

Dahms Wealth Management Group Newsletter



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Cutting Through the Noise

Noise, according to Nobel-prize winning economist Daniel Kahneman, is the unwanted variability that can cloud judgment and impact decision making. We can make different decisions when influenced by noise, such as when we are upset, tired or hungry compared to calm, rested or well-fed. Kahneman shows how doctors give drastically different diagnoses to identical patients as a result of this noise. Most of the time, we are unaware of the noise and neglect it. Yet, by reducing it we can make better decisions.¹

Nowhere is the impact of noise more evident than in investing. Modern behavioural economists have shown that noise can significantly change the way we make investing decisions.

In the excitement of rising markets, there has been a particular amount of noise to distract investors. Strong markets give confidence to some investors to take on greater risks. We are also living in a period of technological change and new innovation can make it difficult to assess risks, as expectations are largely driven by hope and uncertainty about the future.

In May, the cryptocurrency Dogecoin, a joke named after a “doge meme,”² became the fourth most valuable digital currency after gaining over 14,000 percent to start the year. This was a surprise to its cofounder, who reportedly created it in “a few hours” and sold his holdings in 2015.³ Similarly, SPAC issuances have surged, prompting regulators to warn investors not to be “lured into participating in a risky investment.”⁴ SPACs sell shares with the objective of buying a private company and taking it public. They are known as “blank cheque” companies for a reason: they have no operating business and often no stated acquisition targets.

As investors, we must cut through the short-term noise as we invest for the longer term. It’s easy to get caught up in the excitement – we would all like to ride the next superstar investment to financial freedom. We may also feel that we aren’t successful investors unless we are in the middle of the action. Yet, when there is too much enthusiasm for what appears to be a good thing, it can prove unsustainable – the warning signs sometimes only apparent to the astute.

What is the opposite of noise? According to Kahneman, it is discipline. Some of the most successful investors are able to ignore the noise when they make portfolio decisions. They follow the specific rules established to control risk within a portfolio. While such an approach may not produce the results that make overnight headlines, it provides a good litmus test to avoid being carried away by the enthusiasm of the moment. In a world of noise, discipline can be one of the investor’s greatest assets.

Today’s investing landscape looks particularly different than one year ago: Some global economies have reopened and we have seen strengthening commodities prices and increasing inflationary pressures. The changing times are precisely when trusted advisors can provide thoughtful evaluation and scrutiny in investment choices, shifting gears where necessary to position for change.

Let’s enjoy the market advances, but don’t be led astray by the noise. Maintain discipline and continue to look forward – and use my resources to help you achieve your investment goals.

1. Kahneman, Sibony, Sunstein (2021), Noise: A Flaw in Human Judgment. Harper Collins. • 2. Meme: an amusing captioned picture/video widely spread online through social media; [en.wikipedia.org/wiki/Doge_\(meme\)](https://en.wikipedia.org/wiki/Doge_(meme)) • 3. markets.businessinsider.com/currencies/news/dogecoin-price-rally-eclipses-xrp-4th-largest-crypto-doge-2021-5-1030391242. • 4. Special Purpose Acquisition Company; sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert.

In Short: The 2021 Federal Budget – How It May Affect You

In April, the federal government released its first federal budget in two years. Perhaps most notably, the federal government expects to continue its significant spending – over \$101 billion for the next three years – to support strong economic recovery in the fight against Covid-19. It extended various emergency benefits, resulting in a record deficit and significantly higher projected debt for the foreseeable future.

Some would argue that the excessive spending has Canada wading into “Modern Monetary Theory” (MMT) waters. MMT suggests that federal government spending shouldn’t be constrained by its revenues, which are largely created through taxation. It suggests that countries that issue their own fiat currency should determine what their requirements are and spend accordingly, not worrying about running larger deficits as long as inflation is under control. Given the pledged spending, it may seem as though Canada is embracing this new way of economic thinking. And we’re not the only ones. Many governments have followed suit, with an estimated US\$12 trillion spent globally in just the first 8 months of the pandemic.¹

While the future economic consequences are yet to be seen, the injection of significant liquidity into the economy appears to be having inflationary effects. We see increasing commodity prices (lumber prices have more than tripled this year!) and steepening grocery bills, as just some examples. Beyond the spending spree, the budget had no changes to personal or corporate income tax rates. Here is how you may be impacted:*

For Seniors: Extending Benefits. Seniors who are 75 years or older as of June, 2022 will receive a one-time Old Age Security (OAS) payment of \$500 by this August. For this same group, monthly OAS payments will be increased by 10 percent beginning in July, 2022. If you aren’t in need of these funds, consider investing them. If you haven’t maxed out contributions, a tax-free savings account is an ideal way to potentially grow funds on a tax-free basis.

For Investors: Green Investing. The budget pledges \$8.8 billion over five years to support a greener future, including the issuing of \$5 billion of green bonds to finance green projects. The budget suggests that the presence of government-backed bonds may support more mature investors who are “looking for a green portfolio but also need to manage their investment risk.”² With the rise in support for green investing, if you are interested in incorporating environmental factors into your portfolio, please call the office.

For High-Net-Worth Spenders: A Luxury Tax. If you’re considering the purchase of a luxury vehicle in the near future, you may want to do so by Dec. 31, 2021. As of January 1, 2022, sales of cars and personal aircraft with a retail price of over \$100,000, as well as boats priced over \$250,000, will incur a new tax. It will be calculated at the lesser of 20 percent of the value above those thresholds, or 10 percent of the full value of the vehicle.



For Business Owners: Accounting for Capital Assets. If you operate a Canadian-controlled private corporation, the business will now be able to purchase up to \$1.5 million of certain capital assets and fully expense these in the year they become available for use. This includes eligible assets purchased on or after April 19, 2021 and before 2024. There may be tax benefits achieved by immediately expensing certain assets so please consult a tax professional as it relates to your situation.

For greater detail on the initiatives proposed, see the Government of Canada website:

budget.gc.ca/2021/home-accueil-en.html

1. theglobeandmail.com/business/article-whatever-we-may-think-of-modern-monetary-theory-its-day-in-the-sun-has • 2. Budget 2021: A Recovery Plan for Jobs, Growth and Resilience, Government of Canada, page 166.

* At the time of writing, the budget proposals had not been passed into law.

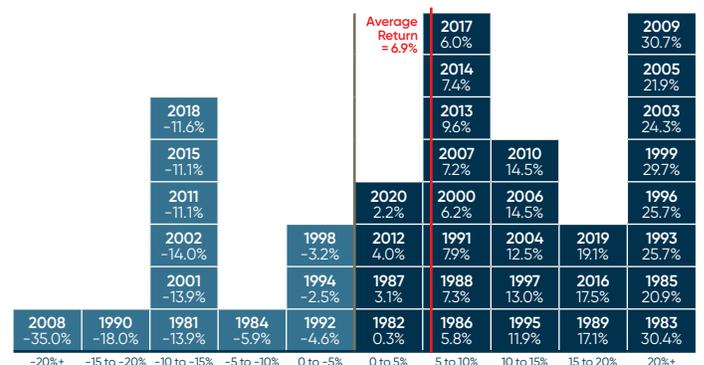
Stock Market Returns: Never a Constant

During buoyant market times, it may be easy to forget that advances in the equity markets often do not happen at a constant rate.

The chart to the right shows the annual returns of the S&P/TSX Composite Index over the past 40 years. It’s worth pointing out how the distribution of returns has significantly varied over this period. In fact, only 20 percent of annual returns fall within the long-term average return of 6.3 percent over the past four decades.

Most of us are longer-term investors and will invest over multiple market cycles. While we should enjoy the market’s advances, we shouldn’t forget that patience, through time in the markets, is often key in helping to provide predictability in investment returns over time.

Annual Returns of S&P/TSX Composite Index, 1981 to 2020



Source: S&P/TSX Composite Index annual returns 1981 to 2020.

Talking to Adult Children: The Hot Housing Market

For those of us who can remember, the average cost of a Canadian home was around \$164,000 when we started the millennium.¹ In just over 20 years, this has risen to around \$716,000 – and, what you get for that price can vary depending upon your location.²

What is driving these increases? Lack of supply in some markets has helped push prices higher. As prices continue to increase, many buyers have entered the markets feeling a sense of urgency and fear of missing out. Low borrowing costs have also prompted some to take on mortgages beyond their means. With prices at all-time highs, there has also been increasing speculation.

The situation is especially discouraging for the younger generation who may feel as though home ownership is quickly becoming out of reach. In a recent interview, Robert Kelly, former Chair of the Canadian Mortgage & Housing Corporation (CMHC), suggested that we have a problem and better education is needed.³ He is an advocate for stiffening the current mortgage rules and suggests that the federal government needs to provide support to increase the housing supply across many markets.

For the younger generation still hoping to enter the housing market, Kelly suggests keeping these four considerations in mind:

Consider that a house is not a guaranteed investment. While we may have become used to a hot housing market, it hasn't always been this way. Kelly points to U.S. housing data over 100 years, which shows an average increase in value of around one percent per year. Buyers also need to consider that there are many hidden costs associated with home ownership and, unlike other investments, it often involves a significant up-front cost.

Focus on needs vs. wants. Focusing on what is needed may help buyers to make more prudent decisions. While a 4,000 square foot home may be the aspiration, a smaller footprint is likely to sufficiently meet an individual's living needs while being more financially achievable.

Factor in the risk of rising interest rates. Consider the impact of a reset in interest rates one or two years down the road. Many mortgage holders may not factor in the likely scenario in which interest rates increase by one percent. Would you still have discretionary income to go on vacation or eat out at restaurants?

Think about absolute debt – and lower it. When holding a mortgage, it is important to consider not just the monthly payments, but also the total amount of debt. The average Canadian household debt-to-income ratio is extremely high at around 175 percent⁴ – the highest of the G7 advanced economies. This puts many individuals at risk of default, such as in the event of a job loss. Kelly suggests that a responsible debt level is around 90 percent, where many G7 countries currently sit.

How About Your Personal Situation?

We have been approached by clients who have asked for perspectives on selling their home. While the gains may be enticing with prices at all-time highs, keep in mind that if you were to sell your home you would still need a place to go – which will likely incur a financial and perhaps even a lifestyle cost. Care should be taken when evaluating the options. Another option may be to sell a home and then rent, potentially leading to higher discretionary funds to support retirement or to gift to children during your lifetime. Renting may also be more pragmatic for many younger folks, in instances where taking on higher debt loads does not make sense.



1. theglobeandmail.com/real-estate/the-market/canadian-home-value-has-doubled-since-2000-report/article4249097 • 2. cbc.ca/news/canada/photos/canada-real-estate-prices-scroller-1.6004260 • 3. bnnbloomberg.ca/real-estate/video/canada-has-a-problem-former-cmhc-chair-robert-kelly-on-the-nation-s-hot-housing-markets-2160679 • 4. ctvnews.ca/business/canadian-households-added-record-mortgage-debt-in-q4-statcan-1.5344672; data.oecd.org/hha/household-debt.htm

Retire Up to 30 Percent Wealthier: Why Not More?

You may have heard an oft-repeated advertisement in the media today that suggests that by reducing investment management fees, you have the potential to retire up to 30 percent wealthier.¹ While few would choose to forego this amount down the road, it may be worthwhile to take a deeper look at these claims

It is true that management fees vary for different products. This makes sense given that an actively managed fund would need to compensate experienced managers for their day-to-day decisions. However, choosing an investment based on the lowest possible cost doesn't necessarily mean the greatest returns. In fact, when comparing the balanced fund portfolio of a self-directed company that promotes these lower fees with a similar balanced mutual fund, over three years the managed fund performed better, providing an overall greater return even when including the cost of higher fees (chart below).²

	2020	2019	2018	3-Year Cumulative	MER
Managed Fund Balanced	8.1%	14.2%	-2.0%	20.3%	1.08
Non-Managed Fund Balanced	6.5%	13.4%	-4.5%	15.4%	0.13
Difference	1.6%	0.8%	2.5%	4.9%	0.95

Of course, this wouldn't hold true for every balanced fund option available in the market – and, we don't know what future returns will look like or how individual investments will perform. However, as this investment performance comparison shows, eliminating fees does not necessarily generate better overall returns.

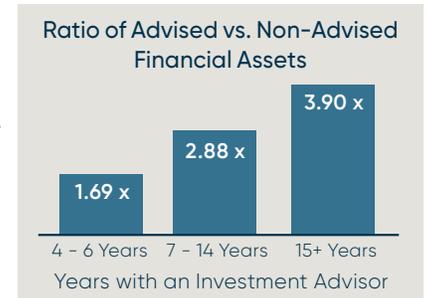
But Why Not More than 30 Percent?

Advice also goes beyond just the investments within a portfolio, and this advice can support future wealth accumulation.

Investors who work with advisors have a significant increase in savings rates. A 2020 study by the Conference Board of Canada showed that having a relationship with an advisor led to a greater accumulation of retirement savings. It suggested that the support of financial advice could increase an individual's retirement savings by 55 to 60 percent.³ A U.S.

study suggests a similar impact – those with financial coaching increased their annual retirement plan contributions from 6.0 to 9.4 percent of their income.⁴ Assuming a 30-year time frame, a 3.5 percentage point increase per year would yield 60 percent greater savings, and this doesn't include the effect of any investment returns!

Over the longer term, the wealth accumulation opportunity can be significant. The average Canadian who works with an advisor has almost 3.9 times the assets than a non-advised investor after just 15 years.⁵



Advice may also be valuable when navigating difficult times. Consider the impact of last year's market drops. If you left the market for cash in March 2020 and missed out on the five best days of the S&P 500 Index in 2020, this would have resulted in a loss of around 30 percent.⁶

There may be other benefits that are derived from wealth management support. Beyond conventional portfolio management activities like portfolio diversification and rebalancing, broader wealth management strategies and tactics, including tax and estate planning, provide opportunities to further enhance an investor's wealth position.

The point, of course, is to suggest that while costs should be an important part of any decision, including within investing, they shouldn't be the sole driving factor. As we invest for the future, we should keep in mind the bigger picture, remembering that the advice which supports wealth planning today has the potential to yield significant benefits down the road.

1. Based on a balanced fund 0.38% annual fee vs average fee of 2.17% on initial investment of \$30k; \$3k annual contribution over 30 years • 2. questwealth.com/questwealth-portfolios/etf-portfolios#balanced; sunlifeglobalinvestments.com/en/sligi-funds/sun-life-granite-managed-solutions/sun-life-granite-balanced-portfolio/?mp=S_LMBF&lang=en&fundCurrencyCd=CAD • 3. ifc.ca/wp-content/themes/ifc-new/util/downloads_new.php?id=24991&lang=en_CA • 4. cnbc.com/2019/05/31/retirement-saving-improves-when-workers-get-help-with-financial-life.html • 5. cirano.qc.ca/files/publications/2016s-35.pdf; • 6. bloomberg.com/news/articles/2020-07-03/the-cost-of-bad-market-timing-decisions-in-2020-was-annihilation

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