

# 2021 Annual Letter to Clients

*Michael Kirkpatrick*

---

## **A good year for the stock market**

From January 1<sup>st</sup> to December 21, 2021 the Canadian stock market (S&P/TSX Composite Index) was up 21.5%. The world stock market (MSCI World Index) was up 18.8% over the same time period.

This our fifth annual letter to our clients. We will share some of the highs and lows of the past year and as always your feedback is welcome.

## **What would we have done differently?**

If we could go back to January 1, 2021, we would have allocated more money to US equity. US equity was the best performing asset and was up 24.7% in 2021 and was led by the energy, real estate and technology sector.

## **Market Highlights and Lowlights/ Le Malaise du Jour**

The stock market just seemed to keep going up in 2021. There were a few small pull backs throughout the year but by and large the market kept creeping higher. The big looming issue is inflation and how that will impact families and the stock market. For now it seems as though the market is not being impacted but I can assure you that our grocery bills are being impacted.

On the fixed income side, the Bank of Canada kept rates the same but will raise rates in 2022. Long term bonds measured by the Canadian Universe Bond Index ETF (ticker XBB) were down 3.43% while Canadian Preferred Shares (ticker ZPR) were up 22.21%.

## **Wealth Management Highlights and Updates**

We hosted a few webinars in 2021 which you can [view by clicking here](#). Topics we discussed included risk management, charitable giving, and business owner planning. Our next webinar is on [January 25<sup>th</sup> at noon and we will be discussing The Smith Manoeuvre](#). For our clients who have a mortgage or have children or grandchildren who have or will soon have a mortgage, this is a must attend. I read The Smith Manoeuvre 17 years ago and I guess I am a slow learner because it took 17 years for it to really sink in. Now that I have fully grasped the concept I want to apologise to my long term clients for not having shared the strategy with you earlier. If it is any consolation, I will make sure

that I share the concept with your children and grandchildren so that history does not repeat itself. The Smith Manoeuvre is a debt conversion strategy that helps Canadians convert their non-deductible mortgage debt into tax deductible debt. The end result is a growing annual tax refund, a reduction of the number of years to pay off the mortgage, and a growing portfolio at the same time.

I will let our guest speaker explain the details to you on January 25<sup>th</sup> but I will share some of the big paradigm shifts I've had since understanding it more fully. Firstly, The Smith Manoeuvre introduces how to get a deduction using interest expenses (line 22100 of the T1 general) as oppose to using the RSP. This is interesting as interest expense is a deduction that can serve Canadians well in their working life and also in retirement. In this case the investor would end up with a significant nonRSP as opposed to a significant RSP. This is helpful because getting income out of a nonRSP is much more tax efficient than pulling income out of an RSP.

Another take home I had was that good debt is a helpful tax deduction. Debt where the interest is not deductible is not good, so we call it bad debt. On the other hand, debt where the interest is tax deductible is good debt. I used to think that all debt is evil but now I appreciate that good debt means paying less tax each year and it means leverage which is a good way to counter inflation.

#### De-accumulation

For our clients that are retired the big issue we are facing is de-accumulation: how to get money out of the various accounts (RSPs/RIFs, corporate accounts, nonRSP accounts etc) in the most tax efficient way. The key here is to ensure the amount hitting the bank account each month is adequate but also ensuring we are not unnecessarily being bumped into a higher tax bracket and or facing OAS claw-back. Every situation is unique but finding the optimal plan does take a bit of planning and organization.

#### Big picture planning

We do our utmost to ensure that all of our clients have what I like to call a Wealth Plan. The key items we cover in your Wealth Plan are:

- your family
- the retirement plan/projections
- the tax plan
- the estate plan
- the insurance/risk plan
- the next generation plan
- the investment plan

To compliment the above items we have a team of professionals that can be of help to us. For instance we have:

- Royal Trust Advisors who can help with estate and trust planning
- Will and Estate Consultants who help with estate planning

- Private and Premier banking partners to help clients with their banking and lending needs
- Risk Assessment Insurance Specialists to help clients with Home and Auto Insurance solutions

### Trusted Contact Person

We are now able to add what we call a Trusted Contact Person (TCP) to your file. This is a good idea in case we are unable to reach you, it would be nice to have the contact information of your TCP to make sure everything is ok.

### Auto funding TFSA's

We can now fund your TFSA's automatically using cash from your bank account or nonRSP account. This ensures that your TFSA is fully funded on January 1<sup>st</sup> of each year. Just reach out if you would like to have this set up.

### Low interest rates and cash:

Many clients are sitting on large amounts of cash and are hesitant to get this money working because they already have money in equity, and they do not want to add to fixed income when interest rates are so low. Having cash is never a bad thing so perhaps inaction in this case is acceptable. Otherwise, folks in this situation can consider the more traditional option would be more of the same: adding to our mix of stocks and bonds via dollar cost averaging in an effort to get more long-term growth with some protection. Another thought which is more outside of the box is to get the cash sheltered in a tax exempt dividend paying whole life insurance policy. The life insured can be the client, their child or grandchild and the policy can get the cash growing in a liquid and tax free environment which will enhance the size of the estate via the tax and probate free death benefit.

### **Wealth Management (WM) Online**

If you have not yet been enrolled for WM online please let us know and we will get you set up.

As a reminder, the secure inbox is a great way for us to send you documents that contain sensitive information and vice versa. I wanted to highlight the secure inbox tool again as a way to encourage you to adopt using this platform when sending us information that should be kept secure.

Your 2021 tax documents can be accessed online so if you would prefer to receive your tax documents electronically instead of by mail please let us know or you can make the switch via WM Online (click on "Settings", then the "Document Delivery" tab and then click on the "delivery type" drop down menu to make the change followed by "save changes")

### **Education and Business Operations**

Many of you have gotten to know my new associate, Adnan. He is fully licensed as an Investment

Representative and now is working on his Wealth Management Essentials Certification and Insurance licensing so he can take on more Wealth Advisory roles in the coming years. Once he is done both these accreditations, he will work on his CIM and CFP certifications. The goal is for both of us to take care of all of you and to ensure we maintain the highest of level of service for every family we take care of. Please don't hesitate to reach out to him regarding account matters. Adnan and I work together and we both are here to deliver on your needs.

I completed The Smith Manoeuvre Certified Professional accreditation program. As mentioned above I think this is an interesting strategy and I wanted to make sure I fully understood all of the ins and outs of the strategy. My hope is it does not take my clients 17 years to understand the concept. Aside from that I am the volunteer coach for my daughter's cross country ski program with [Kanata Nordic](#) so I had to do a course in how to coach 3 and 4 year olds how to ski and enjoy the outdoors. We shall see how this goes. In the New Year I will do a course on tax and estate planning as I know that the ideas I get from these courses can have a big impact for our clients and their wealth plan. Am I the only one who gets excited for these types of courses?

## **Books**

The book I have been sharing this year is The Smith Manoeuvre written by Robinson Smith. Robinson's father Fraser Smith came up with the strategy and wrote the original book 20 years ago. I figured that by sharing the book, having a webinar with Robinson Smith as the guest speaker, and by sharing the concepts with you each individually I will have done my job in raising awareness of the strategy.

I will continue to try and find books that I think are relevant to you and will share them when I find a good one. Your book recommendations are also welcome.

## **Portfolio Highlights and Lowlights**

On the fixed side of the portfolio, our worst performers were: VAB (Vanguard Canadian Aggregate bond index ETF) which was down 3.52% and XEB (iShares JP Morgan USD Emerging Markets Bond Index ETF) which was down 3.45%. This makes sense to me that VAB was down as everyone thinks that interest rates are on their way up and when that happens long term bonds usually go down.

Our best performers on the fixed side were ZPR (BMO Laddered Preferred Share Index ETF) which was up 22.21% and TIP (iShares Treasury Inflation Protected Securities) which was up 5.25%.

This also makes sense since the above two ETFs do well when interest rates rise and when inflation rears its ugly head.

My focus on the fixed side of the portfolio is making sure that we are protected from rising rates which we will see in 2022. I think we have taken the right steps to protect the fixed side from rising rates but I remain vigilant.

On the equity side our worst performers were BMG Bullion (gold, silver and platinum bullion) which was down 9.03% and ZEM (BMO MSCI Emerging Markets Index ETF) which was down 2.29%.

Our best performers on the equity side were ZRE (BMO Equal Weight REIT Index ETF) which was up 32.7% and FXM (CI Morningstar Canada Value Index ETF) which was up 31.58%.

As I write this I can't help but think that the above returns are very high and are not sustainable over

the long term. I also see that last years' worst performer was ZRE (BMO Equal Weight REITs) which was down 8.24 in 2020 and this year it is the best performer being up 32.7%. I also see that this year's worst performer, BMG Bullion, down 9.03% this year was last year's star being up 17.56% in 2020. Interesting how things can change but also makes me thankful for diversifying. You can also see why I am hesitant to bail on a beat up asset class because today's dog usually turns into tomorrow's star.

I wrote this last year but I will reiterate that going forward our two biggest risks will be rising taxes and rising inflation. The only way we can protect our portfolios from these risks is by owning companies that consistently increase their earnings. This worked out well for us over the last decade and it will see us through the next decade.

## **Modifications**

No major changes we made to our portfolios in 2021. I am happy with our stable of ETFs and my focus is making sure each of you have the right balance between equity and fixed income. As always, dollar cost averaging, or regular contributions is the best way to deploy new money or cash as it removes the guess work, acknowledges that we cannot time the market in the short term but also that over the long term equity prices will rise.

## **Thank you**

Adnan and I want to thank you for your trust and we look forward to serving you in 2022 and beyond.

Here's to the end of 2021 and to the start of a New Year!

Michael Kirkpatrick

In case you have not seen enough of the David Chilton videos, here are some more:

Three Will & Estate Planning Facts that will Surprise you

<https://ca.rbcwealthmanagement.com/michael.kirkpatrick/blog/3116645-Three-Will-and-estate-planning-facts-that-will-surprise-you>

The Wealthy Barber's Advice to Bryan and Sarah Baeulmer

<https://ca.rbcwealthmanagement.com/michael.kirkpatrick/blog/3116625-The-Wealthy-Barbers-advice-to-Bryan-and-Sarah-Baeulmer-on-being-named-an-executor-of-a-Will>

How Family Real Estate and Business can complicate finding the right executor

<https://ca.rbcwealthmanagement.com/michael.kirkpatrick/blog/3116606-How-family-real-estate-and-business-can-complicate-finding-the-right-executor>