INVESTMENT FOCUS

Personal Newsletter from Watermark Stone Wealth

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Watermark Stone Wealth

Doug Stone, MBA, CFA, CFP®, FCSI®
Portfolio Manager
iA Private Wealth
Insurance Advisor
D.G. Stone Financial Group Inc.
905-338-3223 ext. 140
doug.stone@iaprivatewealth.ca

Chuck Magyar, CIM®, FCSI®
Portfolio Manager
iA Private Wealth
905-338-3223 ext. 203
chuck.magyar@iaprivatewealth.ca

David Lyon, QAFP®
Senior Wealth Advisor
iA Private Wealth
Insurance Advisor
iA Private Wealth Insurance
905-338-3223 ext. 204
david.lyon@iaprivatewealth.ca

Robert Ridgway, BAS, MBA, CFP®
Associate Investment Advisor
iA Private Wealth
Insurance Advisor
D.G. Stone Financial Group Inc.
905-338-3223 ext. 232
robert.ridgway@iaprivatewealth.ca

Leigh Ann Sullivan, Hons.BBA
Associate Investment Advisor
iA Private Wealth
905-338-3223 ext. 142
la.sullivan@iaprivatewealth.ca

The Sun Also Rises

Investing is never a smooth road, and 2022 was a difficult reminder that the markets can go down just as they go up. Financial markets were largely challenged by the aggressive actions of central banks in raising rates in their attempt to combat high inflation; a stark contrast to the excessive exuberance of 2021. Indeed, the market pendulum can 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*."

While it is 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. For the equity markets, we have seen a return to more reasonable multiples and fair values, better reflecting fundamentals like corporate earnings and economic growth that drive prices over longer time periods.

It is instructive that throughout the turbulence of 2022, renowned investor Warren Buffett added to his portfolio — reportedly his largest net purchases in 30 years.[1] Buffett's investment thesis has always been to buy quality companies at reasonable prices, with the intention of holding them for the longer term. He knows that there will be down years and uses them to seek opportunity, strong in his conviction that brighter days lie ahead. Since the start of the millennium, Buffett has actually underperformed the S&P 500 over 40 percent of the time on an annual basis.[2] Yet, he has stuck to his approach to outperform the markets over time. It is a reminder that even for the most respected investors, investing is never a smooth road.

Have we seen the bottom of this cycle? As the saying goes, it's always darkest before dawn. As we enter 2023, many of the same challenges we faced in 2022 persist: geopolitical tensions, lingering inflation, though there are positive signs of slowing, higher interest rates and continuing central bank tightening policies intended to slow economies. While economies need to slow for inflation to moderate, let's not forget that we may be well positioned to endure these times. Our financial systems continue to be healthy; many companies and individuals are not heavily indebted, a previous driver of more serious downturns. Labour markets have been strong, though this has complicated central bank efforts to rein in inflation. And, after a volatile year, the prospect of an economic slowdown may be somewhat reflected in equity prices: Markets often discount the direction of the economy well ahead of time. Most important, while short-term setbacks are expected to occur from time to time, corporate profits and economies have continued to grow over longer periods — and this isn't likely to change.

This points to the importance of continuing to plan for a better tomorrow. As investors, we will inevitably experience dark days and even down years; yet, as Buffett's actions remind us, we shouldn't forget that the sun also rises.

With the turning of another year, we would like to express our gratitude for your continued confidence in our services. May 2023 bring good health, peace and prosperity.

1. https://markets.businessinsider.com/news/stocks/warren-buffett-berkshire-hathaway-60-billion-record-stock-purchases-portfolio-2022-8; 2. When comparing BRK-A annual returns against the S&P 500 from 1999 to 2021. www.cnbc.com/2021/01/08/how-warren-buffetts-uphill-battle-against-the-sp-500-is-changing.html

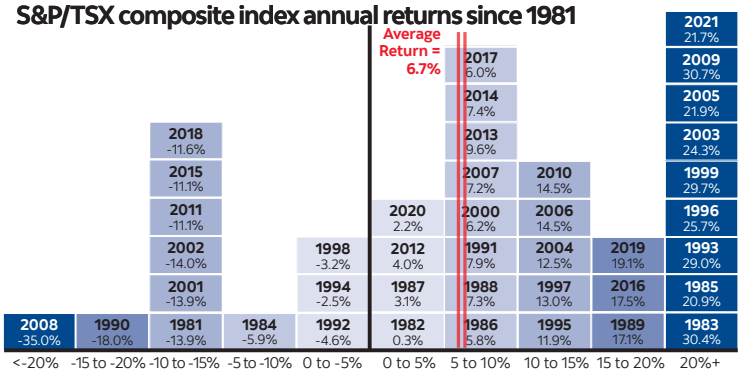
Investing Resolutions for 2023 to Help Keep Perspective

A recent article in the *Washington Post* offered a different perspective to the view that kids these days are getting too much screen time. In fact, there's another demographic struggling to put down their devices: baby boomers. As one man put it: "*My 75-year-old dad's phone may as well be an implant; he lives with it like a teenager!*"[1] Of course, this has implications for our investing ways. With easy access at our fingertips, we may all be guilty of checking investment accounts too frequently. In this regard, and as we begin a new year, here are three resolutions that can help to make better investors:

Pay less attention to investment accounts. It's worth a reminder: Emotions can impact our investing decisions. When we are threatened by the possibility of losses, our brains take control to avoid these losses and we may not make the best investing decisions. In 2022, excessive pessimism dominated the markets. As one market pundit noted, perception swung from "*flawless to hopeless*," and, for many, the urge to react may have felt overwhelming. One important variable for investing success is how long you are able to stay invested. As such, consider checking accounts less frequently.

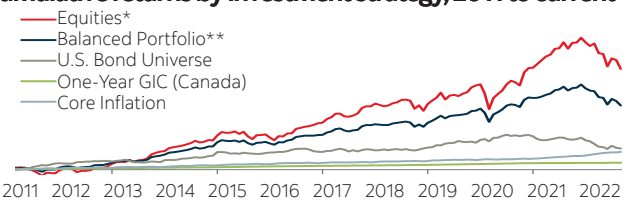
Think longer term. Markets go up and down and returns vary from year to year. While we commonly discuss "average" returns, it's worth repeating that annual returns often don't fall close to this average. Consider the wide dispersion of S&P/TSX Composite Index annual returns since 1981. In 19 of 41 years, returns were less than the average of 6.7 percent. Almost one-third of the time, they were negative. Yet, average returns compounded over time can lead to superior results. An investment of $55,000 would yield about $209,000 in 25 years at a rate of return of 5.5 percent; in 55 years, it would yield over $1 million.

S&P/TSX composite index annual returns since 1981



Remember that equities continue to be one of the best wealth generators of asset classes. Given the market volatility in 2022 and with yields on low-risk, fixed income alternatives at levels not seen in over a decade, products like guaranteed investment certificates may look appealing. While this may be a good opportunity for cash on the sidelines, equities continue to be one of the best asset classes in which to generate wealth and beat inflation over the longer term.

Cumulative returns by investment strategy, 2011 to current



*35% S&P 500, 35% S&P/TSX, 20% MSCI EAFE, 10% MSCI EM; **60% Equities, 40% Fixed Income

1. https://www.washingtonpost.com/technology/2022/11/12/boomers-screentime/

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 (liquidator) 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 often made by executors:

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/

Watermark Stone Wealth
iA Private Wealth
D.G. Stone Financial Group Inc.
iA Private Wealth Insurance
1400 Cornwall Rd., Suite 14
Oakville, ON L6J 7W5
T: 905-338-3223 F: 905-338-3337