The Dream Achiever

DD HUMES

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"One's destination is never a place, but a new way of seeing things."

~ Henry Miller

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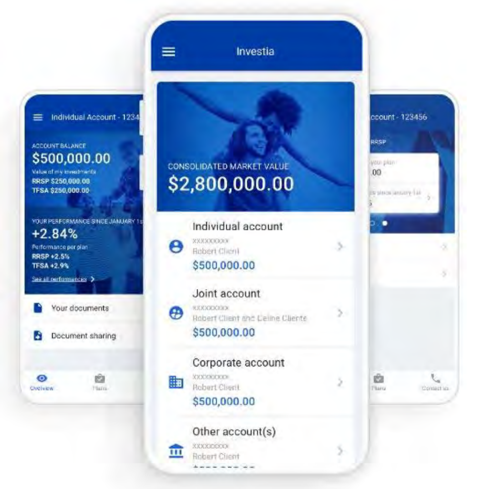

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iA Investia Financial Services Inc.

Are we there yet?

Happy New Year 2023! We hope that you all had a happy and healthy holiday season. 2022 was one where life started to feel a little more normal, but with regards to investment markets the year was far from the norm. Ongoing bond and stock market volatility throughout the past year has many investors asking their advisors "Are we there yet?" with regards to arriving at a better investment environment.

The primary themes that moved the markets during 2022 were geopolitical events that sparked inflation to levels not seen since the early 1980's. This resulted in central banks aggressively raising interest rates to slam the brakes on the economy and bring inflation under control. The 4th quarter finally showed markets turning the tide towards more positive momentum, but even with that most stock and bond markets finished the year down with double digit losses on the year. This scenario is extremely rare and caused balanced portfolios to have one of their worst years ever. Generally, stocks and bonds move in the opposite directions, so act somewhat as a buffer of one to the other, but last year both moved in the same direction, down!

In 2022 there were not many places to hide from the declines. The Canadian TSX composite finished the year with a gain of +5.96% in the 4th quarter resulting in an annual return down -5.84%. The US S&P 500 was up +7.56% in Q4 finishing the year down -18.11%, MSCI World Index ($USD), which measures equity results in 23 developed markets around the world, was up +9.89% for an annual return of -17.73%, and FTSE Canadian (GBI CAD) Bond Index was flat in Q4 for an annual return of -10.3%.* The CAD$ versus the USD$ was up +0.9% in the quarter to finish down -6.7% for the calendar year 2022.

Interest rates were a big story this year. The era of low rates and the corresponding free debt came to an abrupt halt. At the beginning of the year the US Federal Reserve (Fed) had projected that in 2022 there would be 0.75% of interest rate hikes, the equivalent of three hikes of 0.25%. What happened was 4.25% of interest rate hikes which is the **equivalent of seventeen 0.25% hikes**! So, if you feel dizzy about all of this, imagine how the Fed feels.

At the start of 2022 short term money was basically paying you almost nothing and today we are seeing 1-year GICs paying over 5%. What we are also seeing is that the one-year rate is now higher than the 5-year rate. This is referred to as an inverted yield curve. It generally is a pretty good indicator of an upcoming recession, but it doesn't provide much information with regards to timing or severity. Another thing that makes the current environment unique is that generally when the economy is headed into a recession the central banks are looking to cut rates to avoid one whereas today they are raising rates to basically manufacture a recession and haul in inflation.

Our outlook for the fixed income market has turned positive. We are no longer in the TINA (There Is No Alternative) environment for yield. For the first time in years, bond yields are looking very attractive. For example, in 2022 the Canadian Short Term bond index yield went from 1.4% to 4.4%. The yield acts as a buffer (staying above water) before an investor sees a negative return, so even if there is some bad news for the fixed income markets in 2023, there are finally some very healthy buffers before the returns are negative. If we do head into a recession the flight to safety will also provide a very positive investment environment for fixed income. Most portfolios are currently overweight fixed income and cash.

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Market Overview Continued

The Canadian real estate market, which has been hot for decades, is also feeling the effects of these rate hikes. The number of sales is down, and the prices have also dropped significantly since the summer months. The primary reason for this is that in Canada the exposure to variable rate and shorter-term mortgages is greater than in the US. Because of this, the carrying cost of mortgage debt is up significantly. For example, when the loan rate goes from 1.5% to 6% on a $500,000 25-year mortgage, the cost of the monthly payment rises 60% from about $1998 to $3199 per month. That is an extra $1,201/month or $14,412/year! Over the 25-year mortgage period you would now pay $360,134 more in interest! It's no wonder why the lending market has slowed.

As difficult as 2022 has been with rate hikes, high inflation, and market swings, we feel that the worst is likely now behind us and that market conditions are much more compelling looking forward. Central bank policy, which operates with a lag, is likely to weigh on the economy into 2023, but equity and bond valuations have normalized, and the potential returns of several asset classes offer attractive opportunities. Corporate earnings in general have also remained resilient and supply chains are finally moving again.

So, are we there yet? I'll let those in the passenger seats know that the GPS says that we are likely almost there but regardless of where we are in the market cycle, it's important to take a disciplined approach to investing and stay focused on your long-term goals. This strategy helps you keep your emotions out of investing, typically buying high and selling low like many investors do. We would again like to thank all of you for your continued trust in us and for the opportunity to assist you in working towards achieving your dreams.

New Year Planning items

- **RRSP Contribution Deadline:** For the 2022 tax year you need to contribute before March 1, 2023. The maximum room for 2022 is $29,210. If you want to get started on your 2023 contributions, the maximum limit is $30,780. You may need to adjust your automatic savings plans for the coming year accordingly.
- **Registered Education Savings plan (RESP) contributions:** Quebec beneficiaries get the added 10% QESI grant from the provincial government increasing the overall grant to 30%! Your 2023 room is now available.
- **Tax Free Savings Account (TFSA):** A new $6500 of room available since January 1, 2023. Total room since 2009 is **$88,000.**
- **Conversion to RRIF account:** Those of you who turn 71 years of age in 2023 (born in 1952) will need to convert their RRSPs into RRIF accounts before calendar year end. We will be in contact to assist you on how to get that done.
- **$2K pension deduction:** Those who turn age 65 or older in 2023 and receiving recognized pension income.

The Planning Corner: Tax-Free First Home Savings Account (FHSA)

In the 2022 budget, the federal government proposed the introduction of the Tax-Free Home Savings Account (FHSA) which will compliment the use of the Home Buyers Plan. The new registered plan would give prospective first-time home buyers the ability to save $40,000 on a tax-free basis. Like an RRSP the contributions would be tax-deductible, and like a TFSA the withdrawals to purchase a first home would be non-taxable. The 2022 budget announced the key design features of the FHSA including the **$8,000 annual contribution limit in addition to the $40,000 lifetime contribution limit**. As of the time of writing this planning corner I have not yet heard of any suppliers having these accounts available to investors.

To open the FHSA you must be a resident of Canada and at least 18 years old. The individual must also be a first-time home buyer, meaning they can not have owned a home in which they lived at any time in part of the calendar year before the account is opened or at any time in the preceding four calendar years. An individual would be allowed to carry forward unused portions of their annual contribution limit up to a maximum of $8,000. This means that like an RESP the most you can do is double up your contribution to catch up on unused room. So an individual contributing less than $8,000 in a given year could contribute the unused amount (i.e., $8,000 less their contribution in that year) in a subsequent year on top of their annual contribution limit of $8,000 (subject to their lifetime contribution limit). Any savings not used to purchase a qualifying home can be transferred on a tax-free basis into an RRSP or Registered Retirement Income Fund (RRIF) or would otherwise have to be withdrawn on a taxable basis. Individuals that make a qualifying withdrawal could transfer any unwithdrawn savings on a tax-free basis to an RRSP or RRIF until December 31 of the year following the year of their first qualifying withdrawal. Reach out to us if you need more information.

*Source: Morningstar Canada