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MAY 2024 EDITION
VOLUME 13, ISSUE 5

KPW FINANCIAL NAVIGATOR

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IMAGINE YOUR FUTURE

"The function of economic forecasting is to make astrology look respectable."- John Kenneth Galbraith

THE WAY I SEE IT

By SERGIO SIMONE

BALANCING OPTIMISM AND APPREHENSION

In our previous edition of the **KPW Newsletter**, we discussed how investors have been scaling the "Wall of Worry" over the past few years. As we turn the page, we find investors at a pivotal crossroads. One path is paved with hope, illuminated by the 54% of American investors who believe the stock market will rise in the next 12 months, according to Barron's latest poll. The other path is shadowed by fear. According to a new Bankrate survey which finds that nearly two-thirds of Americans (63%) don't expect their personal finances to improve in 2024. This issue delves into these contrasting perspectives, offering insights and strategies for navigating the road ahead.

THE WAY I SEE IT

The stock market was cruising along smoothly in the first quarter, but then—bam!—April hit like a jaw-shattering speed bump. Why? Well, inflation decided to be a stubborn party crasher. Investors suddenly had to rethink their whole outlook on interest-rate cuts by the Federal Reserve.

But wait, there's more! Those longer-term bond yields? They're still riding high, like they're on a caffeine buzz. And just when you thought inflation worries were enough, we've got a double feature: Middle East turmoil and the U.S. presidential election.

If the markets where a soap opera, we would be grabbing our popcorn right about now, wrapping ourselves up in a blanket and glue ourselves to the t.v. as we watched the market's twists, turns, and surprises galore.

Okay, so the stock market had a bit of a hiccup in April as the large-cap benchmark S&P 500 index SPX and the tech-heavy Nasdaq Composite COMP slumped 4.2% and 4.4% to log their first monthly decline since October, but guess what? I am not in the least bit concerned. I feel that April's little stumble was no more than a break after a string of winning months.

This is par for the course. A 5% monthly market decline is relatively common and really nothing to pay much attention to. Historically, a decline of this magnitude occurs about once every year across various time frames. It's important to note that market fluctuations are a normal part of investing, and while they can be unsettling, they are not uncommon.

These corrections and declines are part of the market's natural cycle and can occur due to a variety of economic factors.

Of course, no one knows how the markets will end the year, but as always, I do like to refer to Economic Indicators to help me form an opinion. I began the year with a cautious outlook, based on economic indicators, and these same indicators continue to suggest a cautious outlook for the markets through the end of 2024. Here is a summary of the key points.

Second Quarter: The GDPNow model estimate for real GDP growth in Q2 is 3.3%, suggesting a robust start to the middle of the year.

Mid-Year Outlook: Deloitte's forecast remains optimistic, with expectations of continued strength in the job market, consumer spending, and exports. However, they also caution about geopolitical risks and inflation concerns.

Second Half of the Year: The Federal Reserve is expected to navigate towards a soft landing, potentially cutting rates twice in the second half of 2024, aiming for a neutral rate of 2.5% to 3%.

Year-End Expectations: By the fourth quarter, the economy is forecasted to slow down to 1.8% growth, aligning with the anticipated gradual normalization of inflation and interest rates.

Balancing Optimism and Apprehension - Continued

Overall, while the first quarter has set a positive tone, the rest of the year is expected to see a mix of continued growth with a cautious approach towards rate adjustments and an eye on global economic developments. It's a balancing act between maintaining momentum and preparing for any potential headwinds.

When I take a bird's eye view I see a resilient economy and yet investors are feeling a bit wary about their personal financial situations as we head into the tail end of 2024, and here's why:

Inflation: It's like a shadow looming over everyone's wallets. A whopping 66% of investors are worried about inflation eating into their cash.

Healthcare Costs: Nearly half of the investors (48%) are sweating over rising healthcare bills.

Recession Fears: Almost half (46%) are biting their nails over the possibility of a recession.

Retirement Savings: Saving enough for a comfy retirement is keeping 44% of investors up at night.

Market Volatility: And let's not forget the rollercoaster ride of the markets—35% of investors are bracing for more ups and downs.

So, while the economy might be doing its thing, individual investors are looking at their own financial goals and thinking, "Can I really make this work with all these challenges?" It's a mix of personal goals clashing with economic realities, and that's got some folks feeling a bit blue about their financial future.

In closing, I'd like to offer a financial mantra for you all on how to deal with the balance of 2024.

"Keep calm and invest on!"

Imagine it on a motivational poster right next to a serene beach scene or a soaring stock chart. When the market gets bumpy, when inflation dances its wild jig, and when uncertainty knocks on your portfolio's door—just breathe, stay cool, and keep those investments chugging along.

And never forget the old adage that **"it's not about timing the market; it's about time in the market."** So, keep calm, hold steady, and let those compound long-term returns carry you toward financial harmony.

LIFESTYLE FINANCIAL PLANNING BY KPW

I spent some time in Florida on a family trip recently. Every morning for two weeks, my wife and I would take our son to a new park. Florida has so many beautiful children's play-grounds. One of these play-grounds was pirate themed. The slides, swings, and plat-forms all came together in the form of a pirate ship. They even had a treasure map and all sorts of other things you'd find swashbuckling your way through the Caribbean. My son loved it. He wanted to spend the night on the ship, asking us if "we could sleep here tonight". It took some work, but we were able to convince him that he probably wouldn't want to spend the night on a pirate ship in a children's playground in the middle of a massive Florida park ... with gators. Now that I'm back home and back to work, it's time to worry less about gators and pay a little more attention to things that bite into our financial plans. Things like inflation.

Several months ago, my wife and I updated our financial plan. As we completed our forward-looking review for 2024-2025, I noticed that our long-term inflation rate was set to 3%. For planning purposes, this is considered a high rate but a reasonably conservative planning rate. A more realistic long-term number would be about 2.1% but I like to error on the side of caution. As I mulled over this rate, it occurred to me, given the recent market and fed response to the latest inflation figures, that 3% might in fact be the new norm. Perhaps, I should project a more cautious 3.5% inflation rate or even a 4% rate. Often, the debate is over invest-ment return projections because we see our investment performance as an indi-cator of our potential lifestyle. But inflation is just as crucial a factor to lifestyle as investment returns.

Inflation is the silent saboteur of savings. It is a gradual increase in prices over time, which means today's dollar will not be able to buy as much tomorrow. A properly constructed holistic financial plan can navigate inflationary currents with the grace of a seasoned sailor (I hope you're ready for some sailing references because you can take the Ryan out of Florida, but you can't take the Florida out of Ryan). Imagine you're at the helm of your financial ship, and inflation is the wind trying to knock you off course. If you're not prepared, it can push you into the rocky shores of reduced purchasing power. For instance, if the inflation rate is 3%, the cost of goods and services will rise by 3% each year. That means something that costs $100 today could cost $103 next year. To stay afloat, your money needs to grow at least at the same rate as inflation.

Financial planning is your compass in the stormy seas of the economy. It helps you set a course that accounts for inflation, ensuring that your long-term invest-ments and savings don't get swallowed by the rising tide of prices. By using "what-if" analyses, you can project the impact of inflation on your future cash flow and adjust your sails accordingly. To weather the inflation storm, consider investing in assets that typically appreciate faster than the rate of inflation. It sounds simple but it's true! Stocks, real estate, and certain types of bonds can be your lifeboats, helping you stay dry when the waters get rough. Remember, it's not just about surviving the storm but thriving in it.

We've all heard the saying: "don't put all your eggs in one basket". Or in pirate terms: don't rely on a single sail. Diversify your portfolio across different asset classes to spread the risk. That way, if one investment takes on water, the others can keep you buoyant. This was more difficult over the last 10 years when infla-tion was low because the only asset classes making much money were stocks and real estate. Also, everything was moving in the same direction at the same times. In other words, correlation between asset classes was somewhat high over the last ten years. Fortunately, these days, we're seeing less correlation between asset classes, and underperforming asset classes like bonds and GICs are con-tributing to portfolios again.

Inflation doesn't have to be a dreaded kraken lurking beneath the waves. A Kraken is a mythical sea monster – my son fought off many of them during his time at the pirate park. With a solid financial plan, you can turn the tide in your favor and sail towards a horizon of prosperity. So, hoist your sails, chart your course, and let the winds of inflation propel you to your financial goals!

This article is your map to treasure in the world of inflation and financial planning – without gators. For a deep dive into the strategies that can help you stay ahead of inflation, consult with a financial advisor.

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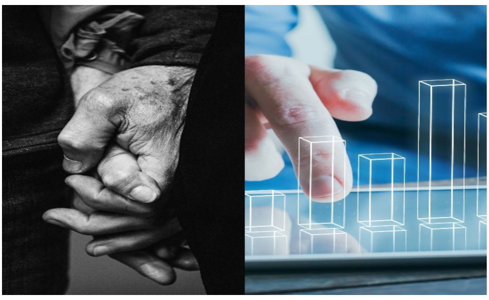


NAVIGATING FINANCIAL CONSIDERATONS AFTER THE LOSS OF A SPOUSE

Without question, the loss of a spouse can be a devastating and overwhelming experience. In both my professional and personal life, I have seen firsthand how the loss of a spouse brings with it an array of financial impacts to deal with in an already difficult time. Although thinking about loss is not usually on the top of our priorities, there is value in careful consideration ahead of time. Fortunately, there are steps to be taken that can reduce the burden on the survivor and allow for grieving and recovery.

In our life planning process, estate planning plays an integral role, and we have seen how the financial implications of losing a spouse vary. Thus, I would like to take some time to discuss some of the key financial considerations with respect to losing a spouse.

As a key part of our life planning process, we emphasize the importance of naming beneficiaries for assets that permit you to do so, such as jointly held assets and registered accounts. It is important to elect the spousal beneficiary designation in these circumstances to allow the assets to transfer to the survivor quickly and bypass probate. This supports the popular recommendation for spouses to hold accounts and real estate jointly, with rights of survivorship and naming spousal beneficiaries. Such transfers typically are done on a “rollover” basis, meaning they occur on a tax-deferred or tax-free basis.

Tax deferred rollovers include RRSP transfers, whereas TFSAs can remain tax free, while real estate and private company shares may be transferred at the adjusted cost base free of any triggered capital gains.

The loss of a spouse often signifies a time to change the investment strategy as income or expenses are generally impacted by the loss. Another indicator of the need to alter an investment strategy is when the deceased loved one had an investment knowledge, risk tolerance, or objective that differs from the surviving spouse.

We always caution against adding children’s names onto assets like bank and investment accounts or real estate, as this can lead to unintended consequences. Some of these include exposing assets to creditors or family law claims, unfavourable tax implications for the family, or providing the child with undue access to the assets.

The topic of the home can be a contentious one, whereby the balance between emotions, affordability, needs and wants, must be navigated. The key is that decisions surrounding the home need not be rushed; bearing in mind that the survivor may not be able to afford it or want to be in it alone which may add pressure. The reality is that the survivor may be able to make a better long-term decision if they are able to defer this decision until some time has passed to allow for mourning.

Pensions are another important consideration, and proper planning is critical when it comes to these. Depending on the type of pension, they may pay a survivor benefit, such as workplace Defined Benefit Pensions. At the time of beginning such payments, one is typically provided with options for the spouse should they survive the recipient. For example, this can look like a 50%-66.7% survivor benefit in the case of normal pensions, while some plans may allow for higher survivor benefits, up to 100%, or even the option to waive the survivor benefit entirely in some circumstances.

It’s important to note that the higher the survivor pension percentage, the lower the monthly payment when the pension begins. You can compare electing a higher survivor option to buying a life insurance policy, and based on this protection, the pension payments are decreased slightly as a result.

Pensions also offer protection if a spouse dies before beginning their pension, such as an immediate survivor pension, a deferred survivor pension, or a lump sum payment, often partially taxable, known as the commuted value. The takeaway is that educating yourself on how your pension will play out for you and your spouse plays an integral role the planning process. Surviving spouses are also afforded protection by The Canada Pension Plan (CPP), with two different potential payments available. The first one is a lump sum payment of $2500 known as the CPP Death Benefit, for those who made sufficient CPP contributions during their working years. Further to this, surviving spouses may qualify for a CPP survivor's pension.

For survivors under 65 years of age, there is a flat rate portion per month plus a percentage of the contributor's retirement pension. For those over 65, there's no flat rate but a higher percentage of the retirement pension, however, you may receive less if you are receiving other benefits. For example, a spouse who is already receiving the maximum CPP retirement pension would not receive any survivor's pension. On the other hand, Old Age Security (OAS) pensions do not tend to pay anything to a survivor. Only for survivors between 60 and 64 living in Canada who have not remarried, with annual income below the maximum annual income threshold, may be entitled to an Allowance for the Survivor.

Following the death of the first spouse there are typically limited immediate tax implications for the survivor, such as a possible decline in pension income, or a higher income tax rate may be the result of losing the ability to income split.

When it comes to wills and powers of attorney, the death of a spouse is a good time to revisit these documents, however this may not necessarily trigger a need for updates provided the typical replacements beyond a spouse are named such as other family members. With respect to life insurance and registered accounts, spouses are the most commonly named beneficiary, sometimes with contingent beneficiaries. Therefore, on the death of a spouse, such designations need to be revisited. As such, children or other family members can be named as direct beneficiaries which can speed up the estate settlement process and avoid probate fees and associated costs.

Alternatively, assets can be left to the estate, allowing for more specific instructions for an inheritance in the will. An important fact to note is that TFSAs allow for either a successor holder or beneficiary designation for spouses. The key difference is that a beneficiary would receive the funds from the TFSA, and the deceased's TFSA would be closed. A successor holder would receive the actual TFSA with the funds still held within it, without impacting their own TFSA contribution room.

As many of our clients are familiar with, in recent years securities regulators introduced the concept of a trusted contact person (TCP), someone you authorize to serve as an emergency contact for your investment firm or advisor to contact on your behalf under certain circumstances. Some examples of when this may come into play is when you are unavailable due to travel, if there is suspected fraud or exploitation, or when there is a concern about mental capacity. The TCP differs significantly from a power of attorney or executor and is not authorized to make investment decisions about your account. The need for a TCP is arguably greater when someone loses a spouse, especially if they are older.

Major life events are always a time to reconsider estate planning and the death of a spouse is a primary example of such. Survivors will likely need to look for support to family members and professionals, so considering who will fill these roles ahead of time is advisable. With the proper planning in place, making rash major financial decisions can be avoided. As always, nobody has a crystal ball, so taking the time to consider these factors sooner rather than later is prudent to ensuring your financial well-being.

PROTECTING YOUR LIFESTYLE BY KPW

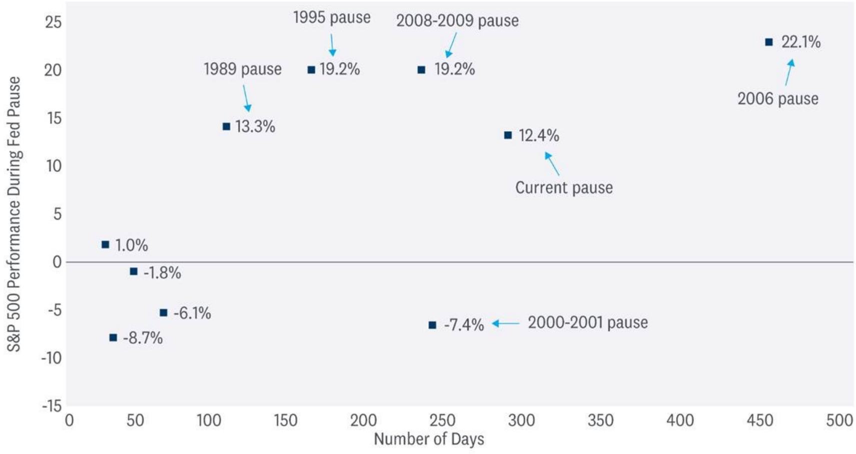
LONG PAUSES IN THE FED TEND TO BE ACCOMPANIED BY ATTRACTIVE MARKET GAINS

Historically, long pauses by the Federal Reserve in adjusting interest rates have often been associated with periods of stock market gains. For instance, during the current pause, which has reached 280 days—the second-longest in modern market history—the S&P 500 has gained 6% on average1. However, it's important to note that past performance is not always indicative of future results, and various factors can influence market movements.

The S&P 500 is aiming for the biggest gain in Fed interest rate pause history, with the index having risen just over 3% to extend its year-to-date advance to 8.8%2. This has been supported by better-than-expected corporate earnings and a pullback in Treasury bond yields, which are influenced by the Fed's assurance that rate increases aren't on the table soon2.

Yet, it's also worth considering that market conditions can change, and there are warnings of potential volatility ahead. For example, Morgan Stanley suggests that more economic and market pain may be in store, and investors should prepare for what could be extended volatility3. This highlights the importance of a well-balanced portfolio and strategies like dollar-cost averaging to navigate uncertain markets3.

In summary, while Fed pauses can be accompanied by stock market gains, investors should remain cautious and consider the broader economic context and potential risks. It's always wise to consult with a financial advisor to align investment strategies with individual financial goals and risk tolerance.



Source: LPL Research, Strategas, Bloomberg, 05/02/24

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LIFESTYLE FINANCIAL PLANNING BY KPW

PRIVATE WEALTH:
SOLUTIONS FOR HIGH-NET-WORTH INVESTORS

CREATING A LEGACY OF FINANCIAL AFFLUENCE

Beyond Wealth: Life Insurance as a Tool for High Net Worth Estates—by Sergio Simone

Contemplating one's mortality is often an uncomfortable task, yet the implications of inadequate preparation can be substantial. Estate planning serves as a prudent measure for those who wish to ensure clear directives for the distribution of family heirlooms, alleviate potential burdens on their loved ones, and optimize financial implications related to probate and taxation. In truth, estate planning is a beneficial endeavor for all individuals, and contrary to common belief, the process in Canada is quite straightforward and accessible.

Life insurance, a key component of estate planning, is often perceived merely as a safety net for the unforeseen, but transcends its conventional role when it comes to high net worth individuals. This article delves into the sophisticated strategies that leverage life insurance not just as a protective measure, but as a versatile instrument for estate planning, wealth transfer, and tax optimization. The following illuminates how affluent individuals can utilize life insurance to fortify their financial legacy, ensuring that their wealth serves their families and philanthropic endeavors long after they have passed. Through expert insights and strategic analysis, we explore the multifaceted benefits of life insurance, positioning it as an essential component in the arsenal of high net worth financial planning.

Two key elements of Life Insurance are its **Tax-Free Death Benefit** and its ability to **Preserve Wealth across generations**.

The Tax-Free Death Benefit is a key feature of life insurance policies in Canada. When a policyholder passes away, the named beneficiaries receive a lump-sum payment that is not subject to income tax. This applies to both term and permanent life insurance policies, regardless of the policy size. It is critical to directly name beneficiaries in the policy to ensure the tax-free status of the benefit. If the estate is named as the beneficiary, the proceeds may be subject to probate fees and other estate settlement costs.

By having a named beneficiary, there is an added benefit that the proceeds from a life insurance policy are also typically protected from creditor claims under provincial and territorial legislation.

Life Insurance as a Wealth Preservation Tool: High net worth individuals (HNWIs) can use life insurance to preserve their wealth across generations. It acts as a financial safety net, especially during market volatility.

High Net Worth Individuals (HNWI) can use life insurance to transfer wealth to their heirs tax-efficiently. The tax-free death benefit ensures that beneficiaries receive the full amount without any income tax implications or holdbacks.

Preserving Family Assets: By designating life insurance proceeds for specific purposes (such as funding education or maintaining a family business), HNWIs ensure that their legacy endures beyond their lifetime.

Life insurance can also act as a Risk Mitigator in volatile markets.

Life insurance policies provide stability during market downturns. While equity-based assets may experience volatility, the cash value of permanent life insurance remains stable or even grows.

HNWIs can access the cash value within their life insurance policies during market downturns without selling other assets at depressed prices. This liquidity acts as a financial safety net allowing them to weather economic storms.

Strategic Uses of Life Insurance:

Life insurance is often viewed through the lens of risk mitigation—a financial safeguard for the unexpected. However, for the astute planner, it is a strategic asset with multifaceted applications. There are sophisticated ways in which life insurance transcends its traditional role. From estate planning to business succession, wealth preservation to philanthropic endeavors, there are a myriad of ways that life insurance can be wielded as a powerful tool in the financial arsenal of individuals and families alike. Leveraging life insurance strategically can secure a legacy, provide for future generations, and offer stability in the face of economic uncertainty. Let's explore some of the less known applications of life insurance.

Funding Buy-Sell Agreements: Life insurance is a strategic tool for funding buy-sell agreements, which are contracts that outline how a business owner's interest will be transferred upon their death or departure. Here's a summary of how it works and the benefits:

Immediate Liquidity: Upon the death of a business owner, the life insurance policy pays out a death benefit, which is used to purchase the deceased owner's share of the business.

Pre-Determined Valuation: The agreement establishes the value of the owner's interest, ensuring a fair and agreed-upon price for the business shares.

Benefits of Using Life Insurance:

Tax Efficiency: The death benefit from a life insurance policy is generally received tax-free by the beneficiaries.

Cost-Effectiveness: Premiums for life insurance are typically lower than the potential loan interest, making it a cost-effective solution.

Family Security: Ensures that the family of the deceased owner receives cash, providing financial security rather than unmarketable stock.

Business Continuity: Facilitates a smooth transition of ownership without financial strain on the business or the remaining owners.

Overall, using life insurance to fund buy-sell agreements creates a clear plan for business succession, protects the interests of all stakeholders, and promotes an orderly transition of ownership. It's a prudent approach that provides peace of mind and financial stability for everyone involved.

Key Person Insurance: Also known as key person insurance, is a policy taken out by a business to compensate for the financial losses that may arise from the death or incapacity of an important member of the business, such as a founder, owner, key executive, or anyone with unique expertise or skills whose loss would be detrimental to the company's operations.

Benefits of Key Man Insurance:

Financial Security: Provides a financial safety net to the business in the event of the loss of a key person.

Operational Continuity: The death benefit helps the company continue operations without major disruptions.

Debt Settlement: Can be used to pay off debts, buy out the deceased's stake, or cover other financial obligations.

Recruitment Costs: Assists in covering the costs of recruiting and training a replacement for the key individual.

Investor Confidence: Maintains investor confidence by showing a plan is in place for unforeseen events.

Tax Benefits: The premiums are often tax-deductible as a business expense, and the death benefit is usually received tax-free.

Overall, key man insurance is a strategic component of business planning, ensuring that a company can withstand the financial impact of losing a pivotal member of its team

Charitable Remainder Trusts (CRTs): HNWIs can use life insurance to fund CRTs. These trusts provide income to the donor during their lifetime, with the remainder going to a charity upon their death. A CRT is an irrevocable, tax-exempt trust that allows you to support a charitable cause while receiving income for yourself or other beneficiaries.

Establishing a CRT begins when you transfer assets into the trust, which may include cash, stocks, or real estate. The trust then pays out income to you or other designated non-charitable beneficiaries for a specified period, which could be for the life of the insured or a term of up to 20 years.

After the income period ends, the remaining assets in the trust are donated to one or more charitable organizations.

By setting up a CRT, you may be eligible for a partial tax deduction based on the value of the charitable interest in the trust. A clear case of having your cake and eating it too. You get an income and a tax-deduction, all while supporting your favorite charities.

CRTs are a powerful tool for estate planning, offering benefits for retirement planning and potentially reducing taxable income. They also provide a way to give back to the community while ensuring that your financial needs, or those of your beneficiaries, are taken care of.

Irrevocable Life Insurance Trusts (ILITs):

An Irrevocable Life Insurance Trust (ILIT) is a legal structure that is primarily used to hold and manage life insurance policies. These trusts serve several valuable purposes for high-net-worth individuals and business owners. Here’s a summary of its key aspects:

Estate Tax Mitigation: ILITs are effective in reducing estate taxes. This tax-efficient strategy appeals to HNWIs who want to pass on a larger, less tax-burdened inheritance to their beneficiaries.

Probate Avoidance. ILITs help bypass probate which makes them extremely attractive to those seeking to avoid delays and costs associated with probate.

Irrevocable Nature: Once established, an ILIT cannot typically be altered or terminated.

Control and Customization: ILITs allow grantors to attach specific terms and conditions to the distribution of insurance proceeds. This will appeal to HNWIs who want tailored solutions for their unique family and financial situations.

Creditor Protection: By placing assets within an ILIT, HNWIs can shield the proceeds from estate creditor claims.

Business Continuity: Business owners often use ILITs to ensure continuity. The trust can hold life insurance policies related to key persons in the company.

In summary, ILITs are a favored choice among HNWIs and business owners due to their tax advantages, flexibility and ability to secure financial legacies while minimizing administrative complexities. ILITs are particularly useful for high-net-worth individuals looking to manage estate taxes and plan their legacy. However, due to their irrevocable nature, it’s important to carefully consider the trust’s terms and provisions.

As always, we recommend that HNWIs collaborate with financial advisors who understand their specific needs. Customized strategies can maximize the benefits of life insurance.

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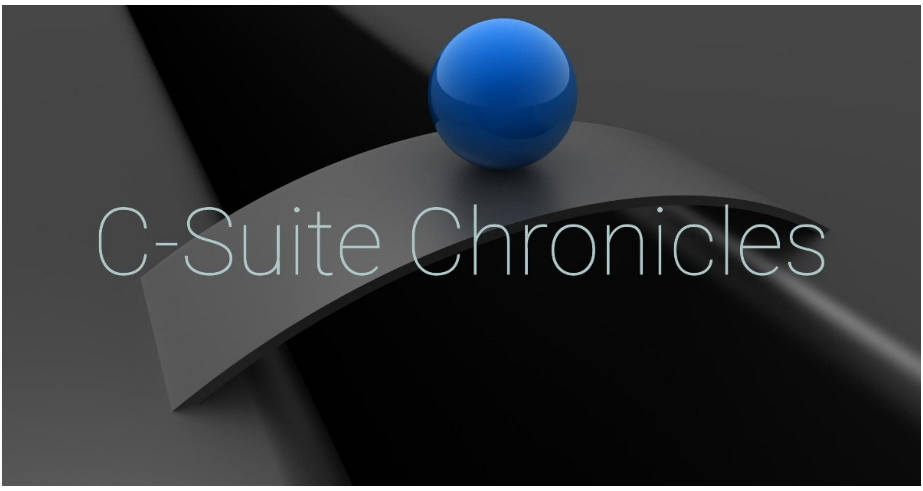

RBC Royal Bank

2024 CANADIAN FEDERAL BUDGET: GRANTS AND FUNDING OPPORTUNITIES FOR BUSINESSES

The recent Canadian Federal Budget announced a number of measures to help small businesses navigate today's economy – from funding for tech adoption and training programs to rebates and green initiatives.

We asked Managing Partner of GrantMatch, Mike Janke to share key funding program announcements found in the Budget.

"There are a number of major economic changes happening and businesses need to adjust their plans and invest strategically. The Canadian Federal government is supporting and incentivizing these major transformations such as environmental impacts, Artificial Intelligence and Housing. If you can align your business investments with the government, you may be able to unlock grants and funding and accelerate your business plan."

BUSINESS GRANTS AND TAX INCENTIVES

New Canada Carbon Rebate for Small Businesses: $2.5B to return fuel charge proceeds from 2019 to 2024 through direct CRA refunds and tax credits.

Venture Capital Catalyst Initiative: $200M over two years starting in 2026-27 to increase venture capital for entrepreneurs.

Regional Economic Growth through Innovation Fund: An additional $158.5M over two years to the regional development agencies to boost regional economic growth.

Futurpreneur Canada: $60M over five years to assist young entrepreneurs with access to funding and support services.

TECHNOLOGY AND AI PROGRAMS

AI Compute Access Fund: $2.4B over five years to launch and support researchers, start-ups, and the scale-up of the development of AI businesses and the industry. $200M to be allocated to regional development agencies for AI start-ups and critical sector adoption.

NRC IRAP AI Assist Program: $100M over five years to help small- and medium-sized businesses scale-up and increase productivity through AI solutions.

$50M over five years for a new Canadian AI Safety Institute for the safe deployment of AI.

$5.1M for an Office of the AI and Data Commissioner to protect Canadians from potential risks of AI and to ensure responsible adoption by Canadian businesses.

Scientific Research and Experimental Development (SR&ED) Tax Credit: $600M over four years with $150M for future enhancements to the program. The second phase of consultations announced to determine how funding will be targeted.

Increase core research grant funding to $1.8B over five years for the federal research grants through the Natural Sciences and Engineering Research Council (NSERC), the Canadian Institutes of Health Research (CIHR), and the Social Sciences and Humanities Research Council (SSHRC). A new capstone research funding organization to be created to improve the coordination of federal research funds.

Businesses to be permitted to immediately write off as a capital cost allowance the full cost of investment in patents, data network infrastructure equipment, computers, and data processing equipment until January 1, 2027. Estimated cost: $725M over five years.

TRAINING AND SKILLS DEVELOPMENT

To train and hire skilled trade workers to build more homes: $90M over two years allocated for the Apprenticeship Service to create apprenticeship opportunities.

Foreign Credential Recognition Program: $50M over two years to remove barriers to credential recognition to decrease delays and get more skilled trades working in the field.

Student Work Placement Program: $207.6M in 2025-26 for work-integrated learning opportunities for post-secondary students.

$200.5M in 2025-25 for the Canada Summer Jobs program and $150.7M for the Youth Employment and Skills Strategy program for youth job placements.

Sectoral Workforce Solutions Program: $50M over four years for skills training to support workers impacted by AI.

Canada Media Fund: $40M over two years

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PROTECTING YOUR LIFESTYLE BY KPW

Kevin Headland
Co-Chief Investment Strategist

Macan Nia
Co-Chief Investment Strategist

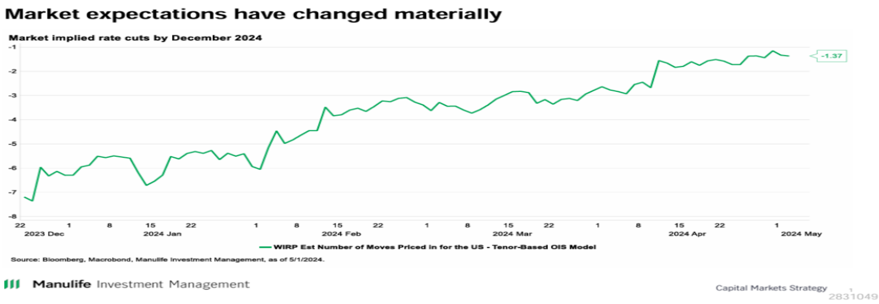
"The best surprise is no surprise."
-Kemmons Wilson, Founder, Holiday Inn

It was no surprise that the Federal Open Market Committee decided against making any changes to their target overnight rate at their May 1 meeting, leaving it at 5.50%.

Markets have moved materially since the beginning of the year. The belief then was that we would see six rate cuts by end of 2024, beginning in March, which we believed was a little too dovish. After Wednesday's meeting, market pricing has changed again—the market doesn't even expect to see two full 25 basis points (bps) rate cuts this year, with the first not materializing until November. In our view, perhaps the pendulum has swung a little too far the other way. The key message from Chair Powell, however, is that the next rate decision is clearly one-sided in favour of a cut.

As my colleague, Alex Grassino, noted on Wednesday "By means of background, the narrative around the Fed has shifted decisively since the last meeting six weeks ago, when the view was still very much that a mid-year cut was on the table. The reason? In essence, a combination of too-strong growth and stubbornly high month-over-month inflation for the first three months of 2024 would have made it difficult for the Fed to credibly ease in June, which has led to higher yields up to today, a stronger US dollar and volatility in the equity markets. Analysts also questioned other central banks' ability to cut if the Fed were to drastically change track.

At last week's meeting, Fed chair Powell went to considerable length to underscore that the next move would be a cut, effectively quashing a modest but growing line of thought that inflationary pressure would force the Fed to reintroduce two-sided risk around their decision-making function, meaning the next move could be a cut or a hike. The elimination of that possibility undercuts the source of recent market volatility, and it was immediately noticeable in markets: U.S. 10-year yields were down ~5bps at that time of writing, the entire curve was steepening, the dollar was slightly weaker."



Our take on the impact of rate moves to investors hasn't changed: The uncertainty of timing and magnitude of future rate cuts, stickier inflation, and a weaker economic environment points to the need for a balanced approach to portfolio management with an emphasis on flexibility within the underlying investments.

Fidelity's Mark Schmehl focuses on out-of-favour stocks and those with exciting futures and a potential for serious momentum

Last year proved quite a comeback for the 3-star silver-medallist $10.5 billion Fidelity Global Innovators F, a global equity fund that has seen its share of ups and downs since its 2018 launch. The fund returned 46.69%, versus 16.19% for the Global Equity category. In 2022, the fund languished, as it returned -29.65%, versus -14.08% for the category.

Mark Schmehl, a portfolio manager with Fidelity Investments ULC who is based in San Francisco and oversees $28 billion in total across three funds, attributes the turnaround not to one factor but a host of them. "There are a lot of reasons why the market bounced last year. One is that in 2022, it got over-sold and a lot of stuff got really cheap. For instance, Facebook [Meta Platforms Inc., or META] was trading at 10 times earnings," recalls Schmehl, "A lot of growth stocks got demolished in 2022. Some of it was fair, but you kind of threw the baby out with the bath water. Lower-quality names got hammered, but so did the good-quality names. Some of what you saw last year was a bounce-back from over-sold conditions and growth. The rest of the market did not move as much. And the Nasdaq Index was down about 33% in 2022."

AI's Been a Phoenix for Tech Bets

Schmehl argues that Artificial Intelligence (AI) names caught fire in February and maintains that's what ignited last year's recovery. "I don't know if I got lucky, but I went to this conference in San Francisco, just an ad hoc thing in an area called Hayes Valley," says Schmehl, a 30-year industry veteran who joined Fidelity in 1999, after earning a Bachelor of Business Administration at Wilfrid Laurier University and an MBA at Columbia University. "The place was an absolute zoo with people sitting on the floor and there were lines out of the door. Like a rock concert. All the who's who in AI spoke—they are now famous billionaires—and I had one of these moments when I thought 'Omigod, I have to buy all this.' I loaded up on Nvidia Inc. (NVDA), Advanced Micro Devices Inc. (AMD) and anything else that was AI-related. It was a great trade and that carried my fund, and much of the Nasdaq to be honest, right through the end of the year. The AI theme is so prevalent and powerful. It's great trade, and it continues," says Schmehl, adding that the strong performance was aided by the fact that the much-predicted recession did not materialize.

On a shorter-term basis, the poor showing in 2022 did affect the three-year performance figure. Fidelity Global Innovators Class F returned an annualized 1.96% (as of Feb. 16), versus 5.15% for the Global Equity category. But on a five-year basis, the fund outperformed and returned an annualized 23.58% versus 8.53% for the category.

Earnings Can Beat Valuations

Given that technology stocks, especially the so-called Magnificent Seven, such as Alphabet Inc. (GOOG) and Microsoft Inc. (MSFT) have had a strong run, many market pundits argue that they are over-valued. But Schmehl disagrees. "I don't really care about valuation. I don't think it matters," he says, referring to similar comments he made in a Dec. 2020 Manager Insight profile. "Stocks respond to fundamental strength, more than valuation. Valuation is a metric. But if you look at the earnings power of some of these stocks, they are really powerful. Nvidia, for instance, up until two weeks ago, was one of the cheapest tech stocks you could find. But its earnings are exploding. So are Microsoft's. But some aren't exploding.

Apple Inc. is one example."

Making a decision based on valuation, argues Schmehl, is wrong-headed. "You don't know what you're doing. For me, it's the least important piece of information. That's my style."

Taking Nvidia as an example, Schmehl notes that it trades at US$715.65, or about 36 times forward earnings. "I think that estimates for Nvidia are too low. The cycle is going to be longer than people expect. So, I think it will keep going up. Whether it's expensive, or not, doesn't really matter," argues Schmehl. "They sell everything that allows people to do AI computing. It's the most important thing in technology today. Nvidia has a virtual monopoly on AI; there is so much demand they can probably sell into for years. It's analogous to the Internet build-out we had in the late 1990s when guys like Cisco and Nortel had virtually infinite demand for five years. Eventually, it did get very bubble-y. But AI is very early in the cycle and I don't think we can say it's a bubble. Nvidia's earnings are unbelievable. Demand is off the charts and we have investments in all these private AI server companies and they can't get power, or GPUs [graphics processing units], or memory. If you wanted to buy a GPU from Nvidia, you can wait two years."

Largely a bottom-up stock picker, Schmehl is currently favouring information technology, which accounts for 42.9% of the portfolio, as of Dec. 31, 2023. That's followed by 17.2% in communication services, 14.3% consumer discretionary and 7.6% industrials. The portfolio has about 150 names, although there are many tiny positions of about 0.1%. But the top 10 account for 48% of the fund and includes names such as Nvidia, as well as some surprises in the form of uranium producer Cameco Corp. which reflects Schmehl's occasional contrarian bent.

Best Opportunities are Found on the Fringes

In searching for stocks, Schmehl looks for several key attributes. Yet rather than dwell on conventional corporate characteristics such as strong balance sheets or defensible moats, Schmehl focuses on what is changing in the marketplace. "I'm looking for positive change. Some things are getting better. Most things that investors buy are good companies that have good operations and good management teams. They will be just fine. But they don't change that much. So there is not a lot of chance of alpha generation for my style," maintains Schmehl. "I tend to own really out-of-favour companies that have terrible balance sheets and management teams and are pretty much flat on their backs with their legs in the air. Or I tend to own companies that are doing so well and are controversial and journalists ask me 'why do you own them, because they seem expensive.' Those are the two areas where I focus the most. And everything else in the middle, which would normally be an investment purview, I generally don't own. It's weird, but it works."

One of his representative holdings is Vertiv Holdings a firm which makes cooling systems. "An AI data centre runs about 10 times hotter than a traditional data centre. Heat is a huge problem and the only way to solve it effectively is with something called liquid cooling. They put water right to the chip. But only one company does this well," says Schmehl. "A bunch of companies do this, but Vertiv is the leader. We're going to build a lot of these data centres. Vertiv was a sleepy industrial name and one of our analysts found it, and thought, 'Omigod, this is AI.' So I bought a ton of it. And it's up almost 100%."

AI Has a Long Runway

Schmehl figures there could be a three-year building period for AI facilities. "Vertiv's earnings could triple from here. I don't know if it will happen. But it's always nice when you can do the math, and say, 'Wow, its earnings will grow an awful lot.' Those are good stocks to own."

Vertiv is trading at US$58.45, or a trailing price-earnings ratio of 25.6 times. “I don’t look at valuation. I care more about the company’s fundamental strength and I think that the street has estimates that are too low. This company will do better than that, and go up.”

Another favourite is Cameco Corp., the uranium miner that was very much out of favour. “The stock was incredibly cheap and in late 2022 the company announced a deal to acquire a 49% interest in nuclear technologies supplier Westinghouse Electric Co. [the remaining 51% stake was bought by Brookfield Renewable Partners ( )], and nobody was interested,” recalls Schmehl. “A colleague and I did a lot of work on it, and we decided, ‘It’s not bad. Nuclear power has a role to play in the climate solution.’ That was our basic thesis.”

Acquired in late 2022 at around $56.85, the shares are up about 75%.

Meanwhile, Schmehl observes that many other observers have started to agree that nuclear power generation is more reliable than solar and wind energy. “If you talk to the data centre guys, they don’t want any part of solar or wind. They will say, ‘I want the power to never change and it has to be dependable.’”

Next Rally Could Go Nuclear

The main part of his thesis is that uranium supply has shrunk, and more people are saying, nuclear power is the only solution. “There is a demand for more electricity and you need to build something that is carbon-free. Nuclear is the only answer and the best place to get leverage is Cameco, since it’s the only game in town. They bought Westinghouse, which builds reactors, and they own two of the best mines on the planet. It’s a sleepy Canadian stock. There could always be a meltdown and something could go wrong. That’s investing. Barring something like that, we need more nuclear facilities and I don’t see how else to get them.”

THE EXCHANGE

FROM THE DESK OF KELLY EVANS

TOP OF MY MIND

I'm running the numbers just to get a feel for things as I get ready to go back on the air on Tuesday. The market has certainly taken off this year, at least until the recent soft patch. In general, everything has done far better than I expected post-Covid. Maybe it really is the AI boom. Maybe it's the still-ongoing fiscal stimulus. Maybe it's the immigration surge. Who knows.

So, the S&P is up a healthy 7.5% since January 1. The Dow is up a more modest 2.6%. But here's the catch: those numbers are actually understating the market's true performance by a half-point or so. And this always happens. Why? Because that price performance doesn't include dividends, which actual investors who own the indexes get to pocket--or more crucially, reinvest.

Yes, you nod. But this becomes a very big deal over time! And the technology does exist today to show the real, all-in returns. The problem is, if we ever switched over to reporting it that way, the average American's head might explode. Because if you include reinvested dividends just since 1987, the Dow would currently be at 95,604. No joke--it's on the provider's own website. Nearly 100,000! And the S&P, instead of 5127 today, would be at 11,152.

Well, this is just a silly thought experiment, you say. But Germany has already been reporting this way--on a total return, not just price basis--for decades. The DAX switched over in 1987. Mark Hebner, the CEO of Index Fund Advisors, has put together a handy, interactive chart (#7 here), where you can see that Germany's market looks pretty good--outperforming all but the U.S.--until you switch the others over to total returns. Then, it trails Australia, the Netherlands, Ireland, and even France. Why those countries don't also make the reporting switch, I don't know.

Point being, if you own the major U.S. indexes, you've actually done even better than you think over the years. This has big implications. It means, for instance, your money does better in stocks versus bonds than you might realize. (Wonky note: researchers Samuel Hartzmark and David H. Solomon think this could even explain the equity return premium; read their paper for more.)

It also means your active manager, mutual fund, or hedge fund may not be outperforming by as much as you think if they are only comparing their performance to the price indexes. It even means supposedly "winning" funds are getting flows they don't merit, since funds typically follow performance.

But it also means that failing to reinvest your dividends is a really big deal. All of this stems from the fact that when stocks go ex-dividend, they drop in price. They didn't "lose value," or finish "in the red" that day because of some actual economic change. They simply lowered in price to reflect the cash amount paid out. But if you don't include the cash amount paid out, your price index underperforms reality.

And if you not only include, but also reinvest the dividend, your total returns over time skyrocket. Hartzman and Solomon note the Dow could be well north of 672,000 by this point if you had included total returns starting in 1926. Maybe it's crazy; or maybe it's crazy we've gone this long not reporting on a total-return basis. As those authors note, you could even try to "harmonize" the total return indexes back to today's current Dow and S&P price levels to help the public stomach the change, and then report total returns going forward.

Perhaps you can sleep a little better knowing that you've probably done better over time in the market than you realize.

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Macro Musings

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Associate Strategist – Quantitative Research

Value and Growth in Europe

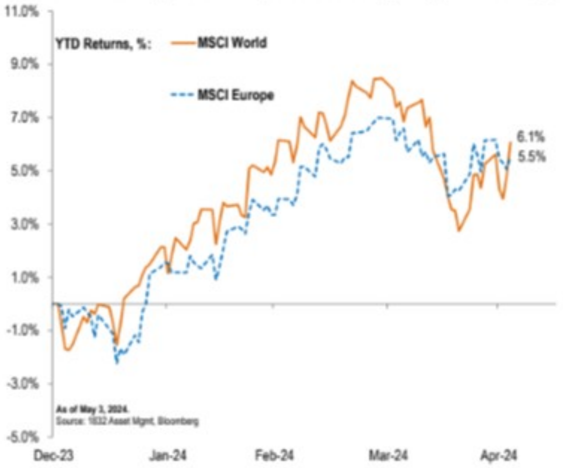
This week, we decided to take a closer look at the European equity market. The European benchmark index is up by 5.5% on a year-to-date basis, slightly underperforming the MSCI World Index which has risen by 6.1%(Chart of the Week). While this doesn't seem all that impressive a feat on the surface, it sure is after considering that European economic growth has been almost non-existent. The U.K. is in a technical recession, after back-to-back negative GDP growth reports, while the continent has grown by very little over the past couple of years.

One thing going for the European equity market right now is that it is inexpensive. Several sectors, including Insurance, Energy, Banks, and Autos & Parts, are trading at single-digit P/E multiples. Inexpensive markets allow for small improvements in economic and earnings growth to translate into meaningfully positive stock price returns. Recent leading business cycle data is showing a notable turn for the better.

The market also has its own version of America's Magnificent 7, often referred to as GRANOLAS (i.e., GSK, Roche, ASML, Nestle, Novartis, Novo Nordisk, L'Oréal, LVMH, AstraZeneca, SAP, and Sanofi). This group of large companies have not only performed very well on the back of strong earnings, but they exhibit about 60% of the volatility of the U.S.'s Magnificent 7. While they are not cheap relative to the rest of Europe, their P/E multiples have trended lower and now stand at 18.1 times which represents a steep discount to the Mag 7 at 28.7 times.

Europe is worth a look for both value and growth-oriented investors.

Chart of the Week: European Equities Slightly Underperforming



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TD Economics

U.S. – Holding Steady for Longer

Thomas Feltmate, Director & Senior Economist
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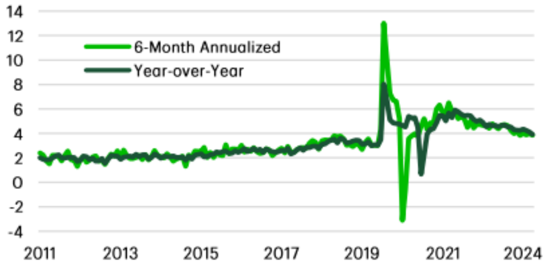
It was a very busy week on the economic data calendar, but the two headliners were a pulse check on the state of the labor market and the Federal Reserve's interest rate announcement. Policymakers delivered no surprises this week, with the FOMC voting unanimously to hold the policy rate steady at the current target range of 5.25% - 5.5%. The same can't be said for April's employment report, which showed job growth coming in handily below expectations. Financial markets greeted the news positively, with the S&P 500 recouping its losses from earlier in the week, while the 10-year Treasury yield was down 14-bps to 4.53% at the time of writing.

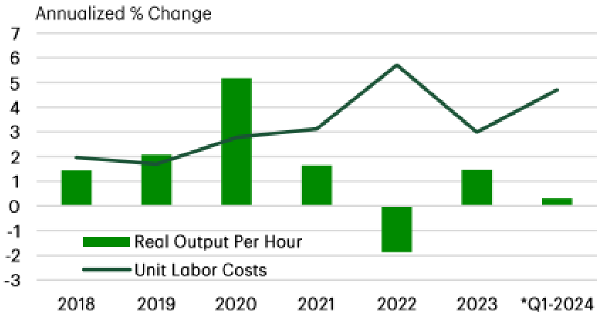
It's not that long ago that investors were expecting the first rate cut to come at this very meeting. But after three months of hotter-than-expected inflation readings, the FOMC appears to be on hold indefinitely, as it looks for "greater confidence that inflation is moving sustainability back towards 2%". What exactly that means remains to be seen, but it will likely require a further rebalancing in the labor market, which ultimately leads to more sustained downward pressure on wage growth.

From that perspective, April's jobs data was a Goldilocks report. Non-farm payrolls rose by 175k while the unemployment rate ticked up to 3.9%. Importantly, average hourly earnings cooled more than expected, with the 12-month change slipping to a near three-year low of 3.9% (Chart 1). While the softening in wage growth will come as welcome news for Fed officials, it needs to be weighed against other measures of employee compensation, particularly the Employment Cost Index—the Fed's preferred wage measure—which showed an unexpected acceleration. Moreover, after rising by a robust 1.5% in 2023, growth in non-farm productivity slipped to a near stall speed in Q1. Taken alongside last quarter's uptick hourly compensation, unit labor costs (ULC) also rose sharply higher (Chart 2). This has important implications for inflation. ULC can best be thought of as a productivity adjusted cost of labor, making it a useful gauge on the extent to which the nominal pace of compensation growth is running above (or below) what would be consistent with achieving 2% inflation. However, with the Q1 reading not only turning higher but also running at an annualized rate that's more than double where it should otherwise settle, provides yet another signal that progress on the inflation front is stalled.



Source: Bureau of Labor Statistics, TD Economics.

Chart 2: Unit Labor Costs Are Pressured Higher in Q1-2024



Source: Bureau of Economic Analysis, TD Economics.
*Denotes quarter/quarter annualized figures.

In the press conference following the release of the FOMC statement, Chair Powell noted that while ongoing progress is "not assured" he still expects that over the course of the year "inflation will move back down". But Powell also emphasized that he's become less confident in that forecast. Moreover, when asked if today's rates were "sufficiently restrictive" Powell instead described them as only "restrictive". While the Chair said further rate hikes are "unlikely", the refusal to characterize today's stance as sufficiently restrictive is an implicit acknowledgment that further policy firming cannot be ruled out. At this point, we view this as highly unlikely. But given the economy's sustained strength alongside the recent stalling on inflation, we now expect the Fed to remain on hold until December.

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