Wealth Management
& Capital Markets Perspective

Wealth Management
Dominion Securities

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Andrew Grimes, CIM
Vice-President & Portfolio Manager
416-842-1008

Julie Handscomb, CIM
Vice-President & Portfolio Manager
416-842-2502

Shelley Knox, CIM, FCSI
Associate Portfolio Manager
416-842-2503

Michael Cochrane
Associate Investment Advisor
416-842-5596

Aurelia Imbrogno
Associate
416-842-2504

Laurie Christensen
Associate
416-842-1009

Karen Murphy
Administrative Assistant
416-842-2446

Yonas Woldu
Administrative Assistant
416-842-2447

RBC Dominion Securities
Brookfield Place
Bay-Wellington Tower
181 Bay St., Suite 2350
Toronto, ON M5J 2T3
Fax: 416-842-2249
Toll-free: 1-855-889-1127

Investing through inflation

by RBC Global Asset Management

After years of low prevailing levels of inflation, investors are now starting to consider the impact that potentially higher inflation may have on their portfolios. The risk of inflation is real, for at least four main reasons:

1. The economic impact of the pandemic has led central banks around the globe to cut interest rates and buy bonds to inject money into the economy and support growth.
2. The substantial fiscal stimulus response by governments has rapidly increased the amount of money in the system, stoking demand.
3. The rapid development of multiple vaccines and a large global vaccination program means economic activity is expected to rise quickly through the fall.
4. Central banks have stated they intend to allow inflation to run slightly hotter than usual before raising interest rates.

Together, these conditions could allow for moderate levels of inflation to take root.

While far from a certainty, a future of higher inflation has important implications for your portfolio. Put simply, inflation reduces purchasing power as it erodes the value of cash over time. Things cost more, so you need more money to buy the same things. For investors, the question is whether the return on their investments outpaces the rate at which their purchasing power is declining. It's even more important when interest rates are low.

Preparing your portfolio to withstand moderate levels of inflation can be thought of from three different viewpoints: that of a fixed income investor, an equity investor, and from a balanced portfolio perspective.

The effect of inflation on bonds and other fixed income

Broadly speaking, the fixed income market is largely driven by interest rate expectations. Inflation impacts the bond market in two ways:

- **It drives up yields.** A yield is the annualized return you receive on a bond if you hold it until its maturity date. When inflation rises, interest rates also tend to rise. This in turn causes bond prices to drop. If you wanted to sell your bond before the maturity date, you would get a lower price than you paid.
- **It erodes the purchasing power of the payments you receive from fixed interest investments.** It does the same thing to the dollars you have invested and will receive back when you sell the investments or they mature.

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How to reduce inflation's impact

1. **Shorter-term bonds**. When you shorten the time between when you purchase the bond and when it matures, you reduce your exposure to changing interest rates. When inflation expectations rise, so do bond yields. This causes prices for bonds to move lower. Investing in shorter term bonds helps protect you from the negative impacts of rising inflation expectations. This can lead to a smoother investment experience.
2. **Higher-risk bonds.** When you invest in bonds, there's a graduated scale of risk. Bonds from governments with a good borrowing history are often rated "risk-free." You are almost certain to be repaid. But you will likely receive less interest (the bond yield) than other bonds that come with higher risk – for example, bonds from governments or companies with higher debt levels or more volatile revenues. Buying higher-risk bonds boosts your yield and helps you stay ahead of inflation, though they do come with a higher risk of default than "risk-free" bonds.
3. **Global bonds.** Inflation may be more prevalent in some countries than others. For example, Japan's aging population and low immigration levels are likely to keep inflation in check. Diversifying your bond exposure outside of North America can help lessen the impact that rising local interest rates would have on your portfolio, though currency considerations should be taken into account.
4. **Flexible yields.** Some fixed income products provide more flexibility, changing their yield as interest rates change. Examples include floating rate notes and rate reset preferred shares. However, active management is important to take advantage of the rising rate environment. The sensitivity to growth also needs to be closely managed.
5. **Alternative bond strategies.** Some funds have the flexibility to adjust the portfolio to protect it, or even benefit, from rising rates. The returns on these funds are primarily driven by the decisions of the investment manager instead of broad market returns. The timing and level of returns for alternate bond strategies can differ from other bond funds. Adding this different source of returns to your portfolio can help smooth out the overall performance, improving risk-adjusted returns.
6. **Real return bonds (RRBs).** RRBs provide a "real" yield plus inflation. They are useful tools for investors concerned about future inflation. However, these products typically have a longer time period to maturity. This means they will be more volatile and sensitive to changes in real yields. If real yields rise, the price of the bonds will fall. This price decline could potentially be more than the income you're receiving from these bonds in a given year. Investors thus need to be cautious when investing in RRBs.

The effect of inflation on stocks and other equities

As compared to fixed income, equities tend to protect investors better against inflation. This is because, in theory, companies should be able to grow their earnings and revenues at a rate that matches or exceeds inflation. Yet higher inflation can discourage corporate investment which in turn can lead to lower overall returns.

Inflation's impact on valuations is also an important consideration. In the past, higher inflation has been associated with lower price-to-earnings multiples (P/Es). For example, in the 1970s inflation was accelerating, and as P/Es compressed, stocks came under pressure despite continued growth in earnings. This could be an additional headwind for stocks, particularly for companies with stretched valuations. However, the impact could potentially be mitigated if interest rates are kept lower for longer under the Fed's new average inflation targeting framework.

Specific areas of the equity market that tend to fare better during times of inflation include:

- Companies with ties to commodities and natural resources, including gold. When demand for goods increases the demand for commodities rises, which leads commodity prices to increase alongside of accelerating inflation. Companies that generate revenues that are tied to the price of commodities see their revenues rise in kind, offering a degree of protection against rising inflation.
- Fixed investments such as property and real estate. Real assets generally store value, meaning that their prices tend to rise with inflation.
- Companies that generate healthy levels of cash flow. In general, businesses that generate rather than consume cash would largely fare better during inflationary environments.
- Businesses that are scalable and able to raise prices without hurting demand would typically see their earnings increase alongside of inflation.

Conclusion

Within the context of a balanced portfolio, protection against inflation tends to lead investors to add more equities at the expense of fixed income. In theory, equities offer more upside potential and have historically demonstrated an ability to generate returns that exceed inflation. Yet equities can also lead to greater volatility – which can in turn make it harder for an investor to stick with their plan.

For this reason, fixed income can still play an important role within a diversified balanced portfolio. Used well, it can help create a smoother investment experience. The key is to choose these investments carefully, with deliberate strategies to address inflation.

Do you have a strategy for your charitable giving?

by RBC Wealth Management Services

Being charitable can mean a number of things. For many Canadians, it's supporting causes or organizations you care about via donations and financial means. For some, it may be contributing your time through volunteering. How and why you give, and the level of emphasis you place on charitable activities, is something completely personal to you or your family.

Motivations for giving are often fueled by wanting to make a positive difference within your community or to give back, or a passion for a specific cause. Amidst the pandemic in particular and in seeing the direct impacts on the charitable sector, for some individuals, these motivations and emotions around charitable giving have grown and deepened. With this in mind and for those who may want to create a more significant charitable impact, it's important to look at the range of benefits that a structured approach can offer as part of your wealth planning as a whole.

Getting started with structured giving

At the core of structured giving is developing a vision for what you want to achieve over time and mapping out when and how you will give. While charitable giving typically tends to be more reactive, a structured approach is more targeted and proactive. Many individuals often ask, "How can I have a greater impact?" and, more recently, "How can I extend my charitable impact over time?" In both cases, considering the different options for giving and carrying out planning introduces a range of potential advantages, tying in tax efficiencies and estate planning, and at the same time helping individuals make a more meaningful difference over the long-term.

As a starting point, you or your family may want to spend some time thinking about and discussing values, causes or charitable organizations that resonate with you. Creating a list of charities or areas of interest that are close to your heart, and articulating what impact you're looking to have with your charitable dollars, may also help in determining the framework for your strategy.

Other aspects to consider are how philanthropy fits into your personal or family circumstances, now, during your lifetime or as part of leaving a lasting legacy. Your family may also have ambitions for getting the next generation involved. From there, the next phase is determining the amounts and timing that best meet your charitable objectives and carrying out the appropriate planning with your qualified advisors to ensure these objectives are properly accounted for in your overall plans.

Identifying areas of charitable interest

As part of early conversations in developing your charitable strategy, and as you give thought to your areas of interest, it may be beneficial to take steps in getting to know certain charities and their programming. Doing so may help identify where you and your family can maximize your giving and accomplish your objectives by supporting a few focused charities. It can also broaden your sightlines to other charities that may be of interest.

What are the different approaches for giving?

Depending on your goals, circumstances and time horizons for giving, there are a number of options that may be suitable and that may offer immediate or long-term tax benefits while at the same time fulfilling your charitable intentions. The following list highlights options for both during your lifetime or as part of wealth transfer and estate planning.

- Direct donation of cash
- Donation of non-cash gifts, including capital property, art and other collectibles, or even life insurance policies
- Donating publicly listed securities with accrued capital gains
- Charitable bequests in a Will
- Making a gift upon death by naming a registered charity as the beneficiary of certain plans and policies (e.g. RRSP, RRIF, TFSA or life insurance policy)
- Private foundation
- Charitable gift fund/donor-advised fund

Note: *This list is non-exhaustive and includes only a selection of strategies and options that may offer potential tax advantages. A financial plan may assist in providing a more comprehensive model for donations. It is crucial to consult with your qualified tax advisor to ensure your individual circumstances are properly considered and addressed and that options are best suited to your needs and goals. Furthermore, when considering a gift of securities, it is important to consult with the charity directly to determine whether they are able to accept this type of gift.*

Determining the right charitable strategy

As you and your family reflect on and consider your charitable objectives and goals, part of the decision-making process will include how, how much and how frequently to make charitable gifts or contributions/grant disbursements if you're using a foundation. This is where tax, financial and estate planning also need to be considered, as philanthropic strategies may be implemented as part of or alongside these other areas of planning.

Also keep in mind that your approach can shift and evolve over time or as your situation changes. Much like any charity you choose to support is a very personal decision, that decision itself or the amount of support may adjust as your goals or priorities change. For example, some may be more interested in seeing their charitable impact now, or may want to start with a smaller amount today to donate to charity or into a foundation for annual or lifetime granting. At a later point, charitable giving may become

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more of a focus or priority in your life or as part of legacy planning. If that's the case, you may then want to consider lasting forms of giving or how it may fit in with your wealth transfer or estate plans.

In the context of more recent times, a hybrid approach to giving has been a growing strategy among some individuals and families. This type of approach incorporates philanthropy during one's lifetime and through an estate. With this method, individuals are able to see the benefits of their charitable impact now and during their lifetimes, and at the same time create a longer-term legacy for years after their eventual passing. A blended strategy can also create tax efficiencies over the course of life and as part of one's estate. For those who choose to engage family members as part of this approach, this may also be beneficial in building and extending charitable values across generations.

Focusing on the long-term impacts of your giving

In looking at the big picture as it relates to your charitable intentions, keep in mind that the process and the approach will be unique to you and your family. Whether you're a younger individual, you have a busy career or growing family, or you're approaching or already enjoying retirement, incorporating structure and strategies with your charitable giving can create benefits now, in the years to come and on a lasting basis for future generations.

Regardless of the amount being given (or granted from a foundation or donor-advised fund) annually, cumulatively in life or via one's estate, if a more focused approach aligns with your charitable goals, it's important to carefully consider your objectives, specifically and holistically. Think about how you're currently giving, and how much in total you're giving — and then measure that against the impact you'd ideally like to have. With these elements in mind, it's here that planning and implementing a giving strategy may help in creating a broader ultimate impact.

Andrew and Nancy on 'the Rock'!

After three years of planning and delays, our retired colleague, Nancy Cobban, and her husband, Allan, finally took their inaugural trip to Andrew's home province of Newfoundland and Labrador this past August. Blessed with beautiful weather, together they took in the spectacular scenery on numerous coastal hikes, visited local museums and galleries, and even sampled some cod tongues! Nancy and Allan were so enchanted with their long-awaited visit, they've promised a return trip in the not-so-distant future to explore some of the many other beautiful areas of the province.

Benchmarks

Equity market 12-month trailing return (for month ending September 30, 2021)	
S&P/TSX composite total return index	28.0%
S&P 500 total return (C$)	23.7%
S&P 500 total return (U$)	30.0%
DJIA total return (C$)	18.2%
DJIA total return (U$)	24.2%
Nasdaq composite price return (C$)	23.2%
Nasdaq composite price return (U$)	29.4%

RBC CM Canadian bond market indices 12-month trailing return (for month ending September 30, 2021)	
Short-term index	0.0%
Intermediate-term	-2.4%
Three-month T-Bill (C$)	0.1%
Three-month T-Bill (U$)	0.1%

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