Streu-Krahn Wealth Management Group
Newsletter

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In this edition

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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 our 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) • 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.

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Tax Planning: A Spousal Rollover May Not Always Make Sense

In married or common-law partnerships, using a spousal rollover[1] has become a conventional strategy for many estate plans. Under a spousal rollover, any associated capital gains on certain capital property or registered plan income that transfers to a surviving spouse will be deferred until the spouse disposes of, or is deemed to have disposed of, those assets or withdraws them (in the case of registered plans).

However, in some cases, there may be reasons why it may not make sense. Why? While deferring tax is often beneficial, it can also result in unintended consequences. Take, for example, a situation in which a surviving spouse rolls their deceased spouse's Registered Retirement Income Fund (RRIF) to their own RRIF. This increases their RRIF minimum annual withdrawal requirements. The higher income results in a higher marginal rate of taxation, and the spouse is now subject to the Old Age Security clawback.

Some forward planning could have potentially reduced the overall tax-related burden. For instance, it may have been better for the deceased spouse to bleed down their RRIF in the years in which they had a lower marginal tax rate. Or, it may have made sense for the RRIF to be partially converted to cash upon death, with only a portion transferred to the surviving spouse's RRIF.

Be aware that an automatic rollover of capital property occurs, for tax purposes, upon the death of the first spouse. As such, an election will need to be made to not use the spousal rollover on a property-by-property basis.

There may be other situations in which electing to not use the spousal rollover may make sense. For example, the deceased may have capital losses carried forward from previous years that can be used to offset realized capital gains. Or, the marginal tax rate on the date-of-death return may be low. The deceased may also own qualified small business corporation shares with unrealized capital gains or an unused lifetime capital gains exemption.

As always, seek the advice of a tax-planning expert as you plan ahead for your particular situation.

1. For tax purposes, a person is generally deemed to have disposed of capital property at fair market value immediately before death. While there may not have been an actual sale, there may be associated gains or losses realized for tax purposes. Unless a rollover is available, the fair market value of a registered plan is included in the deceased's income in the year of death. A spousal rollover is available where such property is transferred to a surviving spouse/common-law partner.

Estate Planning: Preparing for a Wealth Transfer

With over one trillion dollars of inheritances expected to be passed along over the next decade, taking action to preserve wealth across generations has never been more important.[1] Does your estate plan protect this wealth transfer? Here are some considerations:

Preventing Your Estate from Being Contested

It isn't uncommon for disputes to arise during the estate settlement process, especially for families with complex dynamics. In some cases, these disputes can escalate to litigation. While court battles are not only time consuming and stressful, they can also end up being very costly, which can significantly erode family wealth. Perhaps worst of all, they can tear families apart. The reasons are many, including outdated documentation, poorly drafted documents, poorly chosen executor(s) and lack of communication about estate plans with beneficiaries.

There may be ways to minimize this risk. Communicating with heirs about your intentions while you are alive can help to prevent surprises. Importantly, estate documents should be drafted using a reputable professional and should include specific instructions to eliminate doubt. Documents should be reviewed and updated as circumstances require. Care should also be taken when choosing an executor(s), as poor actions by executors can lead to litigation.

Helping Beneficiaries Manage a Wealth Transfer

In some cases, beneficiaries may need support to manage wealth. Young beneficiaries or those with disabilities may not be financially responsible; spouses may need help managing assets such as investments or a business. Beneficiaries may also need to be protected against potential current or future creditors, such as business partners, customers or former spouses.

One of the more common tools used to support beneficiaries is a testamentary trust to hold and manage assets for their benefit. This can help to limit access and manage assets by specifying the timing and amount of distributions to be made.

Accounting for Divorce or Blended Family Dynamics

The transfer of family wealth may need to be protected to account for a complex family structure. In some cases, the way in which assets are currently structured may not be meeting your objectives. For instance, having assets jointly held in a current relationship may unintentionally put children from a previous marriage at risk. An unintended division of assets may also occur if a current spouse becomes a primary beneficiary, when assets were intended for children from a previous marriage. In some provinces, a new marriage can potentially revoke an existing will and the instructions leaving assets to children from a previous marriage would be invalidated. As such, the advice of a lawyer who understands complex family structures can ensure that assets are passed along as intended.

If you have the desire to leave a lasting legacy, planning ahead can help protect family wealth. Given our familiarity with your financial position, we can act as a resource. We recommend the support of tax and legal professionals as it relates to your particular situation.

1. financialpost.com/personal-finance/retirement/canadian-inheritances-could-hit-1-trillion-over-the-next-decade-and-both-bequeathers-and-beneficiaries-need-to-be-ready

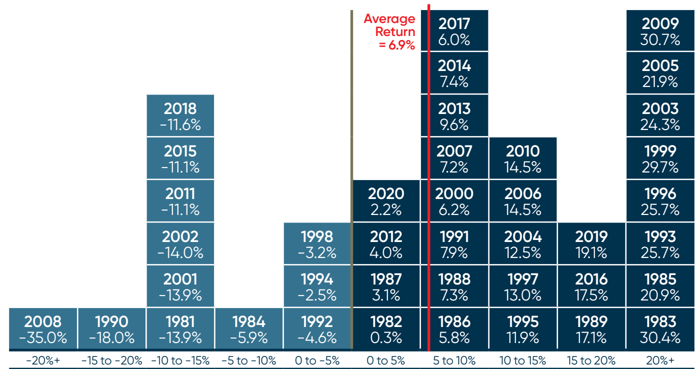
Stock Market Returns: Never a Constant

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.

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.

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.

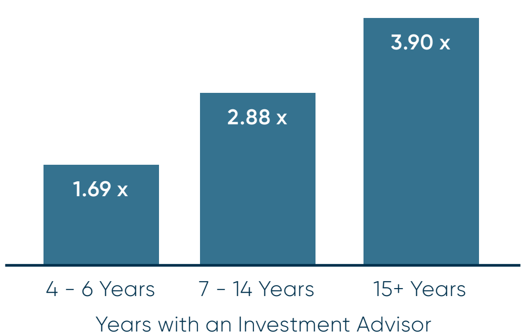
But Why Not More than 30 Percent?

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]

Ratio of Advised vs. Non-Advised Financial Assets



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. questrade.com/questwealth-portfolios/etf-portfolios#balanced; sunlifeglobalinvestments.com/en/slgi-funds/sun-life-granite-managed-solutions/sun-life-granite-balanced-portfolio/?mp=SLMBF&lang=en&fundCurrencyCd=CAD • 3. ific.ca/wp-content/themes/ific-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

Afraid You'll Outlive Your Funds? The Four Percent Rule Revisited

How much can I spend in retirement so that I don't outlast my money? This is one of the more common questions we hear as we help clients to plan ahead.

This question also spawned the birth of the "four percent rule," which has become a commonly used guideline within financial planning circles. It is a simple way to think about retirement withdrawals. Adding all of your investments, you can withdraw four percent of the total during the first year of retirement. In subsequent years, you adjust this amount for inflation. This provides a good proxy for not outliving your money, assuming a 30-year retirement.

The Origins of the Four Percent Rule

The "rule" has been around since 1994 when rocket-scientist-turned-financial-advisor Bill Bengen took on the task of determining a safe withdrawal rate to protect investors from running short of funds in retirement. Bengen's model assumed that there would be no severe market downturns and the investor would rely upon a predictable, steady stream of income. Here are some of his original findings:[1]

- The "absolutely safe" withdrawal rate based on historical market returns was three percent. A portfolio would never be fully drawn down in less than 50 years.
- A four percent withdrawal rate was considered safe as it never resulted in a portfolio being exhausted in less than 33 years.
- The "worst-case" for a 4.25 percent withdrawal rate was a portfolio that lasted 28 years.
- While the model was based on a 50/50 stock/bond portfolio, Bengen suggested allocating a greater proportion to equities, between 50 and 75 percent.

Of course, like most generalizations, Bengen's rule of thumb might not fit every investor's situation. After all, retirement spending isn't necessarily constant from year to year. Some retirees have greater expenditures earlier in retirement as they opt to enjoy their healthy years travelling the world or enjoying other costly pursuits; others may be confronted with high healthcare or caregiving expenditures as they age.

The rule was also based on a suggested portfolio composition and historical returns that were relevant in 1994. Things looked different back then. Treasury yields hovered around 8 percent; today, they are closer to 2 percent. Historical inflation at that time was around 5.7 percent for the previous 25 years; today, the 25-year rate averages around 2.2 percent (see chart).

Chart: A Lot Has Changed Since 1994...

	1994	2021
10-Year Govt. of Canada Marketable Bonds Rate (A)	8.63%	1.90%
25-Year Historical Rate of Inflation (B)	5.7%	2.2%
5-Year Avg. Residential Mortgage Rate (C)	7.89%	3.26%
Cost of 1L Whole Milk (D)	1.36	1.51
Cost of Eggs (doz. lg.) (E)	1.49	3.77
Price of Gas (reg. unleaded)/L (F)	0.52	1.25

Source: A: Bank of Canada; www150.statcan.gc.ca/n1/pub/11-210-x/2010000/t098-eng.htm (v122487) • B: awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/ • C: Bank of Canada; www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3410014501 • D: fraserinstitute.org/sites/default/files/PerfectFoodinaPerfectMess.pdf • E: archive.macleans.ca/article/1994/1/24/the-cost-of-feeding-canada; D, E, F: www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000201 • F: www150.statcan.gc.ca/n1/pub/57-601-x/2010004/t182-eng.htm

The Rule, Revisited for 2021

Given that much has changed in 27 years, you may wonder if the rule has also changed. According to Bengen, yes — and his conclusion may be surprising. He recently suggested that he would actually recommend a higher withdrawal rate: "5.25 or even 5.5 percent, which is going to enrage people even more because it's higher...but that's what history has demonstrated."[2]

Planning Ahead

Having this rule of thumb can be helpful to act as a general guide. However, one of our main roles is to support the planning process to account for your particular circumstances and to make course adjustments as life transpires. If your wealth plan is in need of an update or if you would like to discuss your retirement income plan in greater depth, please don't hesitate to call.

1,2. https://awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/

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