PLANNING MATTERS

Quarterly Financial Planning Newsletter from Coleman Wealth

Summer 2021 - 1st Edition

An update from the Coleman Wealth team

Darren

"How is it summer is over already? What a whirlwind!

The Coleman's had our first summer without David at home. As an NCAA Division 1 baseball player at High Point University in North Carolina, he needed to keep playing baseball all summer, to stay sharp and in shape. He had a very successful season as the center fielder for the Ocean Ospreys in New Jersey. Sue and I made our first trip in over a year to visit him in July and watch him play in the Atlantic Collegiate Baseball League's All-Star game. It was terrific to visit him, meet his new girlfriend, Samantha, and spend a day in Manhattan. Now he's excited to start his sophomore year at High Point and we're excited to have him come home at Thanksgiving.

Olivia enjoyed most of her summer at her barn, taking care of over 50 horses and training in the equestrian sport of reining. We aren't a "horsey" family so this is entirely new to all of us. And frankly, having a 16 year old kid spend almost every day taking care of huge animals and shoveling hay (among other things) isn't a bad thing! Lots of hard work and responsibility. This fall, after a decade of training, she'll be testing for her black belt in karate. She's also been learning to drive. Lord help me.

Sue has been busy tending to our garden, playing tennis and making sure Charlie is a happy boy!

After setting up new offices for the team in Oakville, I took a break and just returned from a week-long motorcycle tour of British Columbia with some friends. The views were gorgeous, the roads amazing and some of the segments were very technical and challenging. The entire adventure is, to me, an object lesson in risk management. It's also my Zen.

So, with our breaks over and cooler days ahead, we put our heads down and look forward to a busy and exciting fall!!"

Andrea

"Our twins, Julian and Ella, recently turned three (Paw Patrol birthday, complete with ice cream truck!) and are heading to nursery school this fall! They kept busy this summer with parks, strawberry picking, chalk art and imagination play. Outside of work, I have kept busy with my e-cycling obsession (great for social distancing and for staying fit!) and enjoying time with our family at cottages in the great province of Ontario throughout the summer."

Pedro

"I managed to take a few weeks off in August and spent a lot of much needed time with family and friends. The weather was fabulous this summer and I traveled up north to cottage country a few times to take advantage of it. Looking forward to a great fall season!"

Vikki

"I enjoyed an active summer of canoe tripping through Algonquin, swimming in Georgian Bay, hiking along the escarpment and floating down the Beaver River on a Unicorn floatie. I also spent a few weeks in Nova Scotia visiting with family and went road tripping around the Annapolis Valley, Acadian Coast and the South Shore. Here is a picture of my husband, Ruben, and I from a lookout on Metcalfe Rock from one of our many hikes in the area."

Nik

"This summer was quite eventful to say the absolute least!

As many of you know, Stefi and I were set to be married in 2020, but amid the world going through a pandemic, many things being shut down, our wedding and wedding plans were too. We continued to plan and had hopes of going through with the wedding we imagined, however due to the unpredictable nature of Covid, we decided to transform our BIG wedding, into a small, personal and intimate one. So, we got married in May!

Our 'honeymoon' phase was very short lived as we welcomed our little baby girl, Ema, into the world in August, turning our little family of three (yes, I included our dog, Remy, in the numbers) to a family of four! Many of you have sent your best wishes and kind words which we sincerely appreciate and thank you for. The challenges as first time parents continue, and everyone has their own advice to give, the main one was, get sleep… BUT, if you have any advice on how to SLOW TIME DOWN, I'll take that! After having some time off to adjust to having Ema home and tending to her 'needs' I'm happy to be back to work and look forward to speaking with all of you over the next few months!"

Neil

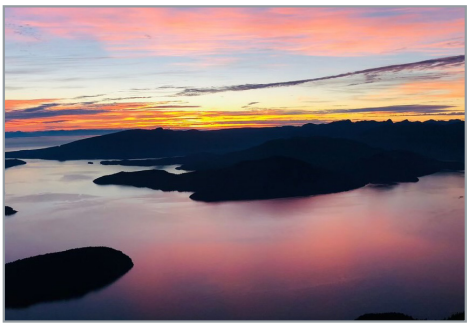
“As many of you know from last year’s Christmas update, we welcomed our firstborn, Jaden, in March. He’s brought so much joy to our lives and has already started helping out around the house!

Although it seemingly flew by as always, we enjoyed a great summer filled with backyard swims, neighbourhood walks, cottage weekends, weddings and a recent getaway to Niagara-on-the-Lake. As the restrictions slowly eased, it was nice to finally spend quality time with family and friends and get out on the patios again!

While it’s always a tad depressing to say goodbye to summer (and my golf clubs ☹), we look forward to a busy fall ahead, reuniting with extended family over thanksgiving and coming up with a costume idea for Jaden’s first Halloween!”

Katie

“I always knew I lived in a beautiful part of Canada but this summer it really hit me how fortunate I am to live in BC. Us Vancouverites were able to move around a little bit and explore the outdoors! Most evenings and weekends consisted of going out kayaking, hiking or camping! I ticked off two major things this summer, I saw a bear in the wild and went whale watching. My new found love of volleyball and tennis kept me active too (don’t be fooled though, just because I like it, doesn’t mean I am any good!). To finish off the summer, I finally adopted a cat, just in time for fall snuggles when the rain is pouring down!”



Designating Principal Residence Years

Some Canadian taxpayers automatically assume that their current residence will be exempt from capital gains tax when they sell it or when they pass away. Their facts and circumstances may be simple enough for that to be a valid assumption, but many Canadians own or **have owned** more than one property in their lifetime.

As an example, a couple concurrently owns two residences: one in the city, one in the country. They think they can sell their city home tax-free, move into their country home in retirement, and then sometime in the future sell the country home tax-free or not incur any taxable capital gains if they hold the property upon death. That conclusion is incorrect. The key word is "concurrently" in that scenario.

It is important to remember that a taxpayer/couple/family unit can choose only one property as their principal residence (PR) for each calendar year for the purposes of excluding the capital gain from Canadian taxable income. Once they have used a particular calendar year for their PR designation, it is not available for any other property. While one property benefits from the exemption, another property owned at the same time may accrue a capital gains tax liability.

The formula for the principal residence (PR) capital gains exemption is:

capital gain X the **eligible** number of years designated as PR plus one year / the number of years owned.

Generally, the taxpayer has to own the property, ordinarily inhabit the property, and designate the years as PR years on their tax return. Refer to the Canada Revenue Agency resource at the end of this article for the finer points of the definitions.

From a tax planning perspective, they must choose wisely when designating PR years on their tax return for the year of sale or death. Homeowners may typically designate the city home as their principal residence, but this may not be the ideal choice, depending on the exemption calculation.

	City Home	Country Home
Purchase year	2015	2019
Purchase price	$300,000	$300,000
Sales proceeds or FMV	$500,000	$500,000
Capital gain	$200,000	$200,000
Designated years:		
2015	PR	n/a
2016	PR	n/a
2017	PR	n/a
2018	PR	n/a
2019	PR	Not-PR
2020	PR	Not-PR
2021	PR	Not-PR
2022	PR	Not-PR
Total PR years designated	8	0
Plus one year rule	1	1
Total exempt years	9	1
Divide by total years owned	8	4
Exempt %	= 100% exempt	= 25% exempt
Exempt capital gain	$200,000	$50,000
Reportable capital gain	$0	$150,000
50% taxable capital gain	$0	$75,000
= BAD TAX RESULT		

	City Home	Country Home
Designated years:		
2015	PR	n/a
2016	PR	n/a
2017	PR	n/a
2018	PR	n/a
2019	PR	Not-PR
2020	Not-PR	PR
2021	Not-PR	PR
2022	Not-PR	PR
Total PR years designated	5	3
Plus one year rule	1	1
Total exempt years	6	4
Divide by total years owned	8	4
Exempt %	= 75% exempt	= 100% exempt
Exempt capital gain	$150,000	$200,000
Reportable capital gain	$50,000	$0
50% taxable capital gain	$25,000	$0
= BETTER TAX RESULT		

If the homeowners allocate their PR exemption years more strategically, they can reduce their taxable capital gain.

"It's tough to make predictions, especially about the future" - Yogi Berra

This illustration happens to use two properties with the same capital gain in the same disposition year to explain the concept. However, in real life, both properties will have different gains and different disposition years. The problem with tax planning is predicting the future. How long will you hold the property? Do you know which property will have the higher capital gain when ultimately disposed of or deemed disposed? Will the market value go up or down for each property? In a hindsight is 20/20 situation, CRA provides options to revoke or amend PR designations, but penalties and interest may apply.

Client's Corner

FOR THE LIFETIME INVESTOR

A Study in the Virtue of Patience

YOU HAVE UNDOUBTEDLY HEARD AND READ ON NUMBERLESS occasions that the very long-term return of the S&P 500 is 10%.

If you have—and even if you haven't—be assured that it's quite true. The highly authoritative (indeed, all but "official") Ibbotson/Morningstar statistical yearbook states that, from the beginning of 1926 through the end of 2020, the average annual compound return of the Standard & Poor's 500-Stock Index was just a tad in excess of 10%.

Without denying said finding—because it is in fact undeniable—a skeptic of mainstream equities might readily voice both an objection and a question. The objection might be something along the lines of "Thank you for that information, but I haven't got another 95 years," which—for purposes of this little essay—we will allow to pass without argument, not least of all because it so totally misses the point.

The question might be, ***"Yes, but what if I had invested at exactly the wrong time?"*** That's the inquiry we wish to take up today. And it's a doozy.

The record will show that the single worst day to invest in the S&P 500 since the end of the Second World War was Tuesday, October 9, 2007, on which date the Index closed at a new record high of 1,565. Almost immediately, one might have begun to hear the first faint rumblings of what—a full year later—would explode into the Global Financial Crisis.

The equity market certainly did hear said rumblings, and began a long, slow decline the following day. That decline accelerated into a historic crash in mid-September 2008, when the Lehman Brothers bankruptcy filing precipitated a global financial collapse and market panic. The Index didn't stop cratering until the following March 9, at a level of 677.

The net effect of all this on the S&P 500 was that in the 17 months (to the day!) October 9, 2007 to March 9, 2009, it declined 57%—quite a bit more than it had at any time since the 1930s. Indeed, it wouldn't get back to the level at which you bought it until 2013.

Now, as you read this essay, we are still about a month shy of the 14th anniversary of that fateful market top. Along the way, in addition to the ensuing 57% drop, the S&P 500 has experienced almost 20% declines twice—in 2011 and 2018—as well as last year's 34% (in 33 days) COVID Crash.

With all of that statistical evidence of serial disaster in hand, we may now proceed to address the question:

"Grownup," by my definition, describes someone who is more or less keenly aware that he/she is probably going to work and accumulate capital for 30 years or more—and then live off that capital for another 30 years...or more.

"What if I'd invested my whole net worth in the S&P 500 at the top on October 9, 2007, and just hung on? What has been the average annual compound return since that spectacularly ill-fated mistake?"

The answer, as difficult as it may be to believe at first, is 10%. Let me say that again: the average annual compound return of the S&P 500 from the market top in October 2007 through this past month was 10%—equal to the market's long-term average. As Casey Stengel always said, "You could look it up."

I suppose if you're a millennial—trading options, or meme stocks, or (heaven forbid) Bitcoin on Robinhood—an interval of 14 years might seem like a period of geologic time (akin, perhaps, to the Jurassic), and cause your eyes to glaze over. You may run along now; I'm going to hang in here and chat with the grownups for a bit.

"Grownup," by my definition, describes someone who is more or less keenly aware that he/she is probably going to work and accumulate capital for 30 years or more—and then live off that capital for another 30 years…or more. That's the real-life investing time horizon of today's long-term investors, even ignoring any impulse they may have to build legacies for their children and grandchildren.

Given that perspective, it may be somewhat hyperbolic to characterize a 14-year period as a "blip." Then again, it may not. But whether it is or isn't, these particular 14 years offer very compelling anecdotal evidence of the tremendous power of ***patience*** in successful lifetime investing. That's the point I have been laboring to make. That's the idea I would have you take away.

Patience is the second of the three cardinal virtues in the temperament of the genuinely superior long-term investor. (And

temperament rather than intellect is almost everything that matters.) The first quality is faith in the future—which in times of extreme stress (such as the aforementioned 17 months of sheer terror) need not be any more complicated than "This too shall pass."

The third virtue is discipline, which simply means having a plan and continuing to work it, looking neither to the left nor to the right, and ignoring the "news." I need hardly add that if you'd kept investing monthly during these 14 tumultuous years—funding your 401(k) or whatever—your average annual compound return would have been one whole heck of a lot higher than 10%.

Faith, patience and discipline—and a perspective that takes in the entirety of your investing lifetime—turn out to be the critical qualities. As you're practicing those virtues, history tells you that the earnings, dividends and values of our economy's leading businesses have gone up so much longer than they went down—and so much higher—that the equity market has almost always been in the process of healing itself.

Thus we find that if the only investment you'd ever made in the S&P 500 took place on the single most inauspicious day of the entire postwar period, it took only about six years (until 2013) for the Index to regain its peak on that day, and only about eight more years until you achieved the equity market's quite handsome long-term average return.

I suppose the only remaining question, then, is: Would that have been too long to wait?

Sources: Ibbotson/Morningstar, Yardeni Research, Standard & Poor's. Average annual compound return October 2007—August 2021: DQYDJ.com "Historical Return Calculator." Compound return assumes the reinvestment of all dividends and the payment of all taxes from another source.

Coleman Wealth

200 King St West, Suite 1900, Toronto, ON

Darren Coleman PFP, CFP®, CIM®, FMA, FCSI,
Senior Vice President & Portfolio Manager Private Client Group
T: 416-777-7158 | darren.coleman@raymondjames.ca

Andrea Thompson CFP®, CRPC (U.S.), CLU, CHS, CDFA, *Senior Financial Planner*
T: 416-777-7031 | andrea.thompson@raymondjames.ca

Pedro Ostia-Vega, *Financial Advisor Associate*
T: 416-777-7159 | pedro.ostiavega@raymondjames.ca

Nik Zabaljac, *Financial Advisor Associate*
T: 416-777-7147 | nik.zabaljac@raymondjames.ca

Vikki Brown CFP®, CRPC (U.S.), *Financial Planner*
T: 416-777-7152 | vikki.brown@raymondjames.ca

Neil Vyas CFP®, *Associate Advisor & Financial Planner*
T: 416-597-7906 | neil.vyas@raymondjames.ca

Katie Power, *Financial Advisor Assistant*
T: 604-659-8077 | katie.power@raymondames.ca