GROW TOGETHER

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CWB Wealth Management

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President’s message

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> “Our purpose is to help families live their best lives. We live this purpose through long-term thinking and careful planning to see us through the noise, complexity, and challenges of an unpredictable world.”

The past several years have required all of us to become accustomed to making adjustments. Whereas the decade between the bottom of the Great Financial Crisis and the beginning of the pandemic was relatively tranquil from an economic and financial markets perspective, the first three years of the ‘20s have been anything but.

The shock of the pandemic reshaped the global economy. And before we could fully sound the all-clear signal on public health, Russia’s early-2022 invasion of Ukraine introduced a cascade of new economic disruptions, humanitarian crises and geopolitical risks. Extreme weather in many parts of the world over the summer has compounded our macroeconomic challenges, further crimping already damaged supply chains and displacing millions of people.

To put it mildly, things are not the same as they were three years ago. Recent events have reminded us that we can’t take stability for granted. The world is unpredictable. It demands adjustments, and our plans need to be resilient to a range of unexpected events. This is the mindset we bring to our work as wealth advisors. Our purpose is to help families live their best lives. We live this purpose through long-term thinking and careful planning to see us through the noise, complexity and challenges of an unpredictable world.

This mindset is apparent throughout the current issue of Grow Together. From a portfolio strategy perspective, we address key macroeconomic aftershocks of the pandemic, including the potential implications of deglobalization. From a personal finance perspective, we consider adjustments that may be prudent in view of the rapid rise in policy interest rates now underway globally to combat very high inflation. We also cover important tax and estate considerations for anyone planning to split time between Canada and the U.S. over the winter, recognizing many will soon resume this tradition for the first time in several years.

For our part, we’re excited to resume our own traditions beginning this fall, including a series of in-person events to be held in cities across the country. Since combining the operations of CWB Wealth Management and CWB McLean & Partners with T.E. Wealth, Leon Frazer & Associates, Doherty & Bryant Financial Strategists and T.E. Wealth Indigenous Services in 2020, we’ve proceeded thoughtfully with a plan to draw from the unique strengths of each legacy organization. In-person events had become a signature of the client experience with each legacy firm over the years. Bringing these firms together created a more vibrant private wealth organization backed by the strength, focus and enterprising spirit of CWB Financial Group, and we can’t wait to demonstrate this renewed energy as we break bread and hear from inspiring speakers together with our clients.

No matter how you engage with our people on a given day – whether through an event, a publication, or in direct consultation with your advisory team – our enduring commitment is to provide you with thoughtful advice, sound planning, and professional investment management customized to your family’s needs.

As always, we appreciate every moment of the time you spend with us, including the time you may spend with this issue.

Sincerely,

Matt Evans

Pandemic aftershocks

CWB Wealth Management Investment Team

The summer of 2022 seemed to mark a turning point in the pandemic. We did indeed have another COVID-19 wave as can be seen in Figure 1. Touted as the seventh wave in Canada since the start of the pandemic, this was the first time we've had a surge where society pretty much ran like the pre-pandemic days of 2019. It's all the more impressive considering that the case count is likely significantly understated given the prevalence of home testing.

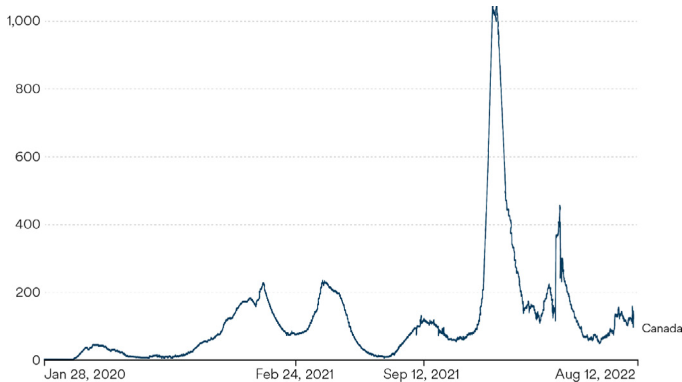
Since this was the third surge this year, we can take hope that there's some built up immunity in society. Couple this with boosters and we have hope for a fairly normal winter and a society that can live with COVID-19 without significant restrictions.

We may be in a stable and sustainable reopening and, if so, it comes not a moment too soon. There are still many economic imbalances in the global economy that need to be worked through that are largely a consequence of locking down society and flooding the economy with low interest rates and government handouts. Fortunately, the imbalances are well understood and governing bodies are dealing with them, largely by increasing policy interest rates.

Higher interest rates should help to slow the economy, lower inflation, balance the overheated job market and ease supply chains by curtailing the demand for goods. The normalization process will likely take several quarters or more, with China's zero-COVID policy being a wild card in the mix.

Figure 1: Daily new confirmed COVID-19 cases per million people.

7-day rolling average. Due to limited testing, the number of confirmed cases is lower than the true number of infections.



Source: Johns Hopkins University

(De)globalization

There are many COVID-19 trends that are well understood like hybrid work (work from home) and accelerated e-commerce penetration. In both cases, people adopted these trends quickly because there was no other choice, and the transition was surprisingly smooth. As investors, we always look to the long-term and try to identify trends that are misunderstood or underappreciated. Often these trends can take years to play out, but identifying them quickly can be lucrative. We think that deglobalization is such a trend.

The last several decades have seen a huge change in connectivity across the globe and increasing amounts of economic integration between developed nations and developing nations. Called "globalization", the biggest beneficiary of this trend has been China, which has seen its share of global GDP rise to 18.8% from 8.1% in the last twenty years, according to the International Monetary Fund. It's a staggering amount of growth that now puts the size of China's economy in the same league as the U.S. Western nations have also benefited from globalization partly through the importing of low-cost goods, which has helped keep inflation rates low and helped corporations grow their bottom line.

In many ways, globalization has been about prioritizing economics over issues like politics or human rights. If another country can do it cheaper, then companies have tended to buy from them regardless of anything else. Of course, not everyone has benefited from the trend and even before the pandemic, a move towards deglobalization was beginning in developed nations for many reasons. The loss of domestic manufacturing jobs was key among them. During the pandemic, there are two trends that have given urgency to rethinking globalization.

The first trend is security of supply. In short, the massive supply chain issues of the last two years have made companies realize the risks of being overly reliant on one country or region for raw materials and goods. Significant sales have been lost due to out-of-stock positions since the pandemic started. Companies clearly need to rethink their supply chains, even if costs increase.

> "In many ways, globalization has been about prioritizing economics over issues like politics or human rights. If another country can do it cheaper, then companies have tended to buy from them regardless of anything else."

The second trend is a refocus on national security. This includes the west's response to the Russian invasion of Ukraine. Europe is actively trying to decouple from Russia economically despite its dependence on Russian energy. Europeans will feel pain from this decision, but after more or less ignoring Russian aggression in Georgia and Crimea, the Europeans have prioritized security over economics.

It also includes changes in the technology space, with the U.S. recently passing the CHIPS Act, which has the dual goal of supporting domestic semiconductor production in America and also limiting expansion of semiconductor manufacturing in countries that pose a national security threat.

What does this mean for investors?

First, globalization is not dead – economies are far too linked. The impact of cutting off significant trade with developing nations would be devastating to western economies and some materials just can't be sourced locally.

However, the other considerations highlighted above mean that companies will look to diversify their sourcing of goods through reshoring (producing domestically) or nearshoring (producing in a nearby location). In fact, there's already evidence that this is happening.

According to Bloomberg, the construction of new manufacturing facilities in the U.S. has risen by over 100% in the last year versus a 10% rise in all building projects combined. It's no wonder that the research firm Piper Sandler is referring to the U.S. mid-west as an attractive emerging market. Of course, this is good news for manufacturing in the west and should be a positive story for smaller companies. It's one reason why we're planning to launch a North American small cap fund this year, which should benefit from the trend of more local sourcing in North America.

Overall, perhaps the biggest takeaway is that less international trade contributes to inflation. By this we don't mean run away inflation like we have today. The amount of decoupling between economies shouldn't be severe enough to cause a massive spike in inflation. Instead, over the long-term, central bank inflation targets will be harder to hit without higher interest rates than we have now.

It also appears we've come through a period of relative political calm pre-pandemic to a world where geopolitics are more important. The outcome of this is harder to predict and makes diversification just as important as ever.

Sources: FactSet, Bloomberg, Johns Hopkins University

When the hawk lands: rising interest rates and your financial future

Trevor Fennessy, MBA, CFP
Senior Planner, Wealth Management

In a landscape filled with bears and bulls, it can be helpful to look to the sky and keep your eye on the hawk and the dove. The hawk and the dove are terms given to federal policy makers and their views on how monetary policy should be used to influence economic cycles.

The dove takes a peaceful approach, keeping interest rates low, favouring expansionary monetary policy and not worrying about rising inflation. Amid the pandemic, the Bank of Canada followed a dovish path by cutting their policy rate to historic lows (0.25%) to provide emergency stimulus to the economy.

On the contrary, the hawk believes that tightening monetary policy through increasing interest rates is an effective tool to combat inflation. With inflation becoming a real concern for Canadians, it's no surprise that the hawk has re-emerged.

What is the cascading impact of a rise in the policy rate?

The Bank of Canada's policy interest rate is the target rate at which financial institutions lend money to one another, or with the Bank of Canada as they settle transactions each day. Once set, the policy rate effectively cascades down to all other forms of personal and commercial lending.

Some of these changes occur immediately, while other impacts are indirect and take time to unfold. The table in Figure 2 shows some impacted areas following an increase to the policy rate.

Ahead of interest rates announcements, we often see expected rate changes priced into the bond and equity markets, reflecting the general market consensus for the interest rate path.

Figure 2: Examples of impacted areas following an increase to the policy rate

Before a Rate Announcement	Immediate Impact	Medium to Long-Term Impact
Bond Yields	Prime Rates	Fixed Term Debt
Equity Valuations	Variable Rate Debt	GIC Rates
	Lines of Credit	Annuity Rates
	Credit Card Debt	Prescribed Interest Rates
	Car & Equipment Leases	Exchange Rates
	Savings Accounts	Housing Prices
		Accounts Payable/Receivable Terms
		Business Valuations

Once the policy rate is adjusted, financial institutions promptly adjust the rates on their lending and savings products. For the hawk, rising rates are believed to discourage borrowing, encourage saving and slow demand for goods and services. For example, in the case of housing, mortgages become less affordable, slowing the demand for housing and eventually cooling down market prices.

As many debt and savings products are negotiated for a fixed term (mortgages, GICs, etc.), the impact is not felt until the product is up for renewal. Similarly, the Government of Canada's prescribed interest rates, that are instrumental to strategies such as spousal loans and family trusts, are set quarterly. For these items, advanced planning is required to understand the impact of an interest rate move.

What are the best ways to weather rising interest rates?

There are three important areas to consider for households and business owners to deal with rising interest rates:

1. Review your debt exposure

The first area to examine is your personal and/or commercial debt exposure. To truly understand the impact, it's best to focus on dollars rather than percentages and look at how and when the rise in interest rates will have a direct impact on cash flow. For those with floating rate debt, it's prudent to stay ahead of the curve and forecast how your payments might change if rates continue rising.

For those holding debt for a fixed term that is nearing renewal, early, even immediate renewal may be worth exploring. There may be penalties associated, but the cost could be more than offset by future interest savings. Debt consolidation, securitization, or repositioning to make it tax deductible can also be helpful to reduce overall interest costs.

It's also a great time to review your mix of floating and fixed-rate debt. This should include a review of your capacity and tolerance towards interest rate fluctuations, and whether floating rate debt is appropriate for your circumstances.

2. Review your capital allocation strategy

At both the business and household level, capital should always be directed to its highest and best use. For households, rising interest rates can have a significant impact on the balance between debt payments and saving. Households should prioritize paying down their highest interest rate debt first, but also need to strike a balance in saving towards their long-term goals.

For businesses, highly leveraged projects could become less desirable. In some cases, abandonment or postponement of capital projects may be required. During these times of financial tightening, businesses can consider renegotiating accounts payable and accounts receivable terms to shorten the cash conversion cycle, liquidating any obsolete equipment or inventory, and revisiting their financing terms.

3. Be on the lookout for opportunities

In any given environment, it's not all bad news. As fixed income markets are heavily impacted by rising interest rates, this could be a great opportunity to review your fixed income exposure and proactively position your portfolio against rising interest rates. Similarly, this could be an opportunity to identify undervalued public companies that have been unjustly impacted by the current economic climate.

Another plus will be the increase in rates on savings accounts, GICs, money-market funds, and bond coupon payments. For those entering retirement or wishing to secure a guaranteed income stream, annuities will also become more favourable.

Closing thoughts

Though the effects of the policy interest rate are far reaching, interest rate cyclicality is nothing to worry about over the long-term as it's a normal part of any economic cycle. At any point, the height and breadth of the interest rate path is unknown. It's best to stick to a long-term plan and focus on the items within your control.

Think like a pilot in a plane. The goal is not to control the weather, but to have a clear destination in mind and stay oriented towards it. As weather patterns change, adjustments are made to ensure that we stay on course. Interest rates are just one of those changes to the weather patterns. We must be willing to fly alongside the hawk and know that it won't take down our plane.

Sources: Bank of Canada

A Snowbird's guide to need-to-know U.S. regulations

Marcy Ages
Financial Planner, Associate Portfolio Manager

Canadians love to get out of the cold for the winter, especially to the nearby U.S. Along with the proximity, common language and familiar food, many U.S. states offer appreciably warmer weather than anywhere in Canada. And great weather is a powerful draw.

A significant portion of the Canadian population spends the entire winter in the U.S. That can be a wonderful thing unless you forget to take a few important steps to ensure you're covered from a financial and regulatory perspective to avoid unnecessary taxes and fees.

Health insurance

While in the U.S., there's always the possibility that you may end up needing to avail yourself of medical services, so it's advisable to purchase medical travel insurance before you go. Your provincial or territorial healthcare plan can cover some of the costs associated with medical procedures, but does have its limits. In Ontario, for instance, it will only cover out-of-country medical expenses if you've lived in the province for more than six months and are away for less than 212 days in any 12-month period.

Income tax

If you spend enough time south of the border, you could be obligated to file a U.S. income tax return. However, if you can prove that you have a closer connection to Canada than the U.S., you can avoid this filing obligation. The **Substantial Presence** Test that's applied by the IRS determines whether a person who is not a citizen or permanent resident still qualifies as a "resident for tax purposes" or a "non-resident for tax purposes".

So, what is the Substantial Presence Test? It's a formula used to determine if you've spent 'enough' time in the U.S. to be considered a U.S. resident for tax purposes. If you've spent 31 days there in the current year, and if the following formula adds up to 183 days or more, you're considered substantially present.

> The number of days you were present in the current year
>
> + 1/3 of the days you were present in the first year before the current year
>
> + 1/6 of the days you were present in the second year before the current year

For example, if you spent 100 days there in 2022, 180 days in 2021 and 180 days in 2020, you'd calculate the number of days as follows:

> 100 + 1/3 of 180 (60) + 1/6 of 180 (30) = 190 days

If this number were *less than* 183 days, there would be no reason for you to file a U.S. tax return. But, as it's *higher*, you'd be considered a U.S. resident unless you make the case that you have closer ties to another country (i.e., Canada).

To make your case, you'd file **Form 8840 – Closer Connection Exception Statement for Aliens**. This form must be filled out and sent to the IRS by the due date for form 1040NR (typically, June 15).

U.S. assets

Your estate may have to file a U.S. estate tax return and potentially pay U.S. estate tax when you die – even if you're not an American citizen. The filing requirement begins if you have U.S. situs assets in the amount of $60,000 USD or greater.

There are many items which qualify as U.S. situs assets, but most commonly this would include real estate property along with U.S. stocks or bonds. While the filing requirement begins when you have U.S. situs assets of $60,000, if your worldwide estate is less than $12.06 million (2022 amount, indexed annually), your estate will not have any U.S. estate tax exposure.

However, please note that the $12.06M figure is currently scheduled to be reduced to the 2017 amount of $5M adjusted for inflation, which is expected to be near $6.5M in 2026. The Biden administration could also implement new legislation prior to 2026.

> **"If you spend enough time south of the border, you could be obligated to file a U.S. income tax return. However, if you can prove that you have a closer connection to Canada than the U.S., you can avoid this filing obligation."**

Wills and powers of attorney

If you spend a substantial amount of time in the U.S. and own significant property there, you should consider having dual wills. A will created in Canada which distributes assets in the U.S. may or may not be valid there, depending on whether the will is accepted pursuant to the laws of the state where your property is located. Your U.S. will should be prepared so that it doesn't conflict with your Canadian will.

In addition, you should have U.S. powers of attorney for healthcare and property drawn up in case you're incapacitated while down south, or even so that your U.S. property can be administered by a loved one if you're incapacitated in Canada. Consult a lawyer who has expertise in both Canadian and U.S. estate law when having your dual wills and power of attorney documents prepared. They should be well versed in the latest changes to any legislation that could affect you.

Spending significant time in countries like the U.S. can be wonderful, but it's possible to get stuck in situations you may not have considered. Removing the unknown is a good idea. If you need any help with any of these matters, your financial advisor can help you navigate your way through.

Sources: IRS, Government of Canada, Government of Ontario

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