Newsletter VOL L – Returning to "normal" Oct 2021

Retirement and financial planning require time, effort, and specialized knowledge. This newsletter is intended to help you plan your retirement and to assist working folks to prepare for the future***. It may include general comments about investing but does not provide investment advice.***

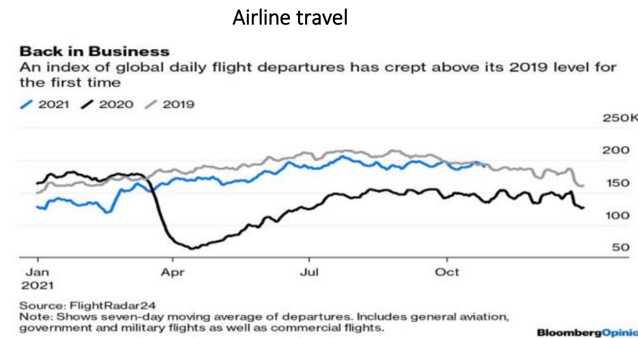
Overview

Several Chinese property development companies are in trouble, to the tune of ~US $301 Billion: Evergrande, Fantasia, Modern Land, Sinc Holdings, and China Property Group. The fallout from an over-leveraged Chinese property market could result in global financial chaos as well as in China. Will the Chinese government come to their rescue – probably? U.S. inflation of 6.2% in October hit its highest level since 1990. Canadian inflation was a mere 4.7%. How will the central banks unwind the low interest rates without creating a market meltdown? Inflationary pressures continue due to oil and labour shortages as well as supply chain and transportation disruptions.

Many key business and economic indicators continue to improve e.g., home sales and airline travel which are economic 'bell weathers.' It appears things may be returning to 'normal' - economically.

US Home Sales

Airline travel



'Blockchain' technology is in its infancy. It will undoubtedly also have a revolutionary impact.

The Chinese government recently told everyone to stockpile food because of possible shortages – a bit odd?

A. Short and sweet

a) Canadian DB plans returned only 0.6% in Q3 (RBC report). Lower returns will be offset by expected future interest rate increases which will lower DB plan liabilities.

b) The US Federal Reserve will begin to reduce its $120 billion/ month bond purchases. The purchases kept loan rates low during the pandemic but now appear to be fueling inflation.

c) Canadian parents gave children ~$10 billion for down payments in 2020-2021 About 33% of 1st-time homebuyers received help. The average 'gift' was ~$82,000 (CIBC Capital Markets).

d) OSFI announced that Canadian banks and other financial firms can resume capital distributions. Banks can again increase executive compensation and dividends and undertake share buybacks.

e) Manulife and Sun Life have increased their dividends by 18% and 20% respectively. Banks and other insurers are expected to do the same.

f) The human papillomavirus (HPV) vaccine is cutting cases of cervical cancer by ~ 90%, the first real-world data shows.

B. Tax Information and Issues

1. 2022 Pensionable Earnings and RRSP Limits

The CRA announced that the maximum pensionable earnings under the Canada Pension Plan for 2022 will be $64,900 vs. $61,600 in 2021. Contributors who earn more than $64,900 in 2022 are not permitted to make additional contributions to the CPP.

The RRSP dollar limit, which is indexed, will be $30,780 for 2023 and $29,210 for 2022, up from $27,830 in 2021.

2. November – tax planning time

It is November - time to start thinking about how to minimize your 2021 taxes e.g., RRSP contributions, tax-loss selling, donations, medical receipts, etc.

Tax Tip: Transferring equities in a non-registered (pension) account, to a spouses' non-registered account, will ***not*** result in a (deemed) disposition or a taxable capital gain. When the equities are sold any capital gains, or the annual dividends, are attributed and taxed in the hands of the transferring spouse.

3. 2022 CPP and EI Contributions – Increase

The maximum combined CPP and EI premiums increase to $4,824 for employees and employers in 2022. This is an 18% increase over the past 2 years. Self-employed will pay a maximum of $9,648. The CPP increased by 5.7% is due to higher average wages in 2022 (statistical anomaly).

C. Other Issues and Information

4. Taxation of dividends and gains in registered accounts - Confusing?

Retirees and other savers often ask about the tax treatment for investments such as interest, dividends, and stock gains in registered vs. non-registered accounts. It pays to know what is taxable and when. The tax payable in registered vs. non-registered accounts differs significantly.

Registered accounts include RRSPs, RRIFs, LIRS, TFSA, and other accounts which allow tax to be differed. Registered accounts are held by financial institutions i.e., banks or insurance companies, or other platform providers. Regular investment accounts are usually held by banks and brokerage or custodial firms.

Interest income includes interest from savings accounts, loans, bonds, mortgages, etc. **Dividends** are amounts paid by companies to shareholders. The actual amount of a dividend is grossed up by 38% and included in taxable income. The grossed-up taxable amount is offset by a non-refundable tax credit of 15.02% (this tax credit cannot be carried forward or back if it is not for the tax year). **'Capital gain'** is an economic rather than finance l or tax terminology. A c*apital gain* ***only occurs when a stock is sold***. If gains occur while a stock is held in an account, they are simply 'gains' not capital gains. A t**axable capital gain refers to a tax event.** It only applies when a stock, held in a **non-registered account,** is **sold.** A 'taxable capital' is tax terminology that refers to the **50% of a capital gain** that included in taxable income.

Taxable capital gains in a non-registered account must be reported in the year the stock is sold regardless of **whether or not any of the sale proceeds are withdrawn.**

The differences in tax payable in registered vs. non-registered accounts for interest and dividend income and taxable capital gains are included in the attachment "Taxation of income by source and account type."

You can transfer equities from a non-registered account to a spouse's non-registered account (at the current market value) ***without creating a taxable capital gain***. However, when the stock is sold taxable capital gains and the dividends received during a year, are attributed and taxed in the hands of the transferring spouse.

There is only a ***tax advantage*** from investing in dividend securities in **non-registered accounts.** There is a smaller benefit from capital gains. The higher your taxable income and marginal tax rate the greater the tax saving from taxable gains vs. dividends or interest income.

There is an **immediate tax saving from having dividends or capital gains in a DC, RRSP, RRIF or LIRA**. However, when an amount, **regardless of source is withdrawn, it is 100% taxable at your marginal tax rate.** Contributions to an RRSP or DC plan are deductible from income at your marginal tax rate. Theoretically, you make contributions in high income years and withdraw it later at a lower marginal tax rate – this is not always the case.

There is no tax payable on interest or dividend income or capital gains realized in a TFSAs or when money is withdrawn from the TFSA. It is usually advantageous to have income and gains in a TFSA. However, contributions to a TFSA are not deductible. The amount that can be contributed to a TFSA is also limited (currently $6,000/year).

The least advantageous investment in a registered or non-registered account, ***from a tax perspective,*** is investments that pay interest income.

When you and your spouse eventually die the balance in an RRSP, RRIF or LIF ***immediately becomes subject to tax, at a higher or the highest marginal tax rate***. It makes sense to draw these accounts down over time beforehand and pay a bit more tax each year to minimize the total tax payable.

Having a financial plan with a robust tax component is essential. A financial plan and a tax advisor with a strong tax background can assist you in sequencing the drawdowns to minimize your overall tax bill.

5. Target Date Funds (TDFs) - Popular but - not for everyone

~84% of Capital Accumulation Plans (CAPs)have TDFs as default investment option. While TDFs may be convenient for some savers with long investment time horizons, they are not ideal for retirees. TDFs assume all investors of the same age have similar financial situations and expectations.
This is not likely to be the case: retiree's financial situations are generally unique.

TDFs performance can vary significantly depending on the fund manager particularly when markets are stressed. In addition, there is seldom enough long-term performance history to assess a TDF's effectiveness. A TDF does not 'guarantee a specific or an adequate pension income.

The question of how to benchmark and assess TDF performance is complex. Simply comparing the return performance of various TDFs is not sufficient. A benchmark should be used that reflects the progress with respect to providing a certain level of pension vs. the associated 'funding' liability (this is seldom provided.)

The main beneficiaries of TDFs are the suppliers. They effectively lock investors into fees on a long-term basis.

See https://www.benefitscanada.com/expertpanel_/gerry-wahl/the-target-date-timing-bomb/

6. 2021 3rd Q Investment Returns

If you manage your investments or pay someone it is essential to track investment performance. Using market and professional balanced fund manager performances are an appropriate way to monitor your investment performance.

3rd Quarter - Benchmark Returns

Performance Indicator	3rd Q	1 year	5 years	10 years
Balanced Fund Managers	0.7%	13.9%	7.7%	8.9%
Canada S&P/TSX	0.2%	28.0%	9.6%	8.8%
Canadian Stocks	0.9%	29.3%	9.7%	10.1%
Cdn Bond Median	-0.3%	-2.4%	2.8%	3.7%
Cdn Corp Bond Median	0.2%	1.0%	4.1%	4.7%
Real Return Bonds	-0.3%	-2.5%	2.3%	3.1%
Cdn Mortages	0.6%	1.4%	3.3%	3.9%
Real Estate Funds	3.5%	11.7%	7.5%	8.5%
Money Market funds	0.1%	0.2%	1.1%	1.1%
2020 Target Date funds	0.4%	7.6%	5.9%	7.4%

Things to remember and "Conventional Wisdom':

a) Published fund manager returns seldom reflect fees.
b) The greater the risk you take the higher the expected return (minimal risk = minimal reward).
c) Risk and return are inseparable concepts. Having performance indicators for both is essential.
d) The objective of a pension is to match cash in with the cash-out (matching the funding 'liability')

e) Retirement is a long-term proposition: long-term return and risk information is needed.
f) A formal financial plan is appropriate for managing your retirement finances and investments.

7. 'Risk-Free' Interest Rates and other key economic and business indicators

12-Nov-21	Current Rate	Previous Month
3-Month Treasury Bill	0.13%	0.12%
1-Year Treasury Bill	0.72%	0.37%
5-Year Treasury Bond	1.46%	1.22%
10-Year Government Bond	1.67%	1.57%
30-Year Government Bond	2.03%	1.99%
Prime Rate	2.45%	2.45%
Inflation	4.70%	4.40%
US$ vs. C$	$1.25	$1.24
Gold (US$/Troy OZ) – Spot	**$1,868**	**$1,729**
Copper (US$/lb) - Spot	**$4.53**	**$4.10**

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1-30 year "risk-free" Canadian Treasury interest rates continued to creep up in October due to inflationary pressures. The Prime Rate, set by the major Canadian banks, remained unchanged at 2.45%.

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12-month CPI in October was **4.7% vs. 4.4%** in October. However, day-to-day purchases of food, clothing, and gasoline (regular and frequent purchases) have gone up 10-30%. Official inflation is well above the Bank of Canada 2% inflation target.

Real rates of return were again negative in October and continue to eat away at purchasing power.

Tax is a critical aspect of planning and investing for retirement

The governments provide benefit programs to help low-income earners. If you use an advisor they will know if you qualify for government assistance programs and new investment products. They should also tell you the tax impact of different investments.

Industry regulators focus on "Know your Client (KYC)." The best way for an advisor to understand a client's risk tolerance is by creating a formal financial plan. An effective plan must have a robust tax component – most do not. Having a formal plan makes it easier for an advisor to be effective and leads to better financial, tax, and estate planning decisions. A plan can be used to determine the amount of investment risk to take and when to withdraw money from a registered account A financial plan is a type of financial 'will': it outlines expectations, and what you expect financially for a spouse or heirs in the future. One of the bigger mistakes that "do it yourself investors" make is not having a financial plan.

Enuff about pensions and taxes?

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