TD Wealth

Wealth Insights

TD Wealth Private Investment Advice

Summer 2022



Paul Kwan
Senior Investment Advisor
T: 604 482 8498
F: 604 482 8427
paul.hc.kwan@td.com
www.paulkwan.ca

In This Issue

To My Clients:

While it may be difficult to look beyond today, this period of market volatility and economic uncertainty will eventually pass. Market pullbacks are discomforting, yet they remain a normal part of investing. While the media has been busy magnifying the uncertainties and suggesting that this time is different, I remain confident that better times will eventually prevail.

As your advisor, I have managed through periods such as these. Part of my role is to help investors navigate these challenging times. If I can help in any way, please call. I hope you will find time to enjoy the long days ahead.

Maintaining Conviction

These days, investors have needed a significant amount of conviction. After last year's largely uninterrupted rise in equity markets, 2022 has seen a rapid reversal in direction and sentiment.

While it was anticipated that inflation would ease as we moved into a post-pandemic world, it largely hasn't. With new headwinds from the war and the spring Covid shutdowns in China, central banks have taken more aggressive action to combat inflation. With slowing economic growth, there are worries that this will lead to a "hard landing" resulting in recession. This has created significant jitters in the markets.

It may feel as though optimism is in short supply, but there are reasons to keep perspective. We have come from a period in which record government stimulus benefitted the markets and economies, so a period of adjustment was expected. We are now seeing earnings facing headwinds as consumption patterns begin to balance toward services and inflation impacts company costs. Yet, while current high inflation is more than just transitory, consider that it's likely not to be permanent.

As the media tries to evoke worry that a recession is imminent, consider that economies, like markets, are cyclical in nature. Recessions also vary in intensity and duration. Our most recent recession during the depths of the pandemic lasted only three months; the one prior in 2008 lasted only seven.[1] Recessions are often characterized by excesses of inventory, capacity or credit, which aren't largely apparent at the moment. Labour markets and household balance sheets are also at healthy levels to support consumer resilience.

Here at home, we are comparatively insulated from many challenges that face other nations. From a broad perspective, we are fortunate to have political and economic stability and security. With energy once again in the spotlight as a matter of national security, our domestic energy production, as well as our vast resources, serves us well. Our economy is expected to fare better than other advanced economies, in part due to our resources sector. Consider that in Q1 2022, Canada's GDP grew at a rate of over three percent,[2] whereas U.S. GDP contracted.

With continuing inflation, the Canadian equity market has performed better than its peers due to its composition (see page 2), especially as commodity prices have been pushed higher. Regardless, history has shown that over the long term, equity market returns have generally outperformed inflation and continued their upward climb.

This may be why Warren Buffett, arguably one of the world's greatest investors, added to his portfolio amidst the market pullback — in fact, the most assets since 2008. He recognizes that the long-term trend of equity markets has been up. Buffett's investing style involves purchasing quality investments at low prices and holding them for the long term. After all, one of the main drivers of equity markets is that economies have continued to progress through time, and investors can benefit from the investment, innovation and growth of participating companies.

Periods of volatility can be expected as we try to overcome the current challenges, but eventually the pendulum will swing back again. Market pullbacks are uncomfortable, yet they remain a normal part of investing. This is a time in which thoughtful portfolio oversight, scrutiny and selectivity can continue to benefit investors. Most important, investors should remember that successful investing often involves having trust in your wealth plan, continuing to stay invested and maintaining conviction that better days lie ahead.

1. C.D. Howe; 2. www.reuters.com/markets/us/canadas-first-quarter-growth-disappoints-31-april-gdp-seen-up-02-2022-05-31/

Paul Kwan
Wealth Advisory

Estate Planning

Trusts: Not Just for the Ultra Wealthy

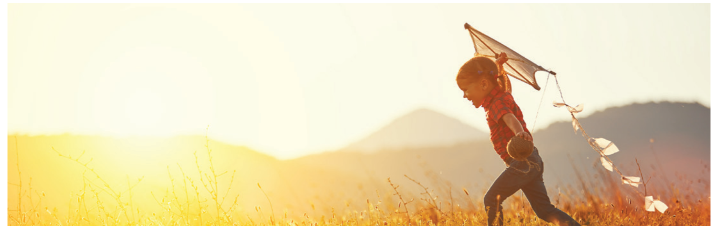
Trusts have often been perceived as a tool only available for the ultra wealthy. Yet, trusts may bring benefits to those of more modest wealth and may be worth the associated costs.

While trusts can be created during an individual's lifetime (known as "inter-vivos trusts"), here we focus on estate planning and the insertion of testamentary trusts in the Last Will. After death, the Will can have a testamentary directive instructing the executor to transfer certain assets (or a share of the residue of the estate) into a testamentary trust, to be held and administered by a trustee for the benefit of the estate beneficiary.

Here are three common situations in which a testamentary trust may act as a valuable estate planning tool:

1. Blended families. A spousal trust could be set up in the Will, where assets and funds are held in trust and made available to the surviving spouse for their lifetime while ensuring children from a previous marriage ultimately inherit the remaining wealth upon the death of the spouse. In the context of a second marriage, without a testamentary spousal trust, upon death the assets that would pass directly to the surviving spouse would ultimately be distributed to the beneficiaries as determined by the surviving spouse's Will. By inserting a spousal trust in the Will, upon the death of the surviving spouse, the remaining assets would be distributed according to the terms specified in your Will.

2. Beneficiaries who need support. A testamentary trust may be a good tool to help ensure ongoing support to dependent beneficiaries or those who may not be financially responsible. Since a minor generally cannot receive an inheritance prior to reaching the age of majority, through a trust, a trustee can manage and administer the inheritance of the minor child until they reach the



age of majority (or later, depending on the terms of the trust). A trust may be beneficial in situations in which dependents are disabled or incapacitated. A trustee would have discretion in the administration of the funds and control the timing and amount to be distributed to the beneficiary. As well, in certain provinces, it may be possible to set up a trust for those with a disability without compromising government disability benefits.

3. To protect inherited assets from a potential marriage breakdown of a beneficiary. A testamentary trust may be one way to pass down important family assets, such as a cottage or family business, while protecting children from having their share subject to a division in the event of matrimonial claims or claims from other potential creditors. With property prices skyrocketing for many cottages and cabins, or given the value of a family business, there may be concerns about passing along family assets to the next generation in the event of a potential marital breakdown of a beneficiary.

In the above circumstances, and others, having the protection of a trust can provide estate planning benefits. Establishing a trust, and the associated tax implications, may be complex and the benefits depend on individual circumstances. As such, we recommend seeking the advice of legal and tax specialists as you plan ahead.

Portfolio Management

Perspectives on Maintaining a Diversified Allocation

Over recent times, you may have heard references to the "rotation from growth to value." Up until 2022, many growth stocks continued their upward climb. However, due to higher inflation, slower economic growth and more aggressive tightening monetary policies, there has generally been a shifting narrative from the growth sector to the value sector.

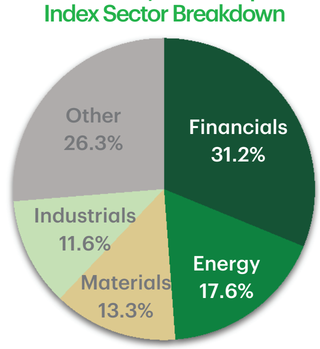
A **growth stock** generally refers to a share in a company that is expected to grow at a rate faster than the market average. Growth stocks often do not pay dividends because earnings are usually invested back in the company to generate further growth. Many technology companies are considered to be growth stocks.

A **value stock** refers to a share in a company that is priced cheaply compared to its fundamental value after accounting for earnings, cash flow and other metrics. Value stocks often issue high dividends. They tend to have more exposure to cyclical areas of the market, for instance financials, industrials, energy and materials sectors.

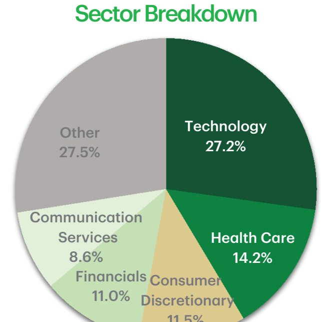
One observation is that Canadian and U.S. equity markets are structured quite differently (chart). The S&P/TSX Composite Index may be more heavily weighted to the value sector, whereas the S&P 500 Index is more highly weighted towards growth.

What does this tell us about the future? Over shorter time periods, different sectors will perform differently. This is one reason why diversification is important. No sector — or even asset class or geographical market — will perform at the top each year. Diversification can provide the opportunity to participate in the upside of the best performers each year. While it does not necessarily shield portfolios from broad-based declines which happen from time to time, diversification can help to protect portfolios from the natural downturns that may affect sectors, asset classes and geographies at different times.

Canada: S&P/TSX Composite Index Sector Breakdown



U.S.: S&P 500 Index Sector Breakdown



Sector breakdown at April 29, 2022. Source: S&P Global Factsheets.

Federal Budget 2022

The Proposed FHSA – Support for New Home Buyers and More?

This year's federal budget introduced a new tool intended to help support new home buyers. Proposed to begin in 2023, the First Home Savings Account (FHSA) is a registered plan that combines the tax benefits of the RRSP and TFSA; tax-free in and tax-free out.

With the average home price now around $817,000,[1] home ownership continues to rise further out of reach for many. Yet, it remains a social norm: according to a recent study, a high number of young Canadians — 88 percent — want to become homeowners.

The FHSA will allow Canadian residents over age 18 to contribute up to $8,000 per year, to a maximum contribution of $40,000, towards their first home.[2] Contributions will be tax deductible, similar to the RRSP, and qualified withdrawals will be tax free, similar to the TFSA. The FHSA can remain open for 15 years.

According to the government, the $40,000 limit was chosen as it represented around five percent of the average home price when the proposal was created, or $736,000.[3] While the limit has been criticized as being too low given prevailing prices, consider that maximizing contributions over the plan's lifetime has the potential to grow to over $75,000 based on a five percent annual return (chart). A couple who are both first-time home buyers could potentially combine their FHSAs.

Saving for a New Home: FHSA or RRSP/HBP?

One constraint is that the proposed rules do not permit use of the existing Home Buyers' Plan (HBP) alongside the FHSA. The HBP allows first-time buyers to withdraw up to $35,000 from the RRSP, subject to repayment in 15 years and other conditions. This has prompted some to ask: will the FHSA or RRSP/HBP be a better savings vehicle?

All things equal, the FHSA's structure appears to be more beneficial given the tax-free benefit for a qualified withdrawal when funds are used to purchase a first home. However, whether the FHSA or RRSP offers greater benefits is likely to depend on various factors, including available income or cash flow, timing of a home purchase, marginal tax rate, current/potential tax bracket, other income-tested benefits (such as child benefit payments), etc.

***Potential Growth of FHSA in 15 Years** — Based on 5% Compounded Annual Growth (Not Including Tax Benefit from Contribution)*

Year	Contribution	Start of Year	Growth @ 5%	End of Year
1	$8,000	$8,000	$400	$8,400
2	$8,000	$16,400	$820	$17,220
3	$8,000	$25,220	$1,261	$26,481
4	$8,000	$34,481	$1,724	$36,205
5	$8,000	$44,205	$2,210	$46,415
...15	—	$72,005	$3,600	$75,606

Under the proposed rules, there will be an option to move funds from one's RRSP to the FHSA, subject to FHSA annual and lifetime contribution limits; however, these transfers would not restore an individual's RRSP contribution room. If not used for a first-home purchase, the FHSA may be transferred to the RRSP after 15 years, without affecting RRSP contribution room.

Regardless, there may be ways to help maximize the value of the FHSA:

- **Start early!** As the FHSA can stay open for 15 years, take advantage of compounding over time. If the FHSA isn't used, funds can be transferred to the RRSP (or taxes paid on withdrawals).
- **Try to maximize the annual limit.** The more you save from the onset, the greater potential benefit you may achieve from compounded growth. Annual contributions are limited to $8,000 and unused contribution room does not carry forward.

Not Just for Young Canadians? Stay Tuned...

The recent budget proposals suggest that there is no age limit to invest in the FHSA. If this stands, there may be opportunities available for older Canadians.[4] As details are finalized and legislation is passed, this will become clearer. More to come...

1. www.cbc.ca/news/business/crea-housing-february-1.6385274; 2. financialpost.com/executive/executive-summary/posthaste-most-canadians-doubt-new-tax-free-fhsa-will-help-them-buy-a-home; 3. liberal.ca/housing/afford-a-downpayment-faster/; 4. "Three ways to make the most of the new tax-free savings account for home buyers," Erica Alini, The Globe and Mail, April 30, 2022, B15.

Upcoming Changes for High-Net-Worth Spenders

Expected To Arrive by Fall: A Luxury Tax on Cars, Boats and Aircraft

As of September 2022, shoppers will likely notice an increase in the cost of certain luxury vehicles. A luxury tax is set to apply to cars and aircraft with a retail value of more than $100,000 and boats with a retail value of more than $250,000.

The tax will be based on the retail sales value* of the good, and is proposed to be calculated as the lesser of:

(a) 20 percent of the retail sales price that exceeds the thresholds listed above: $100,000 for cars/aircraft and $250,000 for boats; or
(b) 10 percent of the full value of the luxury car, boat or aircraft.

For instance, if you were to purchase a car valued at $140,000:

(a) 20 percent of the retail price above $100,000, or $40,000 = $8,000
(b) 10 percent of the full value of $140,000 = $14,000
Luxury Tax = Lesser of (a) and (b) = $8,000
Sub-Total Price (Before Provincial Sales Tax and GST) = $148,000
GST = $7,400**

Total Sales Price with Luxury Tax and GST = $155,400

The luxury tax will be payable by a registered vendor based on the sale of the luxury good delivered in Canada, similar to how vendors are responsible for collecting and paying the GST or provincial sales tax.

While final legislation has yet to be enacted at the time of writing, the federal government quietly released revised draft proposals in March.

For more information, please see the Government of Canada website: www.canada.ca/en/department-finance/news/2022/03/government-releases-draft-legislative-proposals-to-implement-luxury-tax.html

*The retail value notably includes the fair market value of the subject item, the total amount of all fee(s) and charge(s), and additional tax(es), duty(ies), levy(ies) or fee(s) (federal and provincial). **GST calculation based on federal government backgrounder report.

Forward Tax Planning

Will Your Estate Be Subject to a High Marginal Tax Rate?

For some, it may be surprising to learn that their estate may be subject to a high marginal tax rate. This is because our property is deemed to have been disposed of at fair market value at death and subject to taxation.

When we reach retirement, it is common for many individuals to have a marginal tax rate that is lower than during their prime working years. However, at death, this may change. Given that our property is deemed to have been disposed of at fair market value at death and subject to taxation, in some cases, an estate may be subject to the top marginal tax rates.

For couples, the taxes that may be payable at death may be deferred using the spousal rollover or alternative strategies. A spousal rollover involves the transfer of certain registered funds (such as the Registered Retirement Savings Plan (RRSP) and Registered Retirement Income Fund (RRIF)) and/or capital property to the spouse (common-law partner) upon the death of the other. With a transfer to a surviving spouse, there will be no immediate tax consequences. However, upon the death of the surviving spouse, the assets are deemed as disposed of for tax purposes and may result in income inclusion and capital gains on the terminal return of the deceased. This may mean that the estate will be subject to the highest marginal tax rate, potentially leaving a tax bill that may significantly reduce the value of an estate.

As many people wish to maximize the wealth passed along to the next generation, reducing the tax liability on death may be an efficient strategy. Here are three considerations that may require forward planning:

The RRSP exit strategy. While postponing withdrawals from the RRSP allows tax-deferral opportunities, waiting too long to draw down the savings may have consequences. If you have other taxable income streams in retirement, you may be pushed into a higher marginal tax bracket. This may also result in a clawback of Old Age Security (OAS) benefits. As you approach retirement, and if you are in a lower marginal tax bracket, it may make sense to slowly draw down RRSP/RRIF funds. If you aren't in need of these funds, a potential opportunity may be to use these withdrawals strategically to fund a Tax-Free Savings Account to benefit from the future growth opportunity of the investments, as well as their eventual

tax-free withdrawal. However, one must consider the immediate tax implications involved.

Using a portion of the RRSP to fund insurance. Often, for high-net-worth investors who have contributed significantly to their RRSPs over their working years, there will still be funds available within the RRIF accounts at death. A partial drawdown to fund insurance can help to minimize the overall lifetime tax bill, especially when withdrawals occur in years in which the marginal tax rate is not at its highest. Funding a life insurance policy may be a way to provide an inheritance on a tax-free basis to a beneficiary(ies). Joint last-to-die life insurance is commonly used for this purpose by spouses, as insurance proceeds are paid out only upon the death of the surviving spouse.

Electing to not use the spousal rollover. There may be reasons to elect out of a spousal rollover for certain assets upon the death of the first spouse when there are opportunities to offset the potential tax liability. This can be done on a property-by-property basis. One common reason may be to use the deceased taxpayer's lifetime capital gains exemption (LCGE), where available. It may also make sense when the deceased's marginal tax rate is low on the date-of-death return. Finally, the first spouse may have unused capital losses carried forward that can be used to offset the resulting capital gains. A tax professional can help explore the options.

These are just some of the potential tax-planning opportunities to consider as you plan ahead. Please seek the advice of a tax planning professional as it relates to your particular situation.

Paul Kwan Wealth Advisory — TD Wealth Private Investment Advice
700 West Georgia Street, 10th Floor, Vancouver, BC V7Y 1A2
Toll Free: 1 888 668 9966 Fax: 604 482 8427 Web: www.paulkwan.ca

Paul Kwan
Senior Investment Advisor
604 482 8498
paul.hc.kwan@td.com

Erica Ng, CFP®
Associate Investment Advisor
604 482 2531
erica.ng@td.com

Lillian Hsiung
Client Service Associate
604 482 8343
lillian.hsiung@td.com

Paul Kwan
Wealth Advisory