Investing Wisely

A Newsletter from Mike Wise

May 2024

Every year I get impatient for the arrival of Spring, and each year it seems to be longer and longer before we can say "Spring is Sprung!". Some notes from my diary:

April 2: saw 1st robin at Britannia Slopes

April 8: saw 1st robin in back yard

April 10: Prairie Crocus in bloom at River Park

April 12: Robin building nest in patio light (this is the 4th consecutive year – same bird?)

April 20: Glenmore Reservoir ice-free

May 11: Mayday tree blooms

Solar Eclipse in Quebec
Photo courtesy David Wise

Carmen and I don't have any particular plans for the summer. Our big adventure will be in October, when we have booked a cruise to Greece and Turkey. We wanted to include the Holy Land, but for some reason that is not a good place to visit right now.

In the meantime, Carmen has joined a fitness club to try to get in shape for touring Athens, Istanbul and Ephesus in particular.

Where We Are

Table 1 shows how stocks, bonds and commodities are performing this year. Most of my clients have a balanced portfolio. My pension-style Canadian Neutral Balanced Benchmark is up 2.73% so far this year (to May 1).

I wrote in my January newsletter that bond managers were predicting that interest rates would fall by 1.5% this year, and that this was the most aggressive stance ever taken by bond investors. I disagreed with this consensus. So far, I've been proven right. Interest rates have gone *up*, not down, so far this year, The DEX Universe Bond Index was down -2.1% at the end of April. (Bond prices move inversely to interest rates.) I still think that there will be rate cuts; there's a US election coming up, and the US Federal Reserve is overly Democrat. I expect a rate cut in September that will help the Democrat's chances. We'll also likely see some fudged economic data over the summer to help make the Democrat's economic case.

Interest rates remain inverted, which means that short term interest rates are higher than longer term rates. I quote B2B Bank (part of Laurentian Bank) in Table 1. While their 5-year GIC rate is 4.25%, their 1-year rate is 4.8%. Table 1 also shows that my favoured supplier of a High Interest Savings Account offers an "advisor-only" rate of 5.00% to my clients. This rate is for a standard bank savings account,

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Table 1
2024 Returns - Year to 30 April

	31 Dec 2023 Price	30 April 2024 Price	YTD Change
Equities			
TSX (CAD)	20958.44	21947.41	4.7%
S&P500 (USD)	4769.83	5127.79	7.5%
NASDAQ 100 (USD)	15011.35	16156.33	7.6%
Commodities			
Oil (WTI; USD)	$71.33	$77.99	9.3%
Gold (Comex; USD)	$2071.80	$2310.10	11.5%
Fixed Income			
DEX Universe Bond Index (CAD) - Total Return	1121.5	1098.3	-2.07%
Govt of Canada 10-Yr Bond Interest Rate	3.128%	3.680%	0.552%
Best 5-yr GIC Rate (rate as of May 16)	4.10%	4.25%	0.15%
High Interest Savings Account (rate as of May 1)	5.00%	5.00%	
Exchange Rates			
USD/CAD	$0.7549	$0.7313	-$0.0236
EURO/CAD	$0.6840	$0.6792	$0.0048

CDIC-insured, with interest credited monthly. The supplier is one of the Canadian Big Banks.

Stock markets started the year strongly. There was a pullback in April as market participants started to realize that their hopes for a big rate cut aren't likely to be fulfilled. However, there has been a recovery in May (I'm writing this in mid-May) as the optimists still think there will be a substantial rate cut without a recession.

> ***"As the amount of money being taken from our pockets increases year after year it will soon be equal to or greater than the money coming into our pockets from all our hard work. If this is what they mean by net zero, I think we will be there before 2050."***
>
> ***Anonymous***

Chart 1
Seasonality of the US Stock Market
(Presidential and non-Presidential Years)
Source: Goldman Sacs Global Investment Research

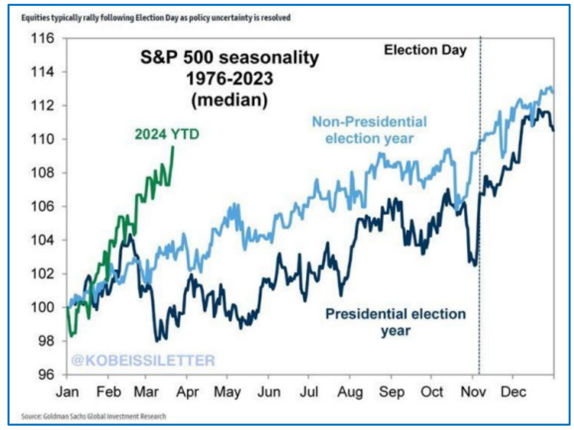


Chart 1 shows how the US stock market has tended to do in presidential and non-presidential years. So far, this year has been unusually good.

Federal Budget 2024

The Liberal's budget has been almost universally condemned by economists and even Liberal-leaning pundits, including former finance ministers. Most seemed to focus on the "Tax on Innovation" – more on that a little later.

I am more of a cynic: I think that the Liberals know they will lose the next election, and are making it difficult for the Conservatives to follow through on their agenda. I grew up with my father's slogan *"Tory Times are Hard Times"* drummed through my head. It seems that the voters choose Conservative when they feel the need to clean up the mess created by Liberals, but then return to the Liberals when the hard work is done. We're seeing this in action right now.

One of the more shocking aspects of this budget is that interest costs on the

Prairie Crocus

existing federal debt now exceed the amount devoted towards healthcare. It is also roughly equivalent to the revenue from GST: the GST that we pay on everything we buy goes solely towards debt interest.

Anyway, here's what one analyst wrote regarding the "Tax on Innovation":

The federal budget confirmed many economists' and commentators' grim predictions. It unveiled a staggering $40 billion deficit, dwarfed only by an even more alarming $52.9 billion in spending over and above previous plans. The budget's most controversial measure, however, was a significant tax hike - an increase in the capital gains tax inclusion rate from 50% to 66.6% on gains exceeding $250,000. The government described this as a minor adjustment affecting less than 1% of the wealthiest Canadians.

Many on social media seem to have bought this tired old "tax the rich" narrative yet again. But, this narrative is nothing more than government spin and - as always - this policy will affect everyone, not just those dastardly one percenters.

First, it's important to realize that the "less than 1% of Canadians" paying this tax are not the same people each year. It fails to consider Canadians who might sell a major asset like a family cottage, a small business, or a substantial investment and then face this heightened tax rate in that particular year. So, while it's true that not many people will pay this tax every year, many will pay it once or twice, or more, throughout their lives.

Second, and worse, the $250,000 exemption applies only to individuals, not to businesses. It applies to any investments held within a business. So, even if your business isn't active anymore, and you just have some savings left in a corporation, well, you're paying, too. If you're a small- to medium-sized business owner, your business could end up paying this higher tax every year.

Third, even tax-sheltered accounts like TFSAs or RRSPs, or pension funds like CPP, indirectly pay this higher capital gains tax on businesses, because the businesses in which they invest have to pay the tax, thus potentially reducing profits and/or the funds available for reinvestment.

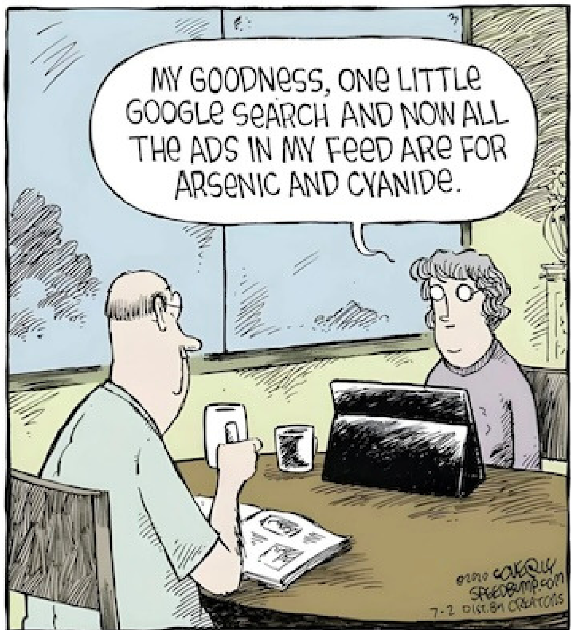
So, now, almost literally every single Canadian is being affected by this tax hike, and the ridiculousness of claiming a tax hike only affects the 1% to begin with is revealed. Despite the government's claims that such fiscal measures only affect a wealthy few, in reality, they influence the broader economic environment, affecting all levels of society and the overall health of our economy.

Incentives for Home Buyers

It seems universally accepted that there is a shortage of housing in Canada. Prices rise when demand exceeds supply. There are various reasons expressed why demand should be so high, but nevertheless there is consensus that we need to increase supply, particularly for low-end housing.

As late as last year, the federal Liberals were claiming that housing is a Provincial responsibility, but that was then; this is now. If votes are at stake, Liberals will always jump in with money to burn. Or at least make announcements that sound good.

The Wonders of AI



Finance Minister Freeland announced that the budget would make provision for the construction of 4,000,000 new homes by 2031. Critics immediately jumped on this as impossible. It would require constructing homes at the rate of 571,400 per year, while the Canada Mortgage and Housing Corporation (CMHC) says that their estimate of the maximum building capacity in Canada is 400,000 units annually. Meanwhile, the actual number of home starts in Canada in 2023 was only 240,267 units.

The first thing one should do when in a hole is to stop digging. When there is a supply/demand imbalance you need to decrease demand. However, the federal budget introduced a new measure to increase demand, while also improving the utility of the First Time Home Buyer's Plan.

First Time Home Buyer's Plan

The First Time Home Buyer's Plan (HBP) allows a prospective homeowner to withdraw up to $60,000 (formerly $35,000) from his/her RRSP for the purchase of an existing or newly-constructed home. The prospective owner's name on the RRSP must match the name on the purchase agreement, and spouses may jointly make HBP applications for their own RRSPs, for a total potential downpayment of $120,000.

A wide range of housing type, ranging upwards from mobile homes, will qualify. HBP withdrawals from Locked-in RRSPs (LIRA) and Group RRSPs are generally not acceptable.

It is important to remember that the HBP is an interest-free loan from your RRSP, not a grant. The funds borrowed have to be repaid to your RRSP over 15 years, at a minimum rate of 1/15 per year. If this is not done, the required minimum will be assessed as an RRSP withdrawal, and added to your annual income for taxation purposes.

There are special rules if the house is to used for a disabled person, and there are also special rules for special situations. Check out the government website before proceeding!

"I think that FHSAs are generally a good idea, although the $40,000 lifetime limit seems awfully low. Portfolio Strategies offers FHSAs to our clients through our mutual fund partners."

First Home Savings Account

This initiative is new, so there might be rules changes in the future. But for now, it operates similarly to an RRSP on the contribution side. The owner of a First Home Savings Account may contribute up to $8,000 per calendar year to their FHSA, and deduct the contribution from their declared income for the year. Almost any financial institution can serve as trustee of the FHSA, and the FHSA can hold a wide variety of investments, similar to those qualified for an RRSP account. Contributions can be in cash, or in-kind from a non-registered investment account. Transfers-in from an RRSP are OK, but these won't be considered a contribution.

The lifetime maximum contribution limit is only $40,000. This includes contributions and any transfers-in from an existing RRSP. Furthermore, the carry-forward of any unused contribution room is only $8,000 in any calendar year.

A withdrawal from a FHSA will be tax-free as long as there is a matching signed purchase agreement for an existing or newly-constructed home in place, and you meet the criteria as a first-time home buyer.

If your circumstances change, you can also transfer your FHSA account over to an RRSP without attracting tax.

If you make a withdrawal without satisfying the requirement to use the funds to purchase an owner-occupied home, or to transfer to an RRSP, the entire amount of the withdrawal will be added to your income in the year of withdrawal.

I think that FHSAs are generally a good idea, although the $40,000 lifetime limit seems awfully low. They are likely to become quite popular. Portfolio Strategies offers FHSAs to our clients through our mutual fund partners. But check out the government's rules and regulations before proceeding with a FHSA!

RESPs for Grandchildren

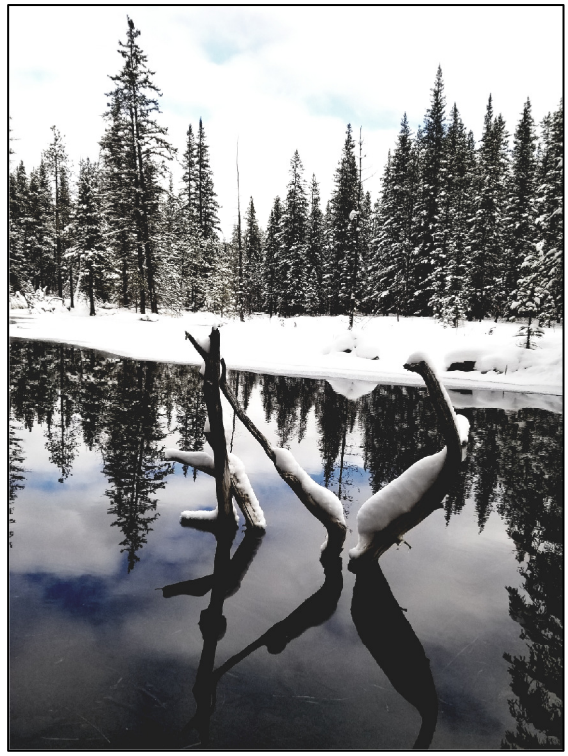
While on the broad subject of government incentives, let's talk about Registered Education Savings Plans. This is another benefit that parents should be taking advantage of. You're leaving up to $500 tax-free per year on the table if you don't participate. I've written about this previously.

Most grandparents want to help their grandchildren get off to a good start in life. In today's world, post-secondary education - whether at a university, career-oriented college, or an apprenticeship - is a necessity.

A Registered Education Savings Plan (RESP) is an excellent way of saving money for a grandchild's future education. The big benefit is that the federal government kicks in an additional 20% on top of your contribution, up to a maximum of $500/yr. You'll maximize the fed's contribution if you contribute $2,500/yr to the RESP.

The best time to start a RESP is at birth. The maximum CESG grant that the government will pay is $1,000 in a single year, so you can only catch-up unused benefits one year at a time. And the grant stops once the child reaches age 18.

Beaver Pond in Spring



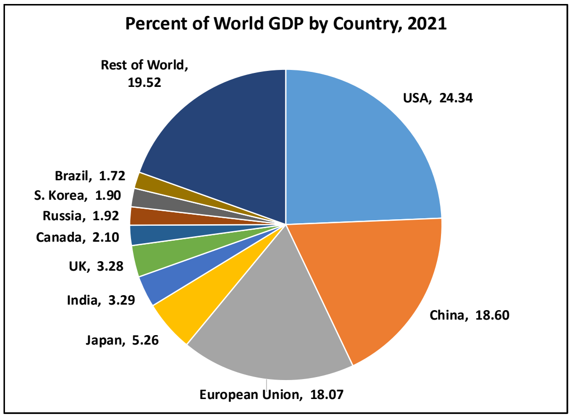
If the parents and both sets of grandparents are all contributing to a child's RESP, the cash outlay for each contributor only needs to be $69.44 per month to maximize the CESG grant. This should be affordable for most families.

While a child can be beneficiary of multiple RESPs, the federal maximum grant applies to the sum of all contributions to all the plans.

As grandparent, you can set up a RESP with you as subscriber and the grandchild as beneficiary, or you can have the parents set up a plan in which the parents are subscribers and you are a contributor.

We are using the second method for Zoe's and Avi's RESPs. Kelly-Anne is the subscriber, and we contribute to both grandchildren's RESPs. The advantage is that Carmen and I, Kelly-Anne's

Chart 2
% of World GDP by Country
Source: www.theglobal economy.com



parents, and of course Kelly-Anne and David, all contribute to the same plan, and we can keep track of total annual contributions.

Gold BRICS

I've written previously that I believe that the US dollar will lose its status as the world's reserve currency within a decade.

Of course, the US remains the world's dominant economic force. Chart 2 indicates that the US represents roughly ¼ of the global economy. (Canada is only 2.1% of the global economy; less than 10% of the US.). This is changing. Some forecasters are predicting that both China and India will surpass the US in economic power by 2050. We have entered a multi-polar world.

The US is also the dominant military force. The country is by far the world's largest spender on Defence, and is not afraid to project that power around the world. According to Wikipedia, the US has something like 1000 military bases of various sizes scattered around the globe.

However, the US is also addicted to spending money it doesn't have, and this is where the weakness lies. It's a little hard to find the numbers, but according to the International Monetary Fund the US debt held by the public amounts to around 29% of total global debt (an estimated $235T), and if private debt

East End of Rundle
View from Canmore

(mortgages, credit cards, corporate borrowing, etc) were included it would represent a staggering 66% of all debt in the world.

The disparity between debt level as a percentage of global GDP and economic status as a percentage of global GDP grows larger every year. The Congressional Budget Office forecasts that the US federal budget deficit will continue to grow at a rate of between $1.5 and $2.0T per year over the next 10 years, from a current accumulated base of $34T. (We worry in Canada about a $40B deficit; that's a rounding error as far as the US is concerned.)

There's no problem with US debt levels as long as the greenback is the world reserve currency.

However, the US, along with its NATO partners, made one of the dumbest possible moves in response to the Russia-Ukraine war, by using its global economic power as a weapon in the fight. The US government has become willing to use economic sanctions against not only Russia and Iran, but almost any country that dares to defy US foreign policy. They have barred Russia from the SWIFT international payments system. The European Union has frozen around $300B of Russian foreign exchange reserves that are held in European banks, and is trying to figure out a legal way of confiscating this money and giving it to Ukraine. They feel that they can legally siphon off the interest from these assets and give the money to Ukraine. Normal people would call this theft.

Canada did much the same thing, on an infinitely smaller scale by freezing the bank accounts of Freedom Convoy participants. The UK is going through a crisis right now after banks began “debanking” clients they didn’t like based upon political views. The policy gained prominence when British politician Nigel Farage got debanked.

Other countries have taken note. No country, or wealthy individual, in their right mind should hold significant wealth in a Western country. Last week, Nigeria announced that it was removing all its gold reserves from New York. The west African countries that were formerly French colonies have thrown out both French and US troops, and have told Paris that they want their gold back; they will store it back home where it is safe.

BRICS (Brazil, Russia, India, China, South Africa) is expanding. Many countries seem to want to join this loose economic federation that is a resource-rich powerhouse. Saudi Arabia and Iran might be religious antagonists, but they now share a mutual distrust of US economic policy.

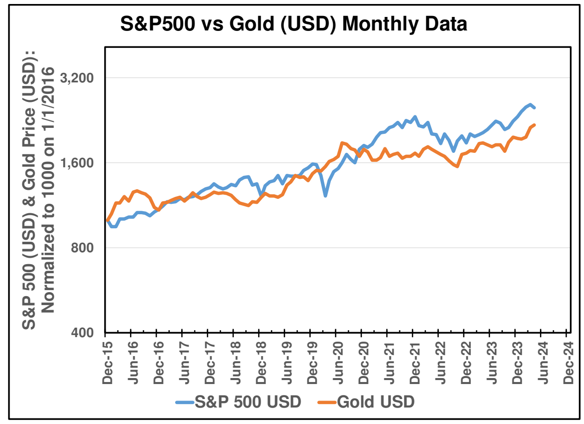
The original BRICS have already set up an alternative to SWIFT, and the general thrust of their monetary policy is to facilitate trade in their own currencies. It looks as if the organization is heading towards a common currency, based upon commodities such as oil and gold.

The following is an essay by financial journalist Ed D’Agostino that gives his opinion on where (and why) gold may be an important component in this shift from the US dollar.

What is Gold Telling US?

Gold started this week at an all-time high. It’s up about 10% since the start of the year. That’s roughly on par with the S&P 500. (Ed note: As of May 17, gold is at USD2419.80/oz, up 16.8% YTD vs the S&P500 up 11.2% YTD) All of this while inflation is trending down (with some bumps).

Chart 3
Gold (USD) vs S&P500 (USD)
Normalized Monthly Data Since 1/1/2016
Source: Barrons



Demand for gold is not coming from individuals, but from central banks. Money flows from ETFs that hold gold have been negative since 2020, while central banks are adding record amounts of gold. The Central Bank of China, in particular, has been a big buyer. Why is that?

Gold is widely accepted as a store of value. Banks can hold gold without political or credit risk. There’s nothing particularly new or revealing about that. But what if gold’s latest popularity is signaling its return to being used as an actual currency—a means of exchange among nations looking to settle trade outside of the US dollar?

Settling trade in gold is one way to thwart US sanctions and avoid the global SWIFT payment system. Iran selling oil for gold is a standout example.

China has a big incentive to derisk from the US dollar. The OEC reports that in 2022, China exported $3.73 trillion worth of goods, while importing only $2.16 trillion. That imbalance results in a massive surplus of foreign currency—mostly dollars, which have to go somewhere. Some of China’s other trading partners, particularly Russia and Iran, don’t find dollars very useful.

There are nations who need to secure grains, uranium, potash, and oil from Russia, one of the world’s largest producers of these and other crucial commodities. But trading with Russia is not easy. It is *under US sanctions, and US dollars aren't very helpful or desirable for Russia at the moment.*

To facilitate trade, Russia has to accept a certain level of foreign currencies, or convince trading partners to deal in rubles. Russia's central bank cannot get overweight any single currency. Indian rupees, Brazilian reals, and Iranian rials only go so far on the global market.

Gold, however, is accepted everywhere. And it doesn't leave a paper trail.

Gold as a store of wealth, as a hedge against currency debasement, and a return to its centuries-old role as a tradable currency… these are all powerful reasons for its price to continue climbing higher. Not to mention the massive government deficits in Washington, DC.

Kids & Technology

"I'm doing my homework, so I don't have time to answer anymore questions about your phone, TV, computer, smart appliances or smart car."

Spring Flower in Glenmore Park