth, economic expansion and progressing equity values.

> ***"Be fearful when others are greedy. Be greedy when others are fearful."*** — Warren Buffett

Success in investing often means having the confidence to make decisions independently and not based on what everyone else may be saying or doing.

> ***"More money has been lost trying to anticipate and protect from corrections than actually in them."*** — Peter Lynch

During times of downward volatility, there may be an urge to act to

protect the value of investments. However, the rapid fall of equity markets in early 2020 and the quick rebound should remind us that equity markets can quickly change direction, often with little or no notice. Timing the markets is a difficult, if not impossible, task.

> ***"Any sound long-range investment program requires patience and perseverance. Perhaps that is why so few investors follow any plan. Investment success is the purpose of investment planning; but a by-product of a good plan is peace of mind."***
> — John Templeton

A well-constructed wealth plan includes techniques that have been put in place to help weather the more difficult times. These include holding quality investments, maintaining appropriate diversification and strategic asset allocation, and focusing on individual risk tolerance levels. Having the discipline to stick to the objectives set out in your plan is one of the hallmarks of successful investing.

South of the Border — A Change in U.S. Leadership: Where to for Investors?

After last fall's highly contested election, complicated by ongoing civil unrest, the American people have chosen a change in leadership. As a Canadian, you may be wondering what impact this change may have on your investments.

We can observe that regardless of the political party that occupies the White House, there is no distinct pattern or outcome for the equity markets. In fact, respected author and investor Ben Carlson wrote in a *Fortune* magazine article last year that politicians often have less of an impact on equity market performance than most people would like to believe. Carlson has shown that the long-term trend of the stock market has been up no matter who the president is.[1] It should also be noted that no president in modern history has been able to prevent the stock market from experiencing a large drawdown, either.

What We Know: Biden's Policies, In Short

Throughout the campaign process, much focus was given to Biden's pledge to increase taxes for corporations and higher-income individuals, reversing some of the tax cuts enacted by the Trump administration. These increases were proposed to help fund trillions of dollars in stimulus measures, social services, manufacturing, green tech and infrastructure projects. A new fiscal stimulus plan has been called "crucial" and was largely stalled by the election. Biden has also expressed support in raising the national minimum wage to $15/hour to stimulate the economy as it moves into recovery. High-net-worth Canadians who hold U.S. situs assets will be watching closely as a change to U.S. estate tax law, including lowering the exemption level, has been proposed.

Biden's policies would likely impact various sectors, including energy, financials and communications. Biden has supported a clean energy agenda, which has concerned many in the oil and gas sector. A proposed tax regime would likely affect the banking sector and greater regulation of the communications sector has been proposed. From a global policy perspective, it is expected that the Democrats will deal with trade policy more diplomatically, which may help temper escalating global trade tensions over the past four years.

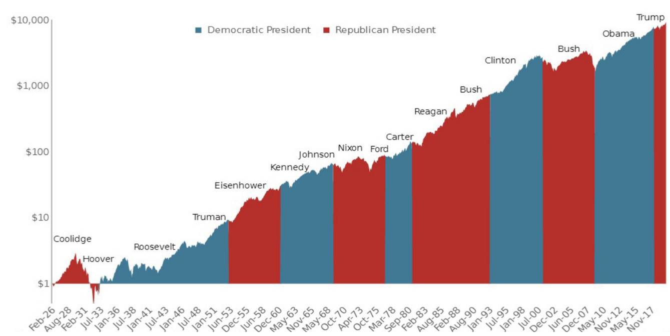
However, it should be noted that success in passing new measures is largely dependent on Congress. After a contentious Senate runoff in Georgia at the beginning of January, with the Democrats taking both seats that were up for election, the chamber is now split 50-50, with Vice President Kamala Harris acting as the tie-breaker on party-line votes. (The Senate was previously controlled by the Republicans.) However, Biden may still face obstacles as a simple majority is usually not enough to pass a bill in the Senate — currently 60 votes are needed to advance most legislation.

The Bottom Line

Basing an investment strategy on the outcome of an election is not a prudent exercise. Nobody can be certain that campaign promises will lead to policy changes or even impact future economic outcomes. For example, Trump's 2016 promises of deregulation suggested that the energy sector would have fared well during his time in office; in hindsight, many other factors negatively impacted the sector. Regardless of what lies ahead, the private sector will continue to produce jobs, invest in innovation and drive growth over the longer term. Often, the winners will be those companies that can best position themselves to adapt to changes in the competitive and regulatory landscape over time.

As advisors, we structure portfolios using diversification to prepare for inevitable changes and ensure that we are not exposed to any single adverse event. We make course adjustments when required and are constantly monitoring investments given that operating landscapes and competitive conditions are always changing. What we shouldn't lose sight of is that the long-term trend of the stock market has been up, regardless of who is in power.

Growth of a Dollar Invested in the S&P 500: Jan. 1926 to Dec. 2019



1. https://fortune.com/2020/10/10/2020-election-investing-trump-biden-stock-market-predictions/