Wealth Management
Dominion Securities

Wealth Management
Review

www.rbcds.com | October 2023

Five year-end financial tips

1. **Turning 71 in 2023?** You must convert your RRSP to a RRIF (or other income source) before year-end.
2. **Converting your RRSP in 2023?** Before you do, consider an early contribution for 2024. While there's a 1% per month over-contribution penalty, the tax benefits should outweigh this.
3. **Have a younger spouse under 72?** If you're still earning eligible income, you can contribute to a spousal RRSP until the end of the year your spouse turns 71 – and claim a deduction on your tax return.
4. **Donating to a registered charity?** Donate before year-end to claim a donation tax credit on your 2023 tax return.
5. **Have taxable capital gains?** If you hold securities with unrealized capital losses, consider selling them to realize the losses and offset the gains.

Talk to your Investment Advisor and consult with your tax advisor to see if these strategies are right for you.

Fuel in the tank

By Jim Allworth

After a long haul moving higher from lows set back in the fall of last year, stock markets took a breather in August and September. That correction could have further to run through the often seasonally weak fall months, by which time we expect markets to reverse course, opening the way to a renewed move to higher ground.

The S&P 500 Index and Canada's S&P/TSX Composite Index are the only broad-based, blue-chip indexes in the developed economies that have not yet moved above their late 2021 high-water marks. We expect them to do so before this advance has run its course.

A possible catalyst for any coming renewed up-leg might turn out to be investor conviction that the U.S. Federal Reserve ("Fed") will begin cutting rates sooner than expected, giving the Bank of Canada and other central banks some room to do likewise.

Rate cutting would most likely be a response to the arrival of weaker-than-expected economic data, especially on the employment front. However, a rising stock market fueled by a deteriorating economic outlook is not a sustainable set of circumstances, in our view, especially when the market is already trading at a comparatively full valuation—currently 20x the 2023 consensus earnings per share estimate for the S&P 500 and 18x next year's forecast.

Mega muted

It must be said that the performance of the TSX has been much more muted than that of the S&P 500 – it is trading at just 14.2x 2023 estimated earnings – almost entirely because it's absent the seven mega-cap, tech-related stocks that have accounted for all of the S&P 500's over-achievement.

While we think new highs for both indexes in the next few months are a distinct possibility, most of 2024 will likely be less upwardly dynamic than 2023 – particularly if a deeper economic slowdown or recession were to arrive over that interval, as we expect.

Expectations for a "soft landing" versus a "hard landing" for the U.S. economy have swung from favouring one over the other repeatedly this year. The jury is still out but we see mounting headwinds in the U.S. for both the consumer and for capital spending by businesses.

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First among these is the continuing tightening of credit conditions. Along with Fed rate hikes, a majority of U.S. banks have been raising their lending standards for more than a year, and a significant fraction expect to further tighten standards.

Excess savings built up in the pandemic are gone or all but gone in the U.S. (although not in Canada). Credit card debt and delinquencies are rising sharply. Student loan repayments for almost 44 million Americans restarted in September. Mortgage refinancing and auto loans are much more expensive and harder to get.

Retail trade has shifted from full-price retailers to price discounters, suggesting that American consumers are feeling less confident about the state of their finances. Job openings, while still elevated, have been falling steeply for several quarters. Consumer confidence is not far above decade lows.

None of the above are insurmountable, in our opinion, but neither do they appear to have run their course. Dynamic new economic expansions usually begin when pent-up consumer demand and cheap credit combine to put unemployed workers and facilities back to work, kicking off a virtuous cycle of rising production engendering even greater demand. Today in the U.S. and Canada, there is very little pent-up demand and very few unemployed workers or idle factories, while credit is expensive and restrictive. Businesses are contending with slowing sales and rising costs.

Focus on quality

We believe there is enough fuel in the tank to push stocks up to new highs—where most averages were almost two years ago – and recommend remaining sufficiently committed to stocks to take advantage of that expected upswing. However, we believe investors should consider limiting individual stock selections to companies they would be content to own through a recession, which, in our view, is the most probable economic outcome in the coming quarters. For us, that means high-quality businesses with resilient balance sheets, sustainable dividends, and business models that are not intensely sensitive to the economic cycle.

Perhaps the most compelling reason for focusing on resilient, high-quality businesses is that all those economic headwinds cited above will in fact run their course and fully dissipate later next year. History strongly suggests that equity markets will anticipate the start of a new economic expansion several months before it gets underway. Portfolios that have held their value to a better-than-average degree will be best equipped to take advantage of the opportunities that are bound to present themselves at that positive turning point when it arrives.

Fixed income opportunity now

Of course, balanced portfolios also have a fixed income component (e.g., bonds). For most of the past 13 years our recommendation has been to maintain a below-normal exposure to fixed income because interest rates were not adequately compensating the investor for the risk that rates might rise from what were abnormally low levels.

Rates were as low as they were in large part because central banks led by the Fed pursued extraordinary policies designed to keep both short and longer-term interest rates well below where conventional markets forces would have taken them. Often during that long stretch when a bond matured in a portfolio the investor was faced with the prospect of having to reinvest the proceeds at a rate that was just a fraction of what they had been receiving.

A desire to fully replace that income propelled some investors into riskier, higher-yielding bonds and even more into dividend-paying stocks where absolute yields were usually higher than GIC and government bond yields, even more so when the favorable dividend tax treatment was factored in. Despite the pandemic, that shift from fixed income to dividend-paying equity worked out well from early 2019 through to early 2022. Taking on some extra risk delivered both more income and capital appreciation.

But now the extraordinary central bank policies that kept rates low have been replaced by aggressive rate hiking and an abandonment of massive bond buying (“Quantitative Easing”). Bond yields have moved dramatically higher. The 10-year Canada bond yield has skyrocketed from just 0.5% in the summer of 2020 to almost 4% today. U.S. yields have moved even higher. That means many maturing bonds today can be re-invested to fully replace or even exceed the income they had been generating.

What’s more, over 2020 and 2021 massive amounts of Canadian and U.S. government and high-grade corporate bonds were issued carrying very low coupons. Today, in the higher rate environment, those bonds are trading at big price discounts to the value they will eventually mature at. A buyer of one of those discounted bonds today will receive a comparatively small coupon income (taxed at regular income rates) and a large capital gain at maturity (taxed at a much lower rate).

In our view it is time to consider moving back to the full targeted exposure to fixed income in a balanced portfolio.

For a more detailed discussion of our outlook for financial markets, ask for a copy of our current issue of *Global Insight*.

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.

First Home Savings Account (FHSA)

How to help children with a first-time home purchase, without compromising your own financial future

Helping your kids with a down payment? Here's how to give them a boost with their first house while keeping your own financial plans intact.

It might seem inevitable that your children will need help buying their first home. Real estate prices, rising mortgage rates and the cost of living are making it less affordable than ever for young people in Canada to own property without some financial assistance from their family.[1] Too often, a financial decision is made quickly and under pressure. Of course, you'd love to help your child win a bidding war for their dream home, but at what cost to your own retirement plans?

"Parents don't always get to spend enough time considering the different ways they could help," says Tony Maiorino, vice president and director, head of Family Office Services at RBC Wealth Management. "A young couple may want to buy a house, are short $50,000 and then ask at the 11th hour, 'Can you lend it to us?' A parent can feel pressured and put on the spot."

"Going through a planning process first is going to set the groundwork for having that conversation," says Maiorino. "If you have a financial plan and are thinking of giving your kids, say, $50,000 each over 10 years, your advisor can model it to see if you can afford it, and how. If yes, you can walk out knowing, 'I can do this.' "

Add housing gifts to your financial planning goals

It's becoming more common to see families allocate gifts for home-buying in their financial plans, says Allison Marshall, vice president of High Net Worth Planning Services and Financial Advisory Support, Family Office Services at RBC Wealth Management.

"I'm a Gen Xer. When my parents were raising me, saving for my post-secondary education was their focus. It still is, for most of our clients; but today, there's an added goal of wanting to help children be able to purchase a home in the future," says Marshall.

"We talk about what makes sense from a tax perspective as well as a family law perspective – things a parent may not think about, like what happens to the gift if there's a divorce. It's also important to understand the impact of any gift on your retirement lifestyle," she says.

Give money to invest in a First Home Savings Account

One way to stretch a financial gift is to guide your adult child to invest the money and claim their first-time homebuyer's tax deduction.

The First Home Savings Account (FHSA) was launched by the federal government in April 2023, allowing prospective first-time homebuyers to save tax-free.

You can't contribute directly to someone's FHSA, but your adult child can deposit up to $8,000 per year into their account, to a lifetime maximum of $40,000.

"One of the features of these accounts is that parents can gift their child – or grandchild – the money for them to invest," says Marshall. "Later, when money is withdrawn to purchase a house, there is no attribution back to the parent or grandparent." That makes this a practical way to transfer wealth.

As with a Registered Retirement Savings Plan (RRSP), FHSA contributions reduce the account holder's taxable income, and those deductions can be carried forward to a later tax year. And like a Tax-Free Savings Account (TFSA), income and

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withdrawals aren't taxable, so long as funds are used for a qualifying home purchase.

This complements use of the Home Buyers' Plan (HBP), allowing up to $35,000 to be withdrawn from an RRSP tax-free for a home purchase.

By taking advantage of both the FHSA and the HBP, an individual could save up to $75,000, plus any growth in the FHSA, to use toward a first home.

Share your roof as a way to boost your kids' savings

If it fits your lifestyle, welcoming adult children to live rent-free in the family home is another way to lend support.

"This can be a non-financial option to help them save for a down payment," says Maiorino. With going rates for a one-bedroom rental ranging from $2,800 in Vancouver to $1,800 in Halifax, the money saved on housing, utilities and food adds up.[2]

"That's an opportunity for a working couple to save thousands a month," says Maiorino. "It could be close to $50,000 in just one year, if they're disciplined about taking what they would have paid for those expenses and putting it into a savings vehicle. You're giving them $50,000 in value for maybe $5,000 or $6,000 in additional costs."

Give a down payment or a forgivable loan

A recent survey reported that 35% of first-time homebuyers across Canada received a lump-sum payment from a parent or relative.[3] And in pricey Ontario, the Ontario Real Estate Association found that about 40% of parents had helped children (ages 18 to 38) buy a house.[4] The amount averaged $71,000 as a gift, or a loan of $41,000.

"I'm personally a huge fan of the lend; 'don't give' approach," says Maiorino, who sees parents offer home-buying help through a formally documented loan.

"They're saying, 'We want to help our children but do it in a way that gives us some flexibility and also protects us.' It's not an equity ownership – the parents own nothing in the house – but they do have a debt against the home," he says.

Plus, the idea of repaying a loan may help the family stay grounded about the value of money.

"Even if it's your ultimate objective to give them the money and forgive the loan, just thinking that their parents might ask for their $100,000 back can change the dynamic of how they choose to live. Maybe they're not going to buy that expensive TV or replace the appliance that doesn't need to be replaced; they're conscious of wanting to pay the money back."

"You can always eventually say, 'Happy holidays! We're forgiving the loan!' " says Maiorino.

Contact your Investment Advisor for more information about opening an FHSA.

[1] "Brighter Days Ahead As Home Ownership Costs Go Through the Roof." Rbc.Com, 29 Mar. 2023, https://thoughtleadership.rbc.com/brighter-days-ahead-as-home-ownership-costs-go-through-the-roof/

[2] "Rentals.ca June 2023 Rent Report." Rentals.Ca, Urbanation, 1 June 2023, https://rentals.ca/national-rent-report

[3] "Down Payment Dilemma: Canadian First-Time Homebuyers' Fear of Falling Short Is Escalating." Newswire.Ca, Royal LePage Real Estate Services, 22 June 2023, https://www.newswire.ca/news-releases/down-payment-dilemma-canadian-first-time-homebuyers-fear-of-falling-short-is-escalating-869359647.html

[4] "Four in 10 Parents of Young Ontario Homeowners Financially Helped Their Child Achieve the Dream of Homeownership." OREA.com, 22 Feb. 2022, https://www.orea.com/resources/media-room/Press-Releases/February-22-2022

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