



Serber Speaking

David Serber

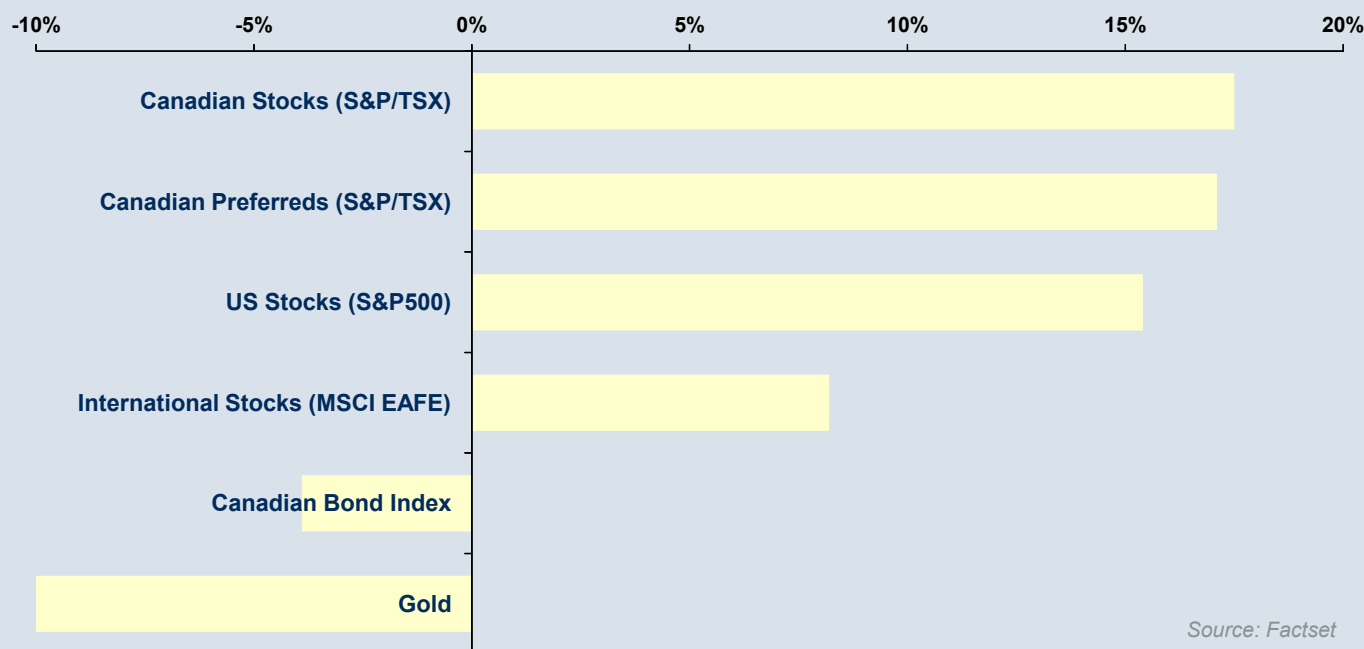
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Commentary for the quarter ended Sept. 30, 2021

The Only Game in Town

After making strong gains in the first half of 2021, investment markets took a breather in the third quarter and came in roughly flat. Still, Canadian stocks are leading the pack so far this year, as seen on the chart below, with a gain of 17.5 percent. Oil and gas prices are up roughly 60 percent and 130 percent respectively so far this year, providing a tailwind to the Canadian market with its relatively high weighting in energy stocks. The US market also continued to perform well, while international markets were OK, but less impressive than their North American peers. Canadian preferred shares also continued their strong gains, helping to boost many of our clients' portfolios, which hold preferreds as an alternative to corporate bonds.

Performance by Asset Class: January 1 to September 30, 2021 (in Canadian \$)



Source: Factset

The outlook for the next 12 months is, in my estimation, a continuation of the same themes that have been at play so far this year. Global economic growth will continue to be reasonably robust. According to Bloomberg consensus estimates, the G7 economies should grow at around four percent in 2022 -- well above the trend rate of recent years that was more in the range of one-to-two percent. GDP growth will be supported by the gradual reduction in COVID-19 related economic drag. To wit, almost 50 percent of the planet's population, some 3.5 billion people, have now received at least one dose of vaccine (source: Our World in Data), and these numbers will only improve going forward. This, combined with high levels of savings, low interest rates, high government spending and falling unemployment will support economic growth, corporate revenues and profits.

Those corporate profits, distributed to shareholders as dividends and/or rising stock prices, are a powerful draw for investment capital looking for a home. With interest rates stuck below two percent, stocks are indeed, for many, The Only Game In Town.

However, the outlook could darken if and when the global economy is producing at capacity, a precondition for potential inflation problems. The current round of inflation appears to be mostly transitory, but it could become more of an issue down the road. If that happens, central banks will raise interest rates to stop inflation from getting out of hand and, if draconian enough, would trigger a bear market and a recession.

Danger around every corner?

In the meantime, a diversified portfolio, custom tailored to meet your risk tolerance level, is the way to go. But it's not so simple. For anyone who reads or watches the financial news, it almost always appears that the markets, the economy, or both, are on the verge of a dangerous turn for the worse. And today is no exception: COVID-19 stories of sickness and death make daily headlines; Evergrande is going broke in China; inflation is hitting 10-year highs; markets are over-valued; governments have too much debt, etc., etc.

I think it's important for investors to understand that, on a certain level, the popular news media must purvey stories that are scary – it provides a psychological and emotional hook that keeps people watching, listening and reading. In television, the network would likely go broke if the news anchor were to read the dry analytical investment research that could actually be quite valuable.

For many of my clients, investing was easier back in the day when one could generate returns of six or seven percent or more, using secure, predictable investments like GICs. Nowadays, the average GIC pays a measly 1.5 percent – lower than the rate of inflation – clearly too low for an investor to maintain the value of their money, let alone increase it. For many who are trying to protect their purchasing power and generate a meaningful return, this means that a large chunk of their life's savings is invested in securities like stocks, preferred shares, ETFs and mutual funds – none of which has a guaranteed rate of return on capital, or even a guaranteed return of capital. Yikes.

It is, therefore, important for investors to clearly understand the risks they are taking. The most critical distinction is the difference between a permanent and a temporary loss of capital. If you own shares of a company that goes broke you suffer a permanent loss. But this is a rather rare event, and for most clients who own blue-chip stocks and ETFs, it is not a significant issue. Much more probable is the risk of suffering a temporary loss. When the stock market falls by, say, 50 percent, as it did in 2008-2009, and then recovers, as it did in 2009-2013, we can see that the loss was temporary – but only for those who held on to their positions.

However, there is another more common category of permanent loss – panic selling. The poor souls who sold at the bottom in the spring of 2009 converted what, as it turned out, would have been only a temporary loss, into a permanent one by virtue of their own actions. This highlights an area of increased interest over recent years, called behavioural finance, which seeks to understand the role of psychology in investment success or failure.

To summarize, the risk of permanent loss due to a company going broke is very low in a portfolio of blue-chip stocks and broadly diversified ETFs. The more important source of permanent loss does not come from the investment markets themselves but from the behaviour of investors who panic, and sell at or near market bottoms.

The key is to invest in a properly constructed portfolio with diversified holdings, custom tailored to one's risk-tolerance level, so as to avoid the emotions that could lead to panic selling in a bear market. If this is done, the losses an investor suffers along the way will be temporary in nature, or at least this appears to be the case, based on the historical evidence.

With this in mind, I wonder to what extent the news headlines and financial TV shows matter to one's investment plan. Short answer – they don't.

From the Planning Notebook

Splitting Pension Income with your Spouse

The Canadian tax code allows those who receive eligible pension income to split up to 50 percent of it with their spouse for tax purposes. These rules generally benefit couples where the recipient of a pension income is subject to tax at a higher rate than their spouse.

Only certain income is eligible to be split under the pension income-splitting rules. Here are some examples of eligible pensions that may be split (This list applies for those age 65 or over and is not exhaustive.):

1. Life annuity payment from an employer pension plan;
2. Payment from a RRIF or LIF;
3. Annuity payment from a deferred-profit sharing plan (DPSP);
4. Payment from a regular annuity; and
5. Payment from certain foreign pension plans (e.g., U.S. Social Security)

Those receiving eligible pension income are generally entitled to claim both federal and provincial tax credits. The federal non-refundable pension income tax credit is on the first \$2,000 of eligible pension income, which translates into a federal tax savings of \$300 per year. The amount of additional provincial tax savings varies, depending on where you reside.

Therefore, if only one spouse is currently receiving eligible pension income, they may want to split at least \$2,000 of it so that both can claim the pension tax credit (assuming other relevant conditions are met). In addition, spouses between the ages of 65 and 71 with no pension income could consider converting a portion of their RRSPs to RRIFs in order to generate \$2,000 each in eligible pension income, to benefit from the pension income tax credit.

It is also important to keep in mind that OAS benefits are subject to a 15-percent clawback for every dollar of net income that exceeds the OAS threshold, currently \$79,845. Splitting the pension income of the higher-income spouse may be an opportunity to reduce or eliminate the impact of the OAS clawback.

Summary

The pension income-splitting rules affect the retirement income planning strategies of many Canadian couples. In certain cases, the opportunity to reduce your family's tax bill during retirement may be meaningful. Since everyone's tax situation is different, it's important to discuss your circumstances with a qualified tax advisor.

If you would like to discuss your personal situation, please reach out to me any time at david.serber@rbc.com.

Until next time, best regards,

David Serber

If you would like to discuss your personal situation please feel free to contact me. Also, feel free to forward this copy of **Serber Speaking** to anyone you think would find it of interest.



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