Holbrook Wealth Management Group

Newsletter

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In this edition

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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
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/

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The FHSA: The High-Net-Worth (HNW) Investor Opportunity

Beyond its benefits in supporting the purchase of a first home, the First Home Savings Account (FHSA) offers a compelling opportunity for investors to transfer wealth to the next generation or potentially increase their retirement nest egg — but planning ahead is important.

What is the FHSA? The FHSA is a tax-advantaged registered account intended for the purchase of a first home. Eligible Canadian residents ages 18 or older who are first-time home buyers can contribute up to $8,000 per year, to a lifetime maximum of $40,000, and grow these funds. Contributions are tax deductible, similar to the Registered Retirement Savings Plan (RRSP), and withdrawals are tax free, similar to the Tax-Free Savings Account (TFSA), if used for the purchase of a first home. The FHSA must generally be closed after 15 years or the year after the first qualifying withdrawal is made or the holder reaches age 71.

The High-Net-Worth Investor Opportunity: Beyond the prospect of supporting young folks to purchase a first home, the FHSA may also provide opportunities for HNW investors:

- A potential intergenerational wealth transfer tool;
- For those who haven't owned a home over the past four years, a potential tax-advantaged way to supplement retirement savings.

Many parents and grandparents choose to gift funds to future generations to help cover large expenses such as an education or a first home purchase. Some HNW investors support a child's education through the RESP but stop contributions around age 17 when the Canada Education Savings Grants cease. The opportunity to then gift funds to a child to contribute to their own FHSA, which can begin at age 18, may be compelling (keeping in mind the loss of control with gifted funds). If the FHSA was opened at age 18, it would need to be closed in the calendar year after the child turns 33. By some accounts, this is the average age of a first-time home buyer.[1]

For HNW renters, the FHSA provides an opportunity for tax-deductible contributions and tax-deferred growth. While the account would need to be closed by age 71 (if the 15-year limit isn't reached), the holder could transfer any amounts to their RRSP/RRIF without affecting any existing contribution room.

The Importance of Planning Ahead: Since the FHSA can remain active for a maximum of 15 years once it is opened, here are some ways to potentially maximize the growth opportunity:

- **Start early** — If the holder intends to purchase a first home, keep in mind that the FHSA must be closed in the year after making the first qualifying withdrawal, so the account's life may be shortened. As such, helping a child to open it closer to age 18 may be beneficial to allow for compounded growth over the longest period possible.
- **Maximize contributions from the onset** — Consider making full contributions at the start of each year to maximize the growth potential. Although unused portions of the annual contribution limit carry forward, the carryforward is limited to $8,000 each year.
- **Consider the way that funds are invested** — The FHSA offers a substantial tax-advantaged opportunity to grow funds. As such, we believe that investing funds in quality securities has the potential to provide meaningful growth and return potential.

The Compelling Outcome: By maximizing contributions from the onset, assuming a five percent annual rate of return, the account could grow to over $75,000 by the end of 15 years, and this doesn't include the tax benefit from the initial contributions!

- **A substantial down payment** — If both first-time buyers, a couple could each access the FHSA alongside the Home Buyers' Plan (HBP). The HBP allows first-time buyers to withdraw up to $35,000 from the RRSP, subject to repayment in 15 years and other conditions. Together, this could provide a substantial down payment — using the example above, over $220,000.
- **Increase retirement savings** — If the holder decides not to purchase a home, the FHSA can be transferred to the holder's RRSP/RRIF without affecting the available contribution room.
- **Defer the tax benefit** — Generally, contribution amounts not claimed as a deduction on an income tax return in the year made can be claimed in a future year — even beyond the FHSA's closure! If saved for future years, this may provide a substantial tax benefit when the holder's marginal tax rate may be significantly higher.

To learn more about the FHSA, please call the office.

1. cdn.nar.realtor/sites/default/files/documents/2021-highlights-from-the-profile-of-home-buyers-and-sellers-11-11-2021.pdf

The Start of a Revolution? The Age of Artificial Intelligence Has Arrived

"In my lifetime, I've seen two demonstrations of technology that struck me as revolutionary…the graphical user interface, the forerunner of every modern (computer) operating system…and artificial intelligence (AI)." — Bill Gates[1]

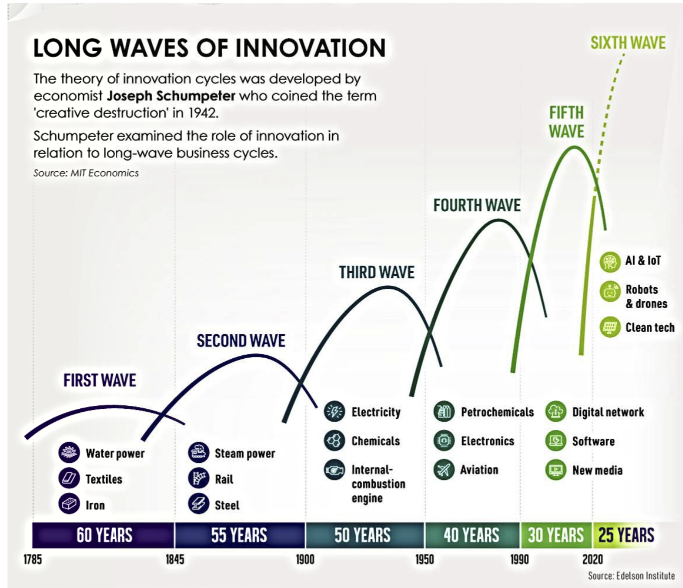
In the summer of 2022, technology pioneer Bill Gates met with the team that developed the algorithm ChatGPT and left them with a challenge: *"Train an artificial intelligence to pass an Advanced Placement biology exam…if you can do that, you'll have made a true breakthrough."* Expecting to keep them busy for two or three years, they came back to Gates in less than a few months. ChatGPT would correctly answer 59 of 60 multiple choice questions on this college-level test and provided outstanding answers to six open-ended questions. Then, to further amplify its capabilities, it masterfully answered this non-scientific question: *"What do you say to a father with a sick child?"* The experience, according to Gates, was "stunning."

Indeed, the age of AI has begun. The remarkable capacity of artificial intelligence is increasingly demonstrating its potential to be a significant disruptor. Quite understandably, it has also ignited a new debate about the threat of our technological advances. Yet, beyond this deeper existential debate, the evolution of AI should remind us of the continued pursuit of humans to constantly advance.

Earlier revolutions, such as those sparked by the development of railroads, electricity and the automobile ignited upwaves of economic growth that lasted for many decades. Consider the impact of the global petroleum industry or the assembly line introduced by Henry Ford — the latter changed global manufacturing processes forever. Will this revolution be any different?

Economist Joseph Schumpeter developed the theory of innovation cycles suggesting that business cycles operate under long waves of innovation (infographic). These new waves emerge as the markets are disrupted by "creative destruction." One observation is that as time progresses, these waves are getting shorter — some suggest that this is because there are diminishing marginal returns for innovation.

What does this mean for investing? Innovation will continue to drive economic growth, just as it always has. Taking a step back, let's not forget that when we invest in the equity markets, we are



investing in the businesses that underlie the economy. Over time, economies have continued to progress and grow because of the motivations of individuals and businesses to innovate and advance, as we are witnessing today.

Of course, in the face of increasingly rapid change, our willingness to adapt also remains important. In the third wave of innovation, Ford and GM had hundreds of competitors that caught the imagination of investors. And do you remember Wang and Commodore? They were the high-tech leaders of the 1980s that have faded from view. Investing involves assessing the changing world, with careful analysis, selectivity and a nimble approach.

Though we may currently be enduring slower economic times, we should expect innovation to support the new growth yet to come — and investors can share meaningfully in the change that lies ahead. Continue looking forward!

1. https://www.gatesnotes.com/The-Age-of-AI-Has-Begun

Infographic source: https://www.visualcapitalist.com/the-history-of-innovation-cycles/

Are We Nearing the End of the Rate Cycle?

Talk of interest rate increases has seemed unending: we are living through one of the most aggressive tightening cycles in 40 years. Back in May, the U.S. Federal Reserve raised rates for the 10th consecutive time in its pursuit to bring down inflation. In less than 14 months, the federal funds rate has risen by a total of 5 percentage points (500 bps) to 5.25 percent from where it stood at 0.25 percent in March 2022. The Bank of Canada has similarly increased interest rates, raising the overnight rate by 0.25 percent to 4.75 percent at the start of June. (*At the time of writing. Note: this newsletter was written before the Fed's June 14 rate announcement*.)

However, in its latest rate announcement, the Fed indicated it would be "determining the extent to which additional policy firming may be appropriate." This prompted the question: Are we nearing the end of the rate cycle?

Until recently, the effects of the rapid rate hikes have appeared relatively benign. One market strategist suggested that if you were to tell investors two years ago that we would be entering one of the most aggressive rate increase cycles in history, alongside inflation that would reach 9 percent in the U.S. (and 8 percent in Canada), you would think that there would be greater effects on the stock market.[1] In fact, in May 2023, both the S&P 500 and the S&P/TSX Composite hovered around similar levels to those of May 2021.

Glass Half-Empty or Half-Full: Are We Headed to Recession?

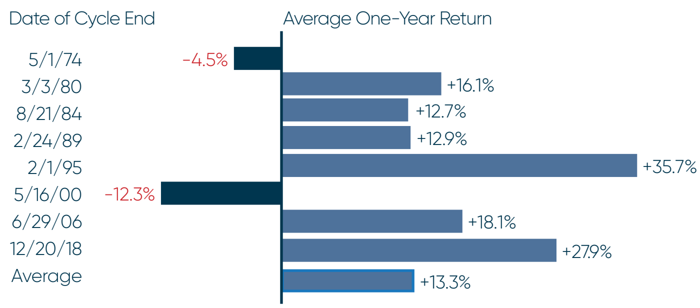
The regional banking sector fallout in the U.S. in the spring was a reminder that there were likely to be follow-on effects from the unprecedented speed and magnitude of the hikes. After all, these actions were intended to slow the economy. As part of the normal course in every business cycle, some businesses will collapse, making room for others to grow. Yet, it is somewhat confounding that unemployment levels remain at lows and consumer spending has been relatively strong. Despite the expectation for slower growth, the latest earnings season has been positive. For many months, market pundits have suggested an imminent recession, but these factors may suggest otherwise.

Equity Markets: What Happens at the End of the Rate Cycle?

If we are nearing the end of the cycle, if history is any indicator, it may be good news for the equity markets. A look back at past tightening cycles shows that equity markets have historically performed well in the year after the final rate increase. Similarly, analyses show that the markets have rallied in the months after a pause.[2]

Chart: What Happens to Equity Markets After the Last Rate Hike?

S&P 500 Average Return One Year After the Final Rate Hike in the Fed Tightening Cycle



However, in the near term, a resilient labour market and more sticky inflation, recently driven by service sector growth and housing costs, could contribute to keeping interest rates elevated — all of which are carefully being watched and likely to influence future rate decisions.

Of course, from our perspective as we manage assets for the long term, the challenge for investors is ignoring the day-to-day noise and continuing to position assets for when we will eventually need to access our capital — sometimes a decade or two into the future, or more, depending on your timeline. For many investors, longer-term returns are the only ones that matter. Though we may all appreciate some respite from the volatility of the past two years, consider also that buying when prices are lower is one of the best ways to improve longer-term results. Keep perspective and continue looking forward.

1. https://ritholtz.com/2023/05/half-empty/
   For historical rate hike cycles, please refer to: https://www.cnbc.com/2015/09/15/when-the-fed-raises-rates-heres-what-happens.html
2. https://ritholtz.com/2023/05/10-wednesday-am-reads-330/
   https://www.bloomberg.com/news/articles/2023-05-06/wall-street-is-in-no-mood-to-celebrate-the-fed-s-last-rate-hike

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