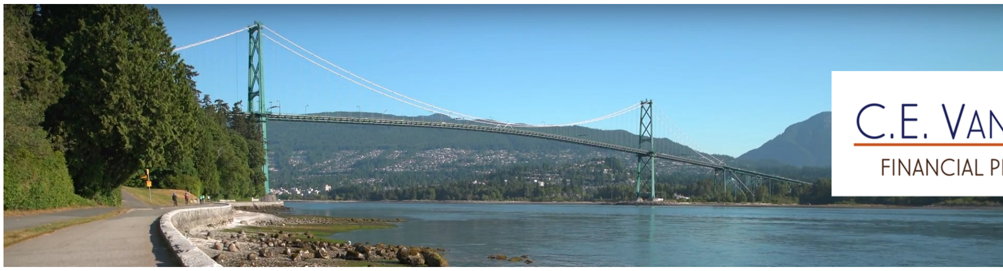

C.E. Vandenberg & Associates Inc.

Financial Planning – Wealth Management – Insurance

mutual gains

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2022: The Year Inflation Subsides?

Seeing the cost of things go up is a very long term historic trend. If you have been around for a while, all you have to do is look at the price of what you paid for your 1st car or house, post secondary education years ago, the hourly wage for your 1st job, the price of a ticket to see 1st Star Wars at the theatre in 1977, a concert ticket stub from the 80's or what a Big Mac used to cost (when you actually ate them). The difference between all of those prices then and today is the result of inflation.

The US has hit a 39-year high in annual inflation, at 6.8%. 1982 was the last time it hit that. At that time it was well on its way down from the 13.55% peak it reached in 1980.

That time was very different than today. We have a significant amount of debt that has accumulated over the past few decades. In the long run that is deflationary because debt payment reduces the ability to purchase goods and services. Along with that we are in the early innings of some new types of technological improvements; these increase productivity, another inflation dampener.

The big question today is, will it subside soon? For the past several months "transitory" has been the word most commonly used to describe current inflation. I read or listened to economists and investment strategists at a few different firms in the fall of last year, including ex-US Fed Chairman Ben Bernanke. At that time it was expected that inflation would peak mid-2022. Since then it seems the timeline has been pushed a bit further out; however, the prognosis for inflation is for it to moderate back close to where we were before Covid hit.

No matter what inflation does, the reality remains that it is a pricing pressure that continues. That is actually good since very modest inflation is needed for the economy to work most efficiently. Since it is almost always at play, it needs to be factored into your long term financial plans. We do that in all our client financial projections, whether it be for funding kids' post secondary education years down the road, or for retirement income projections. Prices can change dramatically over 20 or 30 years. You don't want to get behind because it is very hard to catch up; if ignored long enough, it may even become impossible.

Factoring in inflation to financial planning is much like what a structural engineer does designing a bridge. Possible stresses have to be accounted for because we don't really know what will happen. We can only factor in what are the most possible things that could happen. Inflation should return to a more

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We will listen carefully
to what you are saying
and be attentive to your desires
as well as your fears
so together we can build
and enjoy
a harmonious
and responsive relationship
in attaining your life's dreams
and through that
We will be attaining ours.

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normal historic range; however, a good financial plan connected to a well balanced portfolio takes probabilities into account.

How Getting 1.5% / Year Is Actually Losing 2.8% / Year

	Inflation rate			
Tax rate	1%	2%	3%	4%
25%	1.33%	2.67%	4.00%	5.33%
30%	1.43%	2.86%	4.29%	5.71%
35%	1.54%	3.08%	4.62%	6.15%
40%	1.67%	3.33%	5.00%	6.67%
45%	1.82%	3.64%	5.45%	7.27%
50%	2.00%	4.00%	6.00%	8.00%

I came of age (18) when inflation and thus interest rates, hit the highest they have ever been in the developed world. If you are in your mid to late 50's or older you probably remember that. It wreaked havoc in the economy and devastated housing prices, leaving borrowers hanging on for their lives.

This graph shows the rate of return you need at certain combinations of inflation and tax rates. For example, if you earn $50K to $86K you are paying close to 30% tax. $120K to 155K = 40%. If you are getting close to $200K or more you're in the 50% bracket. Take where you fall on the tax bracket side and slide your finger horizontally right to the 3% line. If you have any "non-registered" money (outside RRSP, RRIF, TFSA etc.), that is the amount you need to be earning on that money to just break even. In a "registered" plan it doesn't have to be that high because those monies can compound tax-free.

Original capital (purchasing power)	$100,000
Less 3% inflation	$ (3,000)
Purchasing power has been reduced to	$ 97,000
Nominal return ($100K @ 3%)	$3,000
Taxes ($3,000 @ 40%)	($1,200)
After-tax portfolio	$98,800

The fact is, your "real return" (what your money is earning after tax and inflation) is the most important metric to determine if you aren't losing money. The basic numbers for 1 year show this in the graph on the right. Yes, it can be comforting to have your $100,000 on your statement go up by even a small amount each year because you hate to see it fluctuate in value. However, don't try to fool yourself – you are losing money.

Why contributing To Your RRSP Can Create Big Wealth

I sometimes hear it argued that contributing to an RRSP is bad because you'll pay a whack of tax when you are forced to withdraw. Yes, that is true but you have many years of using the tax savings you got from the contributions to compound tax-free. This could mean 30—50 years of compounding. Here are some numbers using a tax rate of 40%:

On a $10,000 RRSP contribution you will get back $4,000 in tax. That means, if you contribute $10,000 when you are 30 years old, you will essentially be using this extra $4,000 to compound for 41 years; 41 years before you have to start taking a small amount out every year. $4,000 compounded over 41 years @ 6% per year = $43,612. That number is $0 if you didn't make that RRSP contribution, because you wouldn't have had that $4,000 to work with for those 41 years. Now, do that every year. The numbers are staggering.

The Real Estate Vs Company Investment Debate

Ownership in an asset that is highly needed and widely used in society, that you aren't overpaying for, is where you should be invested. Which is better? From cash on cash ROR (Rate Of Return) perspective, in broad terms, there is really no difference in historic returns (~10% / year). There are long periods of time when both property and shares in companies have gone up for several years and then, for a number of years are flat (take the 90's for BC housing as an example; mostly flat).

If you apply leverage (e.g. a mortgage on real estate), you will magnify the returns. You are using other people's money (the banks) to make money. However, you can apply the same principle to a diversified portfolio of shares in companies. If those investments pay out dividends etc. you can use that income (much like the rent on a real estate holding) to help fund your borrowing costs.

From a future return perspective, if you want to increase your net worth, there are a number of ways you can do it. Each has its own advantages. Use as many advantages as you can which fit best for your personal situation (tax level, how much time you want to spend managing your finances etc.), apply them prudently and you'll do just fine.

Book Value Is NOT What You Invested

Investment portfolio statements have many columns, but most want to know, what is my money worth and how much has it gone up? There are 2 columns that show numbers that appear to give this info; "Book Value" and "Market Value". Often, there is a percentage gain or loss between the 2. The natural inclination (and rightfully so) is for you to think that the Book Value is the amount of money you invested. It isn't. Book Value is NOT what you invested. The Book Value number is simply the "Adjusted Cost Base" (ACB). It is what you invested plus any interest, dividends and capital gains that have been triggered and reinvested. Every time interest and dividends are paid (and reinvested) and capital gains are triggered, it increases your Book Value. Book Value is only there as an accounting entry so you can determine what your tax would be if you sold your investment.

The further confusion is that this number shows in your RRSP, RRIF, TFSA etc. where it frankly isn't relevant. Financial institutions don't seem to want to do the work and list it only where it is applicable. This has been many a Financial Advisor's frustration for decades. I've had to explain this in many a phone call and meeting over the years because of this reporting fog. If you want the most recent full explanation you can read it in a BloG post (March 6th 2020).

How Much Should You Contribute To An RESP?

RESP's are something many parents use to help pay for their kids' post secondary education. In that vein, most people choose a "self-

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directed" (regular) RESP rather than a "Scholar Trust" or pooled RESP (the latter is highly inferior and I would stay away from those). This article will be regarding the most widely used RESPs because pooled RESPs generally will have much lower returns and give your child(ren) much less money to work with (or you'll have to put in way more money to get the same end result as a regular RESP).

How much you should contribute to an RESP can be answered by determining how much you will need to pay for your kids' education. To answer that, the 2 basic parameters I often use for client RESP projections are these: They will be going to a Canadian university, and the goal is only to pay tuition. A child 18 years away from going to post secondary education will need approximately $44,000 (assuming 5%/year return on the RESP, and that education costs will increase by 4% per year from now until then).

The total amount you need to save to cover that cost fully in 18 years is $111/month. The government will be adding another ~$28/month (20% of your contributions with the Canada Education Savings Grant or CESG). You'll be able to pay the full post secondary education bill using compounding on yours and the government's 20% add-on. I think that is very worth doing.

What if you can contribute more? I'd suggest the maximum you should put in the RESP is $2,500 / child per year. That will give you the maximum amount of grant, and there is lots of flexibility in withdrawing money, provided at least one of your kids goes on to post secondary. Only if you have topped up your RRSP and TFSA and have zero debt should you go beyond the $2,500 / child per year.

Eliminate Probate Fees By Naming Beneficiaries

Many people try to reduce or eliminate probate fees at all cost and without considering the risks they are taking do it. Yes, probate fees reduce the amount to the heirs of an estate, but you have to be prudent in how to do it (if at all). Only assets that are in a deceased person's name without a beneficiary designated are subject to probate, and it's the value of those assets that will be charged probate fees (for most people that will be just under 1.4%).

The assets where the most amount of probate fees are paid are principal residences, rental properties, bank deposits and non-registered investments. The reason for this is that the only assets that are charged probate are ones that don't have a beneficiary named on them, and you can't name beneficiaries on these.

However, there are many assets where beneficiaries can be named. These include RRSPs, RRIFs, TFSAs, RESPs, life insurance policies, and many investment and deposit accounts with life insurance companies. So if you want to reduce probate, I'd suggest 1st topping up your TFSAs and start moving any non-registered cash and investments to deposits and investments with a life insurance company. (But do this only if those assets can produce the same returns or better at the life insurance company.) In BC, probate is a one-time ~1.4% cost, so if you can earn more than enough to cover probate fees in a vehicle with no beneficiaries listed, go with that.

Choosing A Professional Executor Instead Of Your "Kids"

Virtually everyone I know chooses an adult child (1 or more) to be an Executor for their estate. There is another option and this could, in many cases, be the best choice for you—that is, a corporate executor. A corporate executor's services are available through a trust company, and many of these are simply subsidiaries of Canada's big banks.

So why go this route? There are many benefits, including: They have the knowledge and expertise. They don't have any other job but to settle estates, so it will be done in a timely manner. They are unbiased and can manage personality conflicts.

The biggest reason someone may not choose a corporate executor is the cost. The maximum any executor can change to divvy up an estate is 5% of the total estate value. Yes, even if a family member is doing the work, they can charge up to 5%. Most do it without compensation, seeing it as family duty. That 5% is a maximum and really only would be charged on a very complex estate. However, there is value in what a corporate Executor does when you simply consider the learning curve for a 1st time Executor (you?). Also, some beneficiaries are never happy no matter what, so those 2 hurdles alone could be well worth the cost.

What If You Can't Work Anymore?

If you could stop work today and be able to create a reliable monthly income from your current assets, you can skip this. (Although if there are people in your life (or who come to mind) who aren't in the same position as you are, I'd suggest maybe passing this on to them.)

So I ask those of you who still need their work income, "What if you can't work anymore? How will your current living standard continue?". For most of you not "financially independent", it couldn't. Some drastic changes would have to be made. You may have to sell your home and downsize significantly. Perhaps you would move in with family who have room to house you – along with a wide range of expense cutting? The fact is, according to a 2017 StatCan report, 22% of the population has some kind of disability. Of course, that doesn't mean that if you have a disability you can't be employed to your full abilities. But according to those same stats, almost 10% of the population has a severe or very severe disability. Of those, most are related to pain, mobility and mental health. Stats however are cold. I'd suggest simply picturing one of the income earners in your household not being able to earn an income – which is a very real possibility and relatively high probability. What would be the reality for your life then?

The other way you can cover a significant income disruption bump in your life is through Critical illness insurance. Should you need to cover costs for several months or even a couple of years, CI insurance will pay you a lump sum of cash to give you the $50 to $100K (or more) cash injection that you may need. This would be much better than digging yourself backwards by having to use your line of credit or pull money out of your RRSP. Doing that could put you in a hole that could take several years to dig out of.

Tech Gems—Downie Live (YouTube)

Going by the last 3 Tech Gems I've featured, I think you'll notice I've been watching a variety of stuff on YouTube lately. If you love travelling and even if you just like to experience travel through other people, you'll want to check out Downie Live. Mike Downie, a Vancouver guy who loves to travel, started his channel just over 5 years ago. When Covid hit he had to narrow his scope to the Vancouver area and places around BC. You'd be amazed at what you'll discover by watching these. He has further expanded to include his most recent feature, a multi-week train trip across Canada. CHEK TV loved the idea so much, they reached out to Mike to ask him if they could feature it on their network. Mike has a highly infectious personality; I think he could be the next Rick Steves.

P.S. My youngest son Marcus (who has his own YouTube video, Roads Untravelled) borrowed our offices one night to have Mike prepare a podcast a few years ago (which I found out after I discovered DownieLive).

HHHMMM...

• Over its history, the S&P 500 index is more likely to experience a 20% up year than a negative one of any amount. Furthermore, since 1950 the S&P has posted a calendar-year gain of 20% or more 19 times and, on 16 of those occasions, the following 12 months produced a positive result with an average return of about 12% / year. Dixon Mitchell Investment Counsel, Jan. 2022

• An investment going up in price doesn't mean it is more expensive. It can actually be cheaper if its earnings have risen faster than the share price. This is why you can't simply use the fact that an investment has gone up as a reason that it should fall in price.

• The ghost of the tech bubble could soon come back to haunt investors as hefty valuations may be threatened by the likely tightening of monetary policy. The S&P 500's long-term PE ratio, which compares the current price with the 10-year average real earnings per share, has reached 37, a level last seen in 2000. IPC Daily Update, Dec. 2021

• Buying or investing in something at a good price involves less uncertainty and much less risk to your money than buying predictions.

• A couple of the Covid lockdown investment darlings have fallen from their peaks by ~76% over the past 12 months and 68% over the past 15 months, respectively.

• The net worth of American households has increased from $110 trillion at end of the 1st quarter of 2020 to $137 trillion by the 3rd quarter of 2021; up 24.5% in less than 18 months. These gains have not been equally distributed. Nevertheless, this accumulation of savings and wealth (in addition to soaring income growth) represents much potential future consumption (and societal anger?). Forstrong Global, Jan. 2022 #GovernmentHandouts #Inflation?

• Canada's debt relative to GDP has expanded more than is the case in any other country in the world. Australia, for example, a fairly close economic peer to Canada, has borrowed about half as much as we have since the beginning of the pandemic. Dixon Mitchell, January 2022

• The Canadian unemployment rate is at 5.9% which is just shy of the 5.7% pre-pandemic low. 65.3% of the population is participating in employment. If lockdowns are cutting jobs so much and the government still needs to dole out money, why isn't our unemployment rate higher? #InaccurateOr?

• What will help decrease inflation is to get consumers to spend a little less on Amazon packages (and things that have to be shipped from China) and more on restaurant meals, hotel rooms, movie theatres and live entertainment. Those are all sectors that still have a lot of excess capacity. If consumers buy fewer material goods and do more outside their houses (which should happen when omicron fades) they will both drive economic growth and help cool inflation. Advisors Edge, Jan. 2022

• "We don't think used car prices in the U.S. will rise by 30% to 40% again. They could even fall by 30% to 40% over the next year." Doug Porter, Managing Director & Chief Economist, BMO, Jan. 2022

• 10 years ago Cheryl and I lived in a smaller house than today. In that house everything that required heat was fueled by natural gas. The combined bill for gas and electricity back in 2011 was $2,465.57. Our current house has baseboard heat with 1 gas fireplace. The gas and electricity bills last year (2021) totalled $1,815.05. Also, our fuel expenses for our car in 2021 vs 2011 (our current car gets poorer gas mileage), were lower as well. #NotAllCostsIncrease

• Quebec is planning to put a "significant" tax on unvaccinated people; taxing people on personal medical choices because they are putting pressure on a province's health care system. 60% of Canadians support this (recent Maru poll). Shouldn't they then charge other groups as well – such as those who indulge in higher risk sports and driving, ride a motorcycle, whose BMI index is above a certain level etc.? It is things like this that make me question if I'm living in Canada or not. #ThisIsCanada?

• Why answer a phone call from a number you don't recognize or where no caller ID is displayed? They'll leave a message and you can call back if it is legitimate. Don't let callers suck you in by using your curiosity against you. #DangerousCuriosity #DontAnswerIt

• Dan Carlin, one of the best historian storytellers, in his book "The End Is Always Near", looks at periods in history when it seemed like the world was coming to an end: wars, famines, pandemics, and societal collapses. #TheEndOftenSeemsNear

• "The man who does not read (good books) has no advantage over the man who can't read (them)." - Mark Twain

Carey

P.S. We have room to add a few new client households to those who we already do Financial Planning and Investment Management for. Email me carey@careyvandenberg.com to look at how we could be partnering together to make your life better... for the long term.