Krahn Wealth Advisory Group Newsletter

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Bull and Bear: Tortoise or Hare?

During strong market times like we experienced in 2024, or times of uncertainty, are you inclined to be more like a tortoise or a hare? As we begin another year, it's a perspective worth remembering: meaningful growth is often measured over decades, not months or even years.

In the excitement of the bull market's run in 2024, Warren Buffett's Berkshire Hathaway became the eighth U.S. company to join the trillion-dollar valuation club.[1] It's worth stepping back to put the magnitude of "a trillion" into perspective: A million seconds is just under 12 days. A billion seconds is around 32 years — roughly one-third of a lifetime. Yet, a trillion seconds is nearly 32,000 years — more than all of recorded history!

For companies achieving this milestone, success didn't happen overnight. Buffett's feat is nearly six decades in the making. When he took control in 1965, Berkshire Hathaway was a struggling textile mill valued at around $22 million.[2] Over the years, it has been fueled by time, compounding and perseverance, with profits reinvested into new investments, allowing the company's value to substantially grow. However, this success hasn't come without challenges: Buffett once suggested that the "dumbest stock" he ever bought was, ironically, Berkshire Hathaway. And, he has acknowledged plenty of other "mistakes" along the way.[3]

Buffett's journey may be reminiscent of the old Aesop's fable, where the slow-but-steady tortoise wins the race against the speedy-but-inconsistent hare. In investing, it's easy to become preoccupied with short-term expediencies. Current concerns — like Canada's declining productivity and lagging economic growth, or new questions about how far equity markets have advanced — often act to distract our investment focus. However, longer-term investors shouldn't fixate on what might happen tomorrow as this tends to be largely unpredictable. It can also strain our investing 'constitution' and shift focus away from longer-term plans. Just look at how much has changed in one year: we shifted to a falling rate environment, expectations of a hard landing evolved into a soft landing, inflation largely tempered and, despite many challenges, the markets continued to advance.

While the double-digit market returns of 2024 have been exciting, they are a reminder that growth in both markets and economies is rarely linear. Viewing investment timeframes over decades highlights the profound impact of time on compounding growth. Investing $100,000 today at an average annual return of 5 percent, a fair expectation over a full market cycle, would yield around $115,000 in 3 years. Yet, over 6 decades — mirroring Buffett's perseverance — it would grow to nearly $1.9 million!

Where will we be in a decade? With a focus on the longer term, a strong case can be made that both markets and economies will continue to advance. This doesn't mean that downturns or setbacks won't occur along the way, but viewing the wealth journey over longer periods allows us to view a full cycle of events — and the substantial opportunity should we choose to participate. While there's never any guarantee of what tomorrow will bring, the only way to miss out on future growth is to sit on the sidelines. Here's to a new year, the next quarter century — and beyond!

1 https://www.visualcapitalist.com/berkshire-hathaway-1-trillion-club-how-long/
2 https://www.berkshirehathaway.com/letters/1985.html; More than 99 percent of his fortune was accumulated after age 50: In 1980, BRK-A closed at $380; today it trades around $700,000 — a staggering 184,000 percent or a CAGR of 19 percent
3 https://www.cnbc.com/2017/12/15/warren-buffetts-failures-15-investing-mistakes-he-regrets.html

NATIONAL BANK FINANCIAL WEALTH MANAGEMENT

KRAHN Wealth Advisory Group

Debunking the RRSP/RRIF Myths

Since the start of the millennium, participation in the Registered Retirement Savings Plan (RRSP) has declined, dropping from 29.1 percent of contributing taxpayers in 2000 to just 21.7 percent in 2022. While the introduction of the Tax-Free Savings Account (TFSA) in 2009 may be partly responsible, persistent misconceptions about the RRSP likely play a role. Let's address some of the common myths:

Myth 1: Non-registered accounts are better because only income/gains are taxed. A common belief is that a non-registered account yields better outcomes because only income and gains are eventually taxed (with favourable tax treatment for dividends and capital gains), whereas RRSP withdrawals are fully taxed at marginal rates. While it's true that withdrawals (usually from a Registered Retirement Income Fund (RRIF)) are fully taxed as income, what is often forgotten is the initial tax deduction at contribution. Remember that a $30,000 RRSP contribution is equivalent to an after-tax contribution of $18,000 at a marginal tax rate of 40 percent. If your tax rate remains the same at the time of contribution and withdrawal, you effectively receive a tax-free rate of return on your net after-tax RRSP contribution (see chart). In many cases, even if your tax rate is higher at the time of withdrawal, you may be better off versus a non-registered account due to the effect of tax-free compounding over longer time periods.

Myth 2: It's better to invest in a TFSA than the RRSP. The RRSP generally yields a greater benefit if you expect a lower tax rate in retirement. In practice, many contribute to their RRSP during higher-income working years and withdraw when income (and tax rate) is lower in retirement, leading to an advantage for the RRSP. Of course, there may be situations when the TFSA is a better choice, such as if you have a higher tax rate at withdrawal or face recovery tax for income-tested benefits like Old Age Security.

Myth 3: Saving too much in an RRSP/RRIF will result in a large tax bill at death. While the fair market value of the RRSP/RRIF at death is generally included in the terminal tax return and taxed at marginal rates, there may be ways to mitigate the potential tax burden. This includes a tax-deferred rollover to a spouse or financially dependent (grand)child. Another way to manage the potential tax bill is to engage in a "meltdown strategy," making withdrawals earlier when your tax rate may be lower than you expect at the year of death. For more information, please call the office.

RRSP vs. TFSA vs. Non-Registered Account (Illustrative)

	RRSP	TFSA	Non-Registered
Pre-tax income contribution	$30,000	$30,000	$30,000
Tax on income @40%*	–	($12,000)	($12,000)
After-tax contribution	$30,000	$18,000	$18,000
Growth: 30 years @5% annual return	$129,658	$77,795	$77,795
Tax on liquidation of account @40%**	($51,863)	–	($11,959)
Net after-tax proceeds	$77,795	$77,795	$65,836
Gain vs. non-registered account	**18.2%**	**18.2%**	**–**

*For the RRSP, assumes tax deduction of 40% is claimed to net taxes to zero.
**Assumes capital gains for the non-registered account, taxed at a 1/2 inclusion rate or 50%.

Start Now to Make 2025 Less Taxing...

As we begin a new year, why not get ahead and make the year less taxing? Here are a handful of reminders to start the year:

Contribute to the RRSP. The deadline for the 2024 tax year is **Monday, March 3, 2025,** limited to 18 percent of 2023 earned income to a maximum of $31,560 (2024). Deferring the deduction may provide tax-planning opportunities: you can choose to delay the RRSP deduction to a future year, perhaps one in which you have a relatively higher income to offset the higher potential tax.

Fund your TFSA. The **2025 TFSA annual dollar amount is $7,000,** bringing the eligible lifetime contribution limit to $102,000. The latest statistics show that high-net-worth taxpayers have, on average, over 34 percent of unused contribution room.[1] Have you fully maximized this tax-advantaged account?

Split income, save tax. Review your family's potential tax bill to determine if there are income-splitting opportunities. For example, you may elect to split eligible pension income with your spouse (partner) on your tax return. Spouses may also apply for CPP pension sharing. There may be an opportunity to open a spousal RRSP. Business owners may consider paying reasonable salaries to spouses/children for services provided to a self-employed business or private company. For ideas, call the office.

Get organized for tax season. While personal income tax returns will not be top of mind for a few months, why not

organize your records before crunch time approaches? This may prevent medical expenses, donations, business charges and other receipts from being overlooked or unclaimed.

Keep in mind that bare trusts are exempt from the 2024 filing. There has been much confusion surrounding the trust reporting rules that came into effect last year as they relate to bare trusts. This was complicated by a last-minute reversal by the CRA in late March 2024 that exempted bare trusts from filing for 2023. Since then, draft legislation has been introduced that "more clearly defines beneficial ownership arrangements subject to the reporting rules." If this passes, trusts with a fair market value of $50,000 or less throughout the year will be exempt from filing. If all parties to the trust are related, the exemption rises to $250,000 if only certain assets are held, such as GICs, stocks, bonds, mutual funds or ETFs. This will apply to bare trusts with years ending December 31, 2025, and later. For the 2024 tax year, bare trusts are exempt from filing.

1 2024 TFSA statistics for the 2022 year, with HNW taxpayers (defined as taxpayers with income over $250,000) having $28,064 of available contribution room (lifetime contribution room of $81,500).

To Start the Year: Five Wealth Planning Questions & Rules of Thumb

Happy New Year! If you're seeking a bit of financial motivation, here are five wealth planning questions that can be addressed with simple "rules of thumb." They may spark discussions about wealth management, budgeting or family and estate planning — and might even inspire better financial choices for you or your family members:

1. How long will it take for my investments to grow?

The Rule of 72: In the investing world, the Rule of 72 is used as a simple way to estimate the time it takes to double an investment based on a constant rate of return. Dividing the number 72 by this rate of return determines the approximate number of years it would take to double. For example, for a 6 percent rate of return, it would take approximately 72÷6, or 12 years. This rule serves as a reminder of the power of compounding and the importance of staying invested for the long term. At a rate of return of 6 percent, even if you've reached the respected age of 70, based on the average life expectancy you're likely to see your funds double — and twice still if you become a centenarian!

2. Am I on track with my wealth accumulation?

The Net-Worth Indicator: This measure, developed by the authors of "The Millionaire Next Door," estimates expected net worth based on household income. Multiply your age by your pre-tax annual household income (excluding inheritances) and divide by ten. This result is your expected net worth. If your actual net worth is more than twice this figure, you are considered a "prodigious accumulator" of wealth; if it is below, you are considered an "under-accumulator."

3. What portion of my budget should go toward saving?

The 50-30-20 Budgeting Rule: This rule divides after-tax income into three buckets: 50 percent to "needs," 30 percent to "wants" and 20 percent to "savings." Needs include essentials like housing, utilities, food, transportation, healthcare and childcare. Wants are non-essentials, like memberships, entertainment and hobbies. Savings include investment and debt repayment. If you hold debt, it may be wise to allocate more to repayment, given higher borrowing costs.

4. How much of my income should go toward housing?

The "Rule of 30" for Home Purchases: In the past, a general rule of thumb suggested the price of your home should be no more than three times your annual gross income. However, with skyrocketing housing prices, this rule of thumb may be largely outdated. Instead, the "Rule of 30" suggests limiting total annual housing costs (mortgage payments, insurance, property taxes, maintenance, etc.) to 30 percent of gross income. This guideline helps frame a purchase decision, especially for younger buyers, to avoid the risk of financial strain or vulnerability in the event of unexpected changes.

5. When should I be having discussions with elderly parents?

The 40/70 Rule for Aging: This simple rule of thumb encourages discussions about aging-related matters, suggesting that these conversations should begin between adult children and aging parents once the child reaches the age of 40 or the parents turn 70. By having these conversations early — while parents are still healthy and capable — families can address topics like future care, living arrangements, finances and end-of-life decisions before a crisis arises.

Of course, these rules are informal guidelines designed to offer broad advice and encourage thoughtful planning — they are oversimplified and intended to be general in nature. However, they can serve as helpful starting points and high-level guidance when managing finances and building wealth for the future.

For a deeper discussion on these, or any other aspects of wealth management, please contact the office.

More Perspectives: The Great Mortgage Renewal — Pay It Down Faster

For many years, historically lower interest rates made it easy to take on debt, particularly in the form of mortgages. While the Bank of Canada reduced interest rates multiple times in 2024, mortgage rates remain at higher levels than the low rates of 2020 and 2021. If you or your family members hold a mortgage, the higher interest costs may prompt you to consider paying it down more quickly.

Here are a few considerations. As always, check your mortgage terms to ensure that penalties don't apply.

1. Buy within your means — Before committing to a mortgage, consider whether it is comfortably affordable. Plan for contingencies, such as the possibility of a temporary loss of income. Mortgage payments should be manageable alongside other living costs, especially as inflation has increased many expenditures. Potential future expenses, like those associated with having a family (childcare or post-secondary education), might also be factored in.

2. Make regular payments — This may seem obvious, but some skip payments. Making regular payments is especially important at the beginning of the mortgage when the principal amount is high and the mortgage's interest is a large component. Missing payments can lead to additional fees and interest charges — and negatively impact your credit score.

3. Set up "accelerated" weekly/bi-weekly payments — Accelerated payments allow for extra payments to be made against the principal as part of the regular payment stream — equivalent to an extra monthly payment per year. This will not only reduce interest costs but also shorten the amortization period — the time it takes to pay down the mortgage.

Example: $330,000 Fixed-Rate, Five-Year Mortgage at 5.2%

Payment Type	Amount	Amortization	Interest Cost
Monthly	$1,957.04	25 years	$257,112.05
Bi-Weekly	$902.74	24.8 years	$256,779.79
Accelerated Bi-Weekly	$978.52	21.2 years	$214,258.10

https://itools-ioutils.fcac-acfc.gc.ca/MC-CH/MCCalc-CHCalc-eng.aspx

4. Overpay payments — Consider rounding up payments if you get a raise at work or have extra spending money on hand. It may be surprising how additional dollars added to weekly payments can impact a mortgage over the long run.

5. Don't forget about the annual lump sum option — Many mortgages allow for paying an additional annual lump sum. Extra funds, such as a work bonus, inheritance or a tax refund from an RRSP contribution can be used to make a one-off payment.

Looking to Renew or Secure a New Mortgage?

Here are a handful of tips that may help secure a better rate.

Start early. Give yourself time to shop around for competitive rates. Keep in mind that not all brokers have access to every rate, so don't hesitate to reach out to multiple lenders or brokers.

Credit score. A strong credit score — usually 700 or higher — may improve your chances of getting a better rate. A higher score signals reliability to lenders, which can work to your advantage.

Mortgage size. Lenders often favour larger mortgages, which may increase your chances of securing a better rate. Consider this when negotiating.

Closing date. The sooner your closing date, the better your position to negotiate. Lenders may be more motivated to offer competitive rates with a quicker closing.

Investing Resolutions From the World's Best Investors

Happy New Year! As we begin another year, here are five investing resolutions and words of wisdom from the world's best investors:

> *"Sometimes the tide is with us, and sometimes against. But we keep swimming either way."* — Charlie Munger

1. Keep swimming. It's easy to feel confident when the tide is in our favour, as it was in 2024. Yet, Munger often emphasized the importance of discipline: keeping a steady stroke regardless of market conditions. Staying invested through the highs and lows, and resisting the urge to overreact to short-term tides, can be key to longer-term success.

> *"The best time to plant a tree was 20 years ago. The second-best time is now."* — Proverb

2. Don't overlook the value of time. After the rapid gains of 2024, it may be easy to overlook the importance of time and patience in investing. Meaningful growth is often measured over decades, not merely days or even years. Starting today, even a modest contribution like $19 per day can yield remarkable results. At an annual rate of return of 6 percent, this small daily amount could grow to over $1.1 million in 40 years — a powerful reminder of the impact of time.

> *"All these noises and jumping up and down along the way are really just emotions that confuse you."* — John Bogle

3. Pay less attention to the noise. On average, we're staring at our screens almost 7 hours a day, amounting to over 17 full years of our lifetimes! While the news we're being fed has always leaned negative to capture attention, this negativity has increased. This may explain why both economic and non-economic sentiment have declined over the last 50 years despite fewer economic setbacks.[1] Focusing too much on tomorrow's uncertainties is counterproductive: it often involves factors beyond our control, causes investors to make hasty decisions and shifts attention away from longer-term plans.

> *"Do not save what is left after spending, but spend what is left after saving."* — Warren Buffett

4. Save more. Saving is among the few elements of investing within our control, unlike factors such as stock market fluctuations, interest rate changes or the timing of economic downturns. Moreover, it is a fundamental pillar in the process of wealth accumulation. Building wealth is possible even with a modest income, yet it becomes improbable without a commitment to saving.

> *"Any sound long-range investment program requires patience and perseverance. Perhaps that is why so few investors follow any plan."* — John Templeton

5. Have confidence in your plan. In our work as advisors, we are here to provide support at every stage of the investment journey to help you achieve your goals. Research continues to show that investors who work with advisors build more wealth over time, with success driven by key factors including asset allocation, savings discipline and coaching to avoid costly mistakes.[2] Have confidence in your plan, and continue looking forward.

1 https://www.ft.com/content/af78f86d-13d2-429d-ad55-a11947989c8f
2 https://www.ific.ca/wp-content/themes/ific-new/util/downloads_new.php?id=27821&lang=en_CA

Where Are Equity Markets Headed? Be Defensive With Dividends

> *"Dividends are like plants. Both grow. But dividends can grow forever, while the size of plants is limited…"*
> — Ed Yardeni, Market Strategist

With the strong performance of U.S. technology stocks, dividend-paying stocks have received less attention as investors focus on earnings growth. However, many are beginning to question whether this momentum is sustainable. As economies and markets show signs of slowing, a more defensive investment approach may be necessary — and this is where dividend investing can provide value.

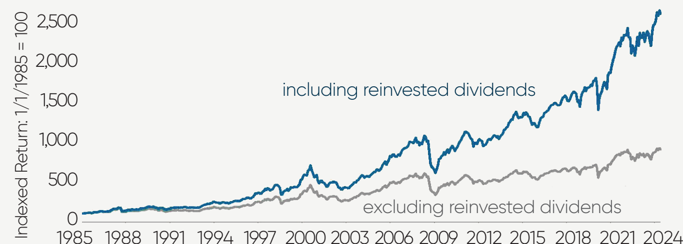
While recent market trends have favoured growth stocks — companies that typically prioritize reinvesting profits back into their operations rather than distributing them — here are a few reminders of why dividends continue to play an important role in our portfolios.

Dividends have historically contributed a significant portion of equity returns. Studies show that at least 60 percent of North American total returns have come from dividends in the past century.[1] Reinvesting dividends can also significantly enhance returns. Since 1985, S&P/TSX Composite reinvested dividends yielded three times the return of relying solely on price performance.

Dividends provide other benefits, including:

- **Reliable income stream.** This is particularly beneficial for those investors approaching retirement.
- **Potential inflation hedge.** Companies regularly increasing dividends often keep pace with inflation.
- **Reduced volatility.** Many dividend payers are mature, stable businesses with predictable cash flows and may be less susceptible to price volatility. Dividends can help smooth out price swings, providing a cushion during difficult market times.
- **Long-term financial stability.** Consistent dividend payments can indicate a company's solid financial health and commitment to sustaining shareholder value. Quality companies that prioritize dividends often have robust balance sheets, helping to weather prolonged market downturns.

Power of Dividend Reinvestment: S&P/TSX 1985 to 2024 (July)



The potential tax advantage should not be overlooked. In non-registered accounts, eligible dividends are taxed at a lower rate than interest or regular income, thanks to the federal dividend tax credit. An article from years ago in **The Globe & Mail** is worth recounting: "How to earn $52,000 tax free — no offshore account required." It highlighted a lesser-known advantage of the dividend tax credit: the ability to earn up to $52,000 in tax-free income from eligible dividends, depending on province.[2] While this amount has increased to $55,704 for the 2024 tax year, note that with no other sources of income, the dividend tax credit and the basic personal amount can effectively reduce taxes on eligible dividends to zero (chart).

2024 Eligible Dividend That Can Be Received Tax Free[2]

Province	Tax-Free Amount	Province	Tax-Free Amount
BC	$55,704	QC	$50,792
AB	$55,704	NB	$55,704
SK	$55,704	NS	$32,402
MB	$39,980	PE	$53,551
ON	$55,704	NL	$28,417

Assumes only "eligible dividend" income is earned and no other sources of income.
https://assets.kpmg.com/content/dam/kpmg/ca/pdf/2024/08/ca-tax-facts-2024-2025-en.pdf, page 43.

In short, we continue to advocate quality dividend-paying securities to support investing programs.

1 https://privatewealth-insights.bmo.com/en/insights/market-insights/investment-strategy-july-2024/
2 https://www.theglobeandmail.com/investing/education/article-how-to-earn-52000-tax-free-no-offshore-account-required/

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