T·E·WEALTH

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STRATEGIES

President's message

Welcome to the summer edition of *Strategies*. The approach of summer solstice brings with it longer days and warmer nights, and we're enthusiastically celebrating better weather. This month, we're also excited to celebrate a key milestone for the firm: June 1 marks the two-year anniversary of CWB's bold step forward to scale up our private wealth advisory presence. This was done through the business combination of CWB Wealth Management and CWB McLean & Partners with T.E. Wealth and Leon Frazer & Associates. An eventful two years on, and we're proud of the results.

Business combinations of this kind can be disruptive under normal circumstances. And as we all know, the past two years have been far from normal. With these facts in mind, and in keeping with our unchanging priority to contribute to peace of mind for our client families, our choices over the past 24 months have been focused to deliver stability and continuity for both our clients and our people. We've already accomplished a great deal together as a combined firm. I continue to be inspired by the skill and integrity of our teams, and how our people have committed to live our shared values. The trust that our client families place in our wealth advisory professionals is well-earned, and well-deserved.

The lasting economic ripple effects of the pandemic and the stubborn, global persistence of COVID-19 itself have compounded this year, with the impact of rising interest rates and economic disruptions related to the Russian invasion of Ukraine. Navigating through these turbulent conditions is an exercise in living with uncertainty. Thoughtfully accounting for uncertainty is part of the value we seek to provide our client families every day, and it's a recurring theme within these pages.

In this issue, we first return to the challenges presented by rising inflation. Our thoughts on the matter in last year's summer issue were timely as we explored a key source of uncertainty for portfolio managers: would price increases prove to be persistent or transitory? Here we revisit the subject, acknowledging the unexpected impacts of the war in Ukraine, and we share a useful playbook to preserve purchasing power during inflationary times. From there, we step back to first principles. We first explore the range of key factors which drive differences in the suitability of a given investment or portfolio strategy from one investor to another. We then move on to cover a range of long-term strategies to support lasting family legacies through the transfer of intergenerational wealth.

Planning beyond near-term circumstances on behalf of our client families comes naturally to us. Our firm's heritage goes back to the founding of Leon Frazer & Associates in 1939 as one of Canada's first investment counsels. Later this year, we'll celebrate the 50th anniversary of the founding of T.E. Wealth by Timothy Egan in 1972. Next year marks 30 years from the founding of Adroit Investment Management, the predecessor firm for CWB Wealth Management, and this month marks 23 years in business for CWB McLean & Partners. Our relationships with many client families go back several generations. This is increasingly rare in professional services, and it represents an endowment of trust we treat with the utmost respect.

As a sign of our deep respect for this heritage, we're investing heavily to ensure our wealth advisory capabilities evolve to meet the changing needs and preference of our client families through each generation to come. We're partnering with market-leading wealth technology players to provide our clients, and our advisors, with powerful digital experiences and the ability to engage through multiple channels. At the same time, we remain committed to preserving our client-centric culture and prioritizing the quality of our personal relationships. Our enduring commitment is to provide our client families with thoughtful advice, sound planning, and professional investment management customized to meet their needs.

We trust this commitment is reflected in these pages – please enjoy this issue of *Strategies*.

Sincerely,

Matt Evans, CFA
President & CEO
CWB Wealth Management

INSIDE

Is inflation peaking?

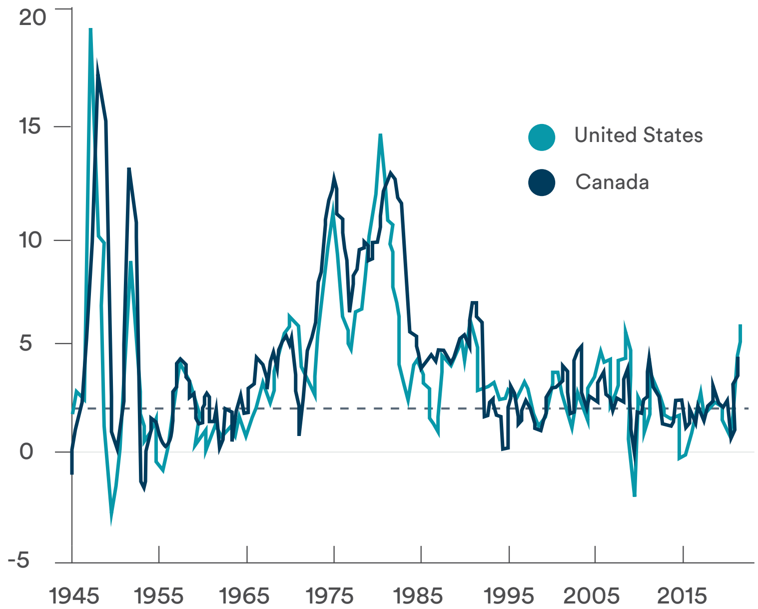
We recently held a virtual client event titled, *Adapting Through Adversity*, where inflation concerns dominated questions from attendees. Canada's latest inflation numbers reinforce why this question is weighing on people's minds.

The Consumer Price Index (CPI) for April showed prices up 6.8% year over year as inflation continued to run at levels we haven't seen in forty years. May CPI is slated to be announced on June 22, and speculation is that we will see year over year inflation exceed 7%, as gasoline prices hit new highs in the month, with much of the country now seeing prices at the pump of $2.00/L or more. The question is: how long will these high levels of inflation last?

Consensus among economists is for CPI in Canada to average 5.9% in 2022 and then to fall to 2.8% in 2023 before proceeding to around 2% the following year, which would put us back to pre-COVID-19 levels. It's a reasonable forecast that implies inflation should peak soon. Unfortunately, forecasting since the pandemic began has been next to impossible. There are too many variables and surprises. For instance, one reason inflation has risen well above what was previously expected has been due to Russia's unforeseen invasion of Ukraine as food and energy costs soared.

Last year, we introduced a chart that showed how inflation performed post WW2 (see figure 1). As you can see, it was all over the map. Prices were up double digits one year, then we had deflation followed by extreme inflation, and then deflation again. Although nothing really compares to WW2, the parallel to now is the sheer disruption we've seen in society and the economy. It takes time to get back to normal. It's unlikely that people who saw double digit inflation post WW2 thought prices would actually decline in a year or two, or that by the mid-50s inflation would have settled into a more normal range. But that's exactly what happened.

Figure 1: Inflation rates in Canada & U.S. from 1945–2015



Source: FactSet

> **"Portfolios that consider multiple possible outcomes help protect capital precisely when the future is uncertain."**

What to do now?

In our recent client event, we shared some ideas on how to protect portfolios against inflation. Here are four ways (in no particular order) to help offset the effects of rising rates:

1. Allocate to floating rate bonds. These reset at a higher coupon as rates rise.
2. Own stocks in companies that increase their dividends to help preserve your purchasing power. Canada has a lot of great dividend stocks.
3. Buy shares in companies with resilient business models and purchasing power can offset inflation and help these companies perform. The U.S. has more of these companies than any other country in the world.
4. Price matters. Uncertainty drives down prices, creating excellent long-term opportunities. Europe is currently a good example, with valuations relative to the U.S. market at twenty-year lows.

These concepts aren't ground-breaking. Chances are, your portfolio has some or all of these strategies currently in use and they don't appear to be working. The fact of the matter is that virtually nothing has worked this year. The combination of slowing growth, high inflation and rising rates is a pretty nasty one. When you add the uncertainty of war in Europe, it's no wonder markets are shaky.

Although there's no silver bullet for this environment, there is a tried-and-true strategy for beating inflation: diversification and focusing on the long term. The table in figure 2 shows returns for the U.S. (S&P 500) and Canadian (S&P/TSX) stock market benchmarks. Despite the challenging start to the year, we can see that markets are still positive over 1 year, and the last 3 and 5-year returns are well ahead of even todays elevated inflation levels.

Perhaps what's most impressive about the returns of the past five years is that we had three significant corrections. The S&P 500 fell over 19% from its highs in the fourth quarter of 2018, and over 30% in the first quarter of 2020. It's down about 13% so far this year in Canadian dollar terms.

Figure 2: CAD total returns and annualized over 1 year as of May 31, 2022

	U.S. S&P 500	Canada S&P/TSX
YTD	-12.9%	-1.3%
1YR	4.4%	7.9%
3YR	13.9%	12.2%
5YR	11.9%	9.4%

Source: Bloomberg

Dealing with the unknown

So, will inflation peak soon? Maybe. While this is an unsatisfying answer, it's the only one available. But the answer matters less when you focus on diversification and long-term investing principles to guide you. Portfolios that consider multiple possible outcomes help protect capital precisely when the future is uncertain. So, to the more important question of "Will I be okay?" the answer is likely yes as long as you stick to your plan. And that's what really counts in the end.

CWB Wealth Management Investment Team

Sources: FactSet, Bloomberg

Suit yourself
Sizing up your investment suitability

You've heard us reiterate the mantra "stick to your long-term plan" dozens of times – it's good advice under any market conditions. But what precedes that advice is a thoughtful, meticulous assessment of your financial aspirations and abilities to create a plan that's worth sticking to. This is known as investment suitability.

Whether you're a novice investor or have been investing for a while but, frankly, find the topic a bit dry and hard to follow (we know not everyone is obsessed with portfolio strategies, like us), there are some basic principles you should know. We're here to share the primary practical and psychological considerations that underlie our process for determining your investment suitability, to ensure a tailor-made plan that suits you best.

What is investment suitability?

Bernadette – Suitability is a fundamental concept in portfolio management, comprised of two components. First, you must have a deep understanding of your personal financial circumstances. This involves assessing your age, financial situation and needs, investment objectives, time horizon, liquidity needs, tax status, investment knowledge and risk tolerance. The second component involves conducting thorough due diligence on the investments in question, to ensure they adequately meet your current circumstances and objectives.

If both components are aligned, suitability has been achieved. However, your life circumstances are continuously evolving (e.g., getting married/divorced, having children/grandchildren, getting a salary increase or inheritance, losing a job, selling a business), so it's important to reassess suitability as these changes occur.

How does your level of financial literacy come into play when assessing investment suitability and risk tolerance?

Anna – It's true that education and experience can influence your risk tolerance. For instance, someone who believes that equity markets are definitively not for them, based on their knowledge of a few fringe/speculative stocks, may change their mind after learning about dividend-focused or value investing.

But once a base level of understanding is reached, risk tolerance is typically innate to a person's character and no amount of facts, figures, or education from an advisor will change that – nor should that be their goal! At its core, the risk/reward trade-off that one settles on for their portfolio should make them feel just as good on the best day in the market as it does on the worst day. Lots of people would be happy with a +30% return – far fewer could stomach a -30% one.

After all, being a stock-picking-wizard and reading the Wall Street Journal are not prerequisites for investing in the stock market. In fact, many people enjoy long-term investment success precisely by recognizing where their investment knowledge (or interest thereof) ends and where that of a trusted advisor begins.

That said, it's every investor's duty to understand the level of risk involved in their investments. Some investors who view the Canadian banks as safe havens would be unsettled to learn that those very names were temporarily down 30% to 40% in March of 2020, for example.

In that same vein, if you're inheriting or being gifted family assets, you should never assume that just because an investment was suitable for your parents it will automatically be suitable for you. Having frank discussions with your advisor and erasing the discomfort around asking "obvious" questions (hint: there aren't any) is crucial to building financial literacy to a point where you can confidently gauge your own penchant for risk.

What's the difference between risk and market volatility?

Bernadette – Risk tolerance is an important factor when determining investment suitability, and there are two ways to gauge this: your *willingness* to take risk and your *ability* to. Risk willingness is largely intrinsic and measured by your propensity to take or avoid risk, whereas your ability to take risk depends on your financial health.

Each type of investment carries a level of risk given its attributes. For example, a 1-year Government of Canada bond will carry far less risk than shares in a brand new, highly-speculative junior mining company.

> **"Suitability is a marriage between your financial and personal circumstances to determine an investment strategy that's the right fit for you."**

However, it's important not to blur the notion of risk with gyrations of the capital markets that create volatility. There's typically a relationship between the amount of volatility and level of risk, but this isn't always the case. When serious unexpected events occur, such as wars or pandemics, uncertainty and fear can exaggerate typical trading and ultimately impact volatility.

How can excessively low-risk investments impact an investor's portfolio?

Anna – Excessively low risk investments (ones that are unlikely to produce the returns necessary to meet the holder's financial objectives) can be just as detrimental to your success as excessively risky ones.

For starters, investors should always remind themselves that no one is paying them out of the goodness of their heart. In other words, if you're making a return of any kind – no matter how modest or guaranteed – then you are, in fact, being compensated for risk.

Let's take Guaranteed Investment Certificates (GICs), for example, which investors often refer to as "no risk" investments because of their principal protection guarantee. In fact, GICs are not "no risk" at all – they are simply "known risk." Here, the GIC investor is offered principal protection and a more attractive return on their cash to compensate them for taking on liquidity risk (the risk that they may need their money before the GIC term is up and be unable to access it), interest rate risk (the risk that rates will rise while they're locked in at the original, lower rate), and inflation risk (the risk that your return will not preserve their purchasing power).

In the same way, when you opt for excessively low-risk investments – perhaps because you're working with gifted or inherited monies which you feel you have a duty to preserve – you may believe that you're avoiding risk altogether. In reality, you are just opting to take on the known risks of possibly not meeting your investment goals, outliving your money, or having your returns erased by inflation.

Suitability is a marriage between your financial and personal circumstances to determine an investment strategy that's the right fit for you. Holding investments that don't suit your needs or life situation can impact if, and when, you meet your financial objectives. So, take steps to improve your financial literacy and be proactive in revisiting your plan when significant life changes occur. This will empower you to feel more confident designing a plan that's right for you.

***Anna Premyslova, CFA**,*
Associate Portfolio Manager
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Bernadette Churchill, MBA, CIM®
Client Portfolio Manager,
CWB McLean & Partners

The magic of tax-sheltered growth for personal estate transfers

In our December 2021 issue of *Strategies*, Wealth Preservation Advisor, Kim Stevens, wrote about tax-efficient estate distribution for business owners. That article generated a number of questions and good discussions from our readers, who wondered whether this concept applies to non-business owners as well. The answer? Absolutely.

Turning taxable assets into tax-exempt ones

A personal estate transfer is similar to a corporate one in that it acts as a highly efficient tax-free wealth transfer to your loved ones upon your passing. Since life insurance proceeds are paid to your estate or beneficiaries without attracting tax, and due to the growth component of Whole Life and Universal Life insurance, this strategy turns taxable passive investment assets into tax-exempt investment assets.

Due to the tax-free environment, the returns generated by the insurance investment are generally unrivaled by traditional asset classes. Additional benefits are creditor protection, an immediate liquidity injection when your family needs it the most, and the avoidance of probate.

The best part is that all of this is possible without losing access to liquidity to fund an exciting retirement. While this may sound too good to be true, it's a tried-and-true practice that many wealthy Canadians have employed for decades.

Reallocate assets to grow your estate's value

At its core, this strategy involves reallocating investment assets from a taxable to a non-taxable environment. One way of doing this is to redirect savings or cash-flow from taxable investments and invest them in a tax-sheltered permanent insurance policy, using either a Whole Life or Universal Life policy as the investment shelter.

This reallocation of funds creates a life policy with no additional out-of-pocket expenses, and a single premium will generate an immediate amplification in your estate's value. Within the first 20 or so years of the policy life, the internal rate of return (IRR) of the policy at the estate level will generally be higher than rates achievable on traditional taxable investments. Let's look at an example of how this works.

Client scenario

Mike is 51, in good health, and a non-smoker. Although his financial plan suggests his retirement is secure, Mike is likely to continue working until age 60. Like many of our clients, he wants to protect the wealth he's earned and leave a meaningful legacy for his children and future grandchildren.

After a discussion with his financial planner and a Wealth Preservation Advisor, Mike considers adjusting his savings plan to divert $25,000/year to an exempt participating Whole Life policy with an initial death benefit of $500,000.

Using the current dividend scale interest rate of 6.05%, Mike's estate receives an increase of $1.14 million at age 85. If we project a lower dividend scale interest rate by 1%, the estate value increases by $871,000. Not bad considering 10 years of investing $25,000 deposits in a traditional portfolio (5% annual ROR, 50% interest, 50% dividends at 50% marginal tax rate)[1] leaves the estate with only $582,107 after taxes, or about 50% less than using insurance.

And that's the magic of a tax-sheltered growth environment coupled with the tax-free benefit on death – investment performance that's tough to beat! Further, consider that a life insurance investment is entirely diversified from most traditional investments, and you'll see why this is such a powerful wealth preservation tool.

> "...the magic of a tax-sheltered growth environment coupled with the tax-free benefit on death – investment performance that's tough to beat!"

While Mike's financial plan suggests that the 10 years' worth of $25,000 annual savings are likely estate-bound assets, he can find comfort in knowing that liquidity is built into his policy by way of cash value collateral. For instance, banks or lenders may consider the cash value of a Whole Life policy to fund a loan of up to 100% of cash value. This gives Mike access to policy cash values without taking taxable withdrawals or lowering the overall value of his policy.

In fact, in the right circumstance, cash value collateral loans can be a tax-efficient method of retirement planning for many Canadians. Of course, this approach should always be discussed with your advisor to ensure it's the right fit with your financial plan.

Other benefits

While the corporate estate transfer strategy Kim wrote about produces even better results due to the multiple layers of taxation associated with holding companies, the personal estate transfer is nothing to scoff at. Insurance proceeds avoid the time delays, legal and executor fees associated with the probate process.

It also provides quick, confidential, tax-free, liquidity upon death. Death benefit proceeds can be used to magnify or equalize the estate, and offset tax liabilities such as those on a family cottage. And that's something many Canadians can benefit from. Could you? We can help you find out.

Robert Bradburn, CFP®, CIM®, CLU®
General Manager, CWB Insurance Solutions

[1] Taxable investment portfolio (50% interest and 50% dividends). No withdrawals. Rate references regular income and is used to simplify illustration.

[2] Equimax Estate Builder® participating whole life insurance, 20 pay. Illustrated values are for a male, age 51, standard non-smoker rates based on rates in effect as of July 1, 2021, and the dividend scale at that time remaining unchanged for the life of the policy. The sales illustration for this case study shows a premium offset point at year 10, after which time you may be able to stop paying premiums for your policy.

Figure 1: Equivalent required internal rates of return[2]

	Required annual pre-tax rate of return[3]				
	Life insurance (Annual after-tax internal rate of return)	Interest	Dividends	Realized capital gains	Deferred capital gains[4]
Current dividend scale	5.23%	10.45%	8.04%	6.97%	6.04%
Alternate dividend scale (current minus 1%)	4.30%	8.59%	6.61%	5.73%	5.04%

[3] Marginal tax rate of 50%; personal dividend tax rate of 35%. [4] Assumes capital gains are deferred until age 85

Source: Equitable Life

Wealth transfer strategies for business owners

Family businesses are as unique as the people who run them, and for each, there are different financial solutions to help minimize taxes and simplify estate settlement for greater wealth longevity. For business owners, transferring wealth requires careful planning that considers the potential financial, tax, and legal issues that can affect the wealth they seek to transfer. Which means, you need to really think about where to plant your trees.

Three common wealth transfer strategies we've implemented with our clients to help them meet their legacy goals are estate freezes, asset clean-up, and trusts. Here are some client scenarios that illustrate their usage.

1. Estate freezes

An estate freeze allows business owners to cap the value and applicable income taxes on their shares in the family company and transfer its future growth to their beneficiaries on a tax deferred basis. For example, the current business owner can exchange their common shares (which grow in value with the company's value) for preferred shares (fixed at the current value of the common shares they just exchanged). The company in turn issues new shares of common stock to the beneficiaries at a nominal value.

Client scenario

Alicia has owned and operated a company for several decades, over which time the value of her business has grown. She's now considering slowing down and letting her family take on some of her responsibilities before she retires, but she would like to maintain control of the business for the foreseeable future.

The increase in the value of her private company shares will eventually trigger a large tax bill when she either sells or redeems her shares. By using an estate freeze to exchange her common shares for fixed value preferred shares, Alicia and her advisors will know the exact value of her shares and can then begin planning how to minimize the unrealized taxes on her shares (e.g., redeeming a small portion of her preferred shares each year to take advantage of her personal marginal tax rates).

Alicia can then have her company issue new common shares to her children (and/or company management), and any future company growth will be allocated to these new shares. This transfer of future company growth to these new shares will also transfer the eventual capital gains and taxes on this growth into the future.

2. Asset clean-up

Business owners may acquire different types of assets over their working lives, for both investment and personal reasons. As they approach retirement, these assets may no longer be relevant to the needs of the business owner and could better serve the needs of their family if they were converted into more useful assets. This asset clean-up may also reduce the complexity, time, and cost incurred by their children to settle the business owner's estate when they pass.

> **"Someone's sitting in the shade today because someone planted a tree long ago." ~Warren Buffet**

Client scenario

After several decades in business, Miguel has acquired many types of assets in addition to his company. These include shares in a few of his friends' start-up companies, a warehouse and a strip mall, and an antique car collection. While these assets have been interesting and somewhat financially lucrative, Miguel is now approaching retirement and considering his family's wealth transfer goals. He thinks it may be time to let go of some of these assets. Let's look at some options available to him.

Miguel's first step is to determine the tax impact of either liquidating or gifting these assets as part of his broader wealth transfer plan. If he were to sell them and pay the taxes, he will be able to:

1. Make a cash gift.
2. Buy new assets that make sense for other family members (e.g., fund a starter home for his children).
3. Make donations to his family's favourite charity(ies) and receive a charitable tax credit to offset any taxes that were triggered.

As a bonus, disposing of these assets may also trigger some tax losses that Miguel can use to reduce taxes on his other sources of income.

3. Trusts

While changes to the Income Tax Act over the last decade have decreased the number of tax planning opportunities available for the use of trusts, they can still provide many wealth transfer benefits. For example, taxpayers over the age of 65 can set up an Alter Ego Trust for themselves, or a Joint Spousal/Partner Trust with their spouse/common-law partners to hold certain assets during their retirement (e.g., family home, cottage, taxable investment portfolios). These trusts can preserve a family's wealth by reducing probate fees/estate administration taxes (in certain provinces), and shelter family assets from creditor claims with the with the added benefit of simplified estate settlement.

Client scenario

At age 67, Sanjay decided to retire from his manufacturing business and pass it on to his adult children. As an Ontario resident, he's concerned about probate fees, legal claims by former business partners and employees, and wants to ensure his children will not be burdened with winding up his estate. What are his options?

By setting up and holding his home and taxable investment portfolio in an Alter Ego Trust, Sanjay can address each of these concerns. He will also benefit from additional privacy since the settlement of his Alter Ego Trust will not be part of the public record.

Sanjay can also use trusts to assist and protect his children and grandchildren. For example, if he uses the estate freeze noted above, he can redeem his new preferred shares over time (to minimize the taxes) and use the after-tax proceeds to fund new family trusts for each of his children. These trusts will also enjoy the same creditor protection and probate fee savings as his Alter Ego Trust.

Alternatively, if Sanjay decides to sell his company, he could allocate a portion of the after-tax sale proceeds to each of his children's family trusts. The funds in each family trust could then be invested to generate annual income to pay his children and grandchildren's living expenses (e.g., annual vacations, post-secondary education, etc.).

These are just three of several wealth transfer approaches available to business owners to reduce their income taxes, simplify their estate, and take care of their family. Implementing any of these strategies can take time, so it's never too early to speak with your financial advisor about putting them in place.

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