Personal Newsletter from Nicole Deters, Harbourfront Wealth Management – Gilman Deters Private Wealth

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Look Forward, Not Back

One of the weaknesses of human nature is our tendency to focus on what is most recent in our memories. Our minds are naturally influenced by things that have just happened, and this can impact the way we make decisions. In investing, this can be amplified. The market pendulum can sometimes swing from one extreme to the other, with prices often overshooting underlying "fair values" in both directions during the course of a cycle. As renowned investor Benjamin Graham once said, "*In the short run, the market is a voting machine. But in the long run, it is a weighing machine*."

The year that has passed was no exception. Financial markets were largely challenged by the aggressive actions of the central banks as they raised rates to combat high inflation. As a result, there was a significant reversal from the excessive exuberance that characterized 2021. While it's never easy to see asset prices under pressure, it has led to a more healthy outlook for how risk assets are viewed and, perhaps, more thoughtful consideration of how capital is deployed.

Yet, many of the same issues we faced in 2022 persist, including geopolitical tensions, lingering inflation, higher interest rates and continuing central bank tightening policies intended to slow economies and rein in inflation. While these are important issues not to be trivialized, we shouldn't allow them to obstruct our view as we look forward.

This is because the investing journey can be lengthy — depending on our objectives, sometimes as long as our lifetimes. For most investors, investing involves building wealth for down the road, and not tomorrow. We can often forget that short-term performance may have little impact on longer-term results.

Veteran investors recognize that market downturns are a normal part of the cycle and allow for them, often using them to build investment positions for the future. Despite the volatility of 2022, it is instructive that Warren Buffett continued on his buying spree, adding a record amount of purchases to his portfolio throughout the year.[1] He knows that interruptions will occur from time to time and uses these periods to seek opportunity, strong in his conviction that better days lie ahead.

Likewise, we can all benefit by looking forward, continuing to position ourselves for the years to come. Indeed, the opportunity to build significant wealth remains within reach for both young and old investors alike. Worth a reminder: The "*Rule of 72*" is a simple way to estimate how many years it will take funds to double at various rates of return. By dividing 72 by an average rate of return of 5 percent, funds can double in around 14 years (72÷5=14.4). So, even if you've achieved the respected age of 70, chances are you can still live to see your funds double — and, twice still if you become a centenarian![2]

The road ahead may be a long one, so don't lose sight of the importance of planning for the future. After a challenging year, I would like to express my gratitude for your continued confidence in my services. May 2023 bring brighter days and better markets. Continue to look forward, not back.

1. https://markets.businessinsider.com/news/stocks/warren-buffett-berkshire-hathaway-60-billion-record-stock-purchases-portfolio-2022-8; 2. Assuming average life expectancy in Canada of age 84 (females) and 80 (males); https://data.worldbank.org/

In this issue

Reducing Demands on Portfolios During More Difficult Times

During more difficult market times, we often suggest the importance of reducing withdrawals to put less stress on investment portfolios. This can be especially challenging for retirees who do not have the comfort of employment income. Many are also faced with mandatory withdrawals from the Registered Retirement Income Fund (RRIF). We do know that markets are cyclical and expect them to resume their upward climb. This is why it's important to leave funds within a portfolio where possible to allow values to recover. Here are some thoughts, noting that individual situations vary based on factors such as income sources, taxation rates, lifestyle considerations and more.

Evaluate your liquid inflows — Having an understanding of your liquid inflows is important. For certain retirees, the income received through government benefits and employer pensions may be sufficient to meet living expenses. However, some may need to apply for additional benefits, like the Canada Pension Plan, to supplement income. Other retirees may consider picking up part-time work to generate income, shorten a retirement time horizon and increase a retirement portfolio by allowing a longer period of compounding for existing funds or through additional contributions.

Revisit your spending — With high inflation, money doesn't go as far as it used to, especially for essential goods like food and gas. A budget may identify opportunities to reduce non-essential expenses and potentially reduce the need for income. For retirees, while a general rule of thumb used in the investing industry has been a four percent withdrawal rate for retirement income, at the onset of retirement this may be high. Spending can change dramatically over a retirement life cycle and depends on many factors. Maintaining a budget can help to provide a clearer picture of income needed at any particular time.

Consider the sources of withdrawal and the impact on taxes — Withdrawing from investment accounts has the potential to trigger taxes. For retirees, in addition to required RRIF withdrawals, this may put you in a higher marginal tax bracket. If you do require funds, you may consider withdrawing from non-taxable sources, such as the TFSA. If you are turning to taxable assets, it may be beneficial to take advantage of tax-loss selling, as 50 percent of a capital loss can be used to offset taxable capital gains. Or, there may be benefit in selling assets with the highest cost basis first, then moving to assets where the cost basis is lower to reduce the potential tax hit. This isn't always the best choice when considering lifetime tax optimization; if you expect to be in a higher marginal tax rate in future years, this may impact your decision.

For those who must make minimum withdrawals from the RRIF, here are a few additional ideas:

Make RRIF withdrawals at the end of the year — By taking withdrawals at the end of the year, it may allow greater time for asset values to potentially recover. This 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, consider making an "in-kind" withdrawal. While the fair market value at the time of withdrawal will be considered income on a tax return, you will continue to own the security. If this is transferred to a TFSA, subject to available contribution room, 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.

Have You Been Appointed Estate Executor? Five Mistakes to Avoid

Administering an estate can be a time consuming and complex task, often occurring during an emotionally difficult time. It isn't uncommon for mistakes to be made, which can lead to increased tax liabilities, conflict with beneficiaries or, worse yet, litigation. Equally concerning, the executor may be held personally liable for any errors. If you have been appointed as executor, being aware of these potential pitfalls may help as you contemplate the role. If you are planning for your own estate, carefully choosing your executor is important to prevent these and other mistakes. In brief, here are common mistakes:

1. Not following the directives of the will. Estate lawyers say that executors can sometimes ignore parts of the will, such as forgiving loans that were to be collected, perhaps due to lack of knowledge or because it is easy or convenient. Others may choose to distribute assets differently than directed within the will, under the belief that they have a more 'fair' idea for this distribution. Neither situation is within the executor's authority.

2. Failing to communicate. One of the executor's duties is to respond to reasonable enquiries from beneficiaries. Sometimes executors become so involved in the process that they forget to communicate. Silence can often be misinterpreted as being secretive, which can prompt estate disputes. Maintaining transparency and ongoing communication can go a long way in preventing conflict.

3. Making incorrect distributions. Oftentimes, distributions are incorrectly made before other liabilities are paid, such as taxes or outstanding debts. Sometimes this is because beneficiaries pressure the executor. Often overlooked: the executor must identify unknown creditors, which can involve a time-consuming process of creating a public notice. Advertising for creditors can protect the executor should a claim be made after the estate has been distributed.

4. Being too prudent. Some executors try to keep estate expenses low, which can result in higher costs. For example, an executor who completes tax returns without the help of an accountant may miss eligible tax credits or deductions. In the past, advertising for creditors in the newspapers of multiple cities was very costly, so some avoided the process, only to be caught by surprise when claims were made.

5. Treating estate funds as their own. Given the assets often available within an estate, some executors may wrongly use them for their own purposes, such as to make loans to themselves or family members. Others may make more honest mistakes, such as incorrectly using funds to cover travel costs for family members to attend a funeral.

RRSP Checkup: How Well Are You Managing Your RRSP?

It is once again Registered Retirement Savings Plan (RRSP) season. How well do you manage your RRSP? Here are some questions to ask:

Do you consider the timing of RRSP deductions? With any RRSP contribution, you're entitled to a tax deduction for the amount contributed so long as it is within the contribution limit. Keep in mind that you don't have to claim the tax deduction in the year the RRSP contribution is made. You can carry it forward if you expect income to be higher in future years such that you may be put in a higher tax bracket, potentially generating greater tax savings for a future year.

When do you make contributions? By making contributions at the beginning of the tax year or throughout the year, instead of waiting until March 1st for a deduction from the previous year, you may benefit from the longer time for tax-deferred growth. Due to the power of compounding, over time this can make a noticeable difference.

When was the last time you updated beneficiary designations? It may be beneficial to review account beneficiaries (in provinces where applicable), especially in light of major life changes. For example, in the event of separation or divorce, be aware that named beneficiaries may not be revoked, depending on provincial laws. Therefore, the designation of an ex-spouse may still be in effect.

Have you considered a spousal RRSP? For couples in which one spouse will earn a high level of income in retirement, while the other will have little retirement income, a spousal RRSP may potentially be a valuable income-splitting tool. If you are working past age 71 and have a younger spouse, you can no longer hold your own RRSP after the year you turn 71, but you can still make a contribution to a spousal RRSP as long as your spouse is age 71 or less at year end and you have RRSP contribution room. This may be a good way to get a deduction and shift income to a spouse.

Have you planned for your RRSP's eventual maturing? There may be benefit in gradually drawing down RRSP funds as you approach retirement. This may be useful if an individual is currently in a lower tax bracket than they expect in future years. Others may seek to limit future sources of taxable income in order to minimize the possible clawback of income-tested government benefits such as Old Age Security. One strategy may be to use RRSP withdrawals to fund Tax-Free Savings Account (TFSA) contributions (subject to available room). As the TFSA grows, there may be greater flexibility to receive tax-free income that can augment or replace Registered Retirement Income Fund (RRIF) withdrawals later. At death, TFSA funds can pass tax free to heirs, unlike residual RRSP/RRIF funds that are subject to tax, potentially at high marginal tax rates.

Do you allow your RRSP to grow uninterrupted? Consider the implications of making taxable withdrawals from the RRSP to pay down short-term debt. You may be paying more tax on the RRSP withdrawal than you'll save in interest costs. In addition, once you make a withdrawal, you won't be able to get back valuable RRSP contribution room. There may be better options, such as a TFSA in which contribution room resets itself in the following calendar year.

Always seek assistance from tax professionals regarding your situation.

RRSP Contribution Deadline: March 1, 2023 for the 2022 tax year, limited to 18 percent of the previous year's earned income, to a maximum of $29,210 (for the 2022 tax year).

A Brighter Side to Inflation: The Largest Index Adjustment in Years

There may be some good news that comes with the significant inflation we've been enduring. The adjustments made to certain government income tax and benefit amounts — such as the basic personal amount (the federal non-refundable tax credit on an income tax return), the annual dollar limit for the TFSA and the GST/HST tax credit — will be the highest seen in many years. This is because the government adjusts these amounts based on inflation using consumer price index data. With inflation reaching 40-year highs in recent times, the indexation increase is the largest since the 1980s.

Indexation Increase Per Year, 2019 to Current

2019	2020	2021	2022	2023
2.2%	1.9%	1.0%	2.4%	6.3%

Many of these adjustments take effect on January 1, such as the increase to the TFSA dollar limit. However, other adjustments will take place on July 1, such as income-tested benefits like the GST/HST tax credit and the child disability benefit, as this coincides with the beginning of the program year for these benefits. It will also increase our income tax brackets.

Why is this important? The adjustment helps compensate for the higher cost of living we are experiencing. For instance, if the tax bracket thresholds are not indexed to inflation, an increase in income would mean higher taxes paid and a loss of purchasing power. This occurred when Alberta de-indexed its tax brackets in 2019, effectively forcing Albertans to pay $646 million more in taxes from 2020 to 2022.[1] Alberta will resume indexing for the 2022 tax year.

For more information on the indexation adjustment, please see: https://www.canada.ca/en/revenue-agency/services/tax/individuals/frequently-asked-questions-individuals/adjustment-personal-income-tax-benefit-amounts.html

1. www.cbc.ca/news/canada/calgary/alberta-taxes-indexation-inflation-1.6510978

2023 TFSA Dollar Limit: As a result of adjustments for inflation, the 2023 TFSA annual dollar limit will increase to $6,500, bringing the eligible lifetime amount to $88,000. The annual dollar limit hasn't increased since 2019.

Don't overlook the opportunity for tax-free growth!

Inflation and the Impact on Timing CPP Benefits

While there has been little reason to embrace the high inflation of today, there may be a silver lining for certain government benefits. Higher inflation means higher Canada Pension Plan (CPP) benefits and the outcome can be especially significant the longer you wait to begin. The standard age to start CPP is 65, but you can begin as early as age 60. In fact, most people start early.[1] However, if you have yet to apply for CPP, it may be an opportune time to revisit the timing decision.

How Does Inflation Impact CPP Benefits?

CPP payments are impacted by inflation in two ways. First, like most government benefits, they are indexed to the consumer price index (CPI). The CPP uses the measure of CPI over the 12-month period ending October of the previous year and makes adjustments the following January 1. Second, CPP is also adjusted based on the year's maximum pensionable earnings (YMPE), an amount indexed to wage inflation. Over recent times, increases to the YMPE have been significant: 4.94 percent in 2021 and 5.36 percent in 2022. This was largely due to the pandemic when the services industry suffered and fewer people worked in lower-paying jobs, pushing up average weekly earnings.[2]

The Timing Decision to Take CPP

If you start receiving CPP benefits before age 65, payments will decrease by 0.6 percent each month to a maximum of 36 percent (at age 60). If you start after 65, payments increase by 0.7 percent each month, to a maximum of 42 percent (at age 70 or after). However, by waiting to take benefits, CPP amounts can grow based on inflation, and this is further enhanced by the increased benefit of starting later.

A recent analysis shows the potential impact. It looks at an individual who started CPP at age 60 in January 2020, with a decreased benefit of 36 percent (0.6% X 60 months). Assuming the maximum CPP pension amount of $1,175.83 in 2020, she received $752.53. Had she waited a year and started at age 61, she would have received $857.07 (a 28.8 percent decreased benefit from $1,203.75). If she waited until age 62, she would have received $982.81, or 30.6 percent more than she would have received at age 60.

Just how significant is the difference? The table shows the potential increase over time, based on actual 2021 and 2022 figures. It assumes future CPI adjustments (after 2022) of two percent and maximum retirement pension increases of three percent based on existing actuarial assumptions. By these calculations, at age 90 an individual would have a cumulative pension that is 83 percent larger by waiting to start at age 70, compared to starting early at 60.

Table: Sample Monthly CPP Benefit for Individual with Maximum Pension Amount[3]

Year	Age	Pension Amount Starting Age 60	Pension Amount Deferring	Increase Over Amount at Age 60
2020	60	$752.53	—	—
2021	61	$760.06	$857.07	12.8%
2022	62	$780.58	$982.81	30.6%
2023*	63	$796.19	$1,105.26	46.9%
2024*	64	$812.11	$1,234.17	64.0%
2025*	65	$828.36	$1,369.83	82.0%
2026*	66	$844.92	$1,529.44	103.2%
2027*	67	$861.82	$1,697.40	125.6%
2028*	68	$879.06	$1,874.05	149.0%
2029*	69	$869.64	$2,059.78	173.7%
2030*	70	$914.57	$2,254.97	199.7%

*estimates based on CPI of 2% and YMPE of 3%

Of course, many factors should be considered as you decide when to begin CPP, including expected longevity, the impact of income-tested benefits, the need for income and more. However, the impact of inflation may be one compelling reason for individuals to consider waiting to begin CPP benefits.

1. financialpost.com/personal-finance/fp-answers-when-should-i-take-cpp; 2. www.benefitscanada.com/pensions/governance-law/why-cpp-premiums-are-getting-a-bigger-bump-than-planned/; 3. www.advisor.ca/columnists_/lea-koiv/consider-inflation-when-deciding-when-to-begin-cpp/

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