



# Wealth Insights

TD Wealth Private Investment Advice

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## To My Clients:

*Before we know it, the end of 2022 will be upon us. Many of us will need to make investment decisions before then, such as RESP contributions, tax-loss selling or converting RRSPs to RRIFs if you've reached age 71. As you consider your own situation, please get in touch.*

*Keep confidence that the markets will work through this difficult cycle, remembering that upturns can begin during the most ambiguous times. Sending my best for the cooler months ahead and please call the office if I can be of any assistance.*

## No Shortcuts to Success

When a leading courier company optimized its delivery routes decades ago, many drivers felt it extended their trips. It favoured right-hand turns at all times, so the most direct route to a destination was almost never taken. Yet, the approach improved efficiency and reduced fuel usage.

The philosophy delivers a good message to investors: sometimes the most effective outcome doesn't involve taking the shortest route. It's natural to want to get to our destination as quickly as possible. However, in investing, time can be one of the investor's greatest allies. Consider that more than 99 percent of Warren Buffett's fortune was accumulated after his 50<sup>th</sup> birthday.<sup>1</sup> While good results may be achieved in years, significant results are usually measured over many decades.

After the significant gains of 2020/21, market performance in 2022 has been a reminder that there are often no shortcuts to investing success. As unpleasant as market setbacks are, we must not forget that periodic downturns are a normal part of the investment cycle.

### Recession or Not?

After reporting its second successive quarter of negative gross domestic product (GDP) over the summer, a great debate was raging about whether or not the U.S. was in recession. Recessions are commonly defined as two consecutive quarters of negative GDP, though other data appeared more benign: robust labour markets, wage growth, continuing consumer demand and solid corporate profits. Semantics aside, there is little doubt that we are into a period of slowing economic activity in both Canada and the U.S. Is a recession in Canada imminent? The continuing aggressive interest rate hikes by central banks to temper inflation are likely to sustain the economic headwinds.

Yet, these factors are not reasons to avoid the investment markets altogether. Many accepted "truisms" about the markets don't stand up to examination. One is that recessions inevitably bring down markets. A recent study suggested that the S&P 500 Index actually rose an average of one percent across all recessionary periods in the U.S. since 1945.<sup>2</sup> And, bull markets, as often as not, have started in the middle of recessions.

Financial markets, like economies, are cyclical and declines will occur on a regular basis. However, we know that equity prices will eventually recover their positive tone in the same way as the cycle swings back towards more optimism. No one can say exactly when this will come to pass; sometimes this can happen quickly and unexpectedly, even when investor sentiment appears at its worst.

Many successful long-term investors are adept at separating their emotions from investment decisions. This is not easy to do, but there are techniques and products available that can help. Systematic investing can limit the urge to otherwise succumb to market timing. Diversification and rebalancing portfolios can help to limit risk. Some look to managed products to put buy-sell decisions on the regular watch of others. Those who consider quality investments may also worry less about enduring values during uncertain times, knowing that price setbacks may be temporary. And, perhaps most important, keeping focused on individual objectives and having the determination to stick to the plan through the inevitable cycles, remembering that the investment journey can be a long one.

1. On August 1, 1980, shares of Berkshire Hathaway (BRK-A) closed at \$340. On August 1, 2022, they closed at \$444,650; 2. www.forbes.com/sites/sergeiklebnikov/2022/06/02/heres-how-the-stock-market-performs-during-economic-recessions/

## Wealth Insights

### ■ Tax Planning

# Making Portfolio Changes? Gain From Your Losses

As we approach the final months of the year, it is a time when investors often engage in tax planning strategies. Given the market declines this year, if you are thinking of making adjustments to your portfolio, there may be an opportunity to gain from your losses through tax-loss selling.

#### What is Tax-Loss Selling?

Generally, an investment held in a non-registered account that is sold for less than its original cost will result in a capital loss. For tax purposes, 50 percent of the capital loss can be used to offset any taxable capital gains realized during the year to reduce your current tax liability. If you do not have sufficient taxable capital gains to offset the losses, the net capital loss can be carried back to any of the previous three taxation years to offset realized capital gains, or carried forward to use against future realized capital gains.

However, be mindful of the “superficial loss” rules if you plan to repurchase the security, which deny the capital loss if you or an affiliated entity (such as a spouse/common-law partner, RRSP, TFSA) acquires the same security either 30 days before or after the date of your loss transaction. Under these circumstances, you will not be allowed to use the capital loss in the current tax year to offset capital gains. Instead, the capital loss will be added to the adjusted cost base of the identical property.

#### Year-End Tax Planning By Donating Securities

Year-end tax planning may also involve charitable giving. Donating publicly-traded securities “in kind” that have appreciated in value will eliminate the tax liability on the capital gains triggered and allow for a donation tax credit for the fair market value of the securities. In order to



eliminate the tax liability on the gain, shares must be donated in kind. However, if you wish to combine tax-loss selling and charitable giving, for securities that have declined in value, you will still be able to claim the capital loss regardless of whether you sell the shares or donate them in kind. As such, it may make sense to sell the shares and donate cash. Remember to make charitable donations in advance of the December 31, 2022 deadline to count towards your 2022 taxes.

#### Year-End Tax-Planning Considerations

- **Charitable Donations:** See above story for tax benefits.
- **Tax-Loss Selling:** Consider realizing capital losses to offset realized capital gains.
- **RRSP Contributions:** While you have until March 1, 2023, consider contributing before year end to benefit your 2022 taxes.
- **RESP Contributions:** Contributions won't affect 2022 taxes, but you may potentially benefit from the CESG grants for 2022.
- **Turned 71 in 2022?** Your RRSP will mature by year end so please call the office to discuss the options available.
- **Income Splitting:** This may include paying reasonable salaries to family members for services provided to your business or electing to split eligible pension income with a spouse on a tax return. Please contact us for more income-splitting ideas.

### ■ Personal Finances

# Helping Younger Generations Deal With Higher Interest Rates

For the first time, the younger generation is experiencing a world of rising interest rates and high inflation.

Over the past two decades, we have grown accustomed to low interest rates due to slower economic growth and low inflation. Now, to try and temper persistently high inflation, the central banks have taken an aggressive approach to hiking rates. As this is the first time that many young people have experienced rising rates and high inflation, here are a few thoughts on helping them prepare for this changing landscape.

**First, why are the central banks raising rates?** Today, demand has exceeded supply for many goods and services, which has pushed prices upward. This has been attributed to actions taken during the pandemic, including unprecedented stimulus and supply chain issues from the shutdowns, as well as the conflict in Ukraine. By raising interest rates, it encourages saving and discourages borrowing by making it more expensive, which in turn helps to reduce spending and demand. This will help to bring down the rise in prices, or inflation.

#### An Opportune Time to Focus on Personal Finances

Due to many years of predictably low interest rates, it was easy to assume debt with little worry. With rising rates, borrowing has become more costly and some may not have been prepared for rates to rise as quickly as they have. As such, for many young people, a focus on personal finances may be a good starting point.

**Pay down debt.** If there are debts to service, consider prioritizing paying it down, especially debt subject to high interest rates, such as credit card debt. It is important to understand the terms of any loan and the effect of rate increases. For instance, for a variable-rate mortgage, consider how interest rate increases will impact interest payments or reduce the amount of principal that is paid down. As an example, raising interest rates from 1.5 to 4 percent while keeping the payment amount fixed will increase an amortization period (the time taken to pay down the mortgage) from 25 to 45 years.

**Create or revisit a budget.** For those who hold debt, it may be beneficial to create or revisit a budget to prioritize paying off debt. Even if no debt exists, the effort of sitting down to map out income and expenses each month can be revealing, especially in this period of high inflation where the cost of most goods/services has increased. This may be worthwhile to uncover spending habits and better allocate where funds go.

**Encourage saving.** Minor reductions in consumption can lead to worthwhile savings. With higher interest rates, low-risk savings vehicles that have been overlooked in the past may start looking more attractive, and many younger folks may not be aware of these products — many five-year guaranteed investment certificates (GICs) now have rates in excess of four percent. Recent market downturns may also be seen as an opportunity to build an investment portfolio for the future.

These are just a handful of discussion points to help generate a dialogue. If you need assistance with these conversations, please call the office.

■ Kids Back in School

# Given the Market Declines, Should I Delay RESP Withdrawals?

Given the disappointing market performance in 2022, those who hold a Registered Education Savings Plan (RESP) may be asking: Is it smart to delay RESP withdrawals?

While there may be value in having patience for equity values to rebound — after all, one of the RESP’s benefits is the opportunity for tax-sheltered compounding, which can grow over time — other considerations may impact your decision.

### Not All RESP Withdrawals Are Equal

First, it’s important to distinguish between the types of RESP withdrawals for educational purposes. A post-secondary education (PSE) withdrawal comprises those funds originally contributed to the plan. These are not taxable but do require proof of enrolment. An educational assistance payment (EAP) is the withdrawal of income, capital gains and grants that have accumulated in the plan. The EAP is taxable in the hands of the beneficiary and requires proof of enrolment in a qualified program.

Since EAPs are taxable, it may be a consideration to spread them out over several years to reduce a potential tax bill. This is because the student can take advantage of tax credits to offset EAP income. Consider that the basic personal amount for the 2022 tax year is \$14,398. Assuming a federal tuition credit of \$6,700 combined with this amount, the federal tax credit would total \$21,098, meaning that a student with no other income in the year could potentially receive \$21,098 of EAPs in 2022 and pay no tax. Keep in mind that the basic personal amount is a non-refundable tax credit, so it cannot be transferred to future years. The tuition credit can be carried forward.

It may also be advantageous to withdraw EAPs when the student has minimal income. If the student has other income, such as from grants, scholarships or a part-time/summer job, this, alongside a larger EAP withdrawal, could put the student in a higher marginal tax bracket.

As such, waiting to make a future, larger EAP withdrawal, instead of spreading it out over multiple years may not be advantageous. While you may benefit from additional tax-sheltered growth by waiting, this



may be offset by the additional tax upon the withdrawal. Even worse, if you delay withdrawals and the student ends up dropping out of school, any remaining income/grant money may be taxable to you, the subscriber, as an accumulated income payment (AIP) and an additional 20 percent penalty tax may apply, though there may be ways to avoid this penalty (which is beyond the scope of this article).

### Haven’t Accessed Your RESP? Plan Ahead

If you’re planning on using funds from the RESP this fall, consider that the withdrawal process can take time. You will need a proof-of-enrolment form completed by the post-secondary institution. This can often be requested online and many schools email an electronic version within one to two business days to the student. You must also complete the RESP withdrawal form to set up the withdrawal, specifying the type of withdrawal (EAP or PSE) and where you wish the funds to go. We can help you to understand how much investment income and grants have been received in the RESP. If you are requesting an EAP, keep in mind that there is a \$5,000 limit for the first 13-weeks of enrolment for full-time programs. Consider also that the settlement process for selling securities can take time.

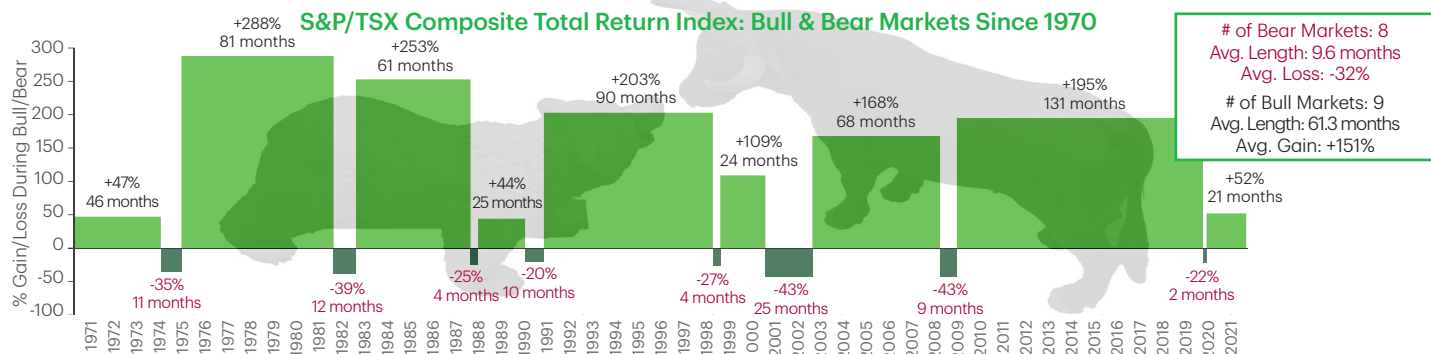
### Haven’t Opened the RESP? It May Be an Opportune Time

This may be a great time to contribute to the RESP. There have been many opportunities for longer-term investors to find quality investments at lower prices than in previous years, and the RESP can certainly benefit from the future growth opportunity.

■ Market Performance

## How Long Do Bear Markets Last?

With the S&P 500 Index entering into a bear market for the first half of 2022, some investors have questioned if Canadian markets will follow. As a reminder, a bear market is often defined as a period in which stocks have declined by 20 percent from a previous peak over a period of usually two months or more. So far, Canadian markets have been comparatively resilient due to a higher composition in resource-related stocks versus the growth- and consumer discretionary-heavy S&P 500. Regardless, bear markets are a normal part of the investing cycle and investors will be wise to remember that they tend to last much shorter than bull markets. Since 1970, the average S&P/TSX Composite Index bull market was 61 months, while the average bear market lasted just 10 months. The last bear market was the shortest on record; only two months at the start of the pandemic.



Source: S&P/TSX Composite Total Return Index (including reinvested dividends) monthly close from 1/1/70 to 12/31/21.



## ■ Macroeconomic Perspectives

# A Recession in the U.S.? Will Canada Follow?

With the U.S. entering a “technical” recession,<sup>1</sup> how will this impact the financial markets? And, is Canada next?

While there continues to be a debate about whether a recession is imminent, there is, however, widespread agreement that we have entered a period of economic slowdown. This is largely due to the actions taken by the central banks to manage inflation.

### How Do Rising Rates Affect Economies and the Markets?

In their effort to halt inflation — the increase in prices due to demand exceeding supply — the central banks have been aggressively raising interest rates. Higher rates raise the cost of borrowing, which can lead consumers to spend less. With decreased demand for goods and services, this can help to ease inflation. However, this can also slow economic growth.

Rising rates also increase the cost for companies to borrow money, as well as their cost of holding debt, which can impact profitability. Sometimes companies pass these costs to consumers. However, if consumers demand less, this can reduce earnings and result in lower stock prices. For the fixed income markets, there is an inverse relationship between interest rates and bond prices: as interest rates rise, bond prices generally fall. This is one reason why we have seen both stock and bond markets struggle in 2022 as the central banks raised rates.

However, the potential for economies to enter into a recession should never be a reason to consider curtailing investment programs. Consider that the stock market and the economy don't always move the same way at the same time, and predicting how and when stock markets react to recessions is difficult, if not impossible. The markets can begin their climb when economic conditions are at their worst. A look back at the last seven U.S. recessions reminds us that the S&P 500 Index has, just as often as not, started its climb during the depths of a recession (chart). After all, equity markets are forward looking in nature.

### Recessions Are a Natural Part of the Economic Cycle

It's not normal for any economy to be in a perpetual expansion and economic contractions that result in recession can be expected to occur from time to time. Recessions can also be quite different in their length and intensity: our most recent recession during the

pandemic was the shortest on record, just two months in length.

Today, there are a variety of reasons to keep perspective. In Canada, labour markets and household balance sheets continue to support consumer resilience. While it was anticipated that there would be a period of adjustment as we returned to normal from the pandemic, corporate earnings fared well in the most recent earnings season. Recessions are also characterized by high unemployment and excesses of inventory, capacity or credit, which aren't largely apparent at the moment.

This is not to suggest we don't face challenges. The pandemic has led to a variety of issues, including significant stimulus debt, higher inflation, supply chain disruptions and more, some of which continue to be exacerbated by the ongoing conflict overseas. However, it may be worthwhile to maintain perspective about recessionary concerns. Economies are cyclical and are prone to expanding and contracting over time. As such, when a recession eventually does arrive, remember that it will be temporary. At the same time, longer-term investors should remember that portfolios have been positioned with the expectation that economic and financial markets will experience both ups and downs — this is a normal part of the investing journey.

1. As reported in late July, <https://cbc.ca/news/business/us-gdp-recession-16534650>; <https://cnbc.com/2022/07/29/white-house-goes-on-offense-to-argue-that-the-us-is-not-in-a-recession-.html>

### What Happens to the Markets When There is a Recession? S&P 500 Returns During Recession, One and Three Years After End

U.S. Recessionary Periods	During Recession	One Year After	Three Years After
Nov. 1973 to Mar. 1975	-17.90%	28.32%	21.99%
Jan. 1980 to Jul. 1980	16.14%	12.92%	55.89%
Jul. 1981 to Nov. 1982	14.66%	25.40%	67.24%
Jul. 1990 to Mar. 1991	7.64%	11.04%	29.84%
Mar. 2001 to Nov. 2001	-7.18%	-16.51%	8.44%
Dec. 2007 to Jun. 2009	-35.46%	14.43%	57.70%
Mar. 2020 to Apr. 2020	-1.12%	45.98%	TBD

Source: <https://awealthofcommonsense.com/2022/06/timing-a-recession-vs-timing-the-stock-market/>



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