

# INVESTMENT FOCUS

SUMMER 2022

We have ideas.

The Mehta  
WEALTH MANAGEMENT GROUP

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#### To My Clients:

During my time in this industry, I've managed through challenging economic periods and market pullbacks before. This newsletter issue provides some thoughts on the importance of holding on through difficult times. As always, please remember that I am here to help.

This period of economic uncertainty is expected to continue, but eventually the pendulum will swing back again. It may be difficult not to focus on the pessimism of today, yet having a view for the longer term can help provide perspective. Longer-term investing involves enduring the inevitable cycles, entrusting that your wealth plan has been put in place to benefit your future.

May you find time to enjoy many leisurely pursuits in the summer days ahead.

– Kairas

## The Importance of Holding On

It has been difficult to find much market commentary that suggests positive developments in the financial and economic markets over recent times. The reasons are many: high and persistent inflation, more aggressive tightening policies by central banks and the prospect of recession. This has created significant uncertainty over the path forward.

Indeed, humans can react unfavourably to uncertainty. Studies have shown that our emotions are a key driver of stock market volatility over shorter periods. One study suggested that roughly 75 percent of short-term market variation can be explained by risk aversion.<sup>1</sup> This is likely because, in the short term, we underestimate our ability to adapt.

Today is no exception. We have seen significant volatility in the financial markets. Market pundits have been having a field day creating worry that this time is different. However, some perspective is warranted. Let's not forget that, over time, economies and financial markets have continued to adapt and progress. We have also come from a time in which record stimulus benefitted both the markets and economies, so a period of adjustment can be expected. Many company earnings that thrived over recent times must now adjust as consumption patterns balance towards a post-pandemic world. High inflation has been a prevailing headwind and although it has been more than just transitory, consider that it will also not be permanent.

Economies, like the markets, are cyclical in nature, so anyone who forecasts a recession has a good chance of eventually being right. In Canada, first quarter GDP grew at a rate of 3.1 percent. Although GDP contracted in the U.S., labour markets in both nations continue to be robust and, for now, household balance sheets suggest consumer resilience. We should also remember that recessions vary in their duration and intensity; the past two lasted only three and seven months.

This is not to suggest that there aren't challenges ahead. We have entered a period of slower growth globally and continue to face many uncertainties. As such, it may be difficult to not take action when experiencing market pullbacks. However, for investors who may feel the urge to sell investments for fear of a greater loss during these times, this can create two issues — selling at low prices and the inevitable need to re-enter the markets. Consider also that the biggest up and down days have historically clustered together and missing the market's best performance can significantly impact future returns (see page 3). And, it's not just the inherent difficulty in timing the market: Selling and rebuying can potentially create a costly tax situation in certain accounts or forego dividend income opportunities.

Consider also that one of the most important variables for how you'll do as an investor can be how long you are able to stay invested. This is because success for many investors comes from uninterrupted compounding over years and decades. In the words of renowned investor Charlie Munger, Warren Buffett's business partner, "the first rule of compounding is to never interrupt it unnecessarily." Don't overlook the importance of holding on.

I understand the challenges that come from an uncertain near-term outlook. During periods such as these, investors should try to stay focused on longer-term goals. Keep your eyes on the horizon, stay invested and look beyond today, as better times will eventually prevail.

1. [www.nber.org/papers/w19818](http://www.nber.org/papers/w19818)

## Federal Budget 2022 Recap: Few Significant Changes for Investors

This past spring, the federal government delivered its budget with few significant changes for investors: no changes to the capital gains inclusion rate or federal income tax rates. Many initiatives address the hot housing market. Here are some highlights:

**Tax-Free First Home Savings Account (FHSA).** The federal government proposed a new account to help Canadians save for their first home. Expected to begin in 2023, the account will have a lifetime contribution limit of \$40,000, with an annual limit of \$8,000. Contributions will be tax deductible, similar to the RRSP, and withdrawals will be tax free, similar to the Tax-Free Savings Account (TFSA). When the FHSA was originally proposed in the 2021 election campaign, it came with an age limit. This was removed in the most recent budget. If this change stands, a recent article in the popular press suggests that tax-planning opportunities may be available to older Canadians by using the FHSA as a savings tool.<sup>1</sup> Stay tuned for updates as the rules are finalized and details become clearer.

**Multigenerational Home Renovation Tax Credit.** This proposed refundable tax credit offers up to \$7,500 by allowing qualifying families to claim 15 percent of up to \$50,000 in eligible renovation and construction costs incurred to construct a secondary suite for a senior or adult with a disability.

**Residential Property Flipping Rule.** Under proposed rules, property sold that is held for less than 12 months would be considered “flipping” and any profits would be subject to full taxation as business income (with certain exceptions). Where the new rule applies, the Principal Residence Exemption would not be available.

**Small Business Deduction.** Under current rules, access to the small business deduction is reduced when a Canadian-controlled private corporation has taxable capital greater than \$10 million, reducing to nil with taxable capital of \$15 million or more. The budget proposes to change the formula such that the small business deduction will

not be reduced to nil until the corporation has taxable capital of \$50 million.

### Minimum Tax for High Earners.

The federal government announced an intention to revisit the current Alternative Minimum Tax regime with a view to ensuring high-income earning Canadians pay a minimum level of tax. Further details are expected in the 2022 fall economic update.

At the time of writing, these proposals have not been enacted into law. For greater detail, please see the Government of Canada website: <https://budget.gc.ca/2022/home-accueil-en.html>

1. “Three ways to make the most of the new tax-free savings account for home buyers,” Erica Alini, The Globe and Mail, April 30, 2022, B15.



### Luxury Vehicles: Prices Are Set to Increase

The federal government quietly released revised draft proposals in the spring to introduce a luxury tax on certain vehicles. As of September 2022, this luxury tax is set to apply to cars and aircraft with a retail sales price over \$100,000 and boats over \$250,000.

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

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

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

## You Asked: Transferring Family Property to the Next Generation

With the arrival of summer comes cottage and cabin season once again! Many family properties have been owned over generations and there is often a desire to keep them in the family for decades to come. Yet, many children do not have the funds needed to buy the property.

In working with clients, we are often asked questions about cottage/cabin succession planning. One question that is commonly asked is: **Can I sell the cottage to my kids for \$1, or a value substantially lower than its fair market value (FMV)?** This is often to try and avoid the capital gains tax. When a cottage is not considered a principal residence, capital gains tax will generally be due on the difference between the FMV and adjusted cost base (ACB) of the property.

However, selling less than FMV is likely to lead to significant tax consequences. The child's ACB will be determined by the actual price paid, which may lead to the child paying tax on a gain already realized by the parent when the child eventually sells the property.

Take, for example, a cottage that is sold for \$1 to a child. If the FMV is \$1 million and the ACB to the parent was \$400,000, the taxable

capital gain to the parent would be 50 percent of \$600,000 (or \$300,000). For the child, a purchase at \$1 results in the child's ACB being \$1, rather than the property's FMV.

So, if the property is sold in the future for \$2 million, the capital gain would be the full \$2 million less \$1. This results in double taxation as it includes the parents' earlier capital gain, as well as the original amount paid for the property. Instead, there may be better options, such as gifting the cottage. Although there will be a substantial tax liability to the parent at the time of gifting, the child's ACB will be equal to the FMV at the time and double taxation will be avoided.

As always, consult with legal and tax advisors familiar with cottage succession planning to help you understand the options available.



## Your Estate Plan: Are There Ways to Better Protect Family Harmony?

An estate plan should consider more than just how you distribute your assets. It can also include strategies for preserving family values and relationships. This may be important: it isn't uncommon for even the most harmonious of families to undergo bitter disputes when dealing with the distribution of assets of an estate. As such, the time you invest in planning has the potential to leave a lasting legacy of family harmony. Here are some thoughts:

**1. Keep documents updated** — Consider reviewing your estate plan periodically to ensure it reflects your current thinking and to avoid future conflict. If you have a Will in place, how old is it? Perhaps this may be a good time for a thorough review of your estate planning documents, especially if circumstances have changed. Equally important: reviewing your designated beneficiaries, where applicable. Many investors fail to revisit these designations to account for major life changes, such as marriage, divorce or the birth of a child.

**2. Rely on professional support** — Improper documentation or vague instruction can lead to misunderstanding, conflict and even escalate to a costly court battle. While you are able to create estate planning documents on your own, such as by using an online Will service, even if the document is valid, do you fully understand the family and succession laws of your province, or income tax and investment rules? These can change over time and should be evaluated against your estate plan. With the rise in blended families, balancing competing interests from children, stepchildren and a new spouse may be challenging. The support of estate planning professionals can help ensure assets are distributed as intended.

**3. Communicate** — Sharing your intentions with beneficiaries can help manage expectations and prevent future conflict. While the topic of death is not always easily broached, consider



communicating with loved ones while you are alive about your estate. In-depth details do not have to be provided, but high-level conversations can be beneficial to avoid future surprises. These conversations can also help you understand the wishes of loved ones for when you are gone, including for items of sentimental value, which can commonly become the centre of conflict.

**4. Understand the implications of joint ownership with children** — Joint ownership\* is sometimes used to simplify the transfer of assets on death. In certain jurisdictions, it is used to minimize probate fees. Yet, it has the potential to lead to complications, often relating to estate equalization. It is a common cause of stressful lawsuits that will easily surpass the cost of probate — perhaps the exact situation you were trying to avoid in the first place! There may also be unintended consequences, such as tax implications or exposing assets to potential creditors.

**5. Consider the support of a professional executor** — It may be money well spent to consider a corporate executor. This can help to preserve impartiality if you have children you were considering appointing as executor(s). More important, it can help take the burden off of loved ones during what is often an emotionally difficult time.

Please seek the support of estate planning specialists for your situation.

\*Not applicable in the province of Quebec.

## Perspectives for Volatile Times: Reasons to Stay Invested

During periods of significant volatility, it may feel difficult to be invested in the equity markets. However, without risk there would be no returns — and equities continue to be one of the greatest generators of wealth of all asset classes. Maintaining discipline and patience throughout volatile times and staying invested is important.

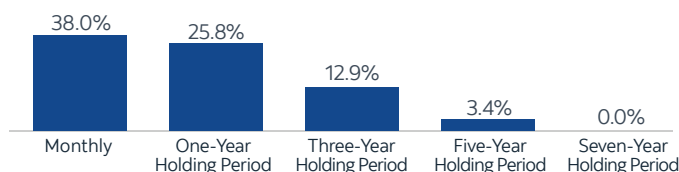
Volatility is a reminder that portfolio growth does not occur at a steady rate. Yet, time reduces the volatility of returns. As history has shown, negative market performance smooths out as an investor's time horizon increases. Over the past 30 years, the likelihood of the S&P/TSX Composite Total Return Index experiencing a negative monthly return is 38 percent. This drops to 13 percent over a three-year rolling holding period, and 0 percent over seven-year rolling holding periods and beyond (chart 1).

Time in the markets also allows investors to participate in the best performing periods in the markets, which, as discussed in our cover story, can often cluster around the worst market declines. Missing these periods can be costly. The chart shows the impact of missing the best performing months of the S&P/TSX Composite Total Return Index over a 30-year period. By staying invested, a notional investment

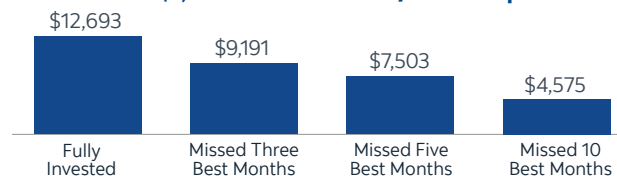
of \$1,000 would have grown to \$12,693. By missing the five best months, this would fall to \$7,503 (chart 2).

These are just two reasons to continue to keep perspective and stay invested during volatile times.

**Chart 1: S&P/TSX Composite Index % of Negative Returns Since 1991**



**Chart 2: Return of \$1,000 Invested in S&P/TSX Composite Since 1991**



Source: S&P/TSX Composite Total Return Index from 12/31/91 to 12/31/21.



## Oh Canada! Reasons to Keep Perspective

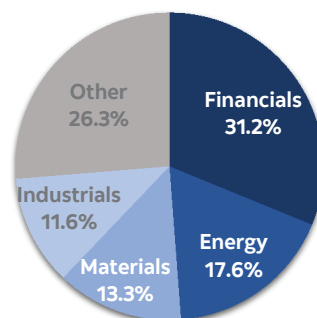
Happy 155<sup>th</sup> birthday, Canada! As the world continues to be out of balance and the financial markets test our resolve, perhaps this is an opportune time to step away from the headlines and focus on the many reasons to be grateful to be in Canada.

We are a nation of peace, prosperity and resilience, considered to have a stable economy and a strong quality of life. Despite our small stature by population — Canada represents just 0.48 percent of the total world's population — we rank as the 10<sup>th</sup> largest economy by GDP (2021).<sup>1</sup> We have one of the highest life expectancies, in part due to our universal healthcare system. And, we consistently rank as one of the best countries in which to live globally when measured by quality of life, freedom, education and health.<sup>2</sup>

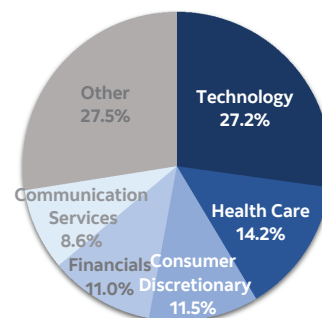
We are relatively insulated from many of the current challenges that face other nations. The ongoing war in Ukraine should be a reminder that even basic necessities like food, shelter, health and safety are luxuries to those in need. With energy production again in the spotlight as a matter of national security, we are fortunate to have access to all major sources of energy. Beyond energy, we are a nation rich in resources, including uranium, zinc, potash, nickel and titanium. Notably, we are ranked fourth in the world for countries rich in natural resources, behind Russia, the U.S. and Saudi Arabia. We are also the fifth largest exporter of agricultural and food products in the world.<sup>3</sup>

For investors, the Canadian equity market composition may be well-positioned to face the challenges of today. It may be comparatively more tolerant to inflationary environments due to its greater exposure to financials, resources, materials and industrials sectors. At the time of writing, while markets have experienced broad-based declines, the S&P/TSX Composite Index has performed better than its U.S. counterpart. Regardless, as history has shown, investors should remember that over the long term, equity market returns have generally outperformed inflation and continued their upward climb. This is also why diversification is important. No sector — or even asset class or geographical market — will perform at the top each

**Canada: S&P/TSX Composite Index Sector Breakdown**



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



Sector breakdown at 4/29/22, S&P Global Factsheets.

year. Diversification can provide the opportunity to participate in the upside of the best performers each year.

While there has been a lot of talk about economic growth being hindered by tightening monetary policy, there may be factors to support our resilience. Canada's expansion is expected to outpace the growth of other advanced economies this year, in part because the impact of the European crisis will be tempered by our commodities sector. This may be reflected in our economic performance to start the year: Q1 2022 GDP grew at a rate of 3.1 percent in Canada, whereas it contracted in the U.S.<sup>4</sup> Also supportive for growth — our labour market continues to be strong, and our population continues to grow at a faster rate than our peers; the fastest of the Group of Seven (G7) advanced countries, at 5.2 percent over the past five years.<sup>5</sup>

Without a doubt, there are many challenges ahead; however, there are also many reasons to keep perspective. We hope that you can take some time to enjoy the summer and celebrate living in our wonderful nation!

1. [worldpopulationreview.com/countries/countries-by-gdp](http://worldpopulationreview.com/countries/countries-by-gdp); 2. [www.worldometers.info](http://www.worldometers.info); 3. [www.newswire.ca/news-releases/canada-is-the-no-1-country-in-the-world-according-to-the-2021-best-countries-report-867033906.html](http://www.newswire.ca/news-releases/canada-is-the-no-1-country-in-the-world-according-to-the-2021-best-countries-report-867033906.html); 4. [www150.statcan.gc.ca/n1/daily-quotidien/211101/dq211101a-eng.htm](http://www150.statcan.gc.ca/n1/daily-quotidien/211101/dq211101a-eng.htm); 5. [www.statista.com/statistics/748223/leading-countries-based-on-natural-resource-value/](http://www.statista.com/statistics/748223/leading-countries-based-on-natural-resource-value/); 6. [www.bloomberg.com/news/articles/2022-04-29/canada-extends-growth-streak-as-first-quarter-tops-expectations](http://www.bloomberg.com/news/articles/2022-04-29/canada-extends-growth-streak-as-first-quarter-tops-expectations); 7. [www.cbc.ca/news/politics/census-2021-release-population-cities-1.6344179](http://www.cbc.ca/news/politics/census-2021-release-population-cities-1.6344179)

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