Lorriman Sturgeon Wealth Management Group Newsletter

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In this edition

Managing Through Uncertainty

With continued moves by the central banks in raising rates to fight inflation, many have pointed to the current outlook for the economy and financial markets as being uncertain: Is a full-blown recession imminent? Will a soft landing be possible?

It is therefore not surprising that the markets have been extremely volatile. Uncertainties tend to raise fears, which can be a driving factor of short-term market behaviour. Today, fear appears to be the dominant emotion governing prices in equity markets. One study has shown that investor risk aversion is responsible for almost 75 percent of short-term market variations.[1] This is because we often underestimate our ability to adapt.

Whether or not we avoid a recession remains to be seen, but it's worthwhile to remember that downturns are a normal part of the economic cycle. Moreover, the stock market and the economy don't always move the same way at the same time, and predicting how the markets react to recessions is difficult, if not impossible. A recent study looked back at recessions in the U.S. since 1945, suggesting that the S&P 500 Index actually rose an average of one percent across all recessionary periods. And, in almost every recession, the markets began their climb well before its end.[2]

Over the summer, there were promising signs that inflation was slowing here at home. However, the bearish forecasters continue to warn of the consequences from the central banks' hard stance against inflation: ongoing rate hikes will further slow economies, put downside risk on equity markets and avert a soft landing. It's no wonder that many of us feel as though we are already in recession[3] — the current narrative, alongside increasing household expenditures, a higher cost of borrowing and stock market declines, certainly hasn't helped to support optimism.

Yet, uncertainties will always be with us and some of the most successful long-term investors are adept at separating their emotions from investment decisions. This is not easy to do, but there are techniques and products available that can help. Systematic investing can limit the urge to otherwise succumb to market timing. Some look to managed products to put buy-sell decisions on the regular watch of others. We also manage risks to help cope with the unavoidable volatility. Diversification continues to be a proven way to increase stability and lower risk by spreading assets across different securities, sectors and asset classes, among others. Those who consider high-quality investments will also worry less about enduring values during uncertain times, secure in the knowledge that any price setbacks should be temporary.

While the current period of economic uncertainty is expected to continue, let's not forget that economies and modern capital markets have always adjusted and progressed over time. This time is no different. The investing journey is a long one, filled with both ups and downs, and there may be merit in never underestimating our ability to continue moving forward, despite the uncertainties.

1. www.nber.org/papers/w19818; 2. www.forbes.com/sites/sergeiklebnikov/2022/06/02/heres-how-the-stock-market-performs-during-economic-recessions/; 3. https://leger360.com/surveys/legers-north-american-tracker-july-12-2022/

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Tax Planning Before Year End: Gain from Your Losses

With the arrival of cooler weather, the end of 2022 is already in sight. This may be a time to consider tax-planning strategies before year end. If you are thinking of making portfolio adjustments, there may be an opportunity to gain from your losses through tax-loss selling.

What is Tax-Loss Selling?

Generally, an investment held in a non-registered account that is sold for less than its original cost will result in a capital loss. For tax purposes, 50 percent of the capital loss can be used to offset any taxable capital gains realized during the year to reduce your current tax liability. If you do not have sufficient taxable capital gains to offset the losses, the net capital loss can be carried back to any of the previous three taxation years to offset realized capital gains, or carried forward to use against future realized capital gains.

Be aware of the "superficial loss" rules, which deny the capital loss if you or an affiliated entity (such as a spouse, RRSP, TFSA) acquires the same security either 30 days before/after the date of the loss transaction. In this case, you will not be allowed to use the capital loss in the current tax year to offset capital gains. Instead, the capital loss will be added to the adjusted cost base of the identical property.

Gifting to Adult Children

Gifting investments that have declined in value to an adult child can put subsequent capital gains/income in the hands of someone in a lower tax bracket, resulting in less taxes payable for the family unit. This will also trigger a capital loss in your hands, which can help to offset realized capital gains. For estate planning, transferring assets to your children while alive can reduce the value of your estate and the eventual taxes or probate fees (where applicable) on your estate at death.

Year-End Tax Planning By Donating Securities

Year-end tax planning often involves charitable giving. Donating publicly-traded securities "in kind" that have appreciated in value will eliminate the tax liability on the capital gains triggered and allow for a donation tax credit for the fair market value of the securities. However, for securities that have declined in value, you may wish to simply sell the securities to claim the capital loss and donate cash, which will entitle you to a donation tax credit. Unlike appreciated securities, where the additional tax benefit (that eliminates the tax liability on the capital gains) will only occur if you donate shares "in kind," you will still be able to claim the capital loss. Remember to make charitable donations in advance of the December 31, 2022 deadline to count towards your 2022 taxes. Please seek the support of tax planning professionals for your situation.

Consider These Year-End Tax Planning Opportunities:

› **Charitable Donations:** See above story for tax benefits.

› **Tax-Loss Selling:** Consider realizing capital losses to offset realized capital gains.

› **RRSP Contributions:** While you have until March 1, 2023, consider contributing before year end to benefit 2022 taxes.

› **RESP Contributions:** This won't affect 2022 taxes, but you may potentially benefit from the CESG grants in 2022.

› **Turned 71 in 2022?** Your RRSP will mature by year end, so please call the office to discuss the options available.

› **Income Splitting:** This may include paying reasonable salaries to family members for services provided to your business or electing to split eligible pension income with a spouse on a tax return. Get in touch for more ideas.

Inflation & Interest Rates: Has Inflation Peaked?

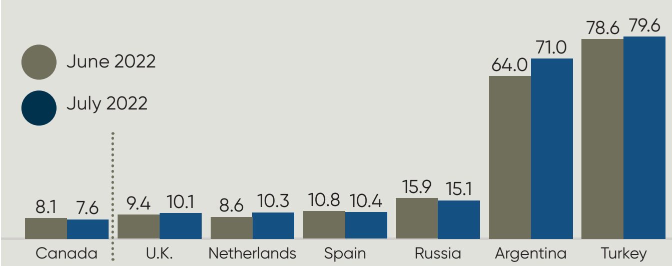
We are in one of the most aggressive tightening cycles in more than 40 years. Are higher rates helping to curb inflation? At the time of writing, there have been positive disinflationary signals as commodities prices, notably energy, have moderated and certain pricing pressures appear to be easing.

While higher inflation rates continue to put a strain on many, consider that we aren't alone. Most of the world has been troubled by inflation; countries like Turkey and Argentina have had unprecedented rates, in excess of 70 percent! Only a handful of nations, such as South Sudan and Bolivia, have been able to escape inflation. Canada continues to be in a comparatively favourable position due to our vast domestic resources production and as a net exporter of both food and energy. Many European countries suffer from high energy and food prices due to their dependence on imports, and there are concerns about a worsening energy crisis over the winter months.

For investors, talk of slowing inflation is welcome because this may slow the pace of future rate hikes. Rising interest rates have been a key driver of the volatile markets in 2022. For fixed income, the inverse relationship between bond prices and interest rates meant a significant decline in the bond markets this year. For equities, valuations often go down as the future value of cash flows is lower when a higher discount rate is used. Company profitability may also be hampered by slower economic growth.

Inflationary pressures are expected to continue, so it's too soon to say if the central banks will ease their approach. Yet, our monetary policy practices appear relatively benign when compared to others: In August, Argentina raised its key interest rate to a whopping 69.5 percent!

G20 Countries with Highest Inflation, as of August 2022



Canada shown for comparative purposes. https://tradingeconomics.com/country-list/inflation-rate

When Did You Last Revisit Your Estate Planning Objectives?

Estate planning should be a consideration for every investor's wealth plan. We often talk about the importance of using tools to support the estate plan, such as a will, powers of attorney, insurance, trusts and the arrangement of the ownership* of assets. These help to protect, manage and distribute assets during your lifetime and after you are gone.

However, before putting these tools in place, an important first step is to set out your estate planning objectives. Even if you have already contemplated these objectives, perhaps a review is in order. These can change with the passage of time or as a result of major life events such as marriage, divorce, birth and death. As such, you may wish to revisit your objectives from time to time to make sure they reflect your current thinking.

Here are some questions that may help with this thinking:

1. What do I want my wealth to achieve during my life and beyond?
2. Will my family be able to maintain their current lifestyle if I am no longer able to contribute?
3. Who do I wish to be my primary beneficiaries? Should I appoint alternate beneficiaries in the event they predecease me?
4. How long do I intend to provide support to beneficiaries?
5. Are there significant assets that need to be addressed? If so, what is the ultimate goal for these assets? This may include a family business or vacation property, such as a cottage or cabin.
6. Will I need to structure assets to limit exposure to potential liabilities? — i.e., a beneficiary's relationship breakdown, future family controversy or to protect against former spouses or creditors?
7. What will be my legacy? Is there a charity/cause I wish to support? Are there ways to preserve my legacy for future generations?

It's Never Too Early (Or Too Late!)

There's never a better time to contemplate your legacy than the present. Planning for how you will provide for the people and/or causes you care about, while balancing your own goals, can happen at any age. We are here to work alongside estate planning specialists, so don't hesitate to call.

*In provinces, and situations, where applicable.

Estate Planning: Consider the Benefits

Once you have established your objectives, building a comprehensive estate plan has the potential to achieve many benefits, including:

- Helping to ensure that the people you care about are protected as intended;
- Protecting assets from unintended beneficiaries or creditors;
- Limiting expense, such as minimizing taxes or reducing other expenses of the estate;
- Simplifying or speeding up the transition of assets;
- Reducing the stress or administrative burden on loved ones;
- Managing potential conflict between beneficiaries;
- Creating a legacy; and
- Allowing you to more fully enjoy your assets today.

You Asked: Should I Delay RESP Withdrawals?

With volatile market performance in 2022, some who hold a Registered Education Savings Plan (RESP) have asked: Should I delay RESP withdrawals? Having patience is never a bad thing when it comes to investing through the inevitable cycles and for those with sufficient funds to cover short-term education needs this may be an option. However, there may be reasons not to delay withdrawing RESP funds.

Remember that educational assistance payments (EAPs) — the withdrawal of income, capital gains and grants that have accumulated in the plan — are taxable in the hands of the beneficiary. The original contributions made to the RESP are not taxable. If you are considering withdrawing EAPs, there may be benefits in doing so before year end to use a student's tax credits. Consider that the basic personal amount for the 2022 tax year is $14,398. Assuming a federal tuition tax credit of $6,700, the combined total tax credit amount would be $21,098, meaning that a student with no other income could potentially receive $21,098 of EAPs in 2022 and pay no tax.

As you plan ahead to minimize the tax bill, consider that the student could carry forward the federal tuition tax credit to a future year. However, the basic personal amount cannot be carried forward; it must be used in the current tax year. As such, you may wish to utilize this tax credit amount. As you look to optimize a family tax bill, you should also consider that a student may transfer a maximum of $5,000 of the current year's federal tuition amount to a parent or grandparent (or spouse/CLP, or the spouse's parent/grandparent).

It May Be a Great Time To Contribute to the RESP!

For (grand)parents with young children looking to support a future education, it may be an opportune time to consider opening and/or contributing to the RESP. Over recent years, it has been difficult to find quality investments at reasonable prices, but 2022 has certainly presented greater opportunities and the RESP can be a beneficiary. Please call the office if we can assist. We continue to advocate the RESP to save for a child's education.

Thinking of Escaping the Canadian Winter?

For the past two winters, many snowbirds have been forced to hibernate at home. With travel now accessible, some are looking to resume their migration south to escape the cold. If this is within your plan, consider the potential implications.

Leaving for Extended Periods? Beware of Tax Issues

If you leave Canada for extended periods, a significant consideration may be the potential tax implications, both in Canada and your chosen destination. Canadian income tax obligations are based on your residency status, which is determined on a case-by-case basis. This can be affected by factors such as the amount of time spent in Canada, residential ties (i.e., property owned), purpose for your time abroad and your ties abroad. Being a Canadian non-resident for tax purposes may still require you to file a Canadian income tax return and pay taxes. A non-resident withholding tax of 25 percent may also apply to certain income received, such as dividends or pension payments.

If you are deemed to be a resident of a foreign country, you may be subject to that country's tax rules. For example, the U.S. Internal Revenue Service (IRS) uses the "substantial presence test" to determine whether an individual is considered a U.S. resident for tax purposes, a formula using the days spent in the U.S. in the current and prior two years. Qualifying as a U.S. resident for tax purposes can have tax consequences, such as subjecting worldwide income to U.S. taxation or exposing Canadians to the U.S. estate tax at death.

Other Financial Implications

Beyond the potential tax issues, there may be other financial implications. Although the rules vary by province, provincial medical coverage may become invalid as a result of extended periods spent out of province. Even if coverage remains valid, certain services received abroad may not be covered by provincial healthcare plans, so having adequate private coverage should be a consideration.

Your government benefits may be affected by your residency status. For example, Old Age Security (OAS) and Canada/Quebec Pension Plan (CPP/QPP) benefits may be subject to a non-resident tax of 25 percent (unless reduced/exempted by a tax treaty between Canada and the country of residence). The value of OAS payments is impacted by how long you have lived in Canada after age 18, so a non-residency status may reduce payment amounts. For Tax-Free Savings Accounts, you cannot accumulate contribution room for any year that you are a non-resident of Canada throughout the entire year and any non-resident contributions will be subject to a penalty tax.

Consider that the laws of the jurisdiction of residence at the time of death may govern how an estate will be taxed. Even if you remain a Canadian resident, if you have appointed a non-resident to administer your estate, your estate may be considered a non-resident estate and may not receive preferential tax-treatment (i.e., on Canadian dividends/capital gains) or it may be subject to the tax laws of the country where the trustee resides. Power of Attorney (POA) documents may also become complicated by a non-residency status. If you are appointed as POA for property but are no longer a Canadian resident, you may be limited in your actions, such as potentially not being able to give trading instructions on an account.

Seek Assistance

There may be other implications resulting from a change in residency status due to extended periods spent outside of Canada. This discussion isn't meant to be comprehensive, so please seek advice from cross-border tax and legal advisors regarding your situation.

How Does a Recession Impact My Portfolio?

Over the summer, the U.S. reported its second successive quarter of declining GDP, which commonly defines a recession. Yet, the U.S. government pointed to economic data that suggested otherwise: strong jobs growth, robust corporate earnings and continued consumer spending. However, it prompted considerable debate about whether the U.S. had entered a recession, and if Canada would follow. Semantics aside, there is little doubt that we have entered a slowing economic period, largely due to continuing efforts by the central banks to aggressively raise rates to curb inflation.

How Do Rising Rates Affect Economies and the Markets?

Higher rates raise the cost of borrowing, which can lead consumers to spend less. While decreased demand for goods and services eases inflation, it can also impact a business' profitability. Rising rates also increase the cost for companies to borrow money, along with the cost of debt. Sometimes companies pass these costs along to consumers. However, if they cannot, it can potentially impact earnings and lower stock prices. As well, valuations often go down because the future value of cashflows is lower when a higher discount rate is used. With fixed income markets, as interest rates rise, bond prices generally fall. This is why we have seen both stock and bond markets struggle in 2022 as the central banks raised rates.

Is a "Soft Landing" Still Possible?

Renowned economist John Kenneth Galbraith once said, "The only function of economic forecasting is to make astrology look respectable." Although likely said in jest, the point is to suggest that nobody knows with certainty how economies will perform over the near term. Economic slowdowns will occur from time to time and recessions, when they do occur, can be quite different in their length and intensity.

At the time of writing, labour markets continue to be relatively strong, with low unemployment and job vacancies. While unemployment is expected to rise as the economy slows, higher savings rates among many Canadian households may act as a buffer. Productivity has also been stable, and our economy has benefitted by being a net exporter of resources. As such, some believe that Canada may avoid a full-blown recession.

What About My Portfolio?

The potential for a recession should never be a reason to consider curtailing investment programs. Portfolios have been positioned to weather the inevitable down periods, with a focus on quality investments, which can be expected to regain their values when better times arrive, as well as diversification and asset allocation to help reduce portfolio risk.

Consider also that the stock market and the economy don't always move the same way at the same time. History has shown that markets can begin their upward climb when economic conditions are at their worst. A look back at the last seven U.S. recessions reminds us that the S&P 500 Index has, as often as not, started its climb during the depths of a recession (chart).

S&P 500 Returns During Recession, One and Three Years After End

Recession	During Recession	One Year After	Three Years After
Nov. '73 to Mar. '75	-17.90%	28.32%	21.99%
Jan. '80 to Jul. '80	16.14%	12.92%	55.89%
Jul. '81 to Nov. '82	14.66%	25.40%	67.24%
Jul. '90 to Mar. '91	7.64%	11.04%	29.84%
Mar. '01 to Nov. '01	-7.18%	-16.51%	8.44%
Dec. '07 to Jun. '09	-35.46%	14.43%	57.70%
Mar. '20 to Apr. '20	-1.12%	45.98%	TBD

Sources: NBER, Returns 2.0, awealthofcommonsense.com/2022/06/timing-a-recession-vs-timing-the-stock-market/

A Pullback, Then More Growth

History also reminds us that periods of retrenchment have always been followed by new growth, economic expansion and improved equity values. There is little reason to expect otherwise in this cycle. Moreover, even during the most challenging times, things can quickly change, so continue to look forward. As always, we remain here to provide support.

Helping Younger Generations Cope with Higher Rates

For the younger generations, this may be the first time they are experiencing rising rates and high inflation. As such, here are a few thoughts on helping them prepare for this changed landscape.

Since the start of the millennium until the pandemic, inflation levels never surpassed four percent and often struggled to reach two percent. Now, with persistently high inflation, the Bank of Canada has taken aggressive action to hike interest rates to try to temper inflation. Today, we have demand exceeding supply in many areas of the economy, which has caused prices, or inflation, to rise. This is largely due to the unprecedented stimulus throughout the pandemic and persistent supply chain issues from the shutdowns.

How do higher interest rates fight inflation? By raising rates, the central banks are trying to reduce demand to ease rising prices. Higher interest rates make borrowing money more expensive, which discourages borrowing and, in turn, helps to reduce demand. With reduced demand, companies are likely to have more supply and may be encouraged to lower their prices to try to stimulate demand.

Helping Young Folks Think About Personal Finances

Due to many years of predictably low interest rates, it was easy to assume debt with little worry. Now, with rising rates, borrowing has become most costly and many may not have been prepared for rates to rise as quickly as they have. As such, for many young people, during these times of rising rates and high inflation, a focus on personal finances may be a good starting point. Here are some areas to consider:

Pay down debt. If there are debts to service, suggest the importance of paying this down, especially prioritizing debt subject to high interest rates, such as credit card debt. It is important to understand the terms of any loan and the effect of rate increases. For instance, for a variable-rate mortgage, consider how interest rate increases will impact interest payments or reduce the amount of principal that is paid down. As an example, raising interest rates from 1.5 to 4 percent while keeping the payment amount fixed increases an amortization period (the time taken to pay down the mortgage) from 25 to 45 years.

Create or revisit a budget. For those who hold debt, it may be beneficial to create or revisit a budget to prioritize paying off debt. Even if no debt exists, the effort of sitting down to map out income and expenses each month can be revealing, especially in this period of high inflation where the cost of most goods and services has increased. There may be value in having a comprehensive view of overall spending, to uncover and correct poor spending habits or better balance spending priorities. Equally important, minor reductions in consumption can lead to worthwhile savings.

Pay yourself first! By "paying yourself first," younger folks can be encouraged to prioritize saving and investing for the future. This may involve putting aside a portion of a

paycheque through a payroll deduction at work or automatic bank account debit, with the idea being that what you don't see, you won't miss...and otherwise spend. Recent market downturns may be seen as an opportunity to build an investment portfolio for the future. A simple example of how saving can lead to future wealth may be worth sharing: A young person who saves and invests $5,000 each year at an annual rate of return of five percent will be a millionaire in 50 years, assuming no taxes. With higher interest rates, low-risk savings vehicles that have been previously overlooked are becoming more attractive and many younger folks may not be aware of these products — some five-year guaranteed investment certificates (GICs) have rates hovering around four percent.

These are just a handful of ideas to provide guidance to the younger generation in this time of rising rates and high inflation. If we can help with these conversations, please don't hesitate to contact the office.

Beyond Estate Planning: The Importance of a Financial Inventory

If an unexpected event were to happen, would you, or others, be able to find important documents to handle your finances?

A financial inventory is a list of all of your financial documents and other important financial information. While we often suggest this be created as part of an estate plan, there may be other situations in which having this inventory can be invaluable — in the event of damage to your home, such as a fire, flood or natural disaster, divorce or separation, incapacity or illness of you or your spouse/partner or theft.

The Benefits: A Big Picture View...and No Lost Funds!

A financial inventory is not only important to ensure continuity in managing your finances in the event of unforeseen circumstances, but it can also provide a big picture view of your financial accounts and your overall financial situation. It should be reviewed periodically and updated to account for changes, including major life events.

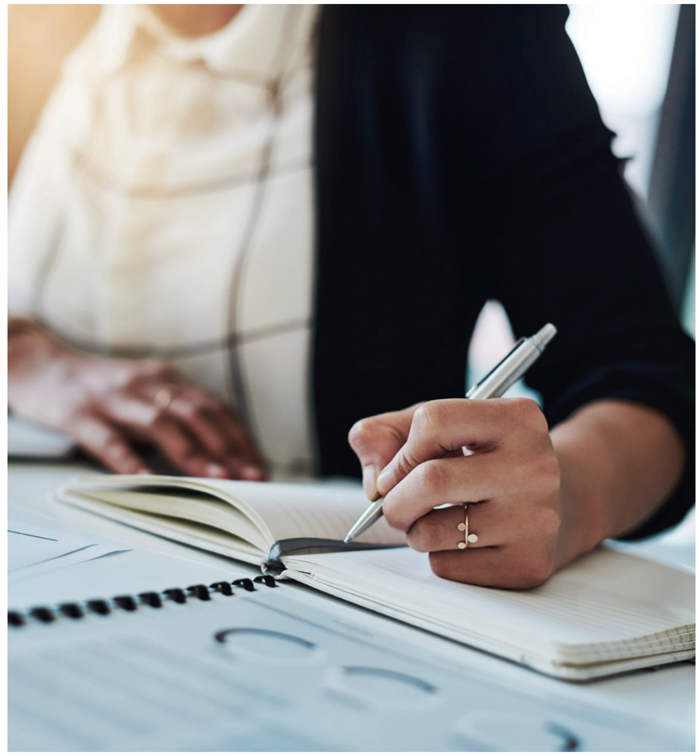
Another reason why this can be important? By keeping track of your financial documents, there is a better chance that your assets will not be lost or forgotten. The latest reports suggest that there are $888 million in unclaimed balances held by the Bank of Canada and the Canada Revenue Agency has around 7.6 million uncashed cheques with a total value of around $1 billion.[1]

Creating Your Financial Inventory

Putting together the initial inventory can be time consuming, but once it is created it can more easily be maintained. You will need to gather information and documentation about all of your finances. In the process, you may also determine that there are areas that can be streamlined to simplify your finances, such as consolidating or eliminating accounts.

The financial inventory should include all assets and debts. Assets include savings, chequing, brokerage and investment accounts, retirement and education savings accounts, real estate holdings and insurance policies (health, home, life, car, disability and long-term care). Debts may include credit card accounts, mortgage accounts and other personal loans. The inventory should also include legal documents such as a will, trusts and power of attorney documents. Other documents include titles, deeds, business documents, as well as any valuable property such as artwork and jewelry. Finally, the list should include the contact details of professionals involved in your finances, such as accountants, investment advisors and lawyers.

A detailed inventory should include contact information, account numbers, user name and password information and other account access details. Other information may be considered, such as social insurance numbers, automobile VIN/licensing details, cell phone providers and loyalty rewards programs. Given the abundance of sensitive information, you will need to ensure that this document is kept in a safe place, yet one that can be accessed by others if needed. It may also be beneficial to keep account number/password information in a separate location for greater security.



If you have yet to create an inventory and are in need of worksheets or tools to assist with this exercise, please call the office.

1. At the start of 2020. nationalpost.com/news/heres-how-to-see-if-you-have-any-of-the-888m-in-unclaimed-bank-accounts-the-bank-of-canada-is-holding; nationalpost.com/news/canada/canada-revenue-agency-1-billion-uncashed-cheques

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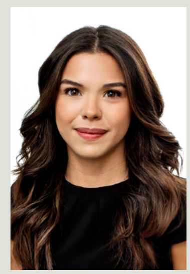

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