INVESTMENT FOCUS

RESEARCH CAPITAL CORPORATION

Personal Newsletter from Janice Honeyman

SUMMER 2023

Janice Honeyman
BA, CIM, FMA, FCSI
Investment Advisor
Portfolio Manager

Research Capital Corporation
199 Bay Street, Suite 4500
Commerce Court West
P.O. Box 368
Toronto, ON M5L 1G2
Telephone: 416-860-7781
Fax: 416-860-6798
jhoneyman@researchcapital.com
www.janicehoneyman.com

Winning the Longevity Lottery

"*Plan on Living Past Your Life Expectancy*" — this is the headline of a recent article in the popular press that suggests many of us will live longer than we expect.[1] In fact, many of us systematically understate our chances of living to age 75 by 10 percentage points or more.[2] Yet, according to longevity researchers, those of us alive today have won a longevity lottery. We have been handed an extra 30 years of life compared to just 100 years ago.

In 1921, the average life expectancy was 57 years; today it is around 84. Reaching the esteemed 100-year milestone is no longer a rarity. As many as half of those born today can expect to become centenarians. The good news is that we are living longer and healthier lives. The not-so-good news is that some may realize too late that they have claimed government benefits too early, passed up the opportunity to buy insurance or annuities or have simply undersaved for these additional years.

What is the possibility that your life might last much longer than you believe — will it change your perspectives on the present moment? Of course, this means a whole new set of issues — notably, those relating to our wealth planning to ensure a good quality of life over an extended period. As advisors, we make retirement planning and beyond a key focus in the wealth planning process. Whatever your plans, you should have the necessary financial means to enable you to make choices freely.

Some will not have that choice. With the increasing cost of living, coupled with greater longevity, some retirees will need to consider work in some form. A recent survey suggests that over two-thirds of those who retired during the pandemic have considered returning to work, with more than half citing financial need as their main motivation. We may be on the verge of what has been referred to as the "Great Unretirement."[3] Yet, there may be a "silver" lining. The growing population of contributing seniors may spur a demographic dividend, accelerating growth per capita, driving economic expansion and enhancing social development. This "longevity economy," in which the anticipated economic contributions from older adults will be higher, is expected to benefit everyone. Yet, it's not just those who need to work to support themselves. Others are challenging the traditional notion of retirement: No longer is it a time for rest, and some will choose to reinvest themselves in different roles to share their wisdom or to enjoy income-generating hobbies.

What about you? What is your vision for retirement and beyond? Regardless of your aspirations, make sure to give your wealth plan the attention it deserves today. Even small contributions can build wealth down the road. Consider that an extra $250 per month invested at a rate of return of 6 percent would yield over $250,000 in 30 years — not an insignificant amount, by any means, for those "extra" three decades we've been granted. By recognizing the current opportunities, even in more challenging times, and committing to them, investors can share in the growth that lies ahead to make that vision a reality. Continue to invest and plan for tomorrow to build your flexibility. And, above all, continue to look forward with confidence.

1. "Plan on Living Past Your Life Expectancy," Josh Zumbrun, Wall Street Journal, Feb. 11, 2023, page A2; 2. www.wsj.com/articles/death-finances-and-how-many-of-us-get-our-money-needs-wrong-51a660a2; 3. https://weforum.org/agenda/2022/10/great-unretirement-older-people-working-longer/

Janice

In this issue

The Housing Market: Will It Impact Your Retirement Planning?

For much of the past year, we've experienced a period of declining housing prices. One reason has been the rapid rise in interest rates. Historically low rates made the cost of holding a mortgage affordable, but rising rates have increased the cost of borrowing substantially. Consider the impact on a $160,000 mortgage: A 5-year, fixed-rate mortgage with a 25-year amortization and 3 percent interest rate will have monthly payments of around $757. If interest rates double to 6 percent, monthly payments increase by $267. At first glance, this may not seem significant, but over the life of the mortgage, this equates to an additional $80,000 in interest costs! Higher borrowing costs have also made it more difficult to qualify for a mortgage and reduced the amount that some are eligible for.

At least for the near term, interest rates are likely to remain elevated as the central banks continue to fight inflation. New rules have also been put in place to try and slow the housing market, such as federal government measures like the "Residential Property Flipping Rule" and the "Prohibition on the Purchase of Residential Property by Non-Canadians Act." However, there continues to be a significant supply shortfall, which is expected to support prices, especially as the population continues to grow. In fact, the latest figures (April) suggest signs of a housing market rebound that may largely be driven by a lack of supply. According to recent reports, the supply of new homes on the market is at a 20-year low.[1]

For many investors, the evolving housing market has changed the way we think about retirement planning. Here are two challenges:

Supporting (grand)kids to buy a home. With the cost of home ownership increasingly out of reach, many are assisting children. By some accounts, the average gift in the two most expensive housing markets — Toronto and Vancouver — has ranged from $130,000 to $180,000.[2] Given this substantial amount, it is essential to carefully factor in how financial support may affect the gifter's own retirement plans — a recent survey suggests that 34 percent of parents are using their own retirement savings to help adult kids.[3]

Consider also that there are different ways to provide support, including purchasing the property in your name, gifting cash or lending funds to the child. Each comes with various tax and family law issues. For example, if the home is not designated as a principal residence, there may be a future capital gain payable upon its sale or disposition. Or, if the child is married/common-law, what happens if there is a marital breakdown? As such, seek advice from tax and family law professionals.

Relying on home equity in retirement. Sometimes a home's value is viewed as a potential source of retirement income. We often suggest exercising caution with this perspective for various reasons: e.g., future real estate prices are not guaranteed; there are often unanticipated costs with a sale, such as renovations or maintenance — and, at the end of the day, you still need a place to live. Or, in due course, some find that selling a lifelong home ends up being too emotionally difficult. Of course, there are exceptions: some choose to become renters; others retire abroad to more affordable destinations. Even in these circumstances, planning for contingencies is important — you may be unable to find a suitable rental property or perhaps you will eventually decide to move back, such as to access Canada's healthcare system.

These factors, along with others, may influence the wealth planning process for retirement and beyond. For a deeper discussion, please get in touch.

1. https://financialpost.com/real-estate/housing-market-sales-surge-double-digits; 2. https://www.theglobeandmail.com/investing/personal-finance/article-parents-gave-their-adult-kids-more-than-10-billion-to-buy-houses-in/; 3. "How Parents are Helping Their Adult Children," R. Carrick, 04/11/23.

This Summer: Check Your Credit Score

When was the last time you checked your credit score or credit history? It may be important for young and older people alike, for benefits beyond just understanding your credit position.

For older couples, one issue that sometimes arises is when one spouse has a good credit rating, but the other has none: If the spouse with the good rating passes away, the survivor may have difficulty qualifying for credit, such as a loan, or even something as basic as a credit card.

Establishing a good credit score can take time. It involves creating a credit history and showing that you are able to pay bills on time and in full. The two main Canadian credit bureaus, Equifax and TransUnion, keep track of your credit through public records of lenders like banks, collection agencies and credit card companies. Credit scores are usually based on a range between 300 and 900, with a score of over 700 considered very good.

Support Younger Folks: The Importance of Building Credit

Many young people may have limited experience with credit and do not realize that having a good credit history can make life easier. It is important because this score determines how lenders assess an individual's credit capacity — the higher the score, the greater the likelihood that you'll be approved for loans or credit. And, it is often checked when applying to rent a property or even for certain jobs.

A Preventative Measure: Protect Against Fraud or Identity Theft

Periodically accessing a credit report may be especially important in this age of increasing fraud and identity theft. A credit report can often detect fraudulent activity, such as identifying accounts you may not have opened or inquiries from companies with which you've never done business. The credit bureaus also offer monitoring services that can notify you if there are changes to your credit position, which may indicate fraud. You can also request extra security measures, such as a "fraud alert," notifying you when financial providers issue new credit in your name. Some of these services have associated fees, but the cost may be worthwhile to help minimize any damage if you become a victim, especially as new scams grow in sophistication. They may also be a consideration to help protect those who are more vulnerable, such as isolated and elderly individuals.

The Principal Residence Exemption: Your Questions Answered

Summer is often one of the busiest seasons for residential home sales. With many investors owning multiple properties, thinking ahead to their eventual disposition may be worthwhile.

As a reminder, when you sell your home and a capital gain is realized,* the resulting tax may be eliminated/reduced if the property is designated as a "principal residence" by claiming the Principal Residence Exemption (PRE). As of 2016, you must report the sale of a principal residence on your income tax return and claim the PRE. If you own multiple properties and sell one, you will need to decide which one to designate as the principal residence for each of the years it was owned: only one can be named each year.[1] Generally, you should consider designating the property with the largest average capital gain per year to reduce the overall tax liability. Yet, the decision is rarely straightforward and may involve multiple factors, such as predictions about the future value of the remaining residence(s).

Here are six common questions relating to the PRE:

1. To qualify, do I have to live in the unit most of the time? A principal residence generally refers to a housing unit that is "ordinarily inhabited." This doesn't mean that the taxpayer needs to live there the majority of the time. The property may qualify if the taxpayer or member of the family unit lived in it at some point during the year.

2. Can a cottage/cabin qualify? Yes, seasonal residences, even those outside of Canada, may be designated as a "principal residence."

3. What if I forget to report the sale on my income tax return? The Canada Revenue Agency (CRA) may charge a late-filing penalty of $100 per month, up to a maximum of $8,000. As well, the PRE may be denied at a further date.

4. Can I use my property for rental/business income? If a property is predominantly used to produce income, it will not be eligible for the PRE. If part of a principal residence is used for rental/business purposes, you may be able to claim the PRE for the portion used as a residence. If you change the use of a property, if it was a principal residence prior to the change, the PRE may be claimed for those years. Note: a "change in use" may result in additional tax implications.[2]

5. What if I leave Canada for extended periods? If you weren't a resident of Canada for the entire time you owned a designated property, the period of non-residence may reduce/eliminate the PRE.

6. What if I move into a care home? The PRE is only available if the unit is ordinarily inhabited, so a property may not qualify during the time an owner lived in a seniors' facility. As you plan ahead to use the PRE, one option may be to have an adult child occupy the home during this time.

*Or a deemed sale for tax purposes; 1. Per family unit. For years before 1982, each spouse can designate a different property; 2. www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/personal-income/line-12700-capital-gains/principal-residence-other-real-estate/changes-use.html

A Reminder: The TFSA is a Valuable Tool for Every Stage of Life

By now, you have likely received your CRA Notice of Assessment for your 2022 taxes. Do you have available TFSA contribution room? Many of us are not fully maximizing tax-advantaged accounts — even the wealthiest Canadians are overlooking the opportunity. At last count, only 30 percent of taxpayers earning $250,000 or more had fully contributed.[1] Beyond the significance of growing funds on a tax-free basis, here are some reminders of how the TFSA can be a valuable tool:

Transferring Wealth While Alive — The TFSA may help to gradually transfer wealth to beneficiaries while you are alive. Gifted funds can be used by adult children to contribute to their own TFSA to grow over time, keeping in mind the loss of control of funds. This can also simplify an estate and potentially minimize taxes upon death.

Approaching Retirement: RRSP/RRIF Meltdown Strategy — There may be benefit in gradually drawing down RRSP/RRIF funds as you approach retirement. One significant reason is if you are in a lower tax bracket than you will be in the future. A strategy may be to use RRSP/RRIF withdrawals to fund TFSA contributions. As the TFSA grows, this tax-free income can augment or replace RRIF withdrawals later. At death, these funds can pass entirely to heirs; residual RRSP/RRIF income could potentially be subject to the highest marginal tax rates.

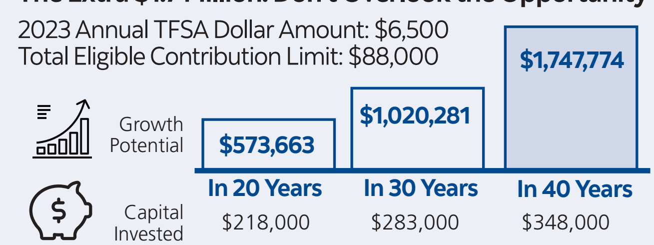
Funding Retirement — The TFSA can help optimize retirement income and cash-flow streams. TFSA withdrawals are not taxable and won't affect income-tested benefits such as Old Age Security. A TFSA may also help with tax planning. For example, if generating RRIF income will put you in a higher marginal tax bracket, you may be able to minimize tax by withdrawing only the required RRIF amount and using TFSA withdrawals to supplement income. On the other hand, if your marginal tax rate is lower than you expect in the future or at death, funds in excess of the RRIF minimum requirement can be withdrawn and put into a TFSA where they can continue to grow. This can reduce an overall lifetime tax bill. The TFSA can also supplement cash flow if a retiree chooses to defer Canada Pension Plan benefits.

Your Estate — The TFSA can be an excellent way to pass along assets on a tax-free basis. Consider the way you have designated beneficiaries: a named "beneficiary" will receive proceeds upon death tax free. However, if a spouse/partner is named as "successor holder," they can continue operating the account "as is" going forward. Please contact the office if you require an update to beneficiary designations.

The bottom line? Ensure you have fully contributed to your TFSA!

1. https://www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2019/table1c-en.pdf

The Extra $1.7 Million: Don't Overlook the Opportunity



This assumes full contributions since 2009 and ongoing $6,500 annual contributions compounded at a rate of 5 percent annually.

Warren Buffett Speaks: His “Secret Sauce” & More…

What’s in Warren Buffett’s “Secret Sauce?” In his latest shareholder letter, the Oracle of Omaha shares one of his key ingredients for success: dividend-paying stocks.

When equity markets are climbing, dividends often take a back seat to capital gains for investor focus. As we continue through a period of slower economic growth, and with interest rates rising from substantial lows, we shouldn’t underestimate the significance of dividends to portfolio growth.

Buffett’s investments are expected to generate a whopping $5.7 billion in cash this year, the majority from dividends.[1] In his letter, he points to two successful dividend-paying investments and the contribution of both dividend growth and share price appreciation in growing portfolio values over time. He compares these to a high-quality bond, referring to it as a “flat-lined” investment that would retain, not grow, its value and pay an unchanged coupon rate from year to year.[2] It’s good food for thought: dividends, alongside share price appreciation, can contribute to substantial growth over time. Consider an investment of $100,000 in the S&P/TSX Composite Index 30 years ago. It would yield $628,273 by investing in the index alone; yet, with reinvested dividends, the value would grow to $1,318,767.[3] Buffett also credits a handful of solid investment choices and the magic of compounding over time.

Today, the S&P/TSX Composite Index has a dividend yield of around 3.12 percent, almost double that of the S&P 500 at 1.67 percent.[4] Many quality Canadian companies pay dividends, some with yields between 4 and 6 percent. Consider that the equivalent pre-tax interest income would be around 5.2 to 7.8 percent for an average high-net-worth taxpayer.[5] Indeed, dividends still lead the way in tax savings over interest, with eligible dividends from Canadian corporations taxed at a rate that is lower than interest income.

This is in addition to the prospect of future share price growth, as well as future increases in dividend payouts, as Buffett reminds us. Many companies that have historically paid dividends continue to pay dividends, and increase their dividends even through more challenging economic times — for example, the “Dividend Aristocrats,” a group of companies that have had 25 years of consecutive dividend increases in the U.S., and 5 years in Canada.

Dividends remain an excellent income source that can meaningfully contribute to portfolio growth over time. Don’t overlook the fact that they continue to work hard behind the scenes within a portfolio.

1. www.wsj.com/articles/warren-buffetts-secret-sauce-involves-one-of-investings-most-basic-strategies-f96c4894; 2. www.berkshirehathaway.com/letters/2022ltr.pdf; 3. S&P/TSX Composite and Total Return Indices, 01/29/93 to 1/31/23 (3,305.47 to 20,767.40; 6,124.83 to 80,772.20); 4. At 04/28/23. Of course, this is because of the significant portion of growth stocks that make up the S&P 500 that typically do not pay dividends; 5. Based on average marginal tax rates for $250,000 of income in 2023: 50.25% for ordinary income and 35.02% for eligible dividends, which are averages across provinces/territories.

The Oracle of Omaha Speaks...

Eagerly anticipated each year by many investors, Warren Buffett’s annual letter is renowned for its insight and humour. This year is no exception; Buffett seems particularly introspective, perhaps a result of reaching the respected age of 92. Here are some notable excerpts:

On the Markets — “It’s crucial to understand that stocks often trade at truly foolish prices, both high and low. Stocks and bonds are baffling, their behavior usually understandable only in retrospect.”

On Investing — “You have to keep learning if you want to become a great investor. When the world changes, you must change.”

On Investing Success — “I have made many mistakes...The weeds wither away in significance as the flowers bloom. Over time, it takes just a few winners to work wonders. And, yes, it helps to start early and live into your 90s as well.”

On Giving — “(Many of our shareholders) live well and eventually dispose most of their funds to philanthropic organizations. Sometimes, the results have been spectacular. I watch with pleasure...the disposition of money unmasks humans.”

On Life — “All I want to know is where I’m going to die, so I’ll never go there. And a related thought: Early on, write your desired obituary – and then behave accordingly.”

On the Future — “We count on the American Tailwind and, though it has been becalmed from time to time, its propelling force has always returned.”

To read more: www.berkshirehathaway.com/letters/2022ltr.pdf

RESEARCH CAPITAL CORPORATION

Janice Honeyman, BA, CIM, FMA, FCSI
Investment Advisor, Portfolio Manager
Research Capital Corporation
199 Bay Street, Suite 4500
Commerce Court West, P.O. Box 368
Toronto, Ontario M5L 1G2
416-860-7781
E-mail: jhoneyman@researchcapital.com