WELLINGTON-ALTUS
PRIVATE WEALTH

- INVESTMENT -
INSIGHT

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For 2021: Reasons for Optimism

Amidst the ups and what seem like mostly downs of the past year, there is light shining from the North. Despite the difficult circumstances we have faced in 2020, there have been bright spots to build optimism for the year ahead.

Unlike previous recessions, the economic effects of the pandemic have been uneven and concentrated to certain sectors. This has resulted in a relatively weak multiplier effect for the overall economy. Sectors that have been able to thrive during the pandemic, such as technology, have helped to drive equity markets, as largely seen with the U.S. markets. Canadian equity markets, generally influenced by the energy and resources sectors, have been hindered by lower demand due to the slowdown. In response, many companies have reassessed their business models, cut costs and leaned operations.

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. Unlike many developed nations, Canada's household incomes grew at a time when the economy contracted; savings rates also increased.[1] Many financial institutions that set aside significant amounts for loan loss provisions in anticipation of mortgage or credit defaults have recently seen reductions in those reserves.

One must not overlook the significance of government stimulus efforts. Canada has been very generous with its support and, as a result, will have 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] Many questions remain: will recovery drive enough economic growth to reduce the burden or will austerity in the form of tax increases or reduced spending be needed?

Darkest Before the Dawn

In the near-term, the outlook continues to have an air of uncertainty as we endure the winter months and an advancing virus. However, we can all take comfort in the recent news of the approval of effective vaccines. This is an exceptional feat considering the typical vaccine time-to-market is 10 to 15 years — the fastest ever, the mumps vaccine, took four years.

South of the border, the U.S. has chosen a new path forward after a highly contested presidential election. Given considerable and continuing unrest, there is hope that change will temper tensions and bring a necessary stimulus package to support Americans throughout the winter.

Progress in combatting a pandemic takes time. Yet, as we have seen in 2020, equity markets don't wait on the sidelines for recovery to happen. They are forward looking in nature — perhaps an admirable quality to uphold as we leave 2020 behind and bring in the new year.

1. https://nationalpost.com/news/canadas-generous-covid-19-income-supports-vastly-outpaced-other-developed-nations-oecd-report; 2. As a % of GDP; 3. "The Bearable Lightness of Canada's Debt Burden", Globe & Mail, 10/30/20, p. B6.

In This Issue

INCOME-SPLITTING STRATEGIES

An Opportune Time: The Spousal Loan Strategy

As you look ahead to 2021, 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 RRSP's introduction 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.

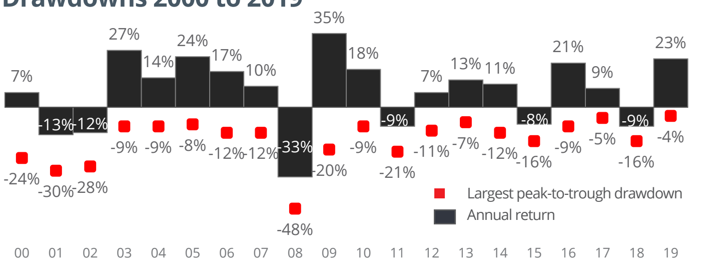
INVESTING PERSPECTIVES

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

As we brace for a long winter, 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**

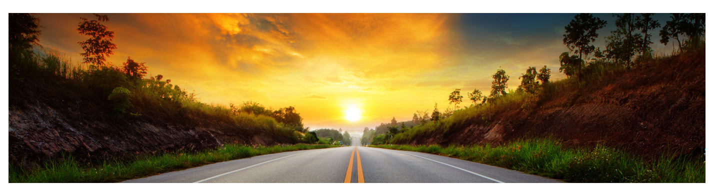
History reminds us that, in the short run, life is full of setbacks. The pandemic has been no exception. History also shows that over the long run, we have continued to advance and progress. Even the worst periods of retrenchment have been followed by new growth, economic expansion and progressing equity 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 the spring of 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 to weather the inevitable storms. 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, especially during down times, is one of the hallmarks of successful investing.

Looking Forward: Lessons from the Pandemic

Amidst the many hardships created by the pandemic, there may be prudent lessons that can assist us in finding greater financial success. As we look to better times to come in 2021, here are some reminders:

Don't Overlook the Merits of an Emergency Fund

The pandemic has been a stark reminder that unexpected events can affect everyone, regardless of income level. Economic shutdowns have affected the income streams of many, highlighting the benefits of having an emergency fund in place. For some high-net-worth (HNW) individuals, a common notion has been that having enough assets negates the need to have funds set aside for an emergency. But one of the strongest arguments for having an emergency fund is to avoid the need to liquidate investments on short notice, especially since larger daily expenses may need to be covered. For retirees, while emergency savings may not be needed to replace a missed paycheque, they may help support other unanticipated costs, such as health care.

Avoid Emotionally-Driven Investment Decisions

The equity market sell-off in March 2020 and the ensuing rebound reminds us that markets can quickly reverse their course, even during the most challenging times. This illustrates the difficulty in attempting to time the market — a testament to the importance of staying invested. Not everyone is able to keep calm during a crisis, which is understandable given that we are constantly bombarded with negative news. This is where our role as advisors comes into play — to help provide objectivity and perspective and offer counsel. While it may be difficult to abandon the worry that comes with fluctuating portfolio values, it is important not to let these worries derail you from achieving your ultimate goals.

Reassess Your Current Budget

This is not to admonish anyone about their spending habits, however taking time to sit down and map out the family income and expenses each month can be revealing. More notably, the current pandemic has altered many household spending habits, due to working remotely or lifestyle changes — perhaps you have saved more by not going to the office or gym or traveling for vacation. Reevaluating spending on a periodic basis may uncover opportunities to put more towards retirement savings, which has the potential to pay significant benefits down the road.

Don't Make Unnecessary Withdrawals

Making early withdrawals from retirement accounts can result in unintended consequences. While the pandemic may have made this temporarily necessary, it is important to have a thoughtful plan for prioritizing sources of potential income during difficult times. Why? Liquidating investments to generate income could result in unanticipated taxes or, in the case of retirees, the loss of income-tested benefits such as OAS (Old Age Security). Equally important, careful thought should be given to how to make up for the potential loss of retirement income down the road.