The Simpson
Investment Management Group

Newsletter

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In this edition

The Increasing Rate of Change

It has been said that "there are decades where nothing seems to happen and then there are weeks where decades happen." This spring was no exception. We have experienced change that occurred at unprecedented speeds, including physical distancing, home isolation and the voluntary shut down of economies. This led to equally unprecedented reactions: oil futures prices falling to negative levels and rebounding, entire industries being shut down, and record unemployment levels.

Equity markets reacted in a similar manner, falling and then rallying quickly. Typical bear market cycles last between 18 to 36 months. However, this past spring, we saw one that was compressed into a matter of weeks.[1]

Global policy responses have also been faster — and deeper — than ever. From the onset of the crisis, central banks have engaged in significant stimulus efforts in an attempt to stem the effects of the crisis. This increase in liquidity has likely been one reason why the equity markets advanced in April and May, despite what was happening on the ground.

What does the path forward look like? As humans, we grasp for certainty. Yet, uncertainty has always played a common role in the financial markets and unforeseen events such as these can make things even more unclear. One such example: economists attempting to quantify the effects of the shutdown on second-quarter gross domestic product predicted U.S. GDP estimates of between -8 and -50 percent.[2]

During these times of uncertainty, one of our most important roles as advisors is to manage risk. With a focus on preserving hard-earned capital, we maintain a disciplined approach to control risk in portfolios. At the same time, we are monitoring investments based on current market conditions and navigating the changing landscape.

In the near term, equity markets are likely to experience volatility as economic data and earnings continue to reflect the impact of the spring economic shutdowns. We face many near-term challenges as many economies start to reopen and attempt to return to a state of "normal."

As containment efforts continue, opinions are likely to significantly vary about the road ahead for the economy and the financial markets. We understand the challenges that come from an uncertain near-term outlook, but, as much as possible, investors should try to stay focused on their long-term goals.

We continue to work hard for you and your investments, managing risk during these difficult times and positioning portfolios for the inevitable changes that lie ahead. Please call if you have any concerns.

1. http://bloomberg.com/news/articles/2020-04-06/no-one-wants-to-call-canada-s-21-stock-surge-a-bull-market
2. http://bloomberg.com/news/articles/2020-03-22/fed-s-bullard-says-u-s-jobless-rate-may-soar-to-30-in-2q

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INVESTMENT STRATEGY

Consider the Benefits of Dollar-Cost Averaging

As we have seen with recent equity market reactions, short-term price movements are often unpredictable and nobody can be certain when the next upturn will begin. Such turns can occur when the outlook is bleak and the natural inclination may be to sell, not buy. In hindsight, all down markets look like buying opportunities. But in the moment, it's not always easy to commit money to an investment that has gone down in price, particularly in a bear market.

Those investors who use a dollar-cost averaging (DCA) program to build their long-term portfolios can have an advantage. A DCA program mandates regular, modest investments, rather than one major lump-sum commitment. As such, investors need not focus on predicting market movements.

DCA can fit nicely with personal cash flow, acting as a way of saving on a steady basis. Payments can be made at any regular intervals, such as monthly or quarterly. DCA can work particularly well with funds as you can buy exact dollar amounts of a fund, which may not always be possible with share purchases. However, there is no reason why DCA can't be used to build any security position, especially in these times in which broad declines have affected many securities.

The example (chart) uses S&P/TSX Composite Index returns to depict a DCA program through the extended bear market period we experienced from 2000 to 2002. Each quarter, $1,000 was invested. Despite poor market performance, the DCA program resulted in a modest gain of $1,130 ($17,130 less $16,000), plus the ownership of significantly more units which benefitted the portfolio as time went on. Had a lump sum investment of $16,000 been deployed at the beginning of 2000, it would have returned a small loss, with an overall value of $15,633 and 1,902 units owned (versus 2,084).

During times of uncertainty, DCA can be a useful strategy. It allows you to take the emotions out of investing, while continuing to put money to work. Even during down or bear market times, DCA is a good reminder that a thoughtful investing plan can result in real progress toward achieving your wealth-building goals.

Profiting Through a Bear Market: DCA Using S&P/TSX Index During 2000 to 2003

12-99	8.4138	118.85	118.85	$1,000
03-00	9.4624	105.68	224.53	$2,125
06-00	10.1995	98.04	322.58	$3,289
09-00	10.3779	96.36	418.94	$4,348
12-00	8.9337	111.94	530.87	$4,743
03-01	7.6080	131.44	662.31	$5,039
06-01	7.7364	129.26	791.57	$6,124
09-01	6.8386	146.23	937.80	$6,413
12-01	7.6884	130.07	1067.87	$8,210
03-02	7.8515	127.36	1195.23	$9,384
06-02	7.1456	139.95	1335.18	$9,541
09-02	6.1804	161.80	1496.98	$9,252
12-02	6.6145	151.18	1648.16	$10,961
03-03	6.3433	157.65	1805.81	$11,455
06-03	6.9831	143.20	1949.01	$13,610
09-03	7.4211	134.75	2083.76	$15,464
12-03	8.2209	--	2083.76	$17,130

*Past performance is never indicative of future performance.

The End of the Office Era? Keep Good Records

Is the office era over? For many office workers, working from home became the new normal this spring. As such, some may be wondering if they are able to claim a tax deduction for home office expenses.

The Canada Revenue Agency (CRA) currently allows for a deduction in instances in which one of the following conditions is met: i) The work space is where you mainly do your work (more than 50 percent of the time); or ii) You use the workspace only to earn employment income, and it is used on a regular and continuous basis for meeting clients, customers, or others in the course of your employment duties.

Deductible costs are based on the type of worker claiming the deduction: employees, commissioned salespeople or self-employed workers. Each of these groups is entitled to deduct different expenses. Expenses generally include electricity, heating, maintenance and supplies. Property taxes and home insurance may be allowable for commissioned salespeople or self-employed individuals, and mortgage interest and capital cost allowance may be claimed for those self-employed. The portion that can be claimed is based on the area attributed to the home office, as a proportion of the total finished area of the home.

If individuals are not self-employed, in order to potentially deduct these expenses, your employer must complete CRA Form T2200: Declaration of Conditions of Employment. Any expenses reimbursed by the employer, such as internet or office supplies, cannot be claimed.

While the current CRA rules normally require that you spend more than 50 percent of total work time in the home office during the tax year to claim deductions, some accounting professionals have indicated that there may be exceptions. Given the unprecedented circumstances in which people have been mandated to work from home, the CRA may consider cases on an individual basis, or may potentially make changes to its policies.[1] As such, keep good records.

Over the foreseeable future, the 50 percent threshold may be met if continued distancing efforts result in fewer workers returning to traditional office spaces. For detailed information, please consult the CRA or seek advice from an accounting professional.

1. theglobeandmail.com/investing/globe-advisor/advisor-news/article-pandemic-led-flight-to-home-offices-brings-tax-perks/?fbclid=IwAR24-wttdbsJ4SfIoK1d5gRR77hoUEYUyeBa0GshEy5s9oi23TXpheggZQcrofessional

Economic perspectives

What is the Economic Path Forward?

It may be difficult to remember, but it was only months ago that we were in the midst of the longest economic expansion in history. How quickly things have changed. As a result, many investors are asking: what is the economic path forward?

Beyond the terrible health consequences of the pandemic, the short-term economic effects have been equally extraordinary. We have seen individuals, companies and industries affected in adverse ways. COVID-19 has also helped to accelerate certain existing economic and political trends: increasing automation, greater scrutiny of foreign direct investment, nationalism and the evaluation of domestic supply chains. It has also magnified continuing U.S.-China trade tensions.

In the short term, we are likely to expect deflationary pressures due to reduced spending and consumption, as well as a weaker housing market, as economies begin to return to a more "normal" state. While certain media voices raised the potential for an economic depression when projecting unemployment levels and economic growth declines, these historic troubles were likely compounded by a series of poor policy decisions, unlike today.[1]

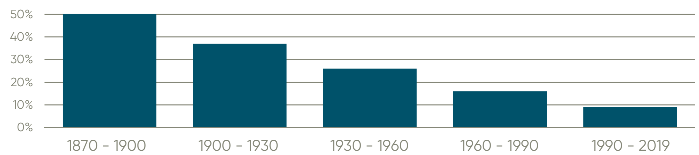
What is a Trillion? Unprecedented Stimulus...

We must not overlook the unprecedented support by global policy-makers in trying to minimize the implications of the crisis. Consider the U.S., where lawmakers have passed trillions of dollars in stimulus relief. To put the magnitude of one trillion into context, if we were to travel back in time by a billion seconds, we would be in 1989. However to go back a trillion seconds would take us to around 30,000 B.C.

Many central banks have engaged in quantitative easing (QE), which is a form of monetary policy, by purchasing financial assets to inject money into economies. The Bank of Canada began its first-ever move into QE in April by purchasing $1 billion of government bonds. Alongside record-setting fiscal policy spending, increases in the money supply have not only helped to support asset prices, but also economies. For some economists, this is one reason to remain optimistic about the rate and sustainability of recovery. Of course, there will be new challenges as a result of significant deficits and debt. There are also questions as to whether these efforts will be enough to help economies quickly recover.

However, economies naturally go through cycles and the speed of recovery from economic downturns has increased over time. Recessions occur when economic output declines after a period of growth. Our economy has spent less time in recession as technology has transformed it to be more service-based, and also due to increased central bank intervention.[2] A century ago, the economy was in recession nearly 40 percent of the time; today this is less than 10 percent.

Percentage of Time in Recession — US Economy[3]



While the longer-term implications are less clear, let's not forget that after the 2008/09 financial crisis, many economists worried about high rates of inflation and slower economic growth, both of which generally did not happen.[4] Instead we participated in one of the longest economic expansions of all time.

Throughout history, economies have continued to advance and progress. Despite the challenges ahead, there may be positive reasons to continue looking forward and maintain a longer-term perspective.

1. http://hbr.org/2020/05/the-u-s-is-not-headed-toward-a-new-great-depression?ab=hero-main-text; 2. https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/Commentary_366_0.pdf; 3. The rate is similar in Canada but economic data prior to 1930 isn't readily available; https://nber.org/cycles.html; 4. Inflation rates did exceed central bank targets in 2011.

What Happens After a Bear Market?

We have encountered many new situations in response to COVID-19 — isolation, physical distancing, economic closures globally, and others — that have created uncertainties for the short term. Doomsayers cite these factors, and others, to suggest that this time is different and the current economic downturn will somehow last forever. However, economic cycles go up as well as down.

Equity markets are also cyclical. Bear markets happen from time to time. Yet, even in the worst situations, equity markets have eventually turned their course. The worst bear markets in history have seen drawdowns of over -86 percent (1932) and -56 percent (2007). Yet, the average returns following some of the worst bear markets were 53 percent, 78 percent and 143 percent over the ensuing one, three, and five year periods, respectively. Although the positive returns came after the depths of the bear markets, history reminds us that time can heal even the worst market declines.

Nobody knows the direction of the equity markets over the near term, but the long-term trend has been up.

In preparation, a disciplined approach emphasizing quality, diversification and a solid plan are expected to continue to serve us well over the longer term.

Forward Returns Following History's Worst Bear Markets, S&P 500

Peak	Trough	Drawdown	1 Year	3 Years	5 Years
1929, SEP	1932, JUN	-86.2%	162.9%	170.5%	344.8%
1937, MAR	1938, MAR	-54.5%	35.2%	38.2%	84.5%
1968, NOV	1970, MAY	-36.1%	34.8%	50.6%	42.2%
1973, JAN	1974, OCT	-48.2%	38.1%	72.7%	117.5%
1987, AUG	1987, DEC	-33.5%	23.2%	55.5%	121.7%
2000, MAR	2002, OCT	-49.1%	24.4%	59.0%	105.1%
2007, OCT	2009, MAR	-56.8%	53.6%	98.0%	181.6%

Source: fortune.com/2020/03/19/coronavirus-stock-market-predictions-bear-market-stocks-bottom-what-to-expect/

Maintaining Balance in Your Portfolio

How have you reacted to the markets of late? In uncertain times, it may be tempting to take a conservative approach to protect investments from the downside.

Selling all of your stocks and holding cash is one alternative, though not practical for many investors. The potential capital gains tax consequences may be one reason this would be unpalatable. But more importantly, equity markets are largely unpredictable and cyclical in nature. The risk of being out of stocks is, over the long run, likely greater than the risk of owning them.

If the turbulence of the markets prompts you to want to take action, here are some constructive opportunities to make adjustments to your portfolio:

Restoring Portfolio Balance — If a particular holding dominates within a portfolio, there may be an opportunity to rebalance. We often think of rebalancing by selling appreciated shares; however, it's not always necessary to sell a position in order to bring balance back in check. Rebalancing can be done by investing new capital in asset classes that are now underweight. This brings the added discipline of focusing on undervalued sectors or asset classes for new investment opportunities.

Upgrading or Switching Securities — Certain companies or industries may offer greater stability and be better able to withstand these uncertain times. Companies with strong balance sheets, low debt and healthy cash flows may be better positioned to fund operations during difficult times. Buying into industries that will be least affected by an adverse economic climate, such as those in "defensive sectors" like consumer staples or healthcare, may help to shield against the downside because they serve consumers' basic needs throughout every market cycle.

Finding Income — As government treasury yields and interest rates have reached all-time lows, many traditional income-yielding investments may provide dismal returns. For investors searching for income, there may be suitable opportunities with equities. Certain quality, sustainable companies have a history of continuing dividend payments during market downturns. Care must be taken when determining which equities or funds have reliable dividend payout streams. However, during down market times, there may be an opportunity for continued dividend payouts while waiting for prices to rebound from depressed levels.

Dollar Cost Averaging (DCA) — Down markets may represent opportunities for investors to put money to work for the longer term. Buying at regular intervals, regardless of market conditions, has the potential to lower the overall cost of shares, turning a downturn to your advantage (as discussed on page 2).

Active Management — During bull market times, the virtues of active management are often largely ignored. Actively managed funds can offer benefits that may be particularly helpful in today's uncertain markets. Professional managers are continuously adjusting to the changing environment, assessing the relative merits of each security and their risk/return potential on an ongoing basis, perhaps more rigorously than most individual investors. Funds may also offer wide diversification in holdings, helping to reduce portfolio risk.

Estate Planning & the Will: Legal Doesn't Mean Effective

In light of COVID-19, many people have turned their minds to their estate plans.[1] One news report indicated that a Canadian online will-creation site saw an increase in sales of 700 percent from the same period last year.[2]

A will is the cornerstone of any estate plan, and creating one on your own is not difficult these days using the support of a will kit or online tool. However, there may be good reasons why more thoughtful planning can be beneficial.

The will itself may not be valid. While you can create legal documents online, they may not be legally binding. Canadian law currently requires that will documents be physically printed and stored offline. In order to be valid, a will must also be signed in the presence of two witnesses who are required to sign the document.

As a result of physical distancing measures put in place due to COVID-19, some provinces have issued emergency orders to permit virtual witnessing of legal documents including wills.[3] However, at the time of writing, there has been some confusion as to the procedures to be followed to ensure validation. There are also concerns about situations involving lack of capacity or undue influence.[4] In addition to this, there may be other nuances in provincial laws and/or language that may affect the validity of a will.

Legal does not mean "effective." Even if the document is valid, do you fully understand family law or succession regulations within your province, Canadian income tax and investment rules, or even the current U.S. estate tax law? These can change over time, and also create risks or potential future consequences to your estate plan. Today's families are more complex than ever, with divorces, remarriages and blended family arrangements. In these cases especially, careful wording in a will can help to ensure that assets are distributed after death as intended. Equally important, a will that has been quickly drafted, such as one created in reaction to the current pandemic, may not thoughtfully consider all aspects of the estate.

Has Your Will Been Updated?

If you do have a will in place, how old is it? Perhaps this may be a good time for a thorough review of the complete document, especially if circumstances have changed.

Seek Expert Advice

The support of a professional can not only ensure the validity of a will, but also its accuracy. Taking the time to do a deep discovery with an estate planning professional can help to ensure that your plan completely reflects your needs and desires. We can help provide a financial perspective, if required.

Improper documentation or vague instruction can lead to misunderstanding, conflicts or even court battles. Don't let this be your legacy.

1. https://www.cnbc.com/2020/03/25/coronavirus-pandemic-triggers-rush-by-americans-to-make; 2. https://www.ctvnews.ca/health/coronavirus/should-you-create-or-update-your-will-in-light-of-covid-19-1.4879831; 3. https://www.investmentexecutive.com/news/industry-news/ontario-quebec-allow-legal-documents-to-be-signed-virtually/; 4. https://www.torkinmanes.com/our-resources/publications-presentations/publication/virtual-witnessing-of-wills-and-powers-of-attorney-permitted-in-ontario-during-covid-19

Our Role in Managing Risk

The exogenous event of COVID-19 has been an uncomfortable reminder that we are all vulnerable to unforeseen risks that can have unprecedented effects. As investors, we could try and avoid these terrible events, but for most of us, overly defensive tactics, such as not participating in the markets, wouldn't help in achieving our goals over the longer term.

As the saying goes, perhaps "the correct lesson to learn from surprises is that the world is surprising." Equity markets inherently come with risks — in order to reap the potential returns offered by the markets, investors must be willing to accept that surprises can happen from time to time.

While risks in investing can never be eliminated, they can be managed. This is one of our main roles — to act as risk managers. As risk managers, we have significant concern and care about preserving your capital and growing it over the longer-term. We put this into practice when we construct and manage portfolios — positioning them so they don't do terribly in any one particular outcome, but also have the chance to do well across the many potential paths the markets could take.

During buoyant market periods, such as the extended bull market run we recently experienced, the need for risk management may not be overly apparent. It may have been easy to get caught up in the prevailing momentum and continuous market advances. Yet, risk management does not focus on achieving the highest possible rates of return — it is about preserving hard-earned capital to support investors in achieving the returns needed to accomplish their goals. Often, it's only when prices head downwards that the value of risk management becomes more obvious.

This means following various guidelines that have been established to control risk. We do this in various ways, such as maintaining a strategic asset allocation, rebalancing portfolios back to target allocations when they drift too far, limiting the size of any particular holding, diversifying exposure across sectors and geographies and paying particular attention to an investor's personal risk tolerance levels.

We're also here to provide counsel. As hard and fast as equity markets fell in late February, the rebound in April was equally stunning. As award-winning finance columnist Morgan Housel has said: "You will likely be more fearful when your investments are crashing and more greedy when they're surging than you anticipate. And most of us won't believe it until it happens." Sometimes emotions can pose risks to our short-term decision-making that can affect our longer-term well being.

While everyone has an idea about how things will continue to unfold, in reality, nobody can be certain about the near-term path forward. Risk management practices are intended to help protect investors from the potential changes. During these challenging times, investing requires patience to understand that the markets will inevitably encounter surprises along the way, as well as the resolve to remember that portfolio guidelines have been put in place to support your journey to investment success. Please call if you would like to discuss.

During Uncertain Times: Avoid These Investing Mistakes

Uncertain times often highlight the mistakes that investors can make with their portfolios. During buoyant markets, making money may not seem difficult. However, the reckoning often comes when markets turn down. Suddenly, mistakes can become glaringly apparent.

Here are some of the more common investing errors:

Overlooking Diversification

The concentration of assets in too few areas can be a common problem. Despite the broad-based market declines we have recently experienced, certain sectors have performed very differently. Some technology companies have outperformed as a result of distancing practices, whereas industries dependent on travel and tourism have suffered significant short-term setbacks. Even during non-crisis times, regardless of the high quality of investments, there is always the danger that a bad quarter or certain industry developments may adversely affect equity values.

No single asset class has consistently performed at the top over time. As such, it is important to maintain a healthy balance of diversification across your assets.

Tax Errors

Don't overlook the effect of taxes on your investments. Remember that different forms of investment income can be taxed differently. In a non-registered account, the nominal return from dividends of an eligible Canadian corporation would be higher than the same fixed-income return on an after-tax basis. Capital gain returns are generally taxed at even lower rates. Pay attention to asset location: different income can be taxed differently depending on the type of account (i.e., registered, non-registered) from which income is generated. Using tax advantaged accounts such as Registered Retirement Savings Plans and Tax-Free Savings Accounts may be great ways to help minimize taxes.

Also important: don't be reluctant to sell a security solely because taxes will be triggered. If the fundamentals suggest change or a portfolio needs to be rebalanced, don't let the tax tail be in control.

Failure to Adjust

The financial markets are constantly changing and the prospects of specific companies, industries or even entire classes of securities can be attractive today, but not tomorrow. Be ready to adapt. Equally important, your needs may change and your holdings may require periodic adjustments as circumstances evolve. Remember, you are not marrying a particular security: the purpose of investing is to earn a solid return, not own XYZ company forever.

Acting on Emotion

Fear and greed are said to be the drivers of market sentiment. When euphoria prevails, unsavvy buyers often rush to purchase investments. In contrast, market downturns may offer bargains, yet many investors sit on the sidelines or, worse, decide to liquidate portfolios.

Having an investment plan with well-defined objectives can help control emotional pressures. Working steadily towards measurable goals helps to focus on outcomes rather than the process. Other tactics may include a dollar-cost averaging program (page 2), which helps to prevent emotion from dictating investment purchases. Avoiding daily attention to the performance of investment accounts may also help to limit emotional responses.

Reminder: 2020 Changes to RRIF Withdrawal Factors

Back in March, the Federal Government reduced the 2020 minimum withdrawal amounts for Registered Retirement Income Funds (RRIFs) by 25 percent "in recognition of volatile market conditions and their impact on many seniors' retirement savings."1

As a reminder, the RRIF withdrawal factors are based on age. If you were 71 at the beginning of the year, under the existing rules you would be required to withdraw 5.28 percent of your RRIF in the year. For a RRIF with a value of $100,000 at the start of the year, the required withdrawal amount would be $5,280. With the changes made for the 2020 year, the withdrawal requirement would be $3,960, or 25 percent less.

Should Retirees Withdraw Less from the RRIF?

While the lower withdrawal requirement allows investments within a RRIF more time to potentially recover from a market downturn, there may be other opportunities for seniors who don't require RRIF income.

Consider, instead, transferring investments "in kind" from a RRIF to a Tax-Free Savings Account (TFSA), subject to available TFSA contribution room. While the withdrawal from the RRIF will be taxable in the year of withdrawal, should investments recover, the TFSA will generate no taxable income on future withdrawals or investment income, unlike the RRIF.

There may be an additional tax opportunity. For seniors who have a lower marginal tax rate today than they expect to have in the future (including at death), drawing RRIF income above the minimum levels may be a way to potentially lower an overall lifetime tax bill. RRIF withdrawals will be taxed at the current, lower tax rate, instead of at a higher anticipated future marginal tax rate. If these funds are invested in a TFSA, any future gains will not be subject to the higher future marginal tax rates. Note that withholding taxes will apply to RRIF withdrawals in excess of the minimum amount. Also keep in mind that the effect on any income-tested government benefits should be considered when contemplating this strategy.

Note that the reduction in the minimum withdrawal factors for the 2020 year also applies to Life Income Funds (LIFs) and other locked-in RRIFs. If you have already withdrawn more than the lower minimum amount in 2020, you are not permitted to re-contribute any excess to your RRIF.

Please call for assistance with this or any other RRIF matters.

1. https://www.canada.ca/en/revenue-agency/campaigns/covid-19-update/covid-19-benefits-credits-support-payments.html

Reminder: Tax Filing Extension for Balances & Instalments Due

The CRA has extended the deadline for balances and instalments due to September 1, 2020.

For those who follow calendar remittances, keep in mind that the regular Sept. 15 quarterly remittance occurs just two weeks later, so plan ahead to help avoid cash flow issues. However, if income has dropped significantly in 2020 compared to what was initially anticipated, the amount required for the instalment payment may be less than what was originally planned. The advice of a tax advisor regarding your situation may be beneficial.

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