TD Wealth

# Wealth Insights

TD Wealth Private Investment Advice

Winter 2021



## Paving the Road to Recovery

**It is a testament to the human spirit: adversity often builds strength. While 2020 was a year that many would rather forget, it has paved the way for the road to recovery.**

There are signs that better times may lie ahead. After the spring 2020 shutdowns, many economists were surprised by the speed at which economic activity rebounded once markets reopened. Employment levels grew faster than anticipated, as did consumer spending. Though the cooler months have slowed momentum due to a resurgence of the virus and new shutdowns, we shouldn't overlook the ability of economies to recover in 2021 once things restart.

Unlike previous recessions, the economic effects have been uneven and concentrated to certain sectors. This has resulted in a relatively weak multiplier effect for the overall economy. Canada's housing market has shown resilience. Many companies continue to adapt to the new normal, reassessing business models, leaning operations and innovating within the digital space.

Yet, others continue to struggle. In the service industry, hard hit with its many small businesses, there has been well-needed recognition that some of the most vulnerable citizens work in sectors that help hold our society together. Canadian equity markets have been hindered more than their U.S. counterparts, largely due to pressure on the energy and resources sectors. Sectors that have been able to thrive, such as technology, have helped drive U.S. equity markets.

One must not overlook the significance of stimulus efforts in providing support. Canada has the largest stimulus deficit of any nation globally in 2020.[1] This has helped to fuel an ongoing debate that challenges mainstream economics. Proponents of "Modern Monetary Theory" (MMT) argue that a country with its own currency should not worry about accumulating debt and can print as much money as needed, as long as there is an increase in demand to keep the currency's value stable. Regardless of this heterodox view, 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.[2] Many economists remain concerned with the future debt burden: will recovery drive enough economic growth to reduce this burden or will austerity in the form of tax increases or reduced spending be needed?

In the U.S., a reset has begun as a result of the highly contested presidential election, widely watched by Canadians. After an autumn of rampant civil and social unrest, there is hope that new leadership and a much-needed stimulus package will support the U.S. this winter.

Most notably, we have made remarkable progress in the race to find a vaccine in a significantly compressed timeline. This is exceptional, given the typical vaccine time-to-market is 10 to 15 years. The fastest to date has been the mumps vaccine, which took four years.[3]

Progress in combatting a pandemic takes time. However, as we have seen in 2020, equity markets don't wait on the sidelines for recovery to happen. They are, after all, forward looking. Moreover, periods of retrenchment have almost always been followed by new growth, expansion and progressing equity values. There is little reason to expect otherwise in this cycle.

After a difficult 2020, we are all deserving of a better year ahead. Continue to look forward to better times to come.

1. As a % of GDP; 2. "The Bearable Lightness of Canada's Debt Burden", Globe & Mail, 10/30/20, p. B6; 3. http://nationalgeographic.com/science/health-and-human-body/human-diseases/coronavirus-vaccine-tracker-how-they-work-latest-developments-cvd/

### In This Issue



**Gosnell Galbraith Wealth Management**
TD Wealth Private Investment Advice
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### To Our Clients:

*While we face continued challenges this winter with the resurging virus, we can take comfort in the news of promising vaccines to bring optimism for 2021. Continue looking forward and positioning your wealth for better times to come; we're here to provide this support.*

*This is likely a different holiday season for many of us. We hope that you and your loved ones stay safe and healthy, and we wish you every happiness for the holidays and the year ahead.*

Tom Doug

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■ Retirement Planning

# Don't Need Excess Funds? RIF Minimum Withdrawal Planning

As you think about retirement, maximizing your retirement income is an important part of this exciting transition. Ultimately, it's your after-tax income that counts: paying the least amount of tax on your income can help you keep more of your hard-earned dollars.

Carefully consider and plan for all sources of income, including pension income, non-registered assets, and Tax-Free Savings Accounts (TFSA). If you have sufficient funds through pension income and non-registered assets to meet your retirement expenses, it may make sense to only withdraw the mandatory minimum amount from your registered Retirement Income Fund (RIF) or locked-in plans such as Locked-in Fund (LIF), Locked-in Retirement Income Fund (LRIF) or Prescribed Retirement Income Fund (PRIF) each year. This allows for continued tax-deferred growth within the plan. Here are some additional strategies to help keep funds invested for longer:

**Basing the withdrawal rate on a younger spouse's age** — If you have a younger spouse, consider basing your withdrawal rate on their age in order to lower the amount of the required annual withdrawal, thereby helping to keep more assets to potentially grow within the plan on a tax-deferred basis.[1]

**Making your first withdrawal at the end of the year in which you turn 72** — You are required to convert your registered Retirement Savings Plan (RSP) or Locked-in Retirement Account (LIRA) into a RIF/LIF/LRIF/PRIF by the end of the year in which you turn age 71, but don't need to make the first withdrawal until the end of the year in which you turn age 72.

**Timing annual withdrawals at the end of each year** — The timing of withdrawals can make a difference over time. If you take your withdrawal at the end of each year, instead of the beginning, you allow for greater time and potential compounding of funds within the plan.

For example, consider a 71-year-old with a marginal tax bracket of 40 percent and an RIF worth $500,000 that has an annual rate of return of five percent. If this individual withdraws the minimum from the RIF at the end of the year in which they turn 72, the after-tax income from age 72 to age 90 will be higher than if payments were made at the start of the year. As well, by the age of 90, $315,970 would be remaining in the RIF, as opposed to $293,177, if payments were made at the start of every year.[2]

**RSP Season Reminder**

*Deadline for 2020 RSP contributions:* **March 1, 2021**.

*RSP contribution limit: 18 percent of the previous year's earned income, to a maximum of $27,230 (for 2020).*

### Plan Ahead

While these strategies involve minimum withdrawals from your RIF, consider that, in some cases, withdrawing more than the minimum amount can improve an overall lifetime tax bill. Every situation is different. As such, please get in touch if you require support as you think ahead.

1. Provincial locked-in plan legislation for LIF/LRIF/PRIF allows for the use of a younger spouse's age, with the exception of New Brunswick; 2. Based on current prescribed RIF withdrawal factors.

■ Income-Splitting Strategies

# Investment Loans to Spouses Can Make Sense

Consider income-splitting opportunities for the year ahead. With the prescribed rate at its lowest level possible, one strategy may involve splitting income with a spouse by use of a loan.

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.

**Why is a spousal loan required for this strategy?** 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 paid will be taxable income to the spouse loaning the money and may be deductible from the investment income earned by 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 (see CRA website[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 within a short period of time. The CRA has stated that where a higher-income spouse gifts funds to a lower-income spouse to contribute to a TFSA, and these funds are immediately withdrawn from the TFSA and reinvested, future income or capital gains earned would be taxable to the original high-income spouse.[2]

Please seek the advice of a tax specialist for your particular situation.

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

## Investing Resolutions

# 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 future financial success. As we look to better times to come, 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 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 the course with your investments. Not everyone is able to keep calm during a crisis, which is understandable. However, 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 as you work towards 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 cash flow could potentially 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.

## Market Perspectives

# Equity Market Volatility: The Norm

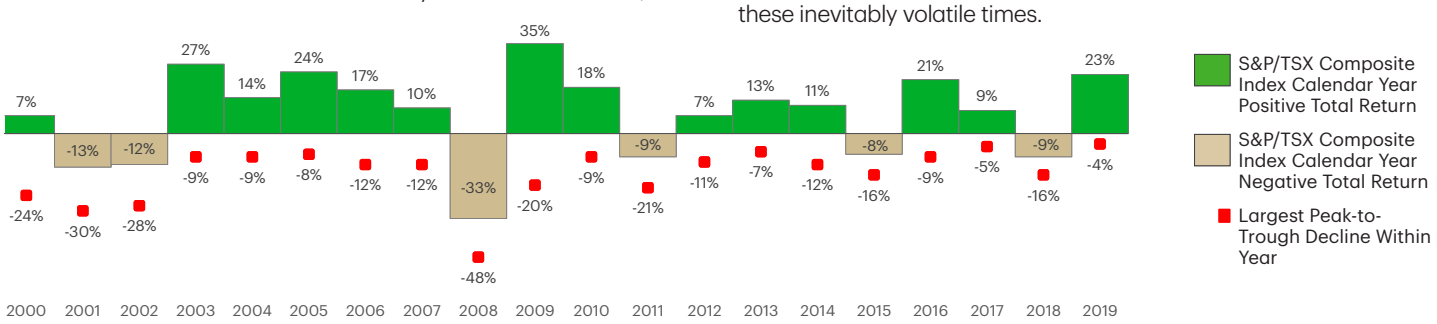
Was 2020 a more volatile year in the equity markets? With heightened noise, it may have felt as though the markets were particularly unsettled.

Yet, a look back over the last 20 years shows that volatility has always been a common feature of the equity markets. The chart below shows the biggest peak-to-trough drawdowns during the year for the S&P/TSX Composite Total Return Index and the resulting annual returns. In 12 of the last 20 years, there has been a double-digit, intra-year correction. Significant volatility is no stranger to the markets.

Today, many factors have helped to drive volatility. Interest rates continue to be at historical lows and many traditional lower-risk, fixed income investments no longer provide meaningful returns, which has pushed many investors into equity markets in search of higher returns. There was no shortage of negative news in 2020, which may also have helped to support volatility. As well, there continues to be significant money sitting on the sidelines, which has driven volatility as investors enter and exit the markets.

However, keep in mind that short-term volatility often has little bearing on what happens over the longer term. In fact, in half of the years where the market experienced a double-digit, intra-year correction, the market ended up finishing in positive territory. Extending the time horizon out across many years may further reduce the effects of volatility.

These perspectives may be good food for thought as we weather these inevitably volatile times.




Source: S&P/TSX Total Return Index, Jan. 1, 2000 to Dec. 31, 2019.

■ Perspectives for the Year Ahead

# The Timeless Wisdom of Warren Buffett

After a difficult year, we may all benefit from some perspective as we enter into 2021. Who better to draw on for that wisdom than one of the most successful investors of our time, Warren Buffett.

Many of Buffett's messages are timeless. In fact, a recent academic study analyzed years of Buffett's shareholder meetings, which draw tens of thousands of investors from around the world, and confirmed that the Oracle of Omaha's key messages have recurring themes.[1] Here are four:

**Don't overlook the power of compounding.** After a year of many setbacks, it may be difficult to remember that growth often takes time. Consider that even though Buffett has been investing since he was young, over 90 percent of his wealth was made after the age of 65.[2] Time and the power of compounding are key drivers of wealth creation.

*"The nature of compound interest is it behaves like a snowball of sticky snow. And the trick is to have a very long hill."*

**Invest with a view for the longer term.** When Buffett invests in a company, he views himself as an owner and takes a thoughtful and longer-term view of its prospects. He worries less about what happens in the short term, and focuses on businesses that continue to have a competitive advantage over the longer term.

*"Nobody buys a farm based on whether they think it's going to rain next year. They buy it because they think it's a good investment over 10 or 20 years."*

**Maintain self-discipline.** Buffett has always said that temperament is key to investing. In this digital age, where we are constantly being fed news and opinion, Buffett reminds us that investing requires the ability to detach from the views of others and make decisions based on the facts.

*"You need to be able to look at the facts about a business, about an industry, and evaluate a business unaffected by what other people think. That is very difficult for most people...Don't do anything in life where the answer is, "everybody else is doing it." If you cancel that as a rationale for doing an activity in life, you'll live a better life whether it's in the stock market or any place else."*

**Controlling emotions can be key to investing.** Investors were tested by extreme volatility in the markets in 2020 — the CBOE Volatility Index (VIX), known as the "fear index," hit its highest level since the 2008-09 financial crisis.[3] But Buffett has always emphasized the risk of letting emotions influence decision making.

*"To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework."*

Buffett has also offered his thoughts on the pandemic, with a view of optimism for the future:

*"This is a terrible event. But there will be other things that happen in the world in the next 5, 10, or 20 years. That's how the world works; it's not a totally even course. The progress of mankind has been incredible and that won't stop...there will be interruptions, but I also know that we'll come out better on the other end."*

Thank you to Warren Buffett for allowing us permission to share his timeless wisdom.



1. https://markets.businessinsider.com/news/stocks/warren-buffett-key-investing-tips-holding-cash-patience-shares-business-2020-10-1029698894; 2. Based on shares of Berkshire Hathaway (BRK-A). 8/30/95: $25,300; 10/30/20: $302,500; 3. https://cnbc.com/2020/03/16/wall-streets-fear-gauge-hits-highest-level-ever.html

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