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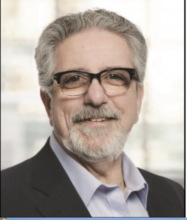
IMAGINE YOUR FUTURE

“The smart way to keep people passive and obedient is to strictly limit the spectrum of acceptable opinion, but allow very lively debate within that spectrum”.—Noam Chomsky



THE WAY I SEE IT

By SERGIO SIMONE

MYTHS IN THE MARKETS

2024 - What an amazing year for investors! While reviewing client portfolios prior to entering Q4 2024, I couldn’t help but beam at the extraordinary gains made by our clients. Unfortunately, this is also the type of year where investors begin to make extraordinary decisions about their investment portfolios. I thought it would be a good time to address some myths and misconceptions about the stock market to help add some perspective prior to investors making choices that may require reconsideration.

The stock market, often perceived as a complex and intimidating arena, is surrounded by numerous myths and misconceptions that can mislead both novice and seasoned investors. From the belief that investing is a game reserved for the wealthy to the illusion of quick riches, these myths can create unrealistic expectations and hinder sound investment decisions. In this article, I hope to debunk some of the most common stock market myths and misconceptions, providing clarity and insight to help you navigate the world of investing with confidence and knowledge.

I will begin with one of the most basic misconceptions. Investing is only for the wealthy. Many people believe that you need a lot of money to start investing. However, with the availability of fractional shares and mutual fund platforms, anyone can start investing with as little as $50 at a time. Deciding where and how to invest should be a function of a number of factors including: your goals, your time horizon and your risk profile. For me, the most important factor is time horizon, because with time the power of compounding can have an enormous impact on any investment portfolio.

I’m sure many of you are familiar with the story of the chessboard and rice but it is worth repeating here.

A wise man challenged a king to a game of chess. The king, confident in his skills, asked what the wise man wanted as a reward if he won. The wise man requested a seemingly modest prize: one grain of rice on the first square of the chessboard, two grains on the second, four on the third, and so on, doubling the amount on each subsequent square. The king, thinking this was a trivial request, agreed.

However, as the game progressed and the grains of rice were doubled on each square, the king soon realized the enormity of the request. By the time they reached the 64th square, the amount of rice required was astronomical—more than all the rice in the kingdom.

The lesson here is about the exponential growth that compounding can achieve. Initially, the increases seem small and manageable, but over time, they grow at an accelerating rate. This principle is crucial in investing, where small, consistent contributions can grow significantly over time due to the power of compound returns.

Disclaimer

Believing that investing is only for the wealthy can prevent people from starting to invest early. This can lead to missed opportunities for compounding returns over time, which is crucial for building wealth.

Another myth I come across frequently is that the stock market is a **Get Rich Quick Scheme.** This investment strategy, and I use this term loosely, plans to obtain a high rate of return for a small investment. Most of these schemes leave investors with the impression that they come with little risk and require little skill, effort or time. This often leads to unrealistic expectations and in most cases, disappointment. Investors unwittingly might take on excessive risk, hoping for quick gains, and end up facing significant losses. These strategies are often vague, offering little transparency, offer no real product or service, require an upfront payment, or rely on “hot tips” and “proprietary secrets”.

The reality is that successful investing typically requires a long-term perspective and patience which takes us back to the previous point of compound returns. The road to wealth creating is often slow and steady, not fast and flashy.

This next one is one of my favorite myths: **Savvy Investors can Time the Market!** Many investors at one point or another fall under the spell of market timing. They are convinced that they can predict market movements and buy or sell at the perfect time. The appeal of trying to buy low and sell high is understandably desirable. However, while this strategy may sound ideal in theory, it often proves ineffective in practice.

The main reason market timing does not work is that no one can predict the movement of countless variables that have an effect on financial markets with any regular consistency. Geopolitical events, changes in monetary policy, technological breakthroughs and natural disasters are only a few of the factors that can disrupt the market.

Take for example the 2008 financial crisis. Very few people foresaw the collapse of the housing market and the subsequent global economic meltdown. Or look at the recent environment that markets have been exposed to. Wars around the globe, inflation, rate hikes, terrorist acts, supply shortages, strikes etc. Any one of these could predictively cause a market collapse. Many investors have abandoned their portfolios to cash for fear of a pending wipeout and yet the S&P 500 has posted a return of over 20% this year.

How many investors pulled money out of the market or hesitated in their decision to invest based on the onslaught of regular negative headlines?

Those investors that benefited most were the ones that stuck to their long-term plans and in fact took advantage of investing more during all the negative news. The better strategy is to invest regularly and stay invested for the long term. Are you beginning to see a pattern here. L-O-N-G—T-E-R-M!

I want to leave you with one more investment myth: **A Little Knowledge is Better Than None.**

THE WAY I SEE IT

While it is good to start learning about investing, making decisions based on incomplete or superficial knowledge can be dangerous. It is important to thoroughly research and understand your investments or at the very least, seek advice from a trusted financial advisor.

For me, when it comes to investing, having a little knowledge is definitely better than none as even a basic understanding of investment principles can help you make more informed and better decisions and hopefully help avoiding common pitfalls. However, it’s important to recognize the limitations of limited knowledge. Without a solid foundation, you might fall prey to biases or make decisions based on incomplete information.

It is no accident that the onboarding of new client investments and investments from existing clients can only be made under the auspices of an up-to-date, regulated Know Your Client form where the question of investor knowledge is explicitly displayed.

At KPW Financial, we have made it one of our operating practices to educate clients because ultimately, we believe that combining their knowledge with our professional advice can be a powerful approach to achieving their financial goals.

Every profession has its own lingo as does the world of investments and markets. Over time we want our clients to have a good understanding of this ‘language’ so that when we are discussing solutions, they have a good grasp of what we are talking about. Understand that we have specialized knowledge and experience that can help you navigate complex financial markets. We are also experienced in helping investors avoid emotional decisions that could negatively impact their investments. Our intention is to handle the details while allowing you to focus on other aspects of your life.

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LIFESTYLE FINANCIAL PLANNING BY KPW

LIFESTYLE PLANNING SOLUTIONS

BY RYAN SIMONE, CFP, CLU, CHS

One of our favorite and most widely used income strategies here at Kleinburg Private Wealth is the T-series strategy. In our opinion it is the best way to draw tax deferred income from a non-registered portfolio. I won't fluff around it; we're experts on this strategy and we use it with our clients a lot. It is one of the few remaining tax-deferral strategies that allow you to take control of and influence the amount of your taxable income. In this month's article I'm going to discuss in detail how a T-series works. There are going to be lots of numbers thrown at you. You'll probably question your sanity and many of you may not make it through the article. If you think you are one of these people, then skip to the last paragraph. I promise I will not judge because I will not know. But if you've got the grit to power through, then I suggest you grab a coffee and some carbs … you'll need it.

Normally, when money is withdrawn from a non-registered investment portfolio, the capital gains portion of the redemption is crystallized, meaning that taxes are owed to the CRA. Since there are limits to how much money can be put into tax protected accounts like RRSPs and TFSAs, it is likely that most investors will hold other non-registered (open) investments in a taxable non-registered account. One of the last remaining tax deferral tactics, and a favorite financial planning tactic that we use to give clients tax deferred income over a period of about 14-18 years is called a T-series strategy.

The "T" in T-series stands for tax-deferred. Suppose you have $1 million in a non-registered investment portfolio. The money is entirely invested in mutual funds and earns 8%. After one year you would have an additional $80,000 or a total of $1,080,000. Under normal circumstances, if you were to withdraw that $80,000, you would have to pay a capital gain tax on the non-return of capital portion of the withdrawal. For purposes of this illustration I am going to assume the entire redemption is treated as a capital gain. Approximately $60,000 (2/3 of the $80,000 gain based on the recent new capital gains inclusion laws). Basically, you would owe the CRA tax for withdrawing an $80,000 income. However, in a T-series strategy, we can withdraw the $80,000 gain completely tax deferred. In other words, you would receive $80,000 of cash to spend however you want and you wouldn't even have to claim it when you file your taxes. No tax, just $80,000. 100% CRA approved.

Let's consider the example above, but instead of having $1 million invested in regular mutual funds, we are going to invest the money in mutual funds with a T-series version. (Side note: many "regular" mutual funds come in a "T-series version"; in other words, a fund that is the exact same as its counterpart but with the added withdrawal tax-deferral). So, we have our $1 million, and let's say it is invested in a single Global Balanced mutual fund consisting of stocks and bonds. This mutual fund is a T6 meaning it will pay out 6% of the market value per year. As a strategy, we can choose various withdrawal percentages from 4% to 8% but I like 6% because it gives the portfolio a chance to keep growing despite the withdrawals.

To recap, we have $1 million invested in a Global Equity balanced mutual fund that will pay 6% of $1 million or $60,000.

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To simplify things, let's say that we started this portfolio on January 1, 2025. By the end of the year, you would have collected $60,000 in tax-deferred income. Now let's say that our Global Balanced mutual fund also grew at 8%. By December 31, 2025, your $1 million is now worth $1,020,000. Basically, we grew the portfolio by $20,000. In fact, the portfolio grew by $80,000 but remember, you were paid $60,000 which brings us back down to $1.02 million.

Now it's January 1, 2026, and you have $1,020,000 in your Global Balanced mutual fund. In a T-series strategy, your income payout resets to whatever your market value is on January 1. Since you now have $1.02 million, your 2026 income with-drawal will be $61,200. You get a $1,200 raise this year! Now fast forward 14 years. Assume we continue to earn 8% in the portfolio and pay out the 6% income. By the 14th year you would have received a total of $958,438 of income from this strategy, and it would have all been tax deferred. Not only that, but your Global Balanced mutual fund would also be worth $1,319,481! So, you'd have more money than when you started, and you would have collected nearly $1 million of tax-free income over a 14-year period.

Sounds too good to be true right? Well, the catch is that all good things must end, and with a T-series strategy, at some point you will no longer be able to collect a tax -deferred income. This is because of something called the Adjusted Cost Base (ACB). It is also why the T-series strategy is a tax-deferred strategy and NOT a tax-free strategy. An important distinction.

When explaining a T-series strategy to a client, I find that understanding the ACB portion of the discussion is where most people tend to struggle. One way to think about ACB is like this: when you invest $1 million, your ACB is going to be $1 mil-lion. If your money grows to $1.1 million, you will still have an ACB of $1 million but your market value will be $1.1 million. Moreover, the ACB portion of your investment is never taxable. So, if you take out $1.1 million and your ACB is $1 million, you cannot be taxed on $ 1 million. You CAN be taxed on $100,000.

I know, too many numbers but if you've made it through the article, congratulations. If you've skipped to this final paragraph that's ok too, here's a little recap: with a T-series strategy you will not be taxed on any portion of your investment that is con-sidered part of the adjusted cost base (ACB). Under normal investment conditions, when you withdraw money from a mutual fund in a non-registered account, you must include any gains in the withdrawal. Therefore, under normal circumstances, you would have tax consequences calculated as the amount withdrawn minus the ACB. However, in a T-series, all your withdrawals come from the ACB and none of it comes from gains. It is considered a "return of your capital" and that means you do not pay tax. But you do start to lower your ACB. For example, in a T-series strategy, if your ACB is $1 million and you take out $60,000, your ACB will drop to $940,000. Eventually, as you continue to withdraw T-series money, your ACB drops to zero. In the example I used earlier on, that happens in year 15. And once that ACB drops to zero, all future withdrawals become taxable as a capital gain. The good news is that capital gains are the cheapest form of taxation. The bad news is that you would have no more tax-free income.

Except … if you use a Split T-Strategy. I'll make sure to discuss the Split T-Strategy in next month's article. And I 'll make sure that 100% of next month's article will have 60% fewer numbers.

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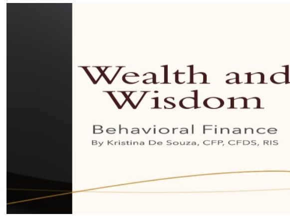

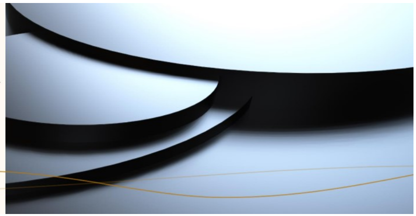

WHAT NOT TO INCLUDE IN A WILL

In our lifestyle financial planning, we always discuss the importance of having a valid will, as it is one of the most important documents you will create as an adult. After all, it is here that you can name beneficiaries to inherit assets, appoint guardians for children and pets, specify funeral arrangement and burial wishes, and delegate an executor for your estate. Identifying what should go in a will is fundamental in developing a sound estate plan. But what's equally as important is being aware of what not to include in your will when it comes to ensuring both the legal validity of your will and that it meets your estate planning needs. One of the major factors to consider is that wills become accessible to the public upon probate. And even greater than this, is the fact that if a will contains things that it shouldn't, there is a possibility for it to be revoked entirely.

Bear in mind that some types of wills do allow for more flexibility than others, and the type of will you choose determines the level of flexibility in what you can include. Nowadays, the options for will creation are more enhanced. For example, will kits are fill in the blank documents that typically restrict you from adding anything additional. On the other hand, holographic or handwritten wills, have little to no restrictions on what you can write in, but do come with their own set of limitations. A happy medium can be custom online will platforms, both affordable and often guide you through all the necessary steps to creating a proper will. However, for more complex situations, an estate lawyer may be warranted. Although this is the most expensive type of will, such professionals can provide necessary legal advice for wills and draft a customized will to meet your needs.

As I mentioned, there are some things that should never be included in a will, regardless of which method is used. The first item for discussion is assets with named beneficiaries. The best way to think about this is by acknowledging that a last will and testament documents your wishes about your estate, whereas assets with beneficiary designations do not enter your estate. Instead, they pass directly to the named beneficiaries, avoiding your estate and probate altogether, meaning they should not be included in a will.

Some examples of these assets include personal property with joint ownership, life insurance policies, registered assets such as registered retirement savings plans (RRSPs) and registered education savings plans (RESPs), tax-free savings accounts (TFSAs), and pension plans. And conversely, if you own a registered asset with no designated beneficiary, the proceeds will become part of your residual estate.

As powerful as a will is, it cannot dictate how beneficiaries or guardians must behave, known as behaviour requests. When it comes to choosing beneficiaries, be mindful of the fact that once the asset is in their hands, it is theirs to do as they wish. Therefore, considering how you want your assets to be used or cared for deserves consideration, and ultimately may help establish why one person may be a better choice as a beneficiary than another. We always encourage conversations with beneficiaries which can help you better understand how to distribute your estate based on your wishes and the wishes of your loved ones.

This is especially true when it comes to naming guardians to care for minor children or pets, as although you can leave assets for guardians, a testamentary trust for children, and a pet trust for pet guardians, you cannot dictate how those guardians care for those dependants and dictating how they behave can be hard to enforce.

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You also need to be mindful of the fact that appointed persons in your will, such as an executor, guardian, or beneficiaries, have the right to decline their role or inheritance, supporting the premise that naming backups is ideal. As such, you should choose guardians wisely and communicate your wishes with them as soon as you can to help make the best choice.

In a similar breath, a will cannot force anyone to do anything that is illegal, unethical, or immoral. Requests in a will that are illegal are not only unenforceable but can potentially invalidate parts of or the entirety of a will. Further, courts will not carry out instructions that violate the law, which could lead to delays in probate, estate administration, and inheritance to beneficiaries. Should a will become invalid, the estate would be distributed based on the inheritance laws of your province. Furthermore, unethical or immoral requests should not be included in your will as they can cause significant distress to beneficiaries and executors. Such requests have the potential to create conflicts among family members or beneficiaries, place executors in difficult positions, forcing them to choose between maintaining ethical standards and honouring the deceased's wishes.

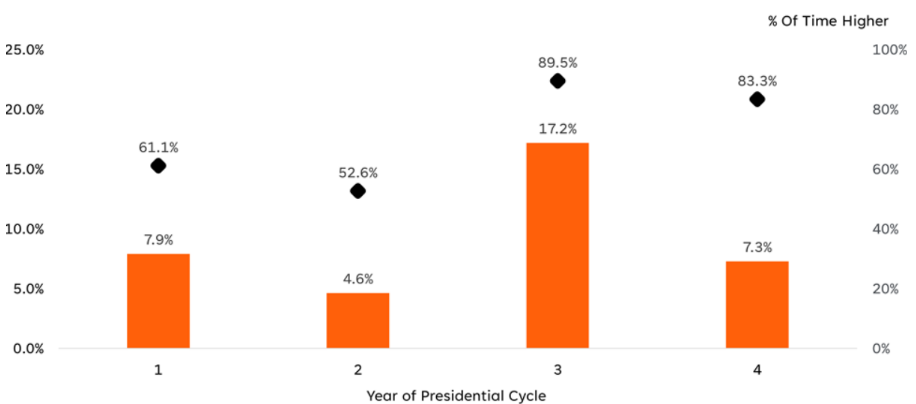
Because probated estates result in wills becoming public property, you want to refrain from including “digital assets” in the will such as security logins or passwords. Also, you may want to consider, for complex business interests, that it's often better to create a separate succession plan rather than include these details in your personal will. Ultimately this may allow for a smoother transition and avoids potential delays due to probate. There are some options that allow you to include your funeral or burial wishes in your will, providing a great opportunity to document your wishes for your estate executor and your loved ones, however, you need to remember that these are more wishes than mandates. Unlike wishes for asset distribution, an executor is not legally obligated to follow funeral wishes, although best practice is to do so.

There is a lot to consider when it comes to the legal requirements for your will and how to avoid making will mistakes. Working with professionals can make it easier and provide the necessary guidance and insight. At the end of the day, you want to ensure your will is tailored to your personal estate, and the proper steps have been taken to ensure to the best of your ability that it will be executed properly when the time comes.

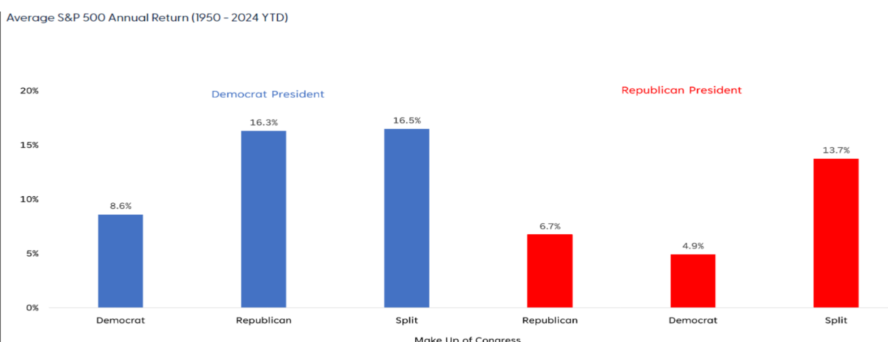
How The Market Typically Reacts In And Around Election Cycles

Stocks tend to dip before election day before a strong performance into year-end. Here is the S&P 500 daily progression since 1950:

The magnitude of this year's return is greater than the average year four of the presidential cycle. Here is the S&P 500 index average yearly returns (1950-2024)



Much is made of the presidential election and how policies may affect the economy and the stock markets, but historically markets don't have a strong preference for one party over the other. Stocks like the certainty that a split congress' gridlock brings.



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CANADIAN TAX COMPLIANCE FOR HIGH NET WORTH INDIVIDUALS (HNWIs)

BY MICHELLE KOSARNIA AND MATTHEW POLLOCK

A high-net-worth individual (HWNI) is someone who possesses liquid assets totaling to at least $1 million after accounting for their liabilities. This growing population in Canada requires unique tax planning as their wealth increases to ensure capital preservation, minimize volatility, and further sustain income generation. In this article, we'll provide comprehensive insights into navigating unique tax considerations as your wealth expands, encompassing everything from residency regulations to strategic tax optimization to help equip you with the knowledge necessary to ensure tax compliance while optimizing your financial efficiency.

Understanding Residency Status

Determining your residency status is crucial for HNWIs as it directly impacts your tax obligations in Canada. The residency rules are nuanced and depend on various factors such as the length of stay in Canada, residential ties, and the primary purpose of your stay. HNWIs, particularly those with international ties or investments, may have complex residency situations that require careful consideration.

For tax purposes, individuals who are considered residents of Canada are subject to taxation on their worldwide income (this includes income earned abroad), while non-residents are only taxed on their Canadian-source income. For HNWIs with international investments, proper reporting of foreign income and assets is imperative to avoid penalties and ensure compliance with Canadian tax laws. Utilizing tax treaties and understanding foreign tax credits can help mitigate double taxation and optimize your tax position.

Tax Planning Strategies for HNWIs

HNWIs often employ sophisticated tax planning strategies to minimize their tax liabilities while remaining compliant with Canadian tax laws. From utilizing tax-efficient investment vehicles such as Registered Retirement Savings Plans (RRSPs) and Tax-Free Savings Accounts (TFSAs) to structuring business interests and assets effectively, there are various strategies available to HNWIs to optimize their tax position. However, it's crucial to ensure that these strategies are compliant with Canadian tax regulations.

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Income Splitting

HNWIs may employ income splitting strategies to allocate income among family members in lower tax brackets. This can be achieved through spousal RRSP contributions, establishing family trusts, or gifting assets to family members. By distributing income more evenly, HNWIs can reduce overall tax liabilities for the household.

Capital Gains and Loss Management

Strategic management of capital gains and losses can help HNWIs minimize taxes on investment income. This may involve timing the sale of assets to offset capital gains with capital losses, utilizing tax-loss harvesting strategies, and maximizing the use of the capital gains exemption for qualified investments.

Estate Planning

Effective estate planning is essential for HNWIs to minimize taxes on wealth transfers to future generations. This may involve the use of trusts, gifting strategies, life insurance policies, and other estate planning vehicles to minimize probate fees, estate taxes, and other transfer taxes.

Charitable Giving

Charitable donations can provide tax benefits for HNWIs while supporting charitable causes. By donating appreciated assets such as stocks or real estate, HNWIs can receive a tax deduction for the fair market value of the donated assets while avoiding capital gains taxes on the appreciation.

Compliance with Anti-Avoidance Rules

Canada has robust anti-avoidance rules aimed at preventing tax evasion and aggressive tax planning strategies. HNWIs must navigate these rules carefully to ensure compliance while still benefiting from legitimate tax planning opportunities. Understanding the General Anti-Avoidance Rule (GAAR) and other specific anti-avoidance provisions is essential for HNWIs and their advisors to structure their affairs in a tax-efficient yet compliant manner.

Disclosure Requirements and Reporting Obligations

HNWIs are subject to various disclosure requirements and reporting obligations in Canada, particularly concerning foreign assets and income. Failure to comply with these obligations can result in severe penalties and legal consequences. It’s essential to stay informed about the reporting requirements and ensure timely and accurate disclosure of all relevant financial information to regulatory authorities such as the Canada Revenue Agency (CRA).

Navigating Tax Audits and Investigations

HNWIs are often targets of tax audits and investigations due to the complexity of their financial affairs and the potential for tax evasion. Being prepared for audits and maintaining meticulous records can help HNWIs navigate these processes smoothly and demonstrate compliance with Canadian tax laws. Engaging experienced tax professionals to represent you during audits and investigations can also significantly mitigate risks and ensure a favorable outcome.

Conclusion

Navigating Canadian tax compliance as a HNWI requires careful planning, strategic decision-making, and diligent adherence to regulatory requirements. By understanding residency rules, leveraging tax planning strategies, ensuring compliance with anti-avoidance rules, and fulfilling reporting obligations, HNWIs can effectively manage their tax liabilities while mitigating risks of non-compliance. Consulting with experienced tax professionals and staying abreast of legislative changes are essential practices for HNWIs to maintain compliance, ultimately securing long-term financial well-being.

**Disclaimer: This article provides information of a general nature only. It does not provide legal advice nor can it or should it be relied upon. All tax situations are specific to their facts and will differ from the situations in this article. If you have specific legal questions, you should consult a lawyer.

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C-Suite Chronicles

The Real Economy Blog

CANADIAN FIRMS IN AN ERA OF A HIGHER COST OF CAPITAL

BY TU NGUYEN

Even with the recent uptick in hiring, the Canadian economy remains in a slump, with sparse activity in the financial markets, slow hiring and lackluster investments.

In response, the Bank of Canada is cutting interest rates—three times since June, with more reductions on the way. It's only a matter of time that the cuts spur more hiring and investment by businesses.

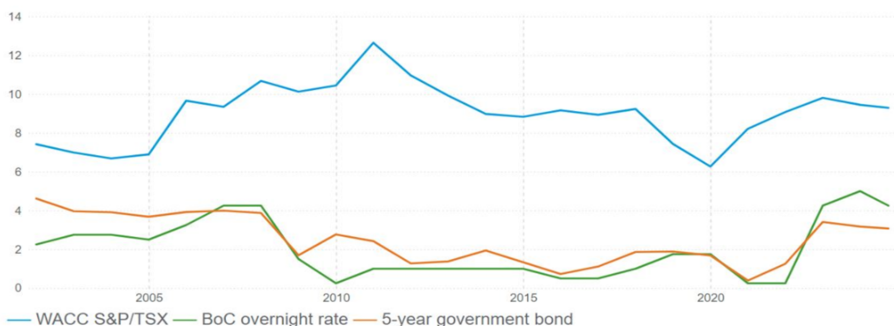
But rates aren't going back to where they were. We estimate that the Bank of Canada will reach a terminal rate of around 3 per cent next year, which is notably higher than much of the past 20 years.

Money, once again, has a price.

For businesses, this new era will lead to fundamental changes in how they operate. No longer can they coast on the low cost of borrowing to improve their bottom lines. Instead, firms will have to focus on adding value and boosting productivity so that they can grow, remain competitive and increase profit.

The Canadian economy, after all, has had little productivity growth over the past decade. Productivity gains are a key recipe for growth, without which businesses would lose out to competitors.

In addition, Canadian businesses and households have high debt loads, which make them even more vulnerable to the high borrowing costs.



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Weighted average cost of capital: a definition

To understand this new era of higher interest rates, consider the weighted average cost of capital, which is the average rate that a business pays for finance its operations. It is calculated by averaging the costs of all sources of capital—such as debt and equity—weighted by the proportion of each source.

The weighted average cost of capital serves a way to determine a required rate of return on investment. For instance, a company would only make an investment in a new technology if the expected rate of return exceeds its cost of capital; otherwise, it would be losing money on the investment.

We examine the weighted average cost of capital for businesses in the S&P/TSX composite index. The index comprises about 250 of Canada's largest firms, encompassing over 70 per cent of total market capitalization on the Toronto Stock Exchange, and is a barometer of the Canadian economy. This will reveal how interest rate changes might affect businesses across sectors.

Implications of rate cuts

When rates fall, so does the weighted average cost of capital. This in turn lowers the required rate of return on investments and increases the appetite for risk.

Businesses will be more inclined to hire and invest in productivity-enhancing projects when the benchmark for required returns are lower. Previously postponed projects because of restrictive rates will be put back into the pipeline.

It might be hard to see that looking at today's data. Despite three rate cuts, the impact has been slow to materialize.

The economy remains at a standstill. Although some firms might have begun hiring again, the unemployment rate is still elevated. Consumer spending slowed even more. Investors and entrepreneurs are sitting on a mountain of cash reserves, potentially waiting for further rate reductions before deploying capital.

This behavior reflects a cautious stance as interest rates remain in restrictive territory. But this risk aversion comes with opportunity costs. The economy is unlikely to return to the near-zero interest rate environment that ruled the past decade.

In the upcoming months, rate cuts will bring capital inflows into the market, and with those come opportunities. Businesses that act quickly to capitalize on this shift will benefit, especially as pent-up demand is released.

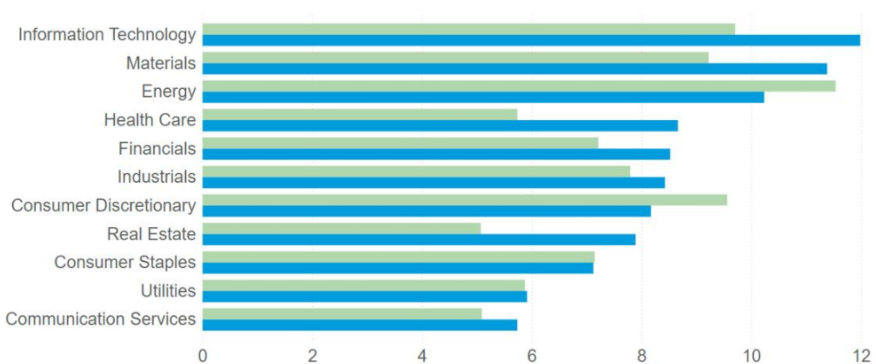
In addition, businesses cannot afford to wait indefinitely. Canada is already well behind in the productivity curve, with productivity flattening over the past decade and falling further and further behind the G7 countries, at a time when the U.S. is undergoing a productivity renaissance.

Waiting too long to invest in productivity-enhancing measures could result in a loss of market share to competitors, both domestically and globally.

Of course, rate cuts through early next year will not affect all industries equally. Information technology has the highest WACC because businesses in this sector are seen as harboring higher risk. In contrast, communication services and utilities have the lowest WACC as these sectors are dominated by oligopolies and thus seen as low risk by lenders.

Rate-sensitive sectors, including technology, energy and materials, will benefit the most from rate cuts. The financial services sector and real estate will also have a substantial uptick in activity.

Since the largest sectors by revenue are financial, energy and industrial, some of those with higher cost of capital, a drop in interest rates will awaken the recovery comes 2025.



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The outlook

The Canadian economy is rather rate-sensitive given its high debt load. By the end of this fiscal year, Canada's total market debt is expected to surpass $1.4 trillion. Household debt exceeds 100 per cent of gross domestic product, largely driven by high housing prices and high mortgages.

Mortgage rates reset every five years in Canada, making households vulnerable to fluctuating interest rates. In contrast, in the U.S., two-thirds of mortgage holders have locked in their rates for 30 years at below 4 per cent, making them essentially immune to rate changes. Businesses face similar challenges, as many loans often have rates fixed for five years.

As rates fall, this rate sensitivity will translate into a quicker recovery in consumer spending, business investments and growth.

Since inflation already returned to 2 per cent ahead of expectations, rate cuts are also happening at a faster pace and will smooth out the debt renewal path for businesses and consumers alike.

Nevertheless, the new era of higher cost of capital will force Canadian businesses to invest more in innovation and productivity growth.

The Bank of Canada has referred to Canada's productivity drag as an economic emergency. The decade-long productivity drag might have been acceptable in an era of cheap money. Now, firms are under pressure to improve efficiency, reduce costs, and increase margins to stay competitive.

As immigration rules tighten, companies should no longer rely on cheap labour to fuel growth. Couple that with an aging workforce means that businesses must prioritize investments in improving productivity to remain competitive.

The takeaway

The era of cheap money allowed firms to grow despite weak productivity gains. In the upcoming months, as rates fall but remain above pre-pandemic levels, businesses must harness opportunities to create and deliver values through strategic investments to boost productivity.

In a world of more volatility, firms will need to adjust to the reality of a long-term, high cost of capital environment. Innovation, automation and strategic investment in long-term growth will be critical ingredients in a recipe for success.

Disclaimer

HOW TO RANK YOUR FINANCIAL PRIORITIES

Circumstances are different for everyone, but this adviser with 20-plus years of experience shares some insights on getting your financial priorities in order

By ANDREW ROSEN, CFP, CEP

When it comes to financial planning there are so many ways to attack it. Additionally, I find one of the hardest things for people to do is to prioritize their needs. Oftentimes, individuals conflate importance with immediacy, as in the sooner something is approaching, the more important it must be. Although I certainly understand this mindset, I don't believe it is the appropriate way to handle one's finances.

I'd like to take a stab at listing in order of priority how, I believe, we should be looking at our finances. Naturally, it is not one-size-fits-all and, of course, I, nor anyone else, can tell you what is most important to you.

1. Protect yourself and your family

To me, the biggest and most important thing you should focus on first is protecting yourself and your family from a tragedy that could derail everything. This usually means making sure you have appropriate insurance coverage. Let's face it — you can always work longer and make more money, but only if you are physically able.

All too often, I see individuals who are in a terrible bind because they didn't have a contingency plan with proper insurance. Life, disability, long-term care, health, property and casualty — these are the basics of a good foundation to build off of. Without proper insurance, you are building a financial plan on a house of cards.

2. Get rid of destructive debt

Next on my list is bad debt, like credit cards. I want to make a clear distinction — I am not referring to mortgages or car loans. Rather, I'm referring to those credit card debts with high interest rates. These can simply crumble a family financially and need to be addressed.

You need to have a well-thought-out plan to eliminate high-interest debt, and it is equally important to ensure that you don't end up back in this hard-to-recover-from place.

I rank this as a top priority because people can be stuck with high credit card debt for years, especially if they make only the minimum payments.

3. Save for emergencies

Simply put, you should have three to six months of expenses saved in an emergency fund that's easily accessible. Many times, people end up with high-interest credit card debt simply because one unexpected expense broke their finances. Having a nest egg or slush fund to insulate you from that situation is highly important.

4. Save for retirement

Finally, something fun to talk about, right? There is an epidemic in our country, and that is that most people don't have enough savings, or aren't saving enough, to ensure they can afford a comfortable retirement.

Disclaimer

You cannot borrow for retirement, and at some point, you might be forced to retire. The last thing you want is to be staring down a 30-year retirement but unable to afford the lifestyle you're accustomed to.

Additionally, the sooner you start saving and the more effort you make in this area, the better your options will be to live the retirement of your dreams.

5. Focus on other savings goals

Now that emergency and retirement savings are on target, you can focus on other savings priorities, whether they be college for your children, a second home or a big project. These items aren't critical to your financial plan, and there are generally other means to achieve these goals, such as borrowing for college.

I am not suggesting these shouldn't be important to you now, as they may seem more important to you than how comfortable your far-off retirement will be. But everyone will need to retire, yet everyone won't need a secondary home.

6. Consider paying off constructive debt

It is probably a tie for me on the next, and last, two categories. I'll give a slight edge to paying off constructive debt, like a mortgage or car loan. If you have a low mortgage rate, though, I see very little benefit to aggressively paying off a home, except for the peace-of-mind factor. After all, if you are mortgage-free, you'll have fewer fixed expenses heading into the next stage of your life, which can leave you feeling mentally clearer and more able to continue making good financial choices.

7. Give to charity

It might seem messed up to have charitable giving as the least important piece of your financial plan. Certainly, a great argument can be made that it is the most important, and I even have clients who prioritize this over almost anything else. I get it and actually highly admire those people.

That said, if I am looking out for my client's finances first and foremost, like I'm supposed to, and the things above aren't in a good spot, giving money away seems, well, conflicting at best.

Let the debates begin, but I'm sticking to my story that this is what I feel works best for most people. There are exceptions to every rule, and people can always shuffle this deck to their own circumstances. This is just my opinion on what I've seen work best in my 20-plus career.

Hope you enjoyed it, and stay wealthy, healthy, and happy.

NARROW NO MORE: WHY CANADIAN EQUITIES MIGHT HAVE AN ADVANTAGE AS RATES EASE

BY STEPHEN DUENCH, CFA (Co Head, Highstreet Private Client & VP and Portfolio Manager, AGF Investments Inc.

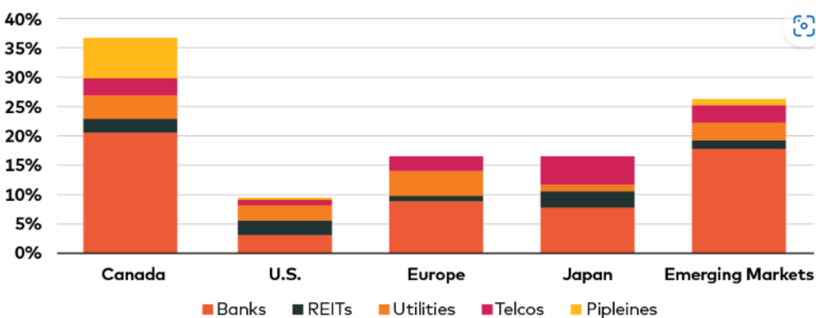
The “great broadening” of financial markets may have begun, and investors in Canadian equities could be among the most significant beneficiaries.

This would be a big reversal of fortune. In global markets, the headline for much of the past three years has been the concentration of returns among a few big names, especially the so-called Magnificent Seven—Apple Inc., Meta Platforms Inc., NVIDIA Corp., Microsoft Corp., Alphabet Inc., Amazon.com Inc., and Tesla Inc. In a higher interest rate environment, that handful of U.S. mega-cap tech stocks, which comprise about a third of the benchmark S&P 500 Index’s market capitalization, delivered outsized returns. In fact, through November 2023 of last year, all of the S&P 500’s year-to-date positive return was generated by the Mag 7 – the other 493 stocks in the index had a combined negative return.

This narrowing of the stock market was not just a sectoral phenomenon – it was also geographical. As the American tech giants soared, markets in other major economies, including Canada, lagged behind. The reason: higher interest rates.

Taken as a whole, non-Magnificent Seven companies in the S&P 500 and in other regions’ equity markets are far more sensitive to rising rates, simply because of the greater presence of interest-rate-sensitive sectors like banks, real estate investment trusts (REITs), telcos and utilities. These sectors are sensitive to interest rate movements because, on the one hand, they tend to be more highly leveraged and higher rates raise their cost of capital, impacting earnings; and on the other hand, companies in these sectors also tend to be dividend-payers, and the relative value of dividend yields goes down as interest rates rise. The chart below illustrates the regional differences in rate sensitivities:

Interest Rate “Sensitives” By Region



Source: AGF Investments using Bloomberg LP data as of October 10, 2024. Interest-sensitive sector weightings established using the following global indexes: S&P/TSX Composite Index (Canada), S&P 500 Index (U.S.), MSCI Europe Index (Europe), MSCI Japan Index (Japan), MSCI Emerging Markets Index (Emerging Markets). One cannot invest in an index. Past performance is not indicative of future results.

As that chart clearly shows, Canada’s equity market has a higher proportion of interest-rate-sensitive stocks than any of the world’s major regions. It follows, then, that the Canadian market would be more adversely affected by the higher rate regime of the past two-and-a-half years than others were.

And this is where the potential opportunity comes in. As central banks lower rates – a process that began in Canada in June but has since been started by the U.S. Federal Reserve, too – we would expect markets to broaden out from the so-called Magnificent Seven to other U.S. and Canadian stocks, and we have already seen that begin: in the third quarter, nearly 70% of the 723 companies listed on the S&P 500 Index and S&P/TSX Composite Index (TSX) had returns greater than the S&P 500 Index's gain of 4.6%. Moreover, just about half of these companies also out-performed the TSX, which returned 10.5% over the same period.

If interest rates continue to fall, we would expect the broadening out of the S&P 500 and TSX to continue, with Canada as a potential prime beneficiary. This may be especially true if central banks in Canada and the U.S. can navigate a soft landing and help keep their respective economies from tumbling into recession.

Of course, there are risks to this outlook. In this uncertain post-pandemic economy, inflation could once again rear its ugly head, prompting monetary policymakers to halt or reverse course on easing. On the flip side of the economic coin, it's possible that higher interest rates have slowed growth too much and could spark a recession – a prospect that seems more likely for Canada than the U.S. at the moment.

Our base case, however, is that rates will continue to ease over the rest of this year and into 2025. If they do, then it could position the Canadian market very well going forward – and potentially transform its interest-rate-sensitive stocks from laggards into leaders.

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HOW TO INCLUDE LIFE INSURANCE IN A PRENUP

BY: JONATHAN GOT

Including a life insurance policy in a prenuptial agreement can be complicated. Couples need to consider how to split a policy in case of separation, possible tax implications of splitting or cashing out a policy, and beneficiary changes.

And when couples draft a prenup, considering how to split a life insurance policy isn't top of mind. "It's not so romantic to talk about the nuts and bolts of life [insurance]," said Linda Cartier, president of the Academy of Financial Divorce Specialists in Sudbury, Ont. "They might be talking about who's going to pay what bills, but they usually aren't talking about much of anything else."

Still, a couple is at least "rational and caring" at that stage compared to when they're separating, Cartier said.

Prenuptial and cohabitation agreements (the latter are for unmarried or common-law spouses) are essentially the same in B.C., noted Ari Wormeli, a family lawyer and partner with YLaw in Vancouver.

A permanent life insurance policy with a cash surrender value can be divided like any other asset, and its division can be specified in the agreement, he said.

A policyholder doesn't have the option to split any single life insurance policy to insure two lives. But couples could agree, if they were to separate, to partially convert a single term policy into two current-dated policies on the original life insured, with different beneficiaries, said Ladelle Baar, assistant vice-president of product taxation and financial underwriting with Canada Life in London, Ont.

If a couple realizes, when drafting a prenup, that a life insurance policy can't be split based on the contract, they could buy a second policy instead, Baar said. The two policies wouldn't mirror each other exactly, given that the partners may be of different sexes, health conditions, and ages. However, having two policies could potentially prevent tax consequences by avoiding the surrender or conversion of a single policy.

The couple should understand the possible tax implications of their prenup agreement. If a policy will be surrendered to buy two new policies, for example, the surrender of the first policy could result in tax consequences if it has cash value.

Some insurers sell joint life policies with the option to exchange such a policy for two single life policies, and policyholders should understand whether their contract includes that option, Baar said. Also, conversion to a current-dated policy could have tax implications.

“People don’t realize that they’re actually disposing of one and buying another one,” Baar said.

Beneficiary considerations could also be part of a prenup. For example, a couple could agree that at separation, one spouse gets the primary residence or liquid assets, while the other becomes an irrevocable beneficiary of a life insurance policy, Wormeli said. However, this arrangement may work only if the life insured has a short life expectancy.

Even when a prenup states that one person in the couple will become the beneficiary of a policy, the couple should make sure that the beneficiary designation is updated with the insurer, Baar said.

Also, if a policy will be transferred from one person to the other upon separation, the policyholder should ensure the policy can be transferred and is not assigned to a bank for a loan, Baar said.

HOW INSURERS EXTENDED LIFE INSURANCE COVERAGE TO CANCER SURVIVORS

DESPITE FEARS TO THE CONTRARY, CANCER SURVIVORS CAN QUALIFY FOR A STANDARD RATING ON LIFE POLICIES

By Jonathan Got

iStockphoto/fizkes

Cancer survivors may be nervous about qualifying for life insurance, but with survival rates increasing and underwriting procedures changing, they stand a better chance of getting coverage, says Darren Devine, a financial planner with Sun Life and the president of Devine and Associates Financial Services in Guelph, Ont.

“The majority of people who’ve had cancer believe that obtaining insurance is absolutely impossible,” Devine said. “But the underwriting world has evolved greatly.”

In the past, life agents would tell cancer survivors to turn to specialty insurers that issue policies with limited face value, exclusions and high rates. But mainstream insurers will now consider those applications and may offer standard ratings depending on factors like cancer type and stability period, said Banasha Shah, a consulting actuary at Jennings Consulting.

“The type of treatment that they had, and the length of time since they’ve been in remission will, I think, inform whether or not people will qualify,” Shah said. “But the fact that [they] can apply now without [being told], ‘Don’t bother, go to one of those specialty products,’ is what has really changed.”

Sun Life offers coverage for cancer survivors across all its life products, said Michael Van Alphen, vice-president, insurance solutions with Sun Life. Underwriting depends on a sufficient recovery stability period to ensure there has been no reoccurrence for several years, depending on the type and stage of cancer.

Each cancer survivor’s case is assessed individually, but Sun Life can make an offer “the majority of the time,” Van Alphen said. “Some of the offers will have a rating, but it is possible that a cancer survivor could qualify for a standard offer.”

Cancer survivors can apply to all of Manulife’s life products based on similar underwriting factors after the applicant has completed treatment, said Karen Cutler, head of underwriting at Manulife.

More people survive cancer than ever before, Cutler said.

Insurers tend to follow cancer survival data closely to understand how various cancer types respond to the latest medical interventions. The five-year survival rate for some thyroid cancers, for example, is close to 100%. For pancreatic cancer, on the other hand, it is 20% or less, according to the Canadian Cancer Society.

Even with low survival rates, the longer an applicant survives with cancer, the more likely they are to qualify for coverage, said Byren Innes, managing director of Jennings Consulting.

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Higher-stage cancers have an increased risk of recurrence, Cutler said. While applications within the first five years of treatment completion are more likely be rated, those premiums come down over time. For example, someone who had melanoma skin cancer removed six years ago could have a standard-rated policy, depending on the stage of the cancer they survived, Cutler said.

If an applicant is denied for applying too soon after treatment ended, the insurer could issue a lesser product in the meantime and ask the applicant to reapply for a mainstream product later, Shah said.

Unlike diabetes, cancer doesn't have ongoing management, so insurers want to get cancer survivors into mainstream products as part of the standard population, even if there is a rating, Shah said. "We want to bring them into the mainstream and adjust for their survival statistics."

When working with clients who survived cancer, life agents should ask for details such as the type and stage of cancer, the treatment received, when treatment was completed and whether there are ongoing concerns, Cutler said.

Agents should also ask about the client's premium tolerance early in the conversation. If the offer comes back rated, agents should gauge whether the client can pay the higher premium or would prefer to take a lower face amount, as an underwriter may reach out to the agent offering two quotes, Cutler said.

To temper client expectations, agents should inform them that the insurer could rate or deny the policy altogether, Devine said. "The last thing you want to do is over-promise and under-deliver."

If the application is rejected, they could look at guaranteed issue products like a group insurance plan from an employer, Devine said. Self-employed clients may be able to join a group plan through a professional association.

In addition, agents should encourage their client's partner to buy life insurance.

"The spouse that has suffered the illness always looks back with a little bit of regret saying, 'Shoot, I should have dealt with this stuff in advance,'" Devine said. "Unfortunately, it reiterates to the healthy spouse, 'I better take a really good look at [insurance] because it's health that buys the coverage.'"

THE INCREDIBLE U.S. DISINFLATIONARY ECONOMIC BOOM

BY HUBERT MARLEAU, MARKET ECONOMIST, PALOS MANAGEMENT

One would think the escalating conflict in the Middle East, combined with the lead-up to an uttermost consequential Presidential and Congressional election would skew the market to the downside. Indeed, it's tempting to theorise that these events should have been directly disruptive to equities. They haven't, but have raised volatility because of the tariff, anti-trust and tax threats attached to them. The VIX, a reliable indicator of fear, is trading about 20, making an 18 months high.

Yet the S&P 500 is up 113 points, registering a 2.1% increase in the 3 weeks ended October 11- an all- time high of 5815. This is because what is more important for forward markets looking is actually going on in the economy; and right now, the market loves the steady growth derived from productivity with falling inflation.

Since the start of October, the docket has been jam-packed with indicators, shedding optimistic light on the employment situation, including where inflation stands and where growth is heading, looking past the tax and tariff swaggers and separating political rhetoric from what will in fact happen. In this regard, several market strategists have upgraded their S&P forecasts to 6,000 for this year, expecting better profit margins still. Even JPMorgan, which has been pessimistic all along this bull run, is sounding more positive. Interestingly, these upward revisions have occurred even though hedge funds have trimmed their exposure in the "Magnificent 7" as a share of total equity positioning to the lowest in 17 months, according to Goldman Sachs. Indeed, the melt-up in stock prices could continue, should the record amount of liquid assets ($6.5 trillion) in money market funds flow into the market; if the disinflationary trend sticks; and if the Fed pulls a soft landing and earnings keep on growing.

The Labour Market is Solid

September employment reports released in the early days of October were absolutely upside blowouts. First, job openings backed up above the 8.0 million mark in August from 7.7 in the prior month. What is particularly interesting is that the uptick in labour demand was not met with new hires because of a serious mismatch between employers seeking skilled workers and the skills job seekers offer. This explains why layoffs are falling, workers are holding on to their jobs, and resignations, - also known as the quick rate - are falling. Thus the job market is not as frozen as many have suggested. As a matter of fact, payroll employment increased by 254,000 in September with upward revisions totalling 72,000 in July and August, taking the 3-month average of monthly payroll gains to 186,000 and ticking down the unemployment rate to 4.1%. Although a part of this can be due to some seasonal adjustment and last week's surge in jobless claims stems from the storm, it nonetheless translated into an annual rate of increase in total employment of 1.3% in Q3. Employed workers transitioning into unemployment fell to 0.93% of the labour force, strongly suggesting that existing unemployment is caused by new entrants into the labour force. On a "skills-adjusted" basis, the economy is at full employment. (I don't attach any significance to the 33,000 increase in job claims, for they were surely attributable to hurricane distortions.)

Inflation is Stable

The Cleveland Fed's Inflation Nowcasting model was projecting a September headline and core inflation CPI y/y increase of 2.3% and 3.2% respectively. Expressed in monthly terms, economists followed by Bloomberg were expecting a 0.1% on headline and 0.2% on core. The headline print, however, came in at 2.4% y/y versus 2.5% in August and core at 3.3% versus 3.2% in August. Consumer prices didn't cool as much as expected, but not enough for the policymakers to panic because the rate has fallen sufficiently to assert that overall inflation was under control. CPI ex-shelter declined to 1.07% y/y, with the 3-month annualised rate down to 0.71%. Moreover, the labour market does not seem like it poses a significant upside risk to inflation. Over the past year, average hourly earnings rose 4.0%, while labour productivity rose 2.1% during the comparative period, setting the almighty unit labour cost within the Fed's guideline. Indeed it is: the Bureau of Labor Statistics (BLS) revealed, on Friday morning, that U.S. wholesale prices were unchanged in September. Overall, these prints correspond with the latest Fed minutes, which made it clear that the 50 bps rate cut should be interpreted as a recalibration of the policy rate to reflect lower inflation.

Growth is Exceptional

U.S. business activity continues to grow at a solid pace because the economy has turned into a productivity machine propelled by technology-driven enhancements. The Atlanta Fed's GDPNow model estimate for real GDP growth in the third quarter of 2024 is 3.2%. Acknowledging that employment had risen at an annual of 1.3% on a comparative basis and that hours worked have remained in line, a 1.9% annual rate of increase in productivity was likely achieved.

This latest batch of strong economic data is bound to continue into the last quarter of 2024. For one thing, consumer sentiment is a bit better and set to rise further because most new economic prints are beating estimates on the plus-side. What is even more important is the fact that revival of the money supply growth in August, which ended an 18-month contraction, reflects support on both empirical evidence and theoretical validity that the current growth path should go forward. Over the past 3 months, the money supply has run at an annual pace of 6.0% - a desirable rate, for it correlates well with 2.0 to 3.0% growth in the economy, with 2.0% to 2.5% inflation. And guess what? The New York Staff Nowcast is predicting that real GDP for Q4 will be 2.8%. This extra productivity should finally put to rest the diehard hard-landers' recession warnings and appease the inflationists.

The Misery Index is in a Perfect Position

The misery index is an economic indicator designed to measure the level of distress experienced by the average everyday person. It is calculated by adding the seasonally-adjusted unemployment rate (4.1%) to the annual inflation rate (2.4%). Thus it currently stands at 6.5, below the threshold of 10, where economic distress can be seen. What is particularly important is that this healthy balance tallies with significant productivity increases. It's as good as it gets.

P.S.1: Jamie Dimon, CEO of the world's most prominent bank, calls the U.S. boom "unbelievable" and the Atlantic, one of the most prestigious magazines in the world dubbed the U.S. as a "superstar." Adrian Wooldridge, a columnist with Bloomberg, has 2 reasons for this envied position, called "American Exceptionalism" - First, the US dominates the industries of the future to an extraordinary degree. 61% of global funding for AI start-ups goes to US companies compared to 17% and 6% respectively for Chinese and European ones. The US attracts 50% of global private funding for quantum computing compared to 5% for Europe, while three giant US companies account for 65% of the global market for cloud computing. Second, the US also dominates a wide range of more down-to-earth industries from chemical to pulp. One of the great pleasures of visiting out-of-the-way America is how often you come across world-beating companies in places such as Wichita, Kansas (Koch Inc.) and Stratham, New Hampshire (Timberland LLC).

If the world economy divides into competing blocks, as pessimists warn, then the US will continue to thrive. The Economist has come up with an article, showing that the US ranks third, as the world's most innovative country in the world, after Switzerland and Sweden.

Given that the Global Innovation Index takes into consideration population size, pound for pound Sweden and Switzerland might be doing a bit better than the US. However, it remains that the U.S. considerably outstrips them in terms of outputs such as patents, scientific publications and high-tech exports as well as inputs like spending on R&D, number of engineering graduates and adaptation of technology, according to the 133 countries included in the survey conducted by the World Intellectual Property Organisation (WIPO).

P.S. 2: Since hitting its cycle bottom on October 22, 2022, the S&P 500 reached a new all time high of 5792 on October 9, 2024, up 61.9%. Historically, however, this 2 -year bull run is young. Since 1950, run-ups, on average, have lasted 5.5 years, gaining more than 181%, notes Ryan Derrick, market strategists at Carson Group, with 75% of these extending 3 years or more. Thus the gains experienced over the past 2 years aren't that extraordinary, and the chances that the bull market will continue are good relative to history. Yardeni Research is targeting at least 8000 for the S&P 500 by the end of the decade. Stocks rallied 582% from 1987 to 2000 and 401% between 2009 and 2020. Voila!

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HOW HOWARD MARKS THINKS ABOUT RISK...AND YOU SHOULD TOO

BY LANCE ROBERTS RIA. REAL INVESTMNET ADVICE

When most people hear the word “risk,” they think about wild market swings, scary headlines, and losing money overnight, but Howard Marks, Co-Chairman and Co-Founder of Oaktree Capital Management, takes a different approach. In his new video series How to Think About Risk, Marks digs deep into what risk is and how investors should handle it. Spoiler alert: It’s not just about volatility.

The CFA Institute recently summarized the video stream, but I wanted to elaborate on some of Howard Mark’s views.

Let’s break down some key lessons from Marks that can help you rethink your investing approach to risk.

Risk Isn’t Just Volatility

One of the biggest takeaways from Marks’ series is the idea that risk and volatility aren’t the same thing. For years, many investors (and academics) have been taught that volatility—the ups and downs of stock prices—equals risk. However, Marks argues that this is a big misunderstanding.

Volatility is one part of the picture, but risk is the probability of losing money. Just because prices bounce around doesn’t mean you’re at risk of a big loss. Investors should focus on managing their downside, not just trying to avoid every little price swing.

The Magic of Asymmetry: More Upside, Less Downside

One of Marks’s most important lessons is the concept of asymmetric investing. Essentially, this means structuring your investments so that your potential gains are much larger than your potential losses. Sounds simple, right? But in practice, it’s challenging.

The goal isn’t to avoid risk altogether — that’s impossible. Instead, it’s about taking on calculated risks where the reward far outweighs what you put on the line. That’s the kind of smart risk-taking that leads to long-term success.

You Can’t Quantify Risk — And That’s Okay

Here’s the hard truth: you can’t measure risk in advance. Markets are unpredictable, and while we can guess what might happen, the future is uncertain. Even after the fact, you might not know how risky an investment is.

For example, just because an investment worked out doesn’t mean it wasn’t risky — maybe you just got lucky. Marks encourages investors to use their judgment and to recognize that past data won’t always predict future outcomes. Trust your instincts and look at the bigger picture.

The Risks We Don’t Talk About

When we think about risk, most of us focus on the risk of losing money. However, Howard Marks reminds us there are other risks we should be aware of, like missing out on gains by playing it too safe or being forced to sell investments during a market crash. Both can be just as damaging to our portfolios in the long run.

Sometimes, not taking enough risk can leave you behind, missing out on opportunities that could have helped you grow your wealth. Marks emphasizes the importance of balancing risk and reward to ensure you’re not just protecting against losses but also positioning yourself for future gains.

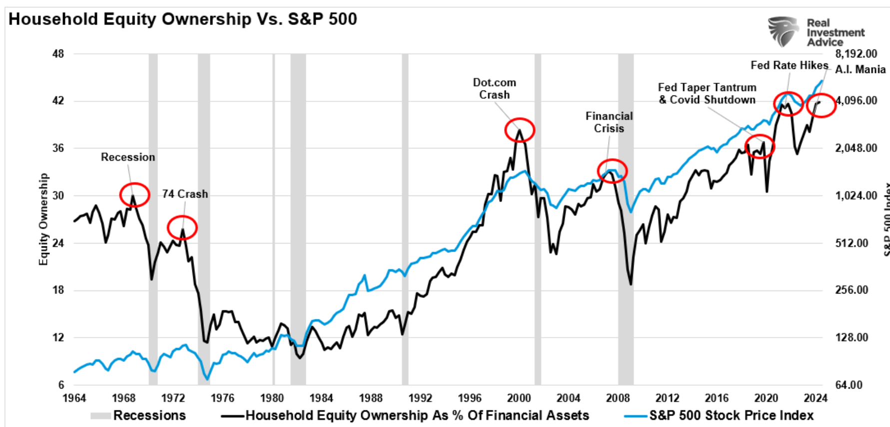
The Future Is Unpredictable

Howard Marks draws on some big thinkers like Peter Bernstein to explain that the root of all risk is our inability to predict the future. Sure, we can anticipate what might happen, but there will always be surprises we can’t see coming. And those unexpected events — like financial crises or major market shifts — can have the biggest impact on your investments.

So, what can you do? Be prepared for anything. Marks stresses the importance of acknowledging what you don’t know and managing your portfolio accordingly.

Risk Can Be Deceptive

Here’s a fascinating insight from Marks: Risk isn’t always what it seems. When the market feels the safest, that’s often when it’s often the riskiest. Think about it — when everything is going smoothly, people tend to take more risks, which can lead to market bubbles and crashes.



On the flip side, it might be a better time to invest when things look risky. It’s counterintuitive, but risk can often be highest when it feels lowest. The lesson here? Don’t get too comfortable when the market seems calm — that’s when mistakes are most likely to happen.

Price Matters More Than Quality

Here’s a myth that Howard Marks shatters: High-quality assets aren’t always safe, and low-quality assets aren’t always risky. The key is the price you pay. You can buy the best company in the world, but if you overpay, it’s still a risky investment. On the other hand, a lower-quality asset can be a great investment if you get it at the right price.

The takeaway? Focus on value. It’s not about finding the best companies — it’s about finding good companies at the right price.

More Risk Doesn’t Always Equal More Return

We’ve all heard the saying “High risk, high reward.” But Marks says that’s not always true. Just because an investment is riskier doesn’t mean it will deliver better returns. Taking on too much risk can lead to significant losses.

Investors need to be careful about chasing returns without fully understanding the risks. The goal should be to weigh the possible outcomes and ensure the potential reward is worth your risk.

You Can't Avoid Risk — But You Can Manage It

At the end of the day, Marks clarifies that risk is an unavoidable part of investing. You can't completely avoid it, but you can manage it. That means constantly evaluating the risks in your portfolio, staying prepared for unexpected events, and focusing on asymmetric opportunities where the upside outweighs the downside.

Final Thoughts And Rules

Robert Rubin, former Secretary of the Treasury, changed the way I thought about risk when he wrote:

"As I think back over the years, I have been guided by four principles for decision making. First, the only certainty is that there is no certainty. Second, every decision, as a consequence, is a matter of weighing probabilities. Third, despite uncertainty we must decide and we must act. And lastly, we need to judge decisions not only on the results, but on how they were made.

Most people are in denial about uncertainty. They assume they're lucky, and that the unpredictable can be reliably forecast. This keeps business brisk for palm readers, psychics, and stockbrokers, but it's a terrible way to deal with uncertainty. If there are no absolutes, then all decisions become matters of judging the probability of different outcomes, and the costs and benefits of each. Then, on that basis, you can make a good decision."

It should be obvious that an honest assessment of uncertainty leads to better decisions, but the benefits of Rubin's approach go beyond that. Although it may seem contradictory, embracing uncertainty reduces risk while denial increases it. Another benefit of "acknowledged uncertainty" is it keeps you honest. A healthy respect for uncertainty and a focus on probabilities drives you never to be satisfied with your conclusions. It keeps you moving forward to seek more information, question conventional thinking, continually refine your judgments, and understand that certainty and likelihood can make all the difference.

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Discuss the risks associated with leveraged mutual fund purchased with an investment funds advisor before investing. Purchases are subject to suitability requirements. Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same if the value of the securities purchased declines.

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RETURN TO PAGE 1