CEVA WEALTH
FINANCIAL PLANNING • WEALTH MANAGEMENT • INSURANCE

mutual gains

ISSUE NO. 215 May / June 2023

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.

Interest Rate Squeeze & Inflation

It has often been said that the solution to higher prices (inflation) is higher prices. This simply means that as prices get higher, eventually people find alternatives or simply refuse to spend the money. Prices moderate because demand drops. However, when people still buy what they want despite rising prices, higher interest rates serve as the brake. Higher borrowing costs make it less attractive to buy bigger ticket items and projects (houses purchases, renos, car loans etc.). Since last March, we have seen an almost unprecedented, rapid rise of interest rates. The effects of this have started the slowdown in rising prices.

It takes a while for consumers to feel this interest rate squeeze. This is primarily because such a large portion of debt is through fixed rate mortgages. As rates stay "higher for longer", eventually more and more people will face the reality of higher mortgage payments which will in turn, force households to cut spending.

Let's look at a $500,000 mortgage, which is relatively small for anyone buying their 1st home in a major urban centre in Canada. In February 2022, only 15 months ago, you could get a 5 year fixed rate mortgage at about 2.7%. The monthly mortgage payments were $2,292.09. Fast forward to today when the cheapest 5 year mortgage rates are around 4.4%. Payments at that rate, for the same mortgage, would be $2,797 / month.

Where is the extra $500 / month going to come from? It will be from delaying major purchases like a newer car, a vacation, home renos, etc. If not that, then cutting back on meals out, swapping higher priced food for cheaper alternatives, renegotiating monthly services (cell phone), etc. Less demand and/or more competition for these things means price increases start to soften, which is what we have been seeing and will continue to see.

What does these mean on the investment front? Business has to adapt: more competitive pricing and eventually the weak fall off. We've seen signs of that already. In BC, from Nov. 2021 to Nov. 2022, bankruptcies have increased by 32.5%. There was a banking scare, triggered by a couple of US regional banks. All of these strengthen the future business prospects for the survivors.

This is very normal in this part of the economic cycle. Just like financially strong consumers, fiscally healthy businesses - particularly those with goods and services that are much needed and desired globally - will be the ones to pull even further ahead. It's these businesses you want to own now, in the late winter of an economic cycle (but only if the price is right; what the price it has sold for before doesn't mean anything). We still might see some economic

(Continued on page 2)

(Continued from page 1)

cold snaps; (bad news is actually good news when it comes to bringing down inflation) however, Spring is just around the corner.

The Best Place To Be (Today) Is In Smaller Companies

These "smaller" companies are generally those the market is pricing at $300 million to $10 billion and often fly well under the radar of the obvious, big names. One of the reasons for this has to do with the number of people who are closely scrutinizing smaller businesses versus much larger ones. The largest of companies has about 60 full time investment analysts in the US working full time on 1 business; 60 people each day looking at only 1 company and they do this every day. Because of that, there really is nothing that isn't known about the large, high profile businesses; the expected future is fully reflected in the share price.

A smaller company may have a maximum of 5 full time people in the US looking at it. That would be for a mid-sized company. The smaller a company is, the fewer the number of investment analysts dissecting it. The future big companies in the world always start as smaller companies. Smaller companies tend to grow faster and are cheaper because of the fewer eyeballs looking at them.

This situation of "fewer miners in the mine" is an ongoing advantage for finding undervalued investments. Today, smaller companies are especially underpriced when compared to larger companies. In fact, the pricing anomaly is even greater than it was when Covid shut the world down. Things might not feel great right now, but I think you'll agree that it's not nearly as bad as it was during the uncertainty of Spring 2020.

The 2 primary portfolio management (PM) firms we use for our clients' portfolios allocate a much larger percentage of their portfolio to these smaller companies. They are positioned that way simply because they are finding so much untapped value there. The 1 other PM firm we use specializes, and only invests in these smaller, very under-analyzed, companies and has done so since 1975.

Bonds Vs GIC's (Which Is Actually Better & Safer?)

I remember watching my 2 sons play soccer when they were really small. Everywhere the ball went a swarm of tykes followed. It was hilarious to watch at the time. Today, we are seeing a similar thing happen in banking. Many people are looking at what a bank is offering in a GIC (usually 3—4.5%), thinking they have struck gold.

The fact is, the interest rate ball is going to move and it is most likely a move down from here. You can tell that in advance just by looking at current GIC and mortgage rates. 1-year rates are generally higher than a 3-year rate, and a 3-year is higher than a 5-year. If you lock into a GIC you get the specified rate of interest and that is all. This is always the case when you simply lend your money out to a bank via a GIC. The alternative and better option (and it could be safer, which I'll get to in a bit), are high quality bonds.

Unlike GIC's, bonds can be bought at a discount to their maturity or "par" value. This usually happens when an economic slowdown or recession is imminent, which is definitely the case today. If you buy a bond for e.g. $90 and it matures in 2 years, you will get $100 plus the interest or "coupon" rate of the bond. So, if the bond has a coupon rate of 5% / year and you buy it at a discounted price (as I've outlined) and holding it to maturity, you will get over 10% / year. You'll get your 5% / year of interest (the coupon rate) and over 5% / year from buying it at $90 and then cashing it in at $100, when it matures. What if interest rates don't decrease? You'll we still be better off with bond because of the capital gains. As well, corporate bonds in general, at any level of interest rate pay a higher rate than you'll get at the bank.

That isn't all. With both a GIC and a bond, you are lending your money out. What you have to consider closely is who you are lending your money out to. For any bank account that has over $100,000, you have no guarantee on that money. You are in essence, buying a bond of the bank because you have no guarantee on any of the balance you hold, over $100,000. You have more upside buying a portfolio of bonds, PLUS you have more safety because you are holding a diversified portfolio.

2 Year Guaranteed Investment: Min. 0% to Max. 12.69% / Year

This kind of guaranteed investment comes across my desk every once in while. What I'm broadly referring to is a "market linked term investment". With these, you are depositing your money with a major Canadian financial institution which links your deposit to a predetermined portfolio of publicly traded companies.

With this particular deposit, should the portfolio of companies be worth less in 2 years than they are at the outset, you are guaranteed to get back what you originally invested. That is your absolute downside. However, if the share prices in aggregate are higher than today, you'll get the gains up to a maximum of 12.69% / year. This is also available in 3, 4 and 5 year terms with no stated limit on the potential increase to your investment.

I have used this kind of investment of almost exclusively for someone who is a US citizen or a resident in Canada, because holding a PFIC (which many Canadian investments are) is punitive. However, this investment can be appealing to many Canadians as well. I'm guessing you can see why. Deadline for deposits is May 19, 2023.

Your FHSA Starter Account

Although the FHSA (First Home Savings Account) is technically a new program in Canada, financial institutions across the country have yet to

(Continued on page 3)

make them widely available to those who don't own a home. As I have written about, FHSA's are a must account to set up for anyone who doesn't own a home, and we are doing what we can to help take advantage of this new and very attractive, tax refund generating, account (up to $21,600 in tax savings).

If you are one of the many non-home owners out there (and are looking at establishing a long term relationship with a Financial Planning office), we can set up an investment account for you to get your money working now. When the FHSA becomes available through any of the various financial institutions we deal with, we will get your FHSA set up and simply move your investment(s) "in kind" (as it is) into your new FHSA.

Get Your Tax Refund Every Month

Did you get a tax refund this year? Do you normally get a tax refund? If so, you are simply lending money to the government over the course of the year, and they are paying you 0% interest for that.

The root cause of a tax refund is routine tax deductions. These are often from RRSP contributions, deductible spousal support payments, interest on money borrowed for investment or business purposes, child-care expenses, and donations. Your employer is simply deducting income tax based on what you are earning, and hasn't taken your tax deductions into account. When you get a tax refund, you are simply getting back the money you lent the Canadian government over the past year.

You can eliminate that interest-free loan to the CRA by filling out CRA Form T1213, which is a "Request to Reduce Tax Deductions at Source". Complete it, send it in to CRA and, once approved, they'll let your employer withhold less tax from your pay-cheque. The end result will be that your monthly income going into your bank account will be higher. If you have been relying on that tax refund every year, take that extra money you now have, set it aside and earn something on it. In the end, you'll have more money.

How To Increase Your Income (For Life)

Virtually all retired people need monthly income from the assets they have amassed. With interest rates now much higher than they were a little over a year ago, there is a tendency to believe that a GIC is the best way to achieve this. However, recognizing that interest rates are most likely to fall, eventually you may want to lock into the higher, guaranteed lifetime income from some of the money that you have outside of your RRIF and / or TFSA.

$1,000,000 Non-Registered

Bond/GIC @ 3% Income		Gtd Income Enhancer
$30,000	Gross Annual Income	$74,849
$30,000	Taxable Income	$4,130
$12,900	Tax Payable @ 43 %	$1,776
n/a	Cost of Insurance	$35,598
$17,100	Net Annual Income	$37,476

An annuity or as illustrated in the comparison on the right, an "Insured Annuity" could be a very good option to consider. Annuities in general are most attractive when interest rates have risen. That is when they will give you the highest monthly income. Unlike the GIC, where you can lock in the rate for only 5 years at the longest, an annuity locks in the higher rates for much longer.

As you can see in the comparison between the GIC on the left and the "Guaranteed Income Enhancer" on the right (which is an insured annuity), the right wins by a wide margin. There is of course a difference between the 2. With an annuity, you are buying a monthly income. In this example, it's costing you $1 million to get ~$75,000 / year of income. After a certain period of time (which can be set at your life's end) the monthly income stops and the $1 million is gone. However, with an Insured Annuity, you are buying life insurance for the same amount of money as you are parting with to buy the monthly, lifetime income. So, while you are alive, you are enjoying life to its fullest by having the most amount of income you can. Because of the attached insurance, your heirs get the $1 million (tax-free).

Estate Freeze To Minimize Tax On Your Growing Portfolio

You've settled into retirement and find that the income you are getting from CPP, OAS, pensions, your portfolio etc. is more than sufficient to provide for your lifestyle. Because you are have a portfolio that seems to keep growing, it is very conceivable that your investments will be worth much more when you eventually pass on. That is all very good. Your situation is well set - however the taxes that will be paid to government when you pass on are growing just as fast (or faster) than your portfolio.

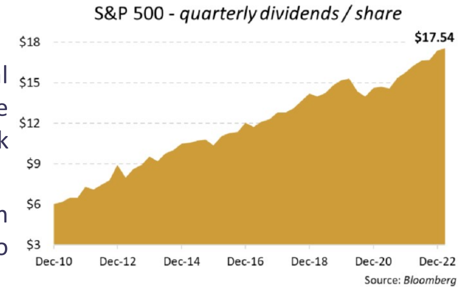
To stop this ever increasing tax bill, you may want to consider implementing an Estate Freeze. With this, you simply transfer investment assets to a "holding company" (Holdco). Shares are issued to you and your children (or a Trust for them which as Trustee, you are in complete control). You get fixed value shares. Your adult children get shares that will increase in relation to the value of the assets of the Holdco. Along with your fixed value shares, you also get a Promissory Note (PNote) for the amount of the assets you rolled into the Holdco. As you need income, you are simply paid back on the PNote. This means tax-free income to you, when you need it.

What is the end result? There will be no tax triggered when you transfer the assets to your kids (or the Trust) since it will be done using a "section 85 rollover," and there will be no tax triggered when you pass on. You'll also be reducing the amount of OAS clawbacks since money coming to you via the PNote is tax-free. Your Financial Planner can determine if this may fit for you.

Tech Gems—ChatGPT .

This is really the infancy of artificial intelligence, which ChatGPT makes available to us every day. I have been using this very regularly to find out anything I would normally "Google". Rather than do a web search and then scrolling through various links to find what you are looking for, simply tell ChatGPT what you want to find out and it will type your answer out, along with a few links to click for more info. ChatGPT is a tool built inside Edge (my own default browser) which makes it like a Swiss army knife for information gathering.

HHHMMM...



• The terms "Bear" and "Bull" market are thought to derive from the way in which each animal attacks its opponents. That is, a bull will thrust its horns up into the air, while a bear will swipe down. These actions were then related metaphorically to the movement of a market. Connor Clark & Lunn

• Markets tend to bottom well before the economy does (Oct 2022?), and we anticipate as inflation data significantly improves, expectations for the Fed hiking path will ease and equities will start to grind higher. CI Global Asset Management, Oct. 2022 #AlreadyInMotion

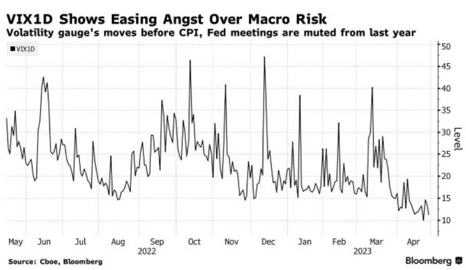
• $6 increasing to $17.54 over 12 years is a 7.64% / year increase in dividends (graph on right): Companies have quietly been paying money back to share holders, either through dividends or buying back shares. Yet, so many people insist on lending their money to a bank via a GIC or savings account.

• The Wall Street Journal tested Morningstar's ratings by examining the performance of thousands of funds dating back to 2003, shortly after the company began its current system of rating investments. Funds that earned high star ratings attracted the vast majority of investor dollars, yet most of them failed to perform. Of funds awarded a coveted 5 star overall rating, only 12% did well enough over the next 5 years to earn a top rating for that period; 10% performed so poorly they were branded with a rock-bottom one-star rating. #ProcessDeterminesReturns

• The U.S. has bank deposit insurance for deposits of up to US$250,000 ($342,000 Cdn). In Canada, it's only $100,000 Cdn. A higher limit encourages banks to take more risk.

• The US balance sheet has expanded every time a crisis occurs and only shrinks marginally. It stands at $8.7 trillion today vs. $4 trillion in 2020 (there is more than twice as much money floating around today than there was 3 years ago. It's not a wonder we have inflation). CI Global Asset Management, April 2023

• Over 25% of Canadians have a variable-rate mortgage. When a mortgage reaches the trigger rate, and the payment period is extended, the majority of the payment goes to interest. Sometimes the payments don't even cover the interest costs. At the end of the mortgage term, the principal amount (owing) barely changes. This can keep Canadians in debt for a lifetime. Financial Post, May 2023



• As a rule of thumb, for each $100,000 you have in a balanced portfolio, whether it be in a RRSP, TFSA and/or outside of those 2 tax shelters, you should be able to receive from your portfolio ~$400 per month starting at age 65, with inflation increases each year, for the rest of your life.

• Volatility (measured by VIX graph, left) has slowly been decreasing which means the market's view of the risk today is considerably lower than it was 1 year ago.

• Without government mandates or subsidies, EVs were all the rage in the U.S. By the turn of the 20th century they accounted for about 1/3 of all vehicles on the road. By 1935 they had all but disappeared. Financial Post, May 2023 #RepeatOfHistory?

• Cheryl and I had to submit proof of our 2022 #CharitableDonations. This happens every year. While we wait, #CRA says we owe them money. We have been told it will take 155 days for them to look at our submission. In the meantime, we are basically being accused of providing wrong information on our tax return. Guilty until proven innocent. #CRAWorkingFromHome

• Canada privatized air traffic control in 1996. US airports are still being run by government (FAA) fearing that privatizing US airports will make air travel, less safe. John Stossel, YouTube March 2023 #SafeCanadian

• The City of Calgary will spend $537 million to build the Calgary Flames new hockey rink, while the Calgary Flames ownership will ante up $356 million and they will have 35 years to pay for it. #1Million/Yr (that's less than what the average 4th liner makes annually)

• Whenever I drive on any road or highway that has 2 lanes going in the same direction, it seems there is a propensity for drivers to travel solely in the left lane, despite the right lane having much fewer cars. The advantage is on the right (faster, leaving yourself an out on the shoulder and less chance of a crash), yet it shows most people let their tendencies over-rule better judgement.

• My house needs to be repainted and new gutters installed. I was in contact with 5 painters recently, and 2 never replied back. Gutters? I sent 3 requests for quotes. With one, there was an auto-reply that it would be about 2 weeks before they would get back to me (they did eventually but the job was already done by that time). 2 others came by my house to calculate an estimate. I've had the same kind of experience with plumbers, electricians and shower glass providers in 2021. A recession would fix this. #RecessionsAren'tAllBad

• Since Covid hit in Spring 2020, in my "spare time" I fully rebuilt our family room wall where our new fireplace now is installed in, completely gutted our master bath (plumbers hired for that work), pulled down our back deck and rebuilt a new 16' x 25' one with PVC planking, leveled our whole sloped back yard and re-landscaped it, and finally I'm 2/3rds the way finishing up a Sprinter camper van conversion. If I was to retire, I'd have to have at least twice as many projects. #NotRetiringAnytimeSoon. #ILikeWork #CreatedToWork