Sandra Sparanese Financial Focus

Wealth Management
Dominion Securities

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RBC Dominion Securities Inc.

Sandra Sparanese, FCSI, CFP, CIM
Senior Portfolio Manager &
Financial Planner
sandra.sparanese@rbc.com
250-356-4859

Heather Murdock, CFP
Associate Advisor & Financial Planner
250-356-3970
heather.murdock@rbc.com

Mary Howley
Senior Associate
250-356-4946
mary.howley@rbc.com

5th Floor, 730 View Street
Victoria, BC V8W 3Y7
www.sandrasparanese.com

TAX SLIPS

Make sure you receive all required tax slips to file your income tax return.

T5 income related slips have been mailed out in February. All other tax slips will be mailed out during March.

To view our tax reporting guide, please visit www.rbcds.com.

Dear Clients and Friends,

As we near the close of the first quarter of 2023, there continues to be plenty to talk about with regards to financial markets.

Inflation has been the main culprit with regards to higher interest rates and lower stock markets. Central Banks (US Federal Reserve and Bank of Canada) are attempting to control inflation by influencing interest rates. When inflation is too high, central banks raise interest rates to slow the economy and bring inflation down. In this scenario, we need to see some bad news with regards to employment and consumer spending to know that higher interest rates are doing what they need to do: individuals and businesses reduce spending which should result in less demand, lower prices and eventually decreased inflation. We have already seen better inflation data over the last few months and we expect inflation to continue to decline but perhaps not as quickly as previously expected.

We do feel that we are nearing the end of this current rate-hiking cycle in both Canada and the U.S. Most likely, a pause should happen over the next 3-6 months as central banks determine if their actions have slowed the economy enough to allow inflation to decline. This is always a tricky scenario that I compare to having your foot on the gas and the brake at the same time and still being able to move forward. The most likely scenario at this time would be for rates to hold over the spring and summer, and possibly starting the decline in the fall and into 2024. History has shown us that interest rates will not remain high forever and therefore we are confident that the peak in interest rates has most likely already happened.

A mild recession is still probable in both Canada and the U.S. over the next few months. I continue to remind clients that this is not catastrophic with regards to investment portfolios. The technical definition of a recession is two consecutive quarters of negative economic growth – so this is a backwards looking economic indicator. By the time a central bank announces their country is in a recession, it has already happened (looking back at the last two quarters) and most likely financial markets have already started to recover. It is understanding that the stock market is not the economy. Stock markets bottomed in October, 2022 and RBC analysts continue to believe that the lows of last fall most likely should not be re-tested. When equity markets are in transition there are usually a number of fits and starts as they work their way through bear market declines and get closer to beginning a sustainable bull phase. So we can expect some continued volatility as investors digest inflation data and speculate on the action of central banks. Even if volatility persists in the coming weeks and months, we continue to see reasons why Canadian and US stock markets can deliver positive full-year returns, once all is said and done.

On the Financial Planning side of my business, I have been busy reviewing and updating retirement income plans for clients using the current lower account values so that investors can look past what has already happened and feel confident in their ability to fund their income needs in retirement. As a Financial Planner, my job is to understand financial goals and create a plan for clients to ensure they can achieve those goals. Generally speaking, there should be no surprises if clients understand the concept of pre-planned savings for future pre-planned spending.

Best wishes for a happy and healthy spring,

Sandra

Investment risk and diversification

What is investment risk?

Investment risk refers to the potential for uncertain return or financial loss on an investment. When you buy a security — for example, a stock or a bond — the price (also known as the market value) changes in response to various market conditions.

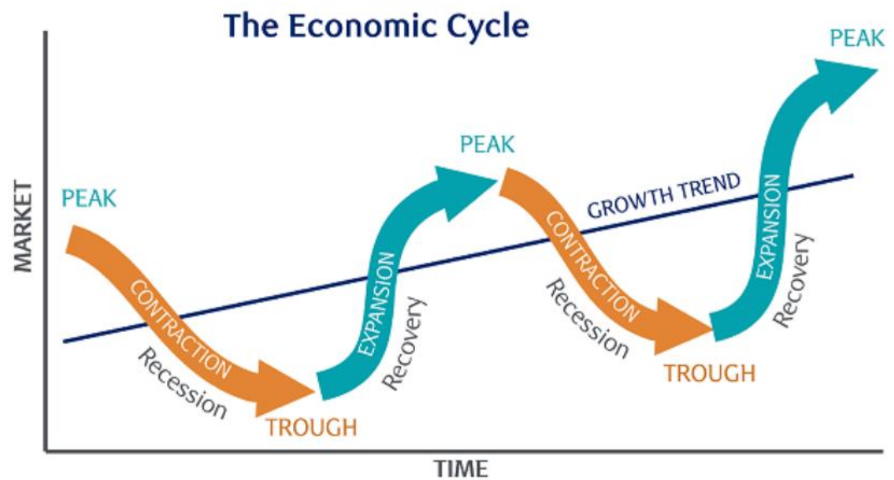
There are several types of investment risk. **Systematic risk** (also called market risk) is the overall risk of a financial market. Markets are cyclical — they move up and down with economic activity. While the up and-down pattern is expected, the degree in which markets move up and down is not predictable. If you invest in securities, you will be exposed to market risk.

Unsystematic risk refers to risks that are specific to certain companies. Every company that issues securities is exposed to risk associated with their own operations, the type of business they're in, the geographic region they operate in, and other market conditions.

Return on investment, or investment return, is primarily the change in the value of a security over time. If the value goes up over the time you own it, the return is positive, and you have a profit. If the value goes down over the time you own it, the return is negative, and you have a loss. Profit and loss are realized when a security is sold. Price movement up and down while you hold the security is normal and to be expected. If you receive interest or dividends from a security, this income may increase your profit or reduce your loss.

Some of these risks include:

- **Business risk:** The operating risk of a company. The more volatile the company's operating profit, the greater the business risk to the investor.



- **Reinvestment risk**: The ability of an investor to find an investment in the future, when their current investment matures or is sold, with similar risk and return characteristics.
- **Interest rate risk:** The potential for a change in interest rates to affect the value of the security. When interest rates rise, the value of a fixed income investment will go down.
- **Inflation risk:** The risk that the cost of goods going up over time will reduce the value of an investment and the return on investment.
- **Marketability risk:** The availability of buyers and sellers in an open market. When there are many investors buying securities, an investor selling a position will likely be matched with a buyer and the transaction will settle quickly. If there are few or no buyers, a seller may be forced to hold their position longer or sell at a lower price.
- **Liquidity risk:** How easily and quickly an investment can be sold or converted to cash.
- **Exchange rate risk:** The risk that while investing in a foreign market, fluctuations in the exchange rate cause the value of your investment, in Canadian dollar terms, to go up or down.
- **Default risk:** The potential for a bond issuer to not make interest payments on time or not pay back principal in full.
- **Political risk:** Changes in a country's government or policies that could cause instability and affect the value of securities or markets.

Diversification

Every investment carries some degree of risk. **Diversification** is a strategy to manage investment risk. By investing in a variety of securities, with different characteristics, an investor spreads their risk. Spreading risk means you're exposed to smaller amounts of different types of risk, rather than being fully exposed to one type. Investors can diversify by asset class, which means choosing the mix of cash, fixed income and equities in their investment portfolio. Investors can also diversify within an asset class, which means choosing securities from different types of companies, operating in different industries or regions, or by using investment funds that hold many positions.

Understanding the new First Home Savings Account

Announced as part of the federal government's 2022 budget, the new First Home Savings Account (FHSA) is scheduled to come into effect in April 2023. It will allow eligible individuals to save up to $40,000, and combines the tax advantages of two existing registered plans — the registered retirement savings plan (RRSP) and the tax-free savings account (TFSA). With final government approvals now in place for the new account, we've answered a few key questions to help you prepare before it officially launches.

1. Can I open an FHSA?
The FHSA is aimed at Canadians planning to buy their first home. To open one, you must be a Canadian resident at least 18 years old (or age of majority in your province so age 19 in BC) and a potential first-time homebuyer. "First-time homebuyer" in this case means you or your spouse or common-law partner did not own a qualifying home that you lived in as your principal place of residence in the year the account is opened or in any of the four preceding calendar years.

2. How much can I contribute?
You can contribute up to $8,000 per year to an FHSA, up to a lifetime maximum of $40,000. Unused room can be carried over to the next year. For example, if you open an FHSA in 2023 and contribute $6,000, you would be able to contribute up to $10,000 in 2024 (i.e., $8,000 for 2024, plus the remaining $2,000 left from 2023). Carry-forward amounts start accumulating only after you open an FHSA. You can open multiple FHSAs, but the annual and lifetime contribution limits apply to the combined accounts, so be careful with your contributions. There is a 1 per cent tax applied to over-contributions for each month the excess amount stays in your FHSA

3. What are the tax benefits?
The FHSA combines the tax advantages of an RRSP and a TFSA. And when it comes to taxes, this is a big deal. First, like an RRSP, contributions to an FHSA are tax-deductible. So, if you contribute $8,000 you can deduct the same amount from your taxable earnings. You can use the deduction in the year you contribute or carry it forward to a later year, which may be useful if you expect to be in a higher tax bracket in the future. (Note: Unlike RRSPs, any contributions you make in the first 60 days of the year can't be deducted from the *previous* year's income.) Second, if you are making a qualifying withdrawal, you won't pay tax on that withdrawal. Like a TFSA, this includes principal and potential growth. (All withdrawals from an RRSP are subject to income tax.)

If you are making a non-qualifying withdrawal, then you would pay income tax on the principal and potential growth, just like an RRSP withdrawal.

4. How is the FHSA different from the Homebuyer's Plan?
With the government's existing Homebuyers' Plan (HBP), first-time homebuyers can withdraw (tax-free and without penalty) up to $35,000 from their RRSP to buy a house. This is considered a "loan" and must be paid back into the RRSP within 15 years.

The HBP isn't going anywhere when the FHSA launches – and first-time homebuyers can choose to use both together. This means that by maximizing both programs, you could put $75,000 (plus any investment growth in the FHSA) toward a down payment.

You have a maximum of 15 years to save within an FHSA, and the account must be closed in the year you turn 71.

Comparing the FHSA and the HBP:

- HBP withdrawals must be paid back into your RRSP. FHSA withdrawals do not.
- The FHSA lifetime contribution limit ($40,000) is higher than the maximum HBP withdrawal limit ($35,000)
- After you pay the HBP back into your RRSP, withdrawals are ultimately taxed. Qualifying FHSA withdrawals are tax-free.

5. What happens when I want to withdraw the money?
The FHSA is designed for people buying a first home. For this reason, withdrawals will only be tax-free if they meet certain conditions. You must have a written agreement to buy or build your home before October 1 of the year after you make the withdrawal. The home must be in Canada and must be your first, as defined above. You can make one lump-sum withdrawal or multiple, as needed, but the account must be closed by the end of the year after your first withdrawal. If your withdrawal does not meet the above requirements, it will be included in your taxable income for that year and tax will be withheld. You do not get the contribution room back after making a non-qualifying withdrawal.

6. What if I don't buy a house?
If you decide not to buy a house, then you can transfer the money you've saved (and any investment income earned) directly to an RRSP. There is no penalty and no tax at the time of transfer. However, keep in mind that once in the RRSP account, the money will then be taxable when you withdraw based on the rules of those account types. When you transfer money from an FHSA to an RRSP, it doesn't change your RRSP contribution limits. It becomes $40,000 (plus any income) of additional contribution room. On the flip side, you won't get that FHSA contribution room back – once used, it's gone.

Understanding the Tax Forms

You may be receiving some of these tax forms to be used with your 2022 tax return

T3	Statement of Trust Income if you have investment income from mutual funds in non-registered accounts and from certain trusts.
T5	Investment income including interest, dividends and certain foreign income.
Summary of Securities Dispositions (T5008)	This form sometimes looks more like a letter than a tax slip so be sure that you do not overlook it. This is a summary of the proceeds of any sale of securities and your capital gain or loss information.
RRSP Contribution Receipt	Reports the value of contributions made to an RRSP plan during the year and up to 60 days in the next year.
T4RSP / T4RIF	All payments made from RRSP, RRIF or LIF accounts are taxable in the year they are received. If tax has been withheld and sent to CRA, it will be reported on the tax slip.
T4A	Education Assistance Payments from a Registered Education Savings Plan (RESP) are taxable in the hands of the child in the year it was withdrawn. This is only the grant and/or income portion of the plan which is taxable as income.

The ABCs of ACBs for Investors

Knowing the adjusted cost base (ACB) of your non-registered investments and how it's calculated is a part of good tax planning

Canadian tax rules require an adjusted cost base (ACB) calculation of an investment's cost for tax purposes to establish capital gains and losses on property you own, which includes your investments in non-registered accounts. The difference between the ACB and the sale price of an investment is what will determine the capital gain or loss for tax reporting.

Purchase price

You may buy the same investment at different times. Each time you buy more of the same investment, an adjustment needs to be made with your ACB to come up with an average cost. The average cost is calculated as the total cost for all purchases of the same investment divided by the number of shares or units you own.

Year-end distributions and allocations

If you invest in mutual funds, it is common to receive distributions and a corresponding tax slip at year-end. If you reinvest the distribution, the amount must be added to your ACB. This is because you are already paying tax on the distribution with the year-end tax slip, so you won't have to pay tax on this amount again when you eventually sell the price. An increase in your ACB means that you will have a lower capital gain in the future when you redeem your units.

Wealth Management
Dominion Securities

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