Newsletter

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In this edition

Time: The Investor's Great Ally..........1

Estate Planning: Your Digital Assets May Have More Value Than You Think 2

CPP/QPP Reforms: For 2024, Expect to Pay More 2

Higher for Longer Interest Rates: How Will This Impact Equity Markets?.......................................3

RRSPs & RRIFs: Be Aware of Taxable Withdrawals 4

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Time: The Investor's Great Ally

It has been said that "*Time is the exponent that does the heavy lifting. The common denominator of almost all fortunes isn't returns; it's endurance and longevity.*" As we look ahead to a new year, don't overlook the impact of compounding and time on investing success.

In investing, compounded returns can have a profound impact on portfolio values, but the potential outcomes are often overlooked. When given the choice between $50,000 per year for 30 years or a penny that doubles in value each year for 30 years, many would choose the first option. This is because it is easy for us to think linearly — $50,000 times 30 years would yield $1.5 million. However, the effects of compounding aren't as intuitive: a doubling penny would result in a whopping $10.7 million over the same period of time.

From an investing perspective, the significant outcomes from compounded growth may often be difficult to achieve in practice. One of the challenges is that compounding only yields impressive results over longer periods of time. This is because initial gains appear small at the onset and moderate in the middle — substantial outcomes are only realized in the latter part of the journey. Consider the doubling penny. After a full decade, it would have grown to just $10.24. Even after fifteen years, it would be worth only $327.68. With the other option, you would have banked $750,000 by this time. Yet, remarkably, after 27 years, the doubling penny would exceed the $1 million mark; after 30 years, it would be worth $10.7 million. Of course, we recognize that the doubling penny's annual rate of return of 100 percent is unrealistic in investing. This example is meant to highlight the profound impact that compounding can have over time — let's not forget this started with just a penny.

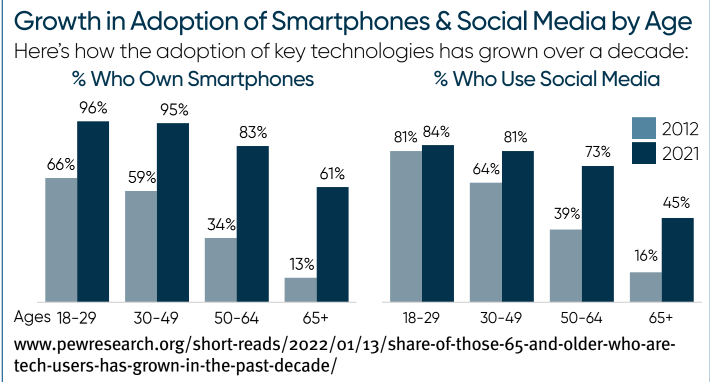
Adding to the challenge is that investor behaviour can disrupt the path toward achieving these outcomes. During heightened uncertainty, periods of downward market volatility can act to derail investment focus, prompting some investors to react. We all know the oft-counterproductive behaviours, such as trying to sell before a market downturn or, worse still, abandoning stocks during a downturn, which deprives the investor of the ability to eventually recover. These appear to be intuitive actions in the face of uncertainty; in many ways, the compounding journey often demands seemingly counter-intuitive behaviour.

However, it's worth a reminder: the world has always been uncertain. Today is no exception. Many are struggling with a higher cost of living and elevated interest rates. Global economies are highly indebted, economic conditions are softening and we're likely to see lagging effects of the rate hikes, among other concerns. Yet, adverse macroeconomic events have always been part of the investing journey: recessions, financial crises, inflation, stagflation — even wars — history has included all of these terrible things. While they can derail the markets for temporary periods, it is investor reactions to these events that can derail compounding.

As advisors, we remain focused on managing portfolios to navigate the challenges that come with the changing times. As investors, don't overlook the importance of a commitment to the longer term: Let time in the markets be one of your keys to success. As we begin another year, we would like to thank you for entrusting us with your wealth management. Wishing you and your loved ones health, happiness and prosperity for 2024.

Estate Planning: Your Digital Assets May Have More Value Than You Think

Even if you're not a significant technology user, your digital footprint may be larger than you think. This may be an important consideration in estate planning. A recent article in the popular press serves as a reminder: While many digital assets often have little monetary value, they may have substantial sentimental value. Overlooking the transfer of these assets may have sad consequences. One widow could not retrieve thousands of photos stored on her partner's cloud account. Another wasn't able to access her late husband's Facebook page.[1]



Canada lacks consistent legislation giving the executor or attorney the automatic authority to deal with digital assets, with rules varying by province — if they exist at all. Saskatchewan was the first province to introduce legislation that grants executors/fiduciaries access to digital assets.[2] Yet, even if laws do allow for authority, the reality is that access can be difficult if no provisions have been made by the deceased. Often, customer support for online accounts is limited, creating challenges and undue stress during an already emotional time.

Many of us carefully construct a plan for investments, real estate and other physical belongings; yet, as more of our lives operate digitally, we may not be doing a good job of planning for our digital assets. As a starting point, here are a few tips to begin the process:

Take inventory — Just as we take stock of our physical assets for estate planning, doing this for digital assets is equally important. Keep a logbook of digital assets, including usernames and passwords. This should be stored securely and updated regularly.

Practice digital housekeeping — Protect and secure your data, not just as part of an estate plan, such as regularly backing up important files, contacts, photographs and other information stored on your computer, smartphone or the cloud and encrypting sensitive data.

Consider a password manager — Often, keeping a list of accounts/passwords isn't enough, as we may forget to update it. A password manager may be helpful. These software programs maintain access information to digital accounts, including account numbers, passwords and other important data you might need to leave behind.

Create a legacy contact or plan — Did you know you can designate a legacy contact for Apple accounts or create a legacy plan for Google accounts? Some social media accounts also offer legacy options. For an iPhone or iPad, go to "*Settings*" and then tap your name. Under "*Password & Security*" you will see the "*Legacy Contact*" option. The system will generate an access key for your contact, which will need to be presented alongside a death certificate to access data. For Google, go to "myaccount.google.com" and tap "*Data & Privacy,*" then scroll down to "*More Options*" and look for the option "*Make a plan for your digital legacy.*" You can decide when Google should consider your account inactive and what will be done with your data, which can be shared with someone you trust or deleted by the system.

Update your estate plan — Make sure your will and power of attorney documents (or other directives, the names vary by province) include language specific to digital assets, giving a representative authority to access, manage, dispose of and distribute them.

1. "Life After Death: Secure Your Digital Legacy Before You Die," Julie Jargon. Wall Street Journal, April 25, 2023, A11;
2. https://dig.watch/updates/saskatchewan-ca-introduces-fiduciaries-access-digital-information-act

As always, please consult an estate planning professional.

CPP/QPP Reforms: For 2024, Expect to Pay More

If you earn employment income, you may have noticed more of your paycheque going towards CPP/QPP contributions. For higher-income earners, starting in 2024, expect to pay even more.

Back in 2019, CPP/QPP reforms were put in place to address the decline in workplace pension plans, amending the CPP/QPP in two ways: i) increasing the income replacement to 33.33 percent from 25 percent of eligible earnings, and ii) increasing the upper limit for eligible earnings. The first phase (2019 to 2023) gradually increased the contribution rate by one percentage point on earnings between $3,500 and the maximum pensionable earnings (MPE) limit. The second phase begins on January 1, 2024, and requires employees and employers to contribute an additional four percent on earnings between the MPE and a new ceiling. With a 2024 MPE of $68,500, the new ceiling will be $73,200 in 2024 and $78,000 in 2025.[1]

What is the potential impact? Under the old rules, those retiring at age 65 in 2023 could receive a maximum annual CPP/QPP benefit of $15,460.[2] Under the new rules, this would increase to $23,490, or by over 50 percent. Consider also that this doesn't account for the 0.7 percent per month enhancement for those delaying benefits after age 65, which further increases the benefit. Studies continue to show that deferring to age 70 may be a financially wise choice should you live beyond average life expectancy.[3]

However, it will take time before the full impact is realized. Those retiring in the near term will see only modest enhancements since benefits are based on an average of the best 40 years of earnings. For details on the CPP changes, see: https://www.canada.ca/en/services/benefits/publicpensions/cpp/cpp-enhancement.html or for QPP: https://www.rrq.gouv.qc.ca/en/programmes/regime_rentes/Pages/regime-supplementaire.aspx

1. For 2024, 107% of MPE; for 2025, 114% of MPE;
2. For Q1 2023, $1,306.57 under the old regime less $18.24 enhanced benefit = $1,288.83. www.advisor.ca/tax/tax-strategies/what-clients-should-know-about-the-cpp-reforms/; www.canada.ca/en/revenue-agency/news/2023/05/the-canada-pension-plan-enhancement--businesses-individuals-and-self-employed-what-it-means-for-you.html
3. www.fpcanada.ca/docs/default-source/default-document-library/fpw/globe-article-delay-cpp.pdf

Higher for Longer Interest Rates: How Will This Impact Equity Markets?

Since the summer, bond yields have risen rapidly. In April, the U.S. 10-year Treasury yield hovered around 3.3 percent; by October, it hit 5 percent for the first time in 16 years. This is a substantial increase in just six months. Many market observers suggest this indicates that the bond market has accepted that interest rates will be kept higher for longer.

Stronger labour markets and relatively resilient economies have put upward pressure on inflation. The central banks have been using interest rates as the main tool to temper inflation, signalling they intend to keep rates at sustained levels as long as the economic data is robust. Of course, should there be an economic downturn, there is room to lower rates to stimulate growth.

Higher rates have been bad news for borrowers — the rapid rise has been particularly difficult for those holding larger debt positions like mortgages. However, the positive news for investors is that the income component of "fixed income" is back: Yields that shrunk to historical lows have risen to heights not seen in decades.

If interest rates continue at higher levels, how will this impact the equity markets? First, it's worth remembering that both the economy and the equity markets have been remarkably resilient given the speed and magnitude of the rate hikes since early 2022.

One market analyst recently looked at the performance of the S&P 500 Index at different interest rate and inflation levels and it may provide some perspective. The best future returns have come after periods of very low and very high starting interest rates, as measured by 10-year Treasury bond yields. The average 10-year yield since 1926 is 4.8 percent, similar to where we are today.

S&P 500 Returns Based on Starting Interest Rates, Since 1926[1]

Starting Yield	+1 Year	+5 Years	+10 Years	+20 Years
0 to 2%	15.4%	103.6%	260.0%	1,452.7%
2 to 4%	13.6%	75.2%	213.7%	835.3%
4 to 6%	6.3%	34.7%	77.2%	420.7%
6 to 8%	9.9%	69.3%	175.6%	766.2%
8% or more	17.6%	110.6%	353.9%	1,249.3%

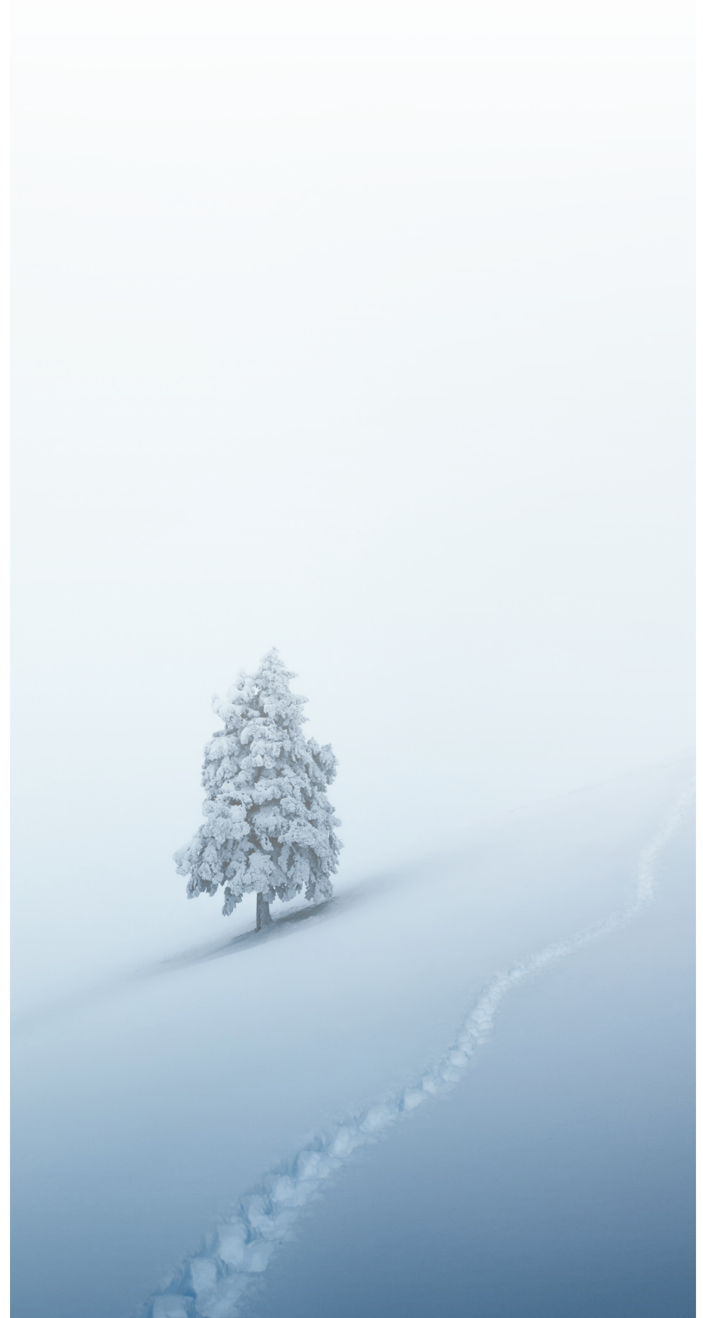
With inflation, the best future returns have come after periods of very high starting inflation levels; the average inflation rate since 1926 being around 3 percent.

S&P 500 Returns Based on Starting Inflation Rates, Since 1926[1]

Starting Inflation	+1 Year	+5 Years	+10 Years	+20 Years
<0%	16.3%	61.4%	149.5%	656.6%
0 to 2%	13.4%	64.3%	159.4%	583.7%
2 to 4%	12.8%	35.0%	172.1%	650.4%
4 to 6%	4.3%	60.1%	235.1%	774.7%
6 to 8%	11.3%	96.7%	319.3%	1,418.5%
8% or more	13.1%	107.9%	346.3%	1,648.4%

Why is this the case? Consider that during this time we've only had one period of extremely high interest rates and two very high inflationary periods (post-war 1940s and the 1970s), but each of these was followed by significant bull markets. Periods viewed as historical outliers may be "*scary while you're living through them but also tend to produce excellent entry points into the market.*"Comparatively, in a more "normal" economic environment, forward returns may appear muted because economies generally expand more gradually, with less interruption, alongside stock prices. Also worth remembering: Changes to rates and inflation may create market volatility in the short run, but consider the 10- and 20-year returns in the charts above — a longer time horizon can yield impressive results. Time continues to be an investor's great ally.

1. https://awealthofcommonsense.com/2023/10/higher-for-longer-vs-the-stock-market/



RRSPs & RRIFs: Be Aware of Taxable Withdrawals

As the cost of living has risen substantially over the past couple of years, some may consider accessing funds from the Registered Retirement Savings Plan (RRSP) or Registered Retirement Income Fund (RRIF). Yet, early withdrawals may be costly. Here are two reasons why:

Tax Implications — Consider that any withdrawal is subject to tax and must be reported as income on a tax return. For the RRSP and any RRIF amounts above the required minimum withdrawal, there is also an immediate withholding tax. If you are accessing funds to pay down short-term debt, you may end up paying more tax on the withdrawal than you'll save in interest costs.

> **Don't Overlook the Opportunity for Tax-Advantaged Growth**
>
> **RRSP Deadline:** February 29, 2024, for the 2023 tax year, limited to 18 percent of the previous year's earned income to a maximum of $30,780.
>
> **2024 TFSA Dollar Limit:** $7,000, for a total eligible lifetime TFSA contribution amount of $95,000.

For RRSP holders, early withdrawals may have additional tax implications. If your current income is higher today than in the future, you may be paying higher taxes today. You will also forego the opportunity for continued tax-deferred compounding, perhaps the most beneficial aspect of the RRSP: A 35-year-old who withdraws $18,000 from the RRSP would have $100,000 less in retirement savings by age 65 at an annual return of 6 percent. Notably, once you make a withdrawal, you won't be able to get back the valuable contribution room.

Asset Values — Market volatility in 2023 put many asset values under pressure. Keeping funds within these plans can be beneficial to allow asset prices to recover.

RRSP Withdrawals: Alternatives to Consider

For those saving for retirement, if funds are needed, consider accessing other accounts, such as the TFSA, where contribution room resets itself at the start of each year. Consider also that the RRSP may allow for tax-free withdrawals and recontribution for qualified home purchases or educational purposes via the Home Buyers' Plan or Lifelong Learning Plan. For more information, contact the office.

RRIF Withdrawals: Ways to Minimize the Impact

For those in retirement, allowing funds to remain in the RRIF may be challenging since minimum withdrawals are required each year. However, here are some ways to minimize the impact:

Withdraw at the end of the year — This may allow greater time for asset values to recover. Making withdrawals at the end of each year also allows for a longer period for potential growth within the plan.

Make an "in-kind" withdrawal — If you aren't in need of funds, with an "in-kind" withdrawal for the required amount you will continue to own the security. While the fair market value at the time of withdrawal will be considered income on a tax return, if transferred to a TFSA (subject to available room), any future gains will not be subject to tax.

Split RRIF income with a spouse — RRIF income qualifies as eligible pension income for pension income splitting. If you have a lower-income spouse and you're 65 or older, you can split up to 50 percent of your RRIF income to reduce your combined tax bill.

If you are turning age 71 in 2024, here are additional options...

Make the first withdrawal next year — You aren't required to make a withdrawal in the year that the RRIF is opened. You can wait until the end of 2025, the year in which you turn 72, to make the first withdrawal.

Base withdrawals on a younger spouse's age — If you have a younger spouse, use their age to result in a lower minimum withdrawal rate. This can only be done when first setting up the RRIF, so plan ahead.

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