PLANNING MATTERS

Quarterly Financial Planning Newsletter from Coleman Wealth

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Pedro and Nik's Tips and Tricks

- **Pedro:** It is imperative to ensure your will(s) and power of attorney for property and personal care are up to date in the event that you're working through any material changes in your life. The same applies to the beneficiary designation on your registered investment accounts (RRSP/RRIF, TFSA, IRA). If you'd like for us to review the current structure of your will(s) and any power of attorney, as well as your beneficiary designations on your registered accounts, please don't hesitate to reach out to me via email.
- **Nik:** Did you know that you have the ability to set up a *'trusted contact'* with us? A trusted contact is someone you would appoint and empower to give us permission to take instruction from in regards to the safety of your accounts and finances. We do not release any of your account details to your trusted contact, nor can this person transact on your behalf. We would only use this information in an attempt to contact you directly. If you have any questions or would like to set this up, please feel free to contact me!

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Time for a fact check about making the rich pay

– Darren Coleman

One thing was clear to me in the federal election campaign: there was a not so subtle implication that *"the rich"* don't pay their fair share of taxes. Indeed, during the English leadership debate I lost track of the times political leaders mentioned the need for the wealthy to pay more.

As a financial planner I am trained to look at hard numbers, and hard numbers don't bear this out. And as every lawyer knows, facts matter. The claim that the system favours the rich is not the case. Let's have a look at the numbers.

Canada has a progressive tax system in which people pay a higher share of taxes as their income rises. The top marginal rate applies to incomes over $210,000, so for simplicity's sake, we could use that as our benchmark for describing the rich. By way of comparison, the top marginal tax bracket in the U.S. kicks in at almost $670,000 *(in Canadian dollars).*

However, tax policy is set by politicians and can be arbitrary. Thus, it might be better to look at actual income earned, and the taxes paid. For the sake of argument, let's assume that the *"wealthy"* are those in the top one per cent of taxpayers, since the phrase *"one per cent"* gets a lot of traction nowadays.

According to Statistics Canada, in 2017 the average annual income of the top 51 per cent to 99 per cent of taxpayers was $71,400. Except for the highest level of earners, that pretty much refers to the upper half of Canada's income earners. The top one per cent of taxpayers earned an average annual income of $477,700. We can go higher still and look at the top 0.1 per cent, who earned an average annual income of just over $1.6 million. By the way, one per cent of all Canadian taxpayers equals about 300,000 people, which is roughly the population of such cities as Victoria, B.C., Kitchener, Ont. or Gatineau, Que.

Now let's look at who is actually paying the bulk of taxes in this country. According to the same report from Statistics Canada: The top one per cent of taxpayers paid 21 per cent of total taxes while receiving 9.9 per cent of total income.

The broad middle-income group paid 74 per cent of total taxes while earning 72 per cent of total income.

The bottom 50 per cent of taxpayers paid just under five per cent of total taxes on 18 per cent of total income.

This bears repeating. The group that earns 72 per cent of total income pays 74 per cent of total taxes. That seems to be in balance. But the top one per cent pay over 20 per cent of total taxes and the bottom 50 per cent pay less than five per cent of total taxes.

Numbers don't lie. The top one per cent certainly pay their fair share of taxes and probably more. Looking purely at numbers, one could make the case that the bottom one per cent do not pay their fair share! But that would not be politically expedient.

It's also interesting to note that in most provinces, anyone earning over $211,000 pays more than 50 per cent tax on their next dollar of income. Since the state already takes the bulk of your compensation for this group, it's hard to imagine a moral case for taking even more. But is there room to do that? Apparently, some political parties say yes.

In 2019, the Fraser Institute reported that the average Canadian family had seen its total tax bill rise by 2,246 per cent since 1961. The rate of inflation over that same time period was 750 per cent. This means that from 1961 to 2019 taxes for the average Canadian family increased by three times the rate of inflation!

That same report says a family today spends more of its income on taxes *(44 per cent)* than it does on food, shelter and clothing combined *(36 per cent),* which certainly wasn't the case back in 1961.

The fact is that over the years, political parties from across the spectrum have contributed to a massive growth in government spending and taxation.

When a family comes to see me to discuss their financial plan, I look at the data. If the data shows they have a single expense item growing three times faster than inflation and eats up more of their budget than all their necessities combined, we would have a talk. Indeed, you might call it a *"financial intervention".*

It would require examining the family's key objectives and hard compromises on what they spend their money on. Belts would tighten and luxuries would be curtailed with a focus on getting the math — the numbers — to work on a timeline that is dollar-specific and date-specific.

Sorry folks, but these things do not balance themselves.

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Fighting Dollar Unemployment

Whether it is a cold, hard bill in our hand or through electronic payments from our bank account, cash is an important part of our day-to-day lives. For many of us, it provides a level of comfort knowing we have quick access to cash in our bank accounts, investment accounts or our secret stash under the mattress. We agree that it is necessary to have some cash on the sidelines for your everyday expenses and emergencies and we recommend having a strategic plan in place.

We see many of our clients holding large cash balances in multiple bank accounts over and above what they need to fund their lifestyles. While we understand the perceived need for stability, in the long run, idle cash deposits will not keep up with the rising cost of living. The inflation rate in Canada is around 2% and most chequing and bank savings accounts do not pay anything close to this. We want your hard earned dollars to be given a job – to earn you an income!

There are cash alternative options that can fight dollar unemployment while still maintaining a similar level of safety as holding cash. These include; money market mutual funds, certificates of deposit *(U.S. clients only),* short-term and/or redeemable GICs, or high interest savings accounts. All, one, or none of these may be the right option for you. It really comes down to your long term financial plan. The three main factors to consider when looking at your options are: liquidity, safety and return. How quickly can I access the cash when I need it? - That's your liquidity. Safety, is it going to be there when I need it? Return, am I missing out on an opportunity for some growth?

When building a strategic plan for your cash, you would likely start with putting a rough timeline together of how much you will need for upcoming expenses/purchases and when you expect them to occur. For example, if you have a major home renovation due to commence in six months, you wouldn't want to subject the principal to any fluctuation, but holding it in a High Interest Savings Account would earn you a bit of extra interest income *(return).*

We help many clients put their dollars to work through a variety of cash strategies and just like our clients, no two strategies are the same. Please reach out to Andrea or Vikki to assist you in ensuring your cash strategy aligns with your overall long-term financial plan.

Client's Corner

Politics and Investment Strategy: Never the Twain Shall Meet

"This is it. This is the end of everything."
—H. L. Mencken, the "Sage of Baltimore," on the morning of November 3, 1948, reacting to the election of Harry Truman

THE RECORD WILL SHOW THAT THE COMMENTATOR CITED above, usually so full of gimlet-eyed realism, wasn't quite so sage that November morning.

Truman's thumping defeat of Dewey the previous day—incidentally, the greatest upset in the history of American politics, bar none—was not the end of everything. In fact, it wasn't the end of anything.

But if you'd bet your investment portfolio that it ***was*** the end—and gotten out of the equity market—you missed about a 50% upswing between Election Day 1948 and the day President Eisenhower was inaugurated in January 1952.

You read that right: in those four tumultuous years—during which the Soviet Union got the atomic bomb, America lurched into a land war in Korea, and our country was torn apart by investigations into communist subversion—the broad equity market went up by about half. And that doesn't even include dividends, which were very substantial: in those days, mainstream equities yielded north of 5%. Indeed, with full reinvestment of dividends, the forerunner of the S&P 500-Stock Index compounded at an annual rate of 20% between November 1948 and January 1952.[1]

Let that be a lesson to you. When you start making investment policy out of your personal dread of (or revulsion at) a political outcome you don't like, all kinds of very bad things can start happening to you. If you won't take my word for this, I call to the witness stand the greatest equity investor who ever lived, one W. E. Buffett. (You only need to watch the first 33 seconds of this ***video.***)

With a bit more than 13 months to go before a highly charged presidential election, it does not seem to me a moment too soon to raise this issue. As a friend, I would urge you to take all the time you need now—before it's too late—to fully indulge your "If so-and-so gets elected/reelected, the world will end and/or I'm moving to Canada" emotions. ***And then take as many more moments as you need, to put those emotions in a drawer.***

We may then proceed to a dispassionate assessment of the historical record, and of the realities of corporate finance. For purposes of this brief discussion, there are two such points to be examined.

1. There does not seem to be any meaningful correlation between the economy and the person of the president. However anecdotally, I would gently point out that the subprime mortgage bubble inflated over several years—and then burst into a global financial conflagration—during the two-term presidency of a strongly free-market Republican. Immediately thereafter, the economy entered a long period of slow but steady recovery—and the equity market fairly soared—during the two-term incumbency of a strongly progressive Democrat. If you made investment policy out of the stated economic/financial proclivities of the two presidents during those 16 years, you got existentially skunked… ***twice***. Perhaps even more important:

2. No president—indeed, no government—can force a business (let alone 500 very large public companies) to lose money for any length of time. Faced with punitive taxation, regulation, tariffs or whatever, a rationally managed enterprise will simply stop doing whatever the president/government has taken a mind to punish. It will husband its capital, wait for the electorate to tire of the current regime…and re-emerge when the political storm blows itself out. This is a matter of logic, even more than it is a lesson of history.

If I may be permitted a personal observation here: that's what I love—now more than ever—about being an equity investor. Given the bitterly divided partisan politics of the moment, and the sometimes bizarre policy pronouncements emanating from both ends of the political spectrum, high quality corporate equities seem to me the last bastion of long-term rationality in a world out of which reality is rapidly leaking.

Feel free to ignore the foregoing paragraph; I'd have been remiss if I didn't say it, but it isn't central to the point of this little essay. Which is simply to reassert, in the strongest terms possible, the wisdom of the world's most admired, least imitated investor:

"If you mix politics with your investment decisions, you're making a big mistake."

[1] *Source: "The S&P 500 at your fingertips" tab of politicalcalculations.com.*

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