Bi-Monthly Newsletter
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In this Issue

Wise Investor – May 2024

Executive Summary

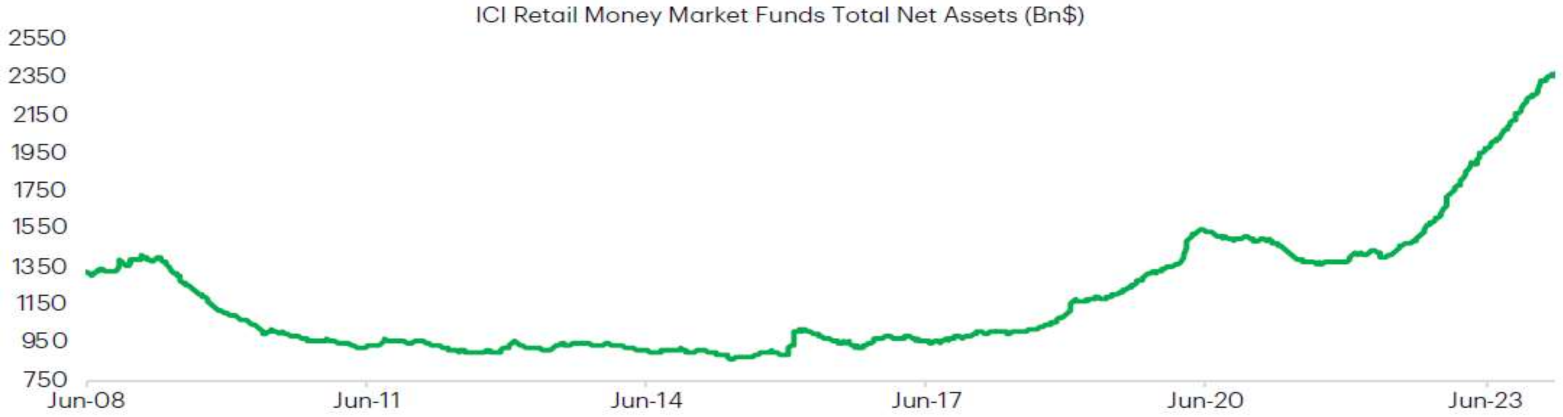
There are a few things in life I believe you should never bet against like increasing taxes, the consumer's ability to spend, corporate profits, our finite time on earth, and the Leafs' opposing team in the playoffs. In this month's publication I will address these important topics but in hesitation of jinxing our beloved Canucks, I will leave out any comments on the Leafs.

Importantly I will address:

- How the strength of the consumer has been driving earnings and stock prices
- What Canada's proposed budget changes could mean for you
- How to help protect a portfolio with bonds
- An unloved area of the market that could outperform
- The 5 components of Estate Planning you need to think about

We never encourage investors the think too much about the short-term as that’s for us to worry about. The markets have posted strong performance late 2023 through to today but we experienced a meaningful pullback in April. Fear, as an emotion, is not only powerful, but also persistent. Although we've seen strong performance as of late, it's always easy to find reasons to fear the worst. Despite what could be a choppy few summer months, we remain optimistic on the years ahead, and that’s what I believe we should always remember to focus on. Our commitment to a disciplined process to investing for our clients based on their long-term goals helps ensure we navigate market complexities with confidence. Your financial well-being is our priority, and we're dedicated to guiding you toward your investment objectives with clarity and assurance.

Figure 1: Increase in Cash on the Sidelines



Source: Investment Company Insitute, Wealth Investment Office as of March 12, 2024

What's Happened Lately

The Markets

In short, the markets realized a little more volatility in April than we've gotten used to lately with inflation, corporate earnings, and geopolitical unease in the spotlight. Inflation readings have revealed that the path to a 2% target will be a challenge and as a result, interest rates may have to stay higher for longer, at least in the U.S. Counterintuitively, inflation, at these levels, is actually good for corporate earnings as companies can increase prices and earnings as long as the consumer still has the ability to spend, i.e. has a job. Lastly, some polarization of political/geopolitical standpoints have continued to come to the forefront perpetuated by social media which has some investors on edge. The important fact is the economy in the U.S. is, all in all, good – and compared to the rest of the world, it's pretty great.

Let's first consider the basic facts:

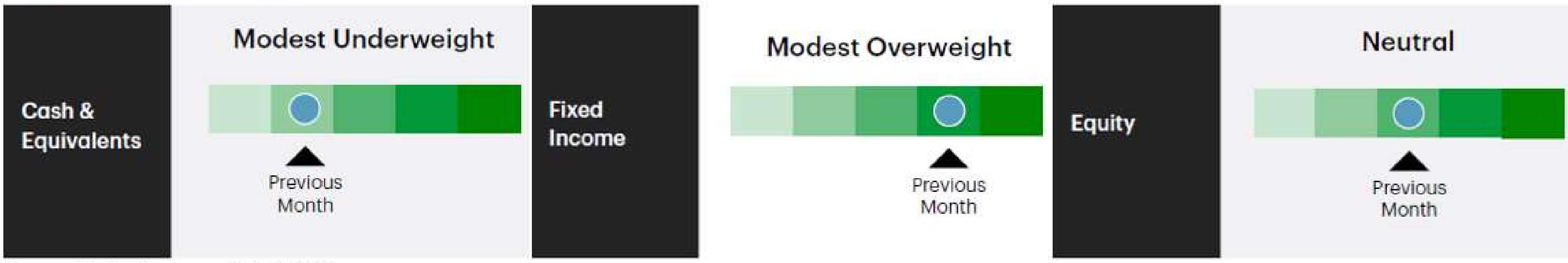
- Inflation has declined meaningfully, albeit starting to get a bit sticky
- North American economic growth, GDP, has been better than expected
- The labour market remains incredibly tight, i.e. low unemployment
- The consumer remains resilient
- Corporate earnings have benefited
- There appears to be some headway being made in Middle East peace talks

This is news to some investors who have continued to grow their cash on the sidelines as we've seen a large increase over the last few years as outlined in figure 1. This is important as I believe any sort of a significant decline in the stock market would be met with investors 'getting back in' which would help to limit any long-term drawdowns.

The Budget

In April the Canadian government laid forth a proposed budget with the biggest change being to how capital gains taxes will be calculated. The current inclusion rate on a capital gain of any kind, except your principal residence, is 50% and it applies to individuals, trusts, and corporations. This means that one-half of the growth on your asset when sold (stock, mutual fund, recreational property) must be included in your income and subject to your applicable tax rate. The inclusion rate for realized gains that occur on or after June 25, 2024 is changing. For trusts and corporations, the new inclusion rate will be 66.66%. For individuals, the first $250,000 of realized capital gains will continue to have a 50% inclusion rate and amounts above would increase to a 66.66% inclusion, numerical example on the next page.

Figure 3: Asset Allocation



Source: Marley Snow, as of May 7, 2024

Why Should We Care

The Markets

Perhaps the most consistent element of the economic environment for the last few years has been the significant strength of the labour market. With consumer spending accounting for around 70% of economic growth, low unemployment means that more consumers have money to spend, and corporate profits can continue to grow.

To date, 80% of the companies in the S&P 500, the 500 largest companies in the US and a good proxy for 'the market', have reported earnings results for Q1 2024. Of these companies, 77% have reported earnings better than expected, which is slightly above the 20-year average of 75%. In the short-term, markets can move up or down a lot as optimism and pessimism about the future waxes and wanes. Over the long-term, which is most people's investment time horizon and much more important, earnings drive stock prices and earnings have continued to improve from late 2023. As a reminder, we never recommend attempting to make short-term timing decisions for long-term objectives.

The Budget

Below is a simple numerical example that a lot of our clients have been faced with, comparing the amount of new taxes payable on the sale of a recreational property. There are of course several complexities to those with family trusts or holding corporations which I would be happy to discuss in further detail directly with those interested. For now, will focus on the simple example of selling a vacation property held in a personal name.

Figure 2: Impact of Proposed Capital Gains Changes

	Pre-June 24 ($)	June 25 Onward
Adjusted Cost Base (purchase of your vacation home + expenses incurred)	$1,000,000	$1,000,000
Proceeds of Sale	$2,000,000	$2,000,000
Capital Gain	$1,000,000	$1,000,000
Inclusion Rate	$1,000,000 X 50.00%	$250,000 X 50.00% $750,000 X 66.67%
Taxable Capital Gains	$500,000	$625,000
Total Tax Payable *(@53.50% - BC top tax rate)*	$267,500	$334,375
Potential increase in tax		**$66,875**

Source: Marley Snow, May 7th 2024

As you can see, there will be extra tax payable for sales, transfers and other taxable dispositions that occur on or after June 25, 2024. Proper wealth planning of course requires an analysis of goals, time horizon, assets, income, family circumstance and other factors but there may be a few things to consider which I'll highlight on page 7.

What Should We Do

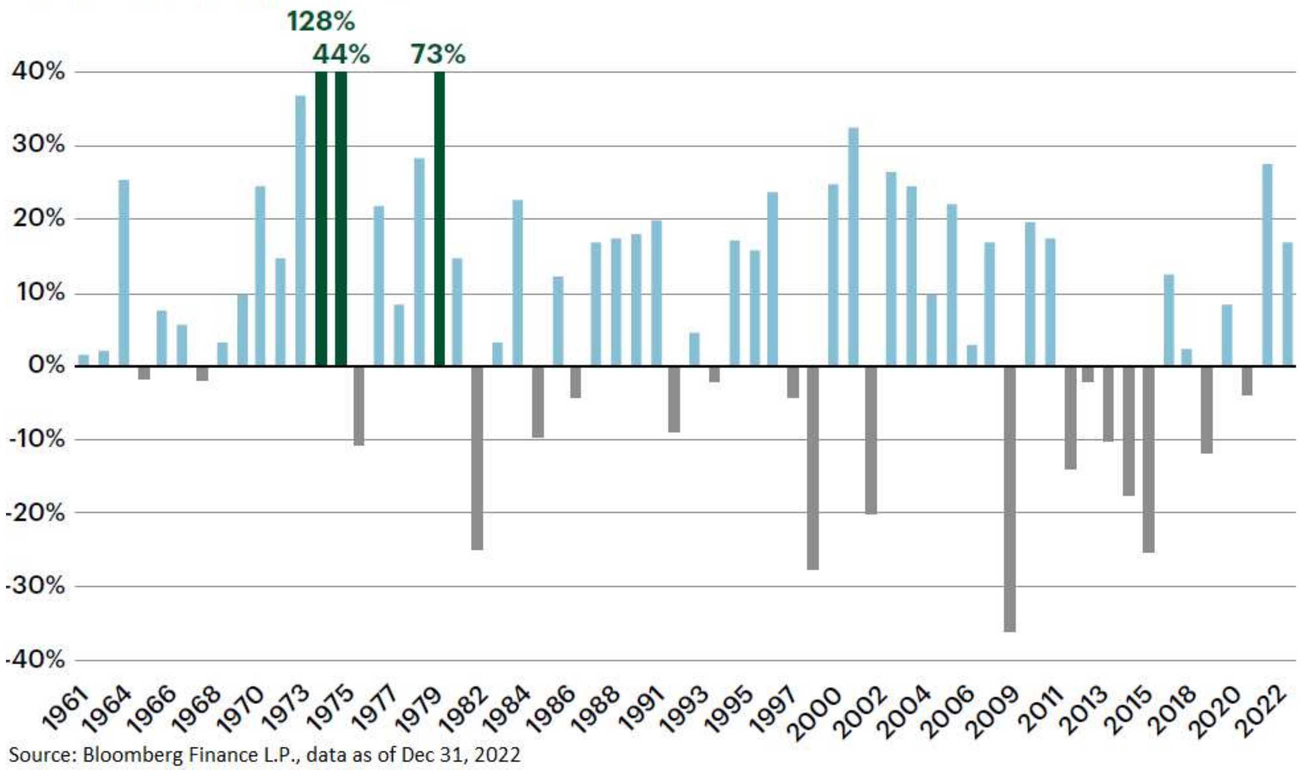
The Market

Overall, we are maintaining our neutral outlook and positioning on stocks meaning that we are on target within portfolios. For those clients targeting a balanced 60/40 allocation between growth (stocks) and defense (bonds) we are right around target of 60% in stocks with a preference for U.S. equities given their more attractive earnings outlook.

We continue to see an opportunity to help protect portfolios against volatility and capitalize on looming rate cuts with bonds. If rates decline, high quality bonds have the potential to generate total returns substantially greater than their current 5% average yields, which is a big improvement from years past. With inflation stabilizing, and growth slowing modestly as the economy feels the impact of higher rates, the next few years could be a compelling time for bonds. Bonds also don't feel the impact of the stock market ups and downs near as much and can provide a good margin of safety and some dry powder should we get any unanticipated, negative surprises. As such, we remain overweight bonds vs cash.

Another unloved area of the market that can be overlooked by investors is commodities which play an important role in portfolio diversification, think gold and oil. With commodity supply constrained following years of underinvestment, we anticipate returns in the asset class could outperform over the coming years. The first period of commodity outperformance on figure 4 was highlighted by the end of the USD-gold conversion and high inflation era of the 1970's. Then in the early 2000's, commodities had a run up driven by the huge surge in Chinese demand. The widening geopolitical rift between the US/China, Russia/Ukraine and now the Middle East is at the heart of the most recent run up. If we remain in a higher inflation and more geopolitically pressured world, a higher allocation to commodities could help protect portfolios.

Figure 4: Annual Commodity Returns



Source: Bloomberg Finance L.P., data as of Dec 31, 2022

In summary, in today's market landscape having an allocation to bonds and commodities in a diversified portfolio can offer valuable benefits. With the next move in interest rates likely down, bonds finally have some capital appreciation potential. With increasing inflationary pressures and global economic uncertainties, commodities like gold, silver, and oil often serve as hedges against inflation and geopolitical risks. As we continue to grapple with the recovery from the pandemic, and a long period of underinvestment, the demand for commodities is expected to rise, potentially leading to price appreciation. Hence, incorporating bonds and commodities into a well-balanced investment strategy can enhance portfolio resilience and potential returns.

What Should We Do

The Budget

Any action or inaction should be intentional and aligned with one's goals and not simply a tax driven solution. If you didn't have an intention to sell your property a month ago, there are things that you can do today to minimize the future tax increase.

- As many have done already, if the intention was to sell soon, you'd want to get your property listed immediately with a quick close clause on your sale agreement
- If you plan to sell in the near future you will want to be extra cognizant of any gains from other assets realized in the year you plan to sell, i.e stock portfolio
- If your property is earmarked for kids or relatives, you could consider gifting or selling some or all of the property to them prior to June 25th but you would need to consider the immediate tax bill along with all of the other factors that would come with no longer controlling the asset
- If your recreational property has more upside than your existing principal residence and qualifies, you may want to consider switching your exemption to the rec property
- If your property won't be sold for many years, using an insurance policy could alleviate the future tax burden

If you have property or assets held in a trust or in a corporation there are some more complex strategies that we can advise on so don't hesitate to contact us for more details. Long-term oals, and not simply tax, should drive your planning and solutions.

What Else Should We Be Thinking About

What Else Should We Be Thinking About – Estate Planning

Estate planning is a crucial component of financial strategy for both individuals and families. It ensures that your assets are distributed according to your wishes, providing financial security for your loved ones after you're gone. Beyond inheritance, estate planning also encompasses crucial elements such as healthcare directives – representation agreement, protecting assets from potential creditors, and minimizing tax burdens through strategic structuring. Additionally, it enables proactive measures for potential incapacity due to illness or injury, ensuring that your affairs are managed according to your preferences. By reducing unnecessary expenses and taxes while safeguarding assets, estate planning can offer financial stability for generations to come.

Personal Note

It was Leonardo da Vinci that once said, nature is the source of all true knowledge. My wife and I seem to live rather frantic lives and there's always something on the calendar or around the house to take care of. For this reason, we make sure to enjoy the weekends. When the weather permits, we have a Snow family practice of getting out into nature, no computers, no sirens and phones conveniently tucked away for emergency purposes only. We like to randomly pick a trail we've never been before, punch it into the navigation system and head into the hills. Two weeks ago, that took us to the First Lake loop at Dog Mountain which happens to be at the base of Mt Seymour ski hill. Given it was a beautiful sunny day in East Vancouver, I figured shorts and light sneakers would be perfect. Let's just say, I was happy I had a couple emergency jackets in the back of the truck because upon arrival we quickly remembered that the ski season wasn't that long ago. In fact, we were even welcomed with falling snow at the end of the hike. Regardless of our poor apparel choices, the forest never disappoints and reminds our eyes, ears and nose to awaken our senses. Next time you find yourself with a few hours of free time, I challenge you to get into the nearest woods, out of earshot of traffic and people and breathe deeply in an attempt to find a meaningful connection with the forest.

It's important to take a moment when you can to really be present and mindful in our beautiful back yard, things could be so much worse. Best,

Marley

"Wealth is not his that has, but his that enjoys it."

Benjamin Franklin

We will take as much time as needed to get to know what matters most to you while establishing a strong working and personal relationship. We have every confidence that this relationship can benefit you greatly. We have proven our value time and time again by helping a small niche of successful affluent Canadians realize their lifelong goals.

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