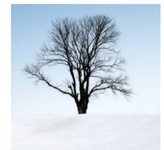
TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Winter 2022



Lessons in Endurance

Adversity can make us stronger. Last spring, during the depths of the pandemic, the *Wall Street Journal* published an article that suggested that when humans prevail through extreme emotional and physical challenges, they often emerge stronger, in what psychologists have termed "post-traumatic growth."[1]

The article sought advice from endurance athletes who overcame the extreme challenges of their sport: a distance-swimmer who regularly trains in 10 degrees Celsius water and a sailor who has competed in ocean swells for 16 hours straight. Through their adversity, they have learned how to maintain confidence, persevere and be resilient.

As we look forward to the year ahead, there may be renewed hope that the worst of the pandemic is behind us. Over the past 20 months, we've each had to endure adversity in our own ways; the pandemic forced many of us to confront uncomfortable and tragic situations. However, the hope is that we will be able to move forward, perhaps a bit more resilient than before.

These lessons in endurance may be particularly helpful in guiding us as investors as we look to the investing journey ahead. Some market observers have pointed to the current outlook for the financial markets as being uncertain. High levels of government debt, ongoing supply chain issues, the likelihood of rate increases by central banks and persistent inflation continue to dominate the headlines.

When new challenges emerge, they can often drive short-term market behaviour. Yet, sometimes overlooked is our ability to adapt and progress. The capacity of many companies to continue to post strong earnings throughout these unprecedented times, some at record levels, is one such reminder. Humans have always been conditioned to overcome new challenges and advance. We may also be wise to remember that predictions, which tend to regularly occur this time of year, can often be wrong. Do you remember last year's outlook? Take the price of oil as one example. A year ago, few would suggest that oil prices would appreciate by over 60 percent within the year.[2]

Uncertainties will always be present in some form or another. However, portfolios built on a solid foundation, using securities selected with quality, diversification, strategic asset allocation and individual needs in mind, can often prove to be enduring within the ever-changing investing landscape.

In This Issue

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To Our Clients:

May the turning of the calendar bring bright days ahead. As we remind readers on page 2, "greatness is not in where we stand, but what direction we are moving." Continue to look forward and keep building your wealth for tomorrow. Despite the near-term uncertainties, we remain optimistic for the future and for longer-term growth prospects.

As we move into 2022, let's expect the best knowing that we have a plan in place to guide us forward. Here's to much health, hope and prosperity for the year ahead.

— Peter and Jeff

At the same time, equity market performance in 2021 should remind us that sitting on the sidelines is not a prescription for growth. For many investors, the road ahead may be a long one and these lessons in endurance may be helpful as we look to withstand the passage of time. The advice of one endurance athlete saliently reminds us of how gratifying arriving at the destination can be: "*eventually you look back and think: 'Wow, look how far I've gone.'*"[1]

1. "Hard Earned Lessons in Endurance," Bonds Bernstein, Wall Street Journal, May 5, 2021; 2. Based on the price of West Texas Intermediate (WTI) oil. At time of writing, WTI crude oil spot price 11/25/21 = $78.31; 1/4/21 = $48.52. At its high, 10/26/21 = $84.65.

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RRSP Season: Here Again

RRSP Check Up: Are You Using Your RRSP to Its Full Potential?

Registered Retirement Savings Plan (RRSP) season is here once again. Are you using the opportunities presented by the RRSP to their best benefit?

Beyond fully contributing to the RRSP to maximize the tax-savings opportunity today and the potential for tax-deferred growth in the future, here are three other considerations:

Contribute to a Spousal RRSP — If you have a spouse (or common-law partner) in a lower-tax bracket, contributing to a spousal RRSP can help build your spouse's retirement nest egg and lower the amount of tax you pay collectively. When you contribute on behalf of your spouse, you will receive the tax deduction. If you are in a higher tax bracket, the tax benefit will be greater than if your spouse contributed to his/her own RRSP. There may also be a tax break, down the road, when your spouse withdraws funds and you remain in a higher tax bracket than your spouse. While there may be noteworthy income-splitting benefits to a spousal RRSP, keep in mind that the RRSP is intended to be a long-term retirement savings vehicle. As such, a withdrawal within three years of a contribution to a spousal RRSP may be included in your taxable income rather than your spouse's.

Draw Down an RRSP...and Consider Funding a TFSA — If you are approaching retirement, there may be benefit in gradually drawing down RRSP funds. This may be useful if an individual is currently in a lower tax bracket than they expect to be in future years. Other individuals may seek to limit future sources of taxable income in order to minimize the possible clawback of income-tested government programs such as Old Age Security. One strategy may be to use these RRSP withdrawals to fund Tax-Free Savings Account (TFSA) contributions, assuming available contribution room. With the growth of investments in the TFSA, there may be greater flexibility in the future to receive TFSA withdrawals tax free as needed; by contrast, the RRSP would generally be converted to a Registered Retirement Income Fund (RRIF), which requires minimum annual amounts to be withdrawn and included in taxable income. At death, funds remaining in a TFSA can pass tax free to heirs, as opposed to residual RRSP or RRIF funds that are subject to tax, potentially at high marginal tax rates.

Consolidate Multiple RRSP Accounts — For many individuals, having multiple RRSP accounts isn't uncommon. Scattered accounts can accumulate over time: you may have had an employer-sponsored account or opened a self-directed RRSP during different points of your life. However, there may be benefit in consolidation. One reason is to avoid having orphan accounts, such as a lost employer-sponsored account that is forgotten after a move of residence. Multiple accounts can also result in unnecessary complications such as failing to maintain a productive asset mix. Consolidation has the potential to improve performance, simplify administration and potentially reduce fees.

RRSP Season Reminders

Contribution Deadline: The RRSP contribution deadline for the 2021 tax year is March 1, 2022.

Contribution Limit: 18 percent of the previous year's earned income, to a maximum of $27,830* for the 2021 tax year.

Update Beneficiaries: Consider reviewing RRSP beneficiaries to avoid any potential issues when settling your estate.

Turning 71 this year? Your RRSP will mature and proceeds must be included in income unless converted or transferred to an annuity or RRIF by December 31, 2022.

*Subject to any applicable pension adjustments.

Reminders to Begin Another Year

Keep Your Funds Working Hard for You

"Greatness is not in where we stand, but in what direction we are moving. We must sail sometimes with the wind, and sometimes against it — but sail we must, and not drift, nor lie at anchor."

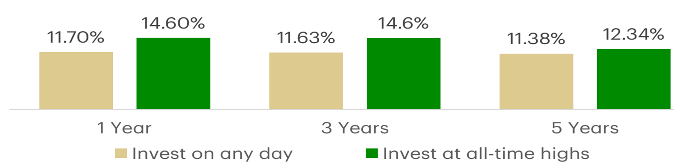
— Oliver Wendell Holmes

Being invested can be one of the best ways to grow wealth over the longer term. Yet, after an extended period of gains, some investors may feel hesitant to put money to work in equity markets. A recent *Forbes* article suggests that historical data does not support the idea that investing at market highs is likely to provide lower future returns (chart 1).

Also worth repeating: While equity market volatility was muted for most of 2021, this is the price paid for the upside potential. Consider that $100,000 invested in equities 10 years ago may have been worth over $177,000; a bond portfolio may have yielded around $147,000 (chart 2), and bond income would be taxed at a higher rate than dividends and capital gains. If you kept funds in cash, at a 2 percent inflation rate your purchasing power would have eroded by 18 percent!

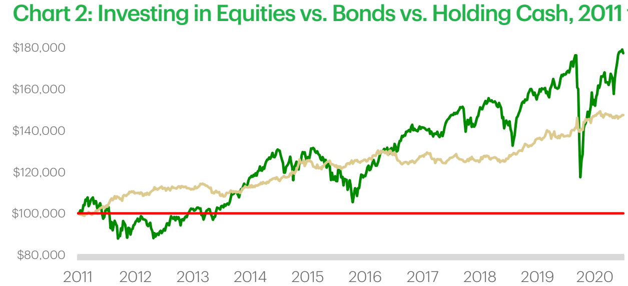
The best investment opportunity is valueless unless we actually make use of it. Put time on your side and keep your money working for you.

Chart 1: Average Annual Returns in S&P 500 Index, 1988 to 2020



Sources: S&P 500 TR Index, based on www.forbes.com/sites/kristinmckenna/2021/03/05/should-i-invest-when-the-market-is-high-dispelling-the-buy-low-sell-high-myth/

Chart 2: Investing in Equities vs. Bonds vs. Holding Cash, 2011 to 2020



Sources: Equities: S&P/TSX Composite TR Index, Bond Portfolio: Core Canadian Government Bond Index ETF, 1/1/11 to 12/31/20.

Happy New Year!

Investing Resolutions for the Start of a New Year

As we look to the year ahead, this is the traditional time for making resolutions. Often, these relate to getting into physical shape after a holiday season of indulgence. However, consider that certain practices may also help to better shape your investing ways. Here are some ideas:

- **Recognize that time can be one of your greatest assets.** The odds of investing success may fall in your favour when you combine a long time horizon with the power of compounding investments. Even average returns, compounded over a long time period, may lead to superior overall results. Consider that a one-time, lump-sum investment of $55,000 could yield around $209,000 in 25 years at a compounded annual rate of return of 5.5 percent. However, in 55 years, it could yield over $1 million.
- **Accept that markets are inherently volatile.** Volatility is what allows equities to be one of the greatest generators of returns of any asset class over the longer term.[1] While volatility was muted for much of 2021, recognize that it is a permanent fixture in equity markets. Over time, equity markets will have up years, such as the one recently experienced, but also difficult down years.
- **Maintain patience, through good times and bad.** Participation, by having the patience to see through the inevitable ups and downs, can make a significant difference in investing. Successful investing often involves overcoming many short-term setbacks to enjoy longer-term compounding and progress.
- **Don't abandon risk controls.** When equity markets are rising, it may be easy to get caught up in the excitement and forget that various guidelines have been established to control risk within a portfolio — for example, strategic diversification, rebalancing to a certain asset mix, limiting the size of any holding and maintaining quality criteria for holdings. These help to guard against being caught in the prevailing momentum by identifying potential risks that may not be overly apparent.

- **Stop listening to the noise.** Everyone has an opinion on investing and the markets. In good times, everyone can sound like an expert and we may fear missing out. In difficult times, media headlines can magnify economic misery and instill fear. At the end of the day, thoughtful analysis should drive decision-making — not any peripheral noise.
- **Save more.** Saving is one of the cornerstones of building wealth. You can build wealth without a high income, but you have no chance without a high savings rate. Saving is one aspect that an investor can control — unlike many others, such as stock market performance, interest rates or the timing of recessions.
- **Don't underestimate the value of support.** We are here to provide support at every stage of the investment journey to help you achieve your goals, and this can extend beyond investment advice. This may include helping to maintain discipline, through saving or investing, or to enhance total wealth management, through retirement-planning, tax-planning or estate-planning support. Studies continue to show that advised clients have greater assets — more than 3.9 times the assets than non-advised investors after 15 years — and greater discipline through volatile times.[2]

1. www.visualcapitalist.com/historical-returns-by-asset-class/; 2. IFIC, https://www.ific.ca/en/articles/canadian-investors-value-advice/

You Asked: Your Questions Answered

Estate Planning: Can I Sell the Cottage for $1 to My Kids? *And More...*

Part of wealth planning is helping to ensure our hard-earned assets are passed along as intended in the future. In our work with clients, we are often asked questions in this area. Here are two:

Q: Can I sell the cottage to my kids for $1?

A: Often, children do not have the funds required to buy a family cottage or cabin. As such, some parents ask if they should sell the cottage for a value substantially lower than the fair market value (FMV). However, there are likely to be tax consequences. If a cottage is not considered the principal residence, there will be tax on the capital gain: the difference between the adjusted cost base (ACB) and FMV. The child's ACB will be determined by the actual price paid, which may lead to the child paying tax on a gain already realized by the parent, when the child eventually sells the property.

Let's take the example of a cottage that is sold for $1 to a child. If the FMV is $1 million and the ACB to the parent was $400,000, the taxable capital gain to the parent would be 50 percent of $600,000 (or $300,000). For the child, a purchase at $1 results in the child's ACB being $1, rather than the property's FMV. So, if the property was sold in the future for $2 million, the capital gain would be the full $2 million less $1. This results in double taxation as it includes the parents' earlier capital gain as well as the original amount paid for the property. Instead, there may be better options, such as gifting the cottage. Although there will still be a substantial tax liability to the parent at the time of making the gift, the child's ACB will be equal to the FMV at the time and double taxation will be avoided.

Q: My granddaughter just turned age 19. Should she have a will?

A: Many estate planning professionals suggest that you are never too young to have a will. Although young adults may not possess significant assets, a simple will can make key appointments, such as who will be the executor, or perhaps direct instructions about the care of pets. Those lacking substantial assets may consider the use of a will kit or online site to do this in a cost-effective way. Still, others may have accumulated significant assets, such as intellectual property, digital assets or even digital currencies. A will can also help to avoid any administrative burden. Without a will, you are considered to have died "intestate," meaning that assets will be divided according to provincial laws. There are likely to be costs to the estate and potential delays in settling the estate. In the least, sitting down with young adults to discuss the importance of a will can help to instill good estate planning habits from a young age. Let's not forget that around half of adults don't have a valid will and it isn't uncommon to procrastinate, even to an old age, in setting up proper estate planning documentation.

For more details, seek the advice of estate planning professionals relating to your situation.

Accessing the Cash Value: The Immediate Financing Arrangement

Life insurance is often viewed as a pure risk management tool. Yet, consider that a permanent life insurance policy with a cash value component, such as universal life or whole life, may also act as a flexible planning tool to support tax planning, fund liquidity needs or facilitate business succession planning.

As the cash value component grows, it may be accessed while the policy continues to provide protection. Generally, this can be done in three ways: i) Withdraw the cash value; ii) Borrow from the insurance company based on the policy's terms; or iii) Use the cash value as collateral for a third-party loan, through an immediate financing arrangement (IFA) strategy.

For high-net-worth individuals and business owners who are comfortable using leverage, an IFA has the potential to be a flexible financial planning tool. The IFA assigns the policy to a lender, such as a bank, as security for the loan, which typically can be between 50 and 100 percent of the cash value. The individual or business pays loan interest to the lender going forward. While the loan can be repaid at any time, the intent is often for it to be repaid upon the death of the insured. Upon death, the life insurance death benefit proceeds would be used to repay the bank loan. Any insurance proceeds remaining after the loan repayment would be paid tax-free to a named beneficiary.

An IFA arrangement may provide various benefits, including:

Tax Planning — Compared to other ways of accessing a policy's cash value, with an IFA income tax is not generally payable by the policyholder and loan proceeds are not considered as income for tax purposes. When the funds from the loan are invested in a business, investment or other income-producing activities, the loan interest may be tax deductible. Assuming the loan interest is deductible, an annual tax deduction is received for the interest paid and the collateral insurance deduction.

Funding Liquidity Needs — The bank loan replenishes the funds used to pay for the life insurance allowing the proceeds from the loan to be used for investment purposes or reinvested into a business. This can reduce net after-tax cash flow by allowing the business to claim tax deductions and keep more funds working within the business while still maintaining insurance protection for the insured.

Business Owner Succession Planning — Generally, when a life insurance policy is held within a corporation, the death benefit amount received less the policy's adjusted cost-basis may be credited to the corporation's capital dividend account (CDA), often allowing a tax-free dividend to be paid to the shareholders of the corporation. With an IFA, the corporation receives a credit to the CDA on the same basis, regardless of the loan amount, even when the death benefit is paid directly to the creditor. This may facilitate business succession planning by providing significant tax savings when distributing assets to shareholders.

Alongside the benefits, there are financial and tax risks associated with any planning strategy when leverage is involved. Depending on the arrangement, there may be tax consequences when the IFA is held within a corporate structure. Typically, proceeds from the loan are received by the policyowner; however, if the loan is made directly to the shareholder, instead of the policyowner, which would be the corporation, there may be additional tax risks. Due to current low borrowing rates, the IFA may appear favourable; yet, IFAs are intended to be long-term arrangements and future increases in interest rates can impact the arrangement. If the spread between the loan interest rate and policy interest rate widens and the accumulated loan balance increases faster than projected, the borrower may need to provide additional collateral, partially repay the loan or surrender the policy. Other risks include potential changes to debt servicing requirements, tax rules, loan requirements due to mortality risk, overall performance of the life insurance policy and the lending institution's practices.

When considering this planning, it is essential that clients seek legal and tax advice from professional advisors to assess the implications relating to your own particular situation.

Note: The terms and conditions noted in this article may not apply within the province of Quebec. In Quebec, the use of a life insurance policy as collateral involves the use of a movable hypothec.

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