INVESTMENT FOCUS

Personal Newsletter from Janice Honeyman

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Growth Will Persist

A little over six years ago, renowned investor Warren Buffett made a bold prediction: The Dow Jones Industrial Average (Dow) would reach the milestone of one million within 100 years.[1] At first glance, his assertion appeared somewhat incredulous since the Dow was hovering around the 22,000 mark. Today, it stands close to the 39,000 level.

Yet, looking deeper into the numbers, the same could be suggested for the S&P/TSX Composite Index (S&P/TSX). At the time, the Dow needed to compound at less than 4 percent annually to achieve Buffett's target. Canada's S&P/TSX would need an annualized return of just 4 percent to reach the 1,000,000 mark by 2124.

However, Buffett's point wasn't to suggest whether some arbitrary benchmark could be achieved. Rather, his prediction was meant to reinforce confidence in future growth and the fact that we can all benefit if we choose to participate. History has shown that equities outperform most asset classes over the longer term; not so surprising since the overall growth in corporate profits has been an upward trajectory over time.

Today, we are living through a pivotal time due to the availability of big data, high-powered computing and advances in artificial intelligence (AI). While the U.S. equity markets have seen substantial gains due to the handsomely-rewarded technology stocks, the productivity and growth potential is expected to be far reaching, well beyond the tech sector.

Canada's stock market has trailed due to its more cyclical nature, but is poised to benefit from interest rate stability and declining long-term rates. Corporate earnings may be driven by higher margins through efficiency gains and lower input costs, particularly as inflation moderates. The comparative strength of the U.S. economy, our largest trading partner, may provide near-term support. And, the potential for interest rate cuts is expected to provide tailwinds to equity markets.

While Canada's economic output continues to be sluggish, consider that our economy has been relatively resilient given the challenges of the past few years. Wealth, wages and employment are all higher than they were before the pandemic began. And, seasoned investors accept that over time economies and markets will ebb and flow. Periods of retrenchment are natural parts of the business cycle and are sometimes necessary to allow economies to cleanse excesses and reset, or even spark innovation and growth. This is one reason that supports diversification in portfolio management. It is also why we continue to invest with a longer-term view.

Indeed, the longer-term outlook for economic growth continues to be positive, with technology set to drive productivity and continued innovation, alongside efforts by governments to control inflation and focus on infrastructure and sustainability initiatives — just some of the factors that should help us prosper in North America. Growth will persist — and we can all benefit if we choose to participate. I am here to provide wealth management ideas, strategies and support as we progress towards the 1,000,000 milestone.

Janice

1. https://www.wsj.com/articles/warren-buffett-says-the-dow-is-going-over-million-1505923803

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Tax Season is Here Again: Here Are Some Reminders

As we deal with tax returns, this may be a reminder that we should be doing all we can to minimize taxes. Here are some actions to consider:

Be Aware of the Deductions and Credits Available — Tax laws change annually, so consulting an expert can ensure you're maximizing available credits and deductions. This can also provide continuity in the event something were to happen to you or a spouse. Encourage younger folks to file a tax return, even if their income falls below the basic personal exemption to generate Registered Retirement Savings Plan (RRSP) contribution room.

Maximize Tax-Advantaged Accounts — Are you fully utilizing tax-advantaged accounts like the RRSP and Tax-Free Savings Account (TFSA)? At last count, only 30 percent of taxpayers earning $250,000+ had fully contributed to the TFSA, with an average unused amount over $23,000.[1] First-time home buyers have a new tax-advantaged "gift" from the government: The First-Home Savings Account.

Optimize Asset Location — The location in which you hold certain types of assets can make a difference. Different types of income (interest, dividends, capital gains) may be taxed differently depending on the type of account from which income is generated. For example, if you hold foreign investments that pay dividends in a non-registered account, you may receive a foreign tax credit for the amount of foreign taxes withheld. If the same asset is held in a TFSA, no foreign tax credit is available. By having a comprehensive view of your assets, there may be opportunities to optimize asset location across different accounts.

Plan with a Spouse — If you're part of a spousal unit with a higher and lower-income earner, there may be income-splitting opportunities. If you expect a spouse to have significantly less income than you in retirement, there may be an opportunity to contribute to a spousal RRSP for the low-income spouse. Retirees may be able to split eligible pension income on their tax returns or elect to split Canada Pension Plan benefits.

"Reduce" Your Refund — Instead of celebrating regular tax refunds, consider adjusting your tax deductions to avoid overpaying taxes throughout the year. Consider reviewing form TD1 with your employer to reduce the tax deducted from your pay. You may also file CRA Form T1213 if you know you'll have significant deductions in a given year.

Consider Opening a Small RRIF if Over 64 — The pension income tax credit generally becomes available at age 65, allowing for a tax credit on up to $2,000 of eligible pension income. If you don't have eligible income, consider setting up a small RRIF for the year you turn 65 (sooner, if widowed) to create pension income. You don't have to convert your RRSP to the RRIF until the year you turn 71, but this way you can still claim the pension tax credit.

These suggestions are just a starting point. As always, seek the advice of a professional tax advisor as it relates to your personal situation.

1. The latest figures are 2022 statistics for the 2020 contribution year. https://www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2020/table3c-en.pdf

Be Aware: Interest on Overdue Tax

For Q2 2024, the interest charge on unpaid balances is at its highest rate in over 20 years: 10 percent. The prescribed interest rate changes quarterly. Be sure to file your taxes on time and pay any taxes due in order to avoid this significant charge.

You Asked: How Long Do I Keep Tax Records?

You are required by law to keep tax records for at least six years from the end of the tax year to which they apply (or from their filing date).

Beware of the TFSA 'Danger Zone'

The first four months of the year have been referred to as a 'danger zone' for those relying on TFSA contribution room data posted on their CRA account. If you've based your TFSA contributions on "My Account" information, be aware that it may not be accurate. According to the CRA, contributions or withdrawals made in the previous year may not be reflected in the current year's contribution room until "after the end of February," as issuers have until the final day of February to submit TFSA transactions to the CRA. However, the lag in updating data could extend to March or even late April.

This is important to prevent penalty charges on excess TFSA contributions, which are assessed at one percent per month on any excess amounts. Over the past few years, the penalties have been significantly increasing. In 2022, the total paid in overcontribution penalties was $132.6 million, over triple the amount paid in 2019.[1]

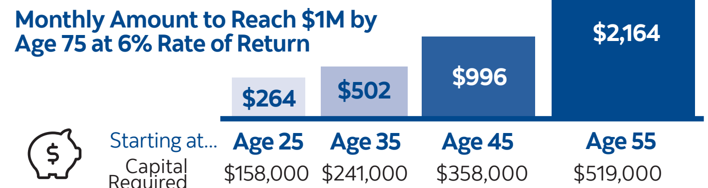
What is driving this increase? There may be various reasons. The lag in CRA reporting times can often create confusion. Some hold multiple TFSA accounts, increasing the likelihood of recordkeeping errors — recent statistics suggest that 245,000 TFSA holders have between five and nine TFSA accounts![1] As well, there may simply be a misunderstanding of the rules. For instance, when TFSA funds are withdrawn, remember that they only become available for contribution at the beginning of the following calendar year.

Ultimately, it is the taxpayer's responsibility to maintain accurate records. If you rely on CRA contribution room information, a general guideline is to wait until late April when all records should be updated.

1. https://www.theglobeandmail.com/investing/personal-finance/article-people-keep-making-this-costly-tfsa-mistake-and-paying-penalties/

Don't Procrastinate, Participate! The Benefits of Starting Early

Here is one perspective on the benefits of investing at an earlier age. It shows the monthly investment needed to accumulate $1M by age 75, based on an annual return of 6 percent.



Note: Compounded monthly, with taxes & expenses ignored. For illustrative purposes only.

The Impact of Taxes on Investments Can Be Significant Over Time

This is the season when many of us are busy preparing income tax returns, perhaps a good time to reflect on the taxes we pay in investing. Just as investments benefit from compounded growth over time, the tax on income and gains can accumulate to become significant.

First, recall the different ways that investment income is taxed in non-registered accounts. Interest income is fully taxable at an investor's marginal rate. Capital gains are taxed at half of this rate since only half of a capital gain is taxable. Eligible dividend income from Canadian corporations generally attracts tax at a rate in between the two.

So how do different taxes impact returns over time? The table below illustrates four scenarios (A to D), each involving an investment of $50,000 at Year 0 and an annual rate of return of 6 percent compounded over 25 years. In A and B, tax is paid each year at different rates based on the type of income earned: interest and dividends. In C, taxes are deferred so there is no annual tax, but tax is paid at year 25 when capital gains are realized. In D, there is no tax; funds grow in a TFSA. After 25 years, the difference in after-tax value is significant. As such, it is prudent to consider making investments more tax efficient where possible.

How Different Taxes Can Affect After-Tax Values (Illustrative)

Year	A: Interest	B: Eligible Dividends	C: Capital Gains	D: TFSA
	Taxed Annually		*Tax Deferred*	*No Taxation*
Tax Rate	*50.25%*	*35.02%*	*25.13%*	*—*
0	$50,000	$50,000	$50,000	$50,000
1	51,492	51,949	53,000	53,000
5	57,921	60,537	66,911	66,911
10	67,098	73,295	89,542	89,542
15	77,728	88,741	119,828	119,828
20	90,042	107,442	160,357	160,357
25	104,307	130,084	214,594	214,594
After-Tax Value	**104,307**	**130,084**	**173,239**	**214,594**
Amount Paid in Tax	54,855	43,163	41,355	—
Difference (% of D)	49%	61%	81%	100%

Based on 6% annual growth. Tax rates are based on the average of 2023 combined federal, provincial and territorial personal marginal tax bracket at $250,000 of ordinary income, eligible dividends or capital gains: 50.25%, 35.02% and 25.13%, respectively.

This includes ensuring that you maximize tax-advantaged accounts like TFSAs, RRSPs and others. Consider also the opportunity to consolidate accounts, to help optimize asset location across all of your accounts.

Certain types of investments may have tax-advantaged attributes. For instance, mutual funds, REITs, limited partnerships and others may provide return of capital (ROC) distributions that are not a taxable receipt. High-quality bonds trading at a discount provide income and a more favourably-taxed capital gains component.

Reminder: Tax Treatment of GICs

With increased interest in Guaranteed Investment Certificates (GICs), remember that the associated tax liability must be reported on an annual basis for non-registered accounts. Many GICs are locked-in, meaning you can't cash them in until their maturity date. Yet, even if a GIC matures in a future tax year and interest has not yet been paid, the amount that has accrued in the tax year must be reported on a tax return. A T5 slip will be issued for amounts of $50 or more.

Other tools may help to defer tax, such as an individual pension plan (IPP) to allow business owners/executives tax-deferred growth to build retirement income. Small business owners may consider using an estate freeze when succession planning to lock in the tax liability at death based on today's business value.

These are just a handful of ideas that may help to improve tax efficiency. For a comprehensive discussion, please call the office.

Are You Associated With a "Bare Trust" Arrangement?

Do you hold assets in an arrangement with a separate legal and beneficial owner, where the beneficial owner oversees the assets? You may be holding a "bare trust" arrangement and subject to new reporting rules.

What is a bare trust? According to the CRA, a bare trust "exists where a person, the trustee, is merely vested with the legal title to property and has no other duty to perform or responsibilities to carry out as trustee, in relation to the property vested in the trust."[1]

Here are two examples where a bare trust arrangement may exist:

- You have been added to the property title of an elderly parent to assist with estate planning, but the parent retains beneficial ownership/control.
- As a parent, you have added your name to the title of an adult child's home to help the child qualify for financing.

New filing requirements. Bare trusts are now subject to reporting requirements that changed for trusts with taxation years ending after December 30, 2023. For most trusts, even if there is no income or activity to report, a T3 Trust Income Tax and Information Return must be filed within 90 days of the trust's tax year end.

The good news is that since reporting rules were expanded to include bare trusts, the CRA will provide penalty relief if a T3 return hasn't been filed by the deadline. This relief applies only to bare trusts for the 2023 tax year.

Seek assistance. Since the intent of the arrangement can impact whether or not it is considered a bare trust, if you believe you may be associated with a bare trust arrangement, it's best to discuss your situation with a tax or legal expert to understand if you are subject to filing obligations. For more information: https://www.canada.ca/en/revenue-agency/services/tax/trust-administrators/t3-return/new-trust-reporting-requirements-t3-filed-tax-years-ending-december-2023.html

1. https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/p-015/treatment-bare-trusts-under-excise-tax-act.html.

Note: This is not intended to be a comprehensive or legal discussion. Please seek the advice of tax and legal experts.

Avoid These Six Common Investing Errors

While we can learn much about successful investing by studying the best investors, it can also help to learn from our mistakes. The CFA Institute has identified the most common investing mistakes and here are six:[1]

1. Having unrealistic return expectations — Having reasonable return expectations can support good decision-making, risk management and long-term planning. However, investors tend to have higher expectations than those who manage money professionally. One study suggests that Canadian investors expect an average annual return of 10.6 percent on investments, whereas financial professionals anticipate 6.5 percent, leading to one of the highest expectation gaps in the world.[1] Consider that the 50-year average return of the S&P/TSX Composite Index (dividends not reinvested) is 5.9 percent.[2]

2. Lack of clear investment goals — Some investors may become too focused on short-term returns or the latest investment fad. A recent study in the U.K. suggested that less than one-third of investors had any specific long-term goal in mind when investing.[3] However, even a modest investing program can yield significant dividends down the road. Investing just $20 per day at an average annual return of 6 percent would yield over $1.2 million in 40 years.

3. Failure to diversify — A well-diversified portfolio is important to achieve an investor's appropriate level of risk and return. Having too much exposure to a single security or sector comes with risks. Diversification is intended to protect from the downturns that may affect sectors at different times, while also giving access to the best performers. Consider the difficulty in consistently picking individual winning stocks over long periods: only 21.4 percent of U.S. stocks beat the market over 20 years from 1927 to 2020.[4]

4. Buying high and selling low — While a fundamental principle in investing is to "buy low and sell high," many investors do the opposite because they are motivated by fear or greed. It has been estimated that the loss in returns by "buying high and selling low" versus a buy-and-hold strategy is on average around 2 percent annually,[4] which can become meaningful over time.

5. Excessive trading — Investing often involves patience to endure down-market times. Timing the markets is difficult, if not impossible. Even if you were to exit the markets before a downturn, you'd need to reenter before the markets resume their upward climb. This often happens with little warning. Consider the S&P/TSX Composite — the rapid climb to end 2023 was largely unpredicted. Studies have shown that the average underperformance of the most active traders annually (vs. the U.S. stock market) is 6.5 percent.[4]

6. Reacting to media narratives — In this modern era of connectivity, we are being fed news at a rapid rate — and this news continues to be increasingly negative.[5] In periods of market declines, this may trigger fear, which can cause investors to make hasty decisions not in their best interests. Yet, despite the negativity, consider that since 1975 the S&P/TSX has posted annual positive gains 77 percent of the time.[6]

As an advisor, I do my best to prepare clients by putting a plan in place to set priorities and using a disciplined approach that emphasizes asset allocation, strategic diversification, risk management and a focus on quality to guide us through the different cycles. We can also choose to integrate different techniques into investing programs to reduce impulsive decision-making, as many investing errors result from succumbing to our behavioural biases. This may include regularly rebalancing portfolios, using managed products to put buy/sell decisions in the hands of experts or incorporating systematic investing programs like dollar-cost averaging or dividend-reinvestment programs.

I am here to help keep you on course, to limit the impact of investment errors as we chart the path to longer-term success.

1. https://www.visualcapitalist.com/portfolio-return-expectations-by-country/; 2. S&P/TSX Composite Index 12/31/1973 - 1,193.56; 12/29/2023, 20,958.40; 3. https://www.fca.org.uk/news/press-releases/young-investors-more-likely-have-long-term-goals-mind-dating-when-investing; 4. https://www.visualcapitalist.com/20-most-common-investing-mistakes/; 5. https://www.bbc.com/future/article/20200512-how-the-news-changes-the-way-we-think-and-behave; 6. https://en.wikipedia.org/wiki/S%26P/TSX_Composite_Index

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