September 2020

Money Wise Magazine

The Importance of Staying Invested

Time in the markets beats trying to time the markets

What is Dollar-Cost Averaging?

How you can mitigate market risk by spreading out your investment over time

Using a Cash Wedge in your olio

If you take income from your investments, this article is for you

Why is CRA asking me for Installment Payments?

… And what happens if you don't make them

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Quadrus Investment Services Ltd.

MANAGE RISK, DON'T AVOID IT

Investing and risk are a package deal. The keys to long-term investment success are to manage your exposure to risk by using time and diversification to your advantage.

Calendar-Year Returns of an All Equity Portfolio[1]

3-Year Rates of Return of an All Equity Portfolio[2]

5-Year Rates of Return of an All Equity Portfolio[3]

Source: Morningstar. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes. Best and worst year rate of returns based on each time period specified. The portfolios are hypothetical and for illustrative purposes only. It is not possible to invest directly in an index.

[1] Based on the calendar year returns of the S&P/TSX Composite Total Return Index from 1960 to 2017.

[2] Based on 3-year annualized returns ending December 31 of the S&P/TSX Composite Total Return Index from 1960 to 2017.

[3] Based on 5-year annualized returns ending December 31 of the S&P/TSX Composite Total Return Index from 1960 to 2017.

[4] Based on the calendar year returns of a portfolio of 50% the S&P/TSX Composite Total Return Index and 50% Canadian Fixed Income Composite from 1960 to 2017.

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Invest with advice.

In this issue...

It has been a few months of big changes around the world, and our office is no exception. Our mutual fund dealer, Quadrus Investments, is rolling out new features for your accounts regularly, and **we now have e-signature capabilities** to place trades on your existing accounts! All we need from you is a valid email and cell phone for the 2-step authentication.

Soon, we'll be able to open new accounts through e-signatures as well, enabling us to even more easily keep on top of your investment strategy while keeping physically distanced.

If you haven't already signed up for Quadrus' NEW client portal, let me know and we will send you the link to register! (HINT: If you use your Client ID to sign in, you're still on the old system.)

It seems like we've gotten to a point in the year, and this pandemic, that there is so much to talk about that it's hard to nail down one or two topics of conversation. Whether it's the upcoming U.S. election, back-to-school season, a potential second wave, or easing travel restrictions, life hasn't been easy and your stress levels are probably telling you so.

Happily, most of our clients portfolios aren't adding to the stress. Markets have performed more positively in the past few months than many investors expected given the uncertain environment around COVID-19 and the election. In this issue, we have some insight from our team of advisors on ways we mitigate risk during times of market turbulence and unknowns like this disease. Rick's Market Watch article takes a look at the importance of staying invested during downturns; Lorna explains how Dollar Cost Averaging works and how we use it in times like these to manage market risk; and Patricia discusses the concept of the "Cash Wedge" strategy to ensure that any income you need from your investments is secured *before* the market drops. Traci also writes about a common question this time of year: Installment payments to CRA, why to make them, and what happens if you don't.

We hope this issue is informative and makes you rethink your reaction when the headlines scream "sell!"

Natalie LeBlanc
Marketing Assistant

Market Watch

We hope you and your family are well and have enjoyed the summer. Fall is fast approaching and the "new normal" continues as students head back to school, whether virtually or in person, and many people continue to work from home. This has certainly been an interesting period to live through as a global society and there are a few chapters of this tale yet to be written.

Globally, the number of COVID-19 cases surpassed 24.4 million in August as reported by Johns Hopkins University. However, infection rates are slowing in many parts of the world. Although some countries have experienced second waves of the virus, many are in recovery mode.

Many global stock markets have recovered a significant portion of their losses from earlier in the year, while the U.S. market has gone on to set new records. The S&P 500 Index, a broad measure of U.S. stock returns, reached an all-time high in August, following the pandemic-induced downturn during February and March. The upward move marks the index's fastest-ever recovery from a bear market (defined as a steep price decline, typically exceeding 20%).

It may seem odd for stocks to come back while there is so much economic difficulty and uncertainty. This simply reflects the forward-looking nature of stock markets and the performance of a number of extremely large (and predominantly technology) companies that have done very well despite, or in some cases, because of, the pandemic.

Will these gains hold, or can we expect more volatility? Short-term market movements are impossible to predict. As I have noted before, market declines have historically been followed by recoveries and new highs – much like we saw during August with the S&P 500 and other markets. In fact, most market gains are achieved shortly after a bear market, as shown in the chart below. By staying invested, your portfolio will be well positioned to benefit from a recovery.

Uncertainty about the potential impact of a "second wave" of the virus and the unknown timeframe for the development and widespread use of a vaccine are weighing on investor's minds right now, and rightly so. Add in racial tensions and the upcoming US presidential election and you can see why some investors may be wondering if they should be taking action and locking in gains now.

Even with all this uncertainty, it's important to remember that we crafted a well-diversified portfolio that is balanced correctly to achieve your investment goals within an acceptable and appropriate framework of risk. While it's a totally normal practice to "shift the sails" as market activity moves portions of a portfolio from their respective target weights, and there are indeed cases where some

Most stock market gains are achieved shortly after a bear market

Source: Morningstar Research Inc, CI Investments. June 2020 using daily returns. Returns are in index base currencies. Canadian Equities = S&P/TSX Composite TR; U.S. Equities = S&P 500 TR USD; International Equities = MSCI EAFE GR USD.

0% cumulative return signifies the market bottom for the financial crisis in 2008-09.

rebalancing is warranted after very strong gains in a few areas, we shouldn't need to make any large shifts to try to anticipate and position for what the next few months might bring. Attempting to do so back in February and March when the shutdown was occurring would have meant locking in losses that were only temporary and missing out on one of the strongest rebounds in history (looking to the US, which was up over 50% in less than 5 months.)

That said, for our clients taking income regularly, now might be a good time to look at topping up the cash reserves inside your portfolio, to provide adequate funding should the markets become more volatile in the months ahead. Typically, we recommend a full year's worth of income needs in cash or a very low risk investment and another 1-2 years in lower risk investments also. Similarly, if you have any expenses coming up you might want to look at cashing in some investments now while things are relatively high.

Other than that, just as it did back in March, our advice is to continue to stay invested in your custom, diversified portfolio. If recent history is any reminder, it's time in the markets, not timing the markets, that matters.

Rick Irwin, CFP, CLU
Financial Planner,
Investment Representative

What is "Dollar

"Averaging in" is something that we talk about on a regular basis with our clients when they have a large amount to invest at once, but it really comes into it's own when the markets are more volatile, as we have seen lately. But what does it mean when we use the term "Dollar cost averaging" (DCA)?

Firstly, we should explain that when you invest in a mutual fund you are actually buying units in the fund and each day the price of the unit changes. The number of units you hold remains the same unless you sell any, buy more or have a dividend reinvested. Dollar cost averaging is something that you are doing when you make a regular payment (PAC) into an investment, this can be done by saving monthly, bi-weekly, etc., or if we invest a lump sum over numerous time periods, which we also call "averaging in".

The most simple way to explain this is by showing an

Cost Averaging”?

example, lets say you are investing $100 each month:-

1st Month - $100 payment – price of each unit is $1 – you would purchase 100 units

2nd Month - $100 payment – price of each unit is 90 cents – you would purchase 111.11 units

3rd Month - $100 payment – price of each unit is now $1.10 – you would purchase 90.90 units.

Over the three months you have paid $300 and you hold 302.01 units.

Now let’s assume a few months have passed and the unit price is now worth $1.15, this gives your account a value of $347.30. The “Cost” of those units still remains to be $300 assuming no distributions have been reinvested. Alternatively, say the unit price went down to 95 cents; the value would be only $317.91, but still only “cost” you $300.

In the same market conditions as the above example, if you didn’t pursue the DCA method and invested the full $300 in Month 1 ($1 per unit) and the price per unit increased to $1.15, you will have $345 which is less than the $347.30 if you “averaged in”. If the price per unit decreased to $0.95, you will now only have $285, and lost $15, rather than still being $17.91 in the positive if you averaged-in!

The process of making regular investments reduces the overall volatility of an investment because you buy a different number of units each time, sometimes more, sometimes less and this process averages out the risk as apposed to make a lump sum purchase on one day.

The real benefit of dollar cost averaging is when you have bought units or shares at a lower price, ie you’ve bought more units or shares for your $100 and then the price rebounds. It also helps to put peoples minds at rest if they are planning a large lump sum investment and don’t feel comfortable investing it all on one given day.

We use this strategy with our clients all the time but even more so when we are in a period of market uncertainty. If you are interested in setting up regular payments rather than trying to invest lump sums before the RRSP deadline, let your advisor know and we can get you started.

Lorna Maughan, CFP
Financial Planner,
Investment Representative

Using a Cash Wedge to

When markets are fluctuating, it makes a big difference to your long-term plan whether you're adding or withdrawing funds from your portfolio. As Lorna discussed in her article, Dollar Cost Averaging is a great strategy to take advantage of market ups and downs while you're putting money in.

But what happens when it's time to enjoy those savings we diligently squirreled away every month? How do we protect our portfolios from those same ups and downs while supplementing our monthly income?

manage your income

By using a strategy called the "Cash Wedge", we aim to lessen the impact of market fluctuations within your registered portfolio when taking income.

Essentially, we divide your portfolio into 3 wedges. How much is in each wedge depends on your income needs:

The 1st wedge has the money you need (or want) in the short term and is invested in low risk cash assets like high interest savings accounts or money market funds. My clients know I like them to have at least 12 months of income in this portion of the wedge. For example, if you're withdrawing $500 a month for expenses, you should have about $6000 in this wedge.

The 2nd wedge is invested in low volatility fixed income investments such as a monthly income funds or bond funds. These types of investments create a relatively stable portion in the portfolio that may grow but without taking on too much risk.

The 3rd wedge is invested in the asset mix that suits your individual investment and risk profile. Typically, this wedge is made up mostly of dividend earning equity funds and is where most of the growth in the portfolio happens. However, their values change daily and we don't want to have to sell an investment from this portion of the portfolio to provide income or we could lose capital permanently.

Wedge #1 is replenished from the less volatile short-term fixed income investments in wedge #2. Wedge #2 is replenished when we have growth and dividend earnings from wedge #3. Breaking out your portfolio in this way allows us to manage the withdrawal risks and enables us to secure your income without losing out on potential growth from equity markets.

This type of strategy is good regardless of whether you're withdrawing only the Minimum Annual Payment (MAP) once a year from your Retirement Income Fund (RRIF) or if you're supplementing your monthly income to offset expenses. It's designed especially for registered accounts as there are other, tax efficient, strategies we can incorporate with non-registered funds like Return of Capital (ROC), but that's a topic for another article.

Patricia Bell, PFP
Financial Planner,
Investment Representative

Income Tax Installments

… And why CRA asks for them

I don't know a single person who enjoys paying the taxman their annual installment payments but there are some who begrudgingly resign themselves to making them because they know that they are going to owe on April 30th. And there are some taxpayers who downright refuse to pay their installments and in doing so take their punishment by way of interest and penalties on April 30th.

Installments are meant to cover tax that you would otherwise have to pay in a lump sum for the previous tax year. Installment payments are not your taxes paid in advance but rather the taxes that should have been taken off your income at source and remitted to CRA on your behalf. Taxpayers who are self-employed, own rental properties, investment income, or have capital gains in non-registered accounts will receive a notice in August advising them of their installment payment requirements. CRA determines if you are required to make installments based on prior years' tax returns. Taxpayers who owe $1,800 in Quebec and $3,000 in the rest of Canada on your previous year's return, will be required to make installments. Once you don't owe CRA, without making installments, they won't request them anymore.

In a normal year, your installment payments are due the 15th day of March, June, September, and December. (This year, due to Covid-19 , installments are due on the 15th of September and December. March and June were postponed and included in Sept/Dec.)

Any taxpayer who does not pay their installments *and owe tax at the end of the year* will pay interest on the unpaid tax instalments dating back to the due date of the missed payment. CRA's interest rate is generally around 5%. If a taxpayer still owes taxes after making the required installment payments as set forth by CRA, the taxpayer will not be penalized. If your installments total more than you owed, you will receive it back by way of your tax refund.

However, *if you know you won't owe CRA at the end of the year, you won't be charged for not making installments.*

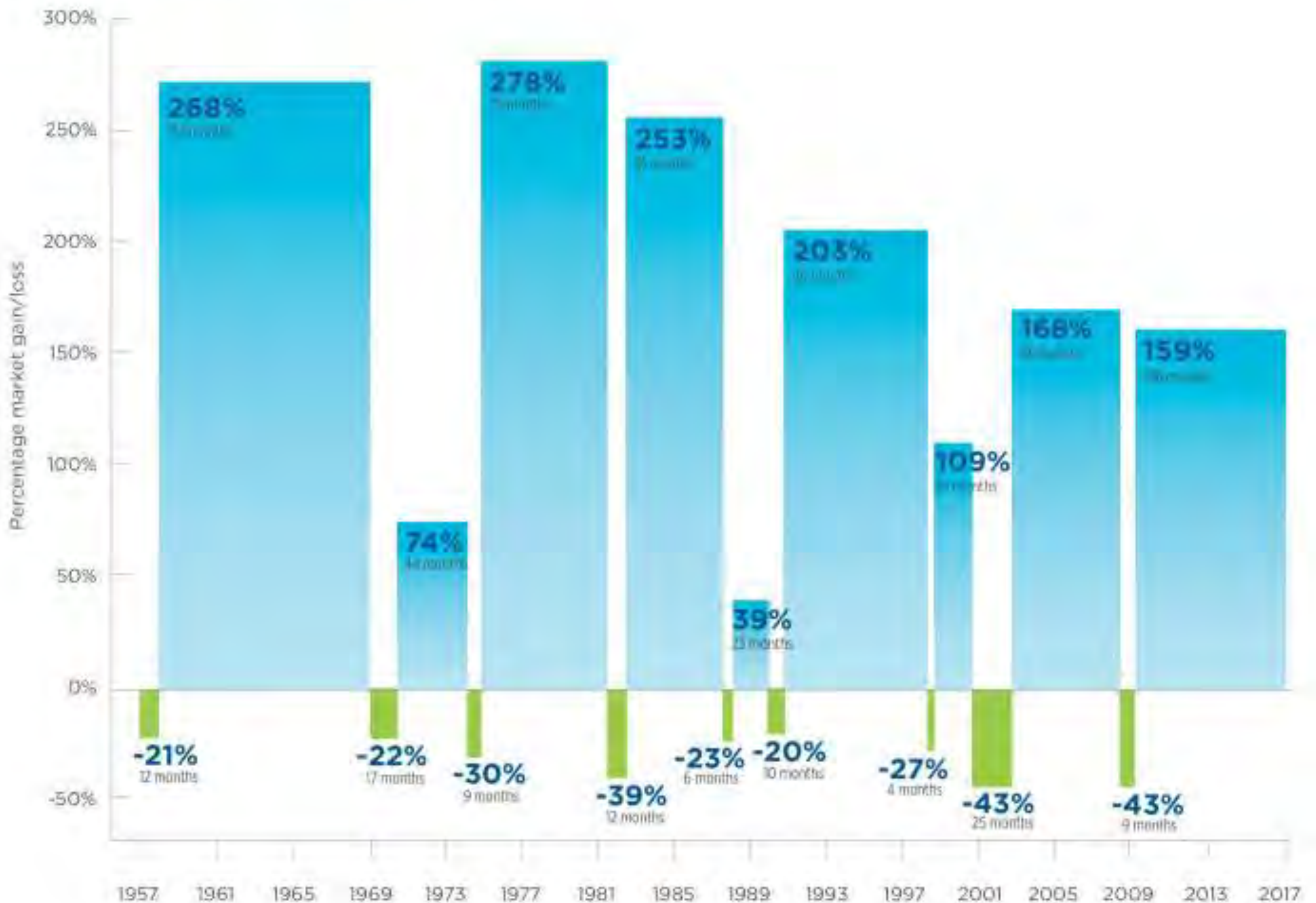
In summary, it is best to make your installments if you want to avoid giving CRA any extra money! Like any other debt we, the taxpayers, are responsible to pay interest on what we owe. If you will be in a refund position anyway, you don't need to pay.

Traci-Lyn Kerr, DFA
Income Tax Specialist,
Nova & Beyond Bookkeeping

BULLS AND BEARS

Since 1957, there have been nine bull markets and bear markets for Canadian stocks. Historically, bull markets have lasted longer than bear markets. The average bull market increase was 141% over an average duration of 70 months. Conversely, the average bear market decline was 30% over an average duration of 12 months.

S&P/TSX Composite Total Return Index



Source: Bloomberg. Percentage market gain/loss based on monthly compounded returns from the S&P/TSX Composite Total Return Index from December 31, 1956 to December 31, 2017. Returns are calculated in Canadian currency. Assumes reinvestment of all income and no transaction costs or taxes.

The terms bull market and bear market describe upward and downward market trends, respectively. Bull markets are movements in the stock market in which prices are rising and the consensus is that prices will continue moving upward. Bear markets are the opposite – stock prices are falling, and the view is that they will continue falling. In the above illustration, the generally accepted measure of a price increase or decline of 20% or more, respectively, over any given period, has been adopted.

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TRINITY
WEALTH PARTNERS

Mu on Cove,
Bramber, NS

1148 Bedford Highway
Bedford, NS
B4A 1B8

(902) 835-1112
www.trinitywealthpartners.ca
info@trinitywealthpartners.ca

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