Serber Speaking

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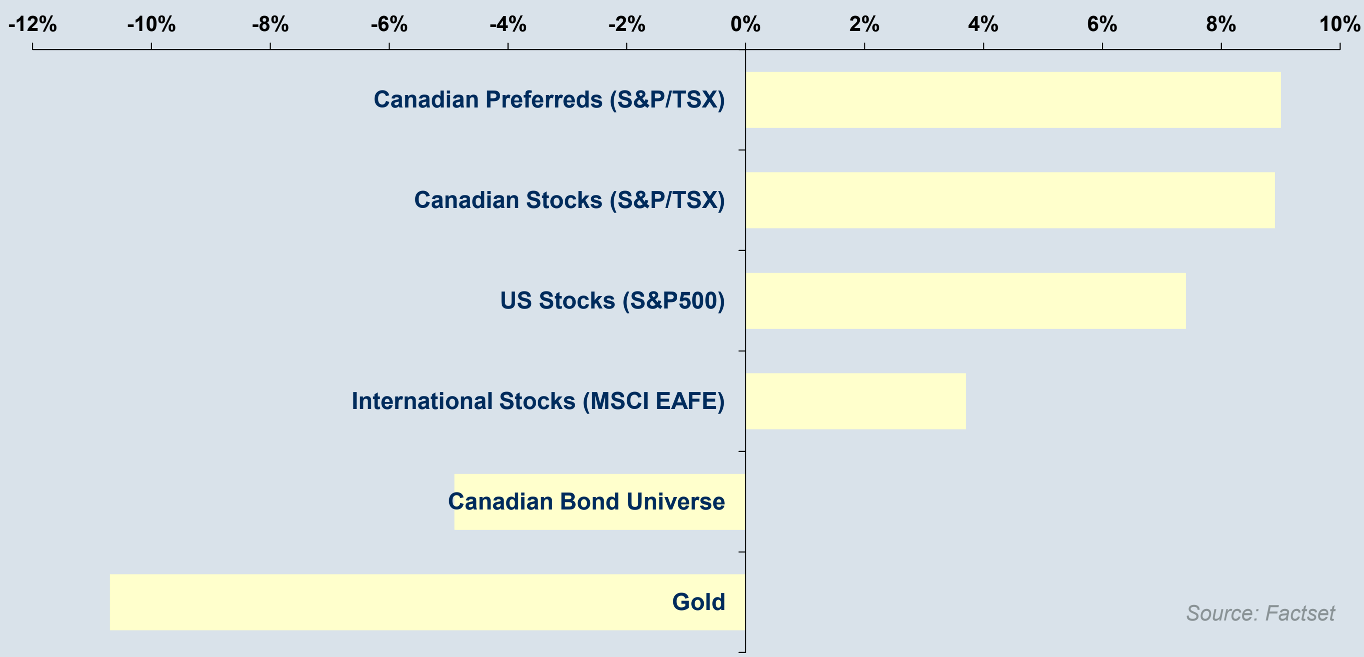
Commentary for the quarter ended March 31, 2021

2021 Starts with a Bang, not a Whimper

After financial markets' strong finish last year, most analysts expected early 2021 to be tepid at best, with many calling for a significant market drop. As the chart below shows, this was definitely not the case. Canadian stocks and preferred shares delivered big returns in Q1, while other stock markets were similarly rewarding, albeit a bit less so.

The Safe Haven categories of bonds and gold were the losers, as it seems investors are less worried about the future than perhaps they were last year, so there were more sellers than buyers of these capital-protection assets in Q1.

Performance by Asset Class: January 1 to March 31, 2021 (in Canadian $)



That said, there is an interesting difference between bonds and gold if we look at returns from Jan. 1, 2020 (before COVID-19) to the present. Over this 15-month period, gold is up about nine percent, while bonds have returned less than three percent. While both categories are considered safe havens, gold did three times better. The reason may have something to do with expectations for inflation. More about this on the next page.

With such recent strong returns from equity markets, I don't expect much in the way of additional gains for the remainder of 2021. One of the arguments in favour of equities over the past year was the positive impact of low and falling interest rates, including the boost in valuation for financial assets. However, interest rates have risen quite a bit lately. The US 10-year government bond yield, a global benchmark for interest rates, is up from its record low of 0.5 percent last summer to a current 1.7 percent and may be on its way to 2 percent or more in the coming months. Rising interest rates combined with high-priced equities is not normally a recipe for big gains, but of course in the short run anything is possible. For the rest of this year, I expect to earn my dividends plus maybe a bit extra if all goes well -- which is still better than making 1.7 percent or 2 percent on bonds or on GICs.

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Inflation, Inflation, Wherefore Art Thou, Inflation?

During the Great Financial Crisis (GFC) of 2008-2009, governments and central banks around the world took drastic steps to prevent an economic implosion. This included monetary measures such as lowering interest rates and printing large amounts of money, as well as fiscal measures such as increased government deficit spending. At the time, many pundits were certain that the unprecedented largesse would lead to rampant inflation that would wreak havoc on the economy. In the event, the inflation never arrived.

Over the past year, government and central bank actions taken in the wake of the COVID-19 pandemic make the GFC measures look comparatively mild. To wit, during the GFC period, the US central bank, the Federal Reserve, created about one trillion new US dollars. During the COVID-19 crisis to date, they have created more than US$3 trillion and are still going at it to the tune of about US$120 billion per month. During the GFC, the flagship US fiscal relief package, known as TARP, was valued at US$700 billion when signed into law in October 2008, later reduced to US$475 billion. This amount seems positively quaint in comparison to the US$5.6 trillion in fiscal stimulus launched to date during COVID-19, not to mention the proposed US$2 trillion infrastructure bill working its way through Congress.

And yet, despite the much larger level of money-printing and fiscal largesse unleashed over the past year, the mainstream does not seem particularly worried about inflation. In fact many authorities, including the Chairman of the Federal Reserve, Jerome Powell, are hoping that inflation, which has been too low for too long, will perk up a bit. The dire warnings of an inflation outbreak post-GFC proved to be wrong, and many assume the same will likely be true this time around.

Maybe. What this logic misses is that the measures taken during the GFC and the pandemic are not directly comparable. The top priority of the GFC stimulus was to prevent a depression-style meltdown of an overleveraged banking system. The COVID-19 stimulus, on the other hand, is primarily focused on stimulating demand by handing out money to individuals and to firms. As a result, Americans today are indeed in good shape to boost spending, as they hold about US$2 trillion more cash in their bank accounts than they did a year ago.

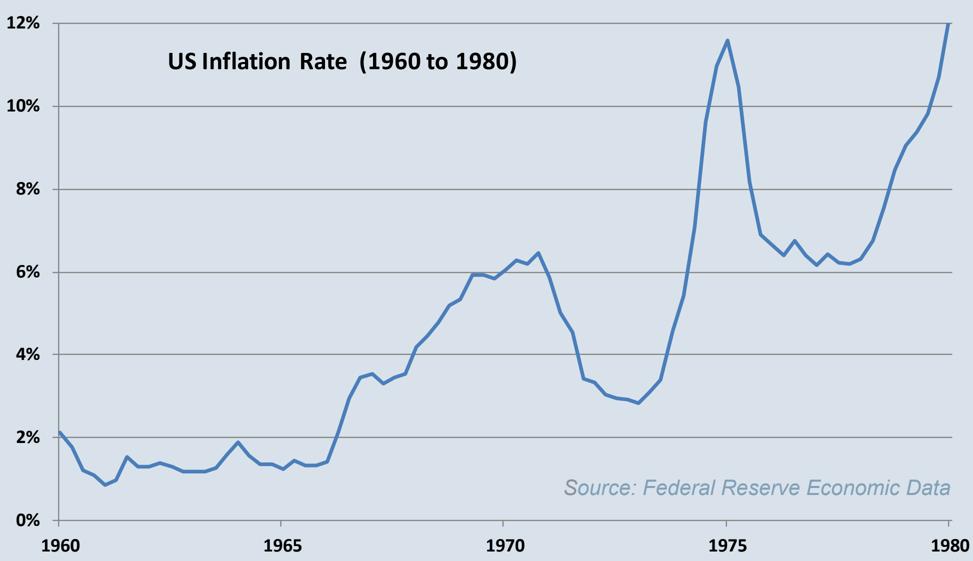
As 2021 progresses and spending picks up, there will be some inflation pressure, especially in the year-over-year comparisons to last year's depressed numbers. However, unused capacity in the economy will mean the uptick in inflation should be relatively mild and short-lived. The unemployment rate currently sits at 9.4 percent in Canada and six percent in the US. Unless and until these figures fall by several percentage points, serious inflation is unlikely.

The good news is that the lack of a serious inflation threat over the next couple years will allow government largesse to continue, which will help underwrite strong economic growth. The bad news is that this growth may eventually result in more problematic inflation down the road. Such a scenario is reminiscent of the early 1960s, when government spending was on the rise and yet inflation was only one or two percent per year, as seen on the graph below. Then, starting around 1966, inflation became a problem. While history doesn't repeat itself, it often rhymes, as the saying goes. In other words, there is a good possibility that inflation is preparing to pounce later this decade. What are the conclusions for investors today?

1) Maintain exposure to stocks, within your comfort zone, which should do better than bonds over the next few years.

2) Reduce stocks if and when central banks begin making noises about slowing down the economy to prevent inflation.

3) Hold and slowly build exposure to inflation assets such as gold and real property over the next few years.



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Financial Planning for Seniors

Some strategies and planning opportunities become more relevant as we age. I include a brief sample below. For a more complete list, please ask me for our ***2021 Financial Planning Strategies for Seniors*** publication.

Income splitting

Pension-income splitting: If your spouse has a lower marginal tax rate, consider splitting eligible pension income to reduce your family's overall tax bill. Generally, you can allocate up to 50 percent of your eligible pension income to your spouse.

Pension sharing: If you and your spouse are both age 60 or over and are receiving Canada Pension Plan (CPP), consider sharing your benefits. Pension sharing may reduce tax when some of the higher-income spouse's CPP is paid to the lower-income spouse.

Other tax-minimization strategies

Tax-free savings account (TFSA) contributions: Consider maximizing your TFSA. If you've lived in Canada since 2009 and have not yet contributed to one, your contribution limit would be $75,500 as of Jan. 1, 2021.

Use your spouse's age for RRIF minimum payments: When you convert your RRSP to a RRIF, the minimum amount you must withdraw each year is based on your age. If you have a younger spouse you can elect to use your spouse's age when setting up the RRIF. Doing so will reduce your annual taxable RRIF withdrawals.

Tax credits

Age amount: If you're 65 or over, you may be able to claim the age amount on your tax return. The age amount is a federal non-refundable tax credit of $1,157 (15 percent of $7,713 for 2021). The credit is reduced by $0.15 for every $1 of net income above $38,893, and it's completely eliminated when your net income is $90,313 or higher.

Pension income: You may be entitled to receive a federal non-refundable pension income tax credit on the first $2,000 of eligible pension income you receive in the year.

Other considerations

There are many additional issues and options to consider in your financial plan, including the use of trusts or gifting assets during your lifetime. Also, always ensure that your will, beneficiary designations and power-of-attorney documents are valid, up to date and that the relevant persons know where these documents are stored.

If you would like to discuss any wealth management topics in more detail, I am happy to oblige and can be reached at david.serber@rbc.com. In any event, please ensure you consult tax and legal experts before implementing any tax or estate strategies.

Until next time, best regards,

David Serber

If you would like to discuss your personal situation please feel free to contact me. Also, feel free to forward this copy of ***Serber Speaking*** to anyone you think would find it of interest.