

The Francis Forum

Winter Edition 2021

What 2020 Has Taught Us

Did anyone else think 2020 was going to be their best year yet? For most, it wasn't what people had envisioned. The historical year of 2020 has finally... come to an end. There have been many lessons learned, whether it be for the benefit of ourselves, or others. With the vast uncertainty that the pandemic created for the economy, and our personal finances, there are many financial and investment planning lessons that we can takeaway and apply in 2021; a year with hopefully more financial opportunity, growth and stability.

Needs Over Wants

Have you noticed that you've spent a lot less in 2020; perhaps, less money on travel expenses, coffees at your local shop, dinners at your favourite restaurants, new attire for work or entertainment? If you have been able to reduce expenses which in turn has allowed you to save money, why not invest it or start an emergency fund. Last year highlighted that many items that we spend our money on during "normal" times are mainly wants as opposed to needs and anytime we are able to save money, it is important to be proactive when it comes to financial planning.

Always Be Prepared For The Unexpected

The pandemic has demonstrated the importance of always being prepared for the unexpected and the various "what ifs." Before the pandemic, we might have been spending our money on miscellaneous things, but now there is a great deal of realization that at any moment there might be an unexpected event or expense. A major renovation for your home, furloughed from work or maybe your loved one is involved in a serious accident, or falls ill; it is crucial to have a dedicated emergency fund in order to protect yourself from unanticipated events and be able to sustain yourself during difficult times. The recommended amount to save in an emergency fund is anywhere between three to six months of your expenses. There is no right amount to place in this fund, but the amount allocated should strengthen your financial plan without overextending. The amount of money in your emergency fund all depends on your unique situation, such as job stability, being a homeowner or renter, vehicle owner or leaser, and family size. This fund is to be treated as a protection armor if anything were to go wrong; it is there to sustain you until you regain financial strength.



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Ask Yourself Some Important Financial Planning Questions

Now that you've gained insight on the importance of saving for the what if's and just having an emergency fund in general, it is crucial to sit down with your loved ones to discuss your financial goals and to plan accordingly. The first question to ask is whether you have money to pay for your essentials, without missing any payments. The next question to ask is whether you could survive financially if you lost your job; this is when your emergency fund comes into play. Once you've answered these two questions regarding your immediate goals, you should start to address your long-term financial goals. Write down specific long-term goals that you are looking to accomplish such as buying a home, paying for your child's post-secondary education, purchasing a luxury car, retirement, or maybe establishing a travel fund (once it's safe to travel again, of course!) A follow-up question to ask yourself is what is preventing you from achieving these long-term goals? Implementing an action plan to achieve these goals then becomes your top priority. Look internally into ways in which you can save money by reducing your spending, perhaps gain employment at a higher paying salary, and most importantly meet with me or one of the team to review and update your comprehensive wealth plan to ensure you are still on track to achieve your financial goals.

Continue to Invest

The stock market has been quite volatile this year and has caused many people to be question if right now is the best time to invest. Focusing on your long-term financial goals by aligning them with your investment policy statement, will help us assess your return potential based on the amount of risk you are willing to take. Most importantly, do not let your emotions lead you astray and pull you away from your future long-term goals. We know that the financial markets have proven that they go up over an extended period of time but they do not advance in a linear fashion. Keeping your emotions in check will allow you to do the right thing when your emotions are telling you to "run for the hills" and go to cash. As well-known and successful investment adviser once said, "When you are at the point when you are so upset at me and you want to throw a brick through my window, stop, write out a cheque, tie it to the brick then throw it". The time when your emotions and anxiety are at their highest is usually the best time for to be adding money to your investment portfolio. True wealth creators have control of their emotions and that is why you have us on your side.

Everyone can agree that the year 2020 has been quite the unpredictable ride. Despite what the world has experienced, there were many key lessons that were learned; the distinction between needs and wants is clear, the importance of establishing an emergency fund, answering/actioning on essential investment questions and continuing to invest in your future. Now, on to 2021, a year with more prosperity and less uncertainty!

Written by Catherine Hansen in conjunction with Duane Francis, Senior Portfolio Manager



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Around the Branch

- We did our best to **Do Well – Do Good** by providing support to those less fortunate. We were again major sponsors of the Christmas Exchange Breakfast. As well, despite Covid-19 we were able raise over **\$15,000** in support of the Ottawa Regional Cancer Foundation at our first Let's Take a Drive for Cancer – a socially distance city wide scavenger hunt!
- We learned late fall that **Janet Nunn will not be able to return to work**. Her medical condition simply does not allow it and thus is on permanent long-term disability. Janet has asked me to thank those clients who continued to inquire, support and otherwise wish her well. Hopefully, Janet will be able to attend some client functions over the years ahead and say hello in person
- Due to new COVID-19 restrictions **there cannot be any meetings at the branch** until the province gives us permission. Our branch is considered essential and therefore some staff will always be present to handle any inquiries and business needs.
- **James Hickman has decided to leave** us due to the current COVID-19 situation for more flexibility for family obligations. For any inquiries regarding outstanding work in progress by James, please write Natalie Nunn at nnunn@mandevillepc.com or Duane Francis at dfrancis@mandevillepc.com

Control Market Risk via Dollar Cost Averaging

The U.S. election has come and gone and it appears that one or more effective vaccines will soon be at hand to help curb and ultimately bring an end to the COVID-19 pandemic. What remains however is uncertainty over the economic restart and how this will impact stock markets. There is always something to concern someone.

We all know that owning high quality businesses is key to earning above average returns and wealth creation over time. Investing in “quality” ensures sustainability, and survivability, particularly through challenging socioeconomic times as the world has experienced.

But what about market risk because of all the noise surrounding investing? Some people cannot help but worry about whether they should invest now or wait for a downturn. What about a methodology that effectively helps to take away market risk for those worried about uncertainty?

It is called Dollar Cost Averaging. This involves committing equal amount of capital to purchase equities on a recurring basis at specific intervals – most effectively on a monthly or at least quarterly timeline. Anyone who has read “The Richest Man in Babylon” recalls the lesson about “paying yourself first” which is another benefit of regular periodic investments. After all, if you pay everyone else first...what is left for you? Often, not much! By committing to paying yourself first you ensure the most important bill of all gets paid – you!

Dollar Cost Averaging works effectively by distributing the price at which you buy shares across a broad period of time – sometimes the price may be low (attractive) and other times the price may be higher (less attractive) but this price averages out over time to ensure that 100% of your purchase is not at the WRONG time. The effect is that with an equal periodic investment, when economic or COVID-19 events cause equity values to fall, you automatically purchase a higher quantity of shares.

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When markets rise to what may be considered overvalued territory in good economic times, you automatically purchase a lower quantity of shares. The end result over time is an “average” price somewhere in the middle. Let’s look at a simplified hypothetical scenario covering three payments of \$100 over three months.

Amount invested	Share Price	# shares Bought
\$1000	\$100	10.00
\$1000	\$ 50	20.00
\$1000	\$ 75	<u>13.33 (rounded to 13)</u>

You invested \$3,000 in total. You bought 43 shares – a few at high prices and many more at lower prices. Would you profit or lose if after three months you sold all shares at the last price of \$75? The fact is that 43 shares x \$75 is \$3,225 or a profit of \$225 or 7.5%. Even with minimal commissions, the profit is compelling. Imagine the impact over a 10, 20 or 35 year time period by investing in the S&P500 or similar proven managed fund. Wealth creation is simple if you stick to a plan, invest regularly in proven investments, and don’t let your emotions derail you. Anyone looking to build wealth and minimize their risk could easily adopt the above strategy.

Written by Michael Prittie, Senior Portfolio Manager

Transferring Corporate assets to the next generation...Is there a better way?

Dave and Samantha Hopeful are both 55 years of age and are shareholders of Hopeful Holdings Ltd. in Ontario. They have accumulated significant cash in their holding company which was derived from profits from their successful operating company.

Dave and Sam plan to retire at age 60. They do not need the cash in their holding company for their immediate and retirement needs yet they wish to preserve it. As a result, the excess cash has been invested in a fairly conservative investment which generates passive income. Unfortunately, this income is taxed at the highest corporate tax rate which is currently 50.17% in Ontario. Furthermore, in order to extract the cash from the corporation the income would have to be paid out as a taxable dividend to Dave and Sam. Currently the top dividend tax rate is 47.74% in Ontario. These tax issues are quite disconcerting to Dave and Sam and they are looking for a better way!

They met with their financial advisor to discuss their dilemma. One very interesting solution is to transfer some of the excess corporate cash into a tax-advantaged environment by purchasing a permanent cash value life insurance policy. By retaining the cash inside the corporation, Hopeful Holdings Ltd. will not pay dividends and therefore Dave and Sam won’t lose one-third of the corporate assets to personal dividend tax.

By purchasing an exempt permanent cash value life insurance policy, a portion of the existing investment can be deposited into the life insurance policy which is a tax-advantaged growth environment. As such, the annual growth isn’t subject to tax as long as it remains within the policy. In addition, the death benefit provided by the insurance policy is paid tax-free to the beneficiary which



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in this case would be Hopeful Holdings Ltd. The death benefit payment in excess of the adjusted cost base (ACB) is credited to the corporation's capital dividend account (CDA). Interestingly, Hopeful Holdings Ltd. may then distribute the dividend from the CDA **tax-free** to the surviving shareholders whom could be the children or the estate.

Dave and Sam think this is a great idea and have decided to allocate \$50,000 per year for seven years to a new joint policy. What intrigued them is seeing how this strategy compares to the corporation's current savings strategy.

Assume that the current fixed income investment provides a 3% annual return. The new life insurance policy has a face amount of \$1,000,000. In both cases \$50,000 is deposited for seven years. Dave and Sam are both in good health and non-smokers. At the end of 35 years comparing the after-tax estate values resulted in \$362,699 for the corporate fixed income investment versus \$1,889,211 for the life insurance solution. Conversely, even if the Hopefuls assumed a blended 5% return from the corporate investments, the after-tax estate values resulted in \$904,269 versus \$1,889,211 for the life insurance solution. Evidently the life insurance strategy provides an opportunity to control the erosion of the corporate assets due to taxes and offers an enhanced strategy to transfer corporate assets for the benefit of the Hopeful family and also reduce significant taxes during the accumulation years.

This information is general in nature using accurate calculations. To learn more about this and other strategies using life insurance please feel free to contact Shawn Ryan, CFP, TEP, Insurance & Estate Planning Specialist at sryan@mandevillepc.com or call 613-728-0101.

Written by Shawn Ryan, Insurance & Estate Planning Specialist

Understanding IPO Performance Metrics

With the year coming to a close, we are also seeing the end of Initial Public Offering (IPO) season in public markets. Often, a firm will go public as its next step in growth, to gain access to capital markets, or if market sentiment is positive, secure a high price and reap the benefits of cheap equity capital. This year saw some notable entries into the public market to take advantage of at least one of these reasons, and two very successful IPOs were Snowflake, and Palantir, however, not all faced this same short-term prosperity.

While day one returns may be substantial, the IPO is not the be all and end all of investing. Frequently, firms tend to soar on day one, but face severe price drops in the following days, but it's important to ask why some firms succeed long term compared to their peers who soared on day one, but saw long term underperformance. Historically, IPO underpricing has held true for highly anticipated offerings, but upon investor realization of the true intrinsic value, the price point settles to a realistic expectation within the market.

In our previous newsletter, I discussed the efficient market hypothesis and how investment prices are a reflection of all available information, both public and private. This same concept holds true to the IPO as private firms have substantially less information available on day one. As such, investors may demand the issue be discounted to reflect the risk of entering into a new security. This may be done by the issuing firm itself as it seeks to attract new investors, or it may be requested by the institutional investors that



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traditionally hold the majority of shares as compensation for taking on the added risk. Additionally, a financially conservative firm may deliberately underprice its offering to ensure there is no overstatement of value (under-promise, over-deliver)

Consequently, if a firm is widely sought after, the release of information to the public markets will cause this underpricing to be very prominent as day one returns rise, one such example is the public launch of Beyond Meat in 2019, but like Beyond Meat, the long-term performance of many firms following a public debut has been lackluster. Those that tend to perform best are the ones who are deliberately conservative in their valuations as day one returns may be high, but as investors price the issue, see positive long-term performance as the price rises to a true intrinsic value.

Some of the theories and implications from long term underperformance stem from three main schools of thought: 1) Divergence of opinions, 2) Market Optimism/Pessimism, and 3) Overinvestment. The first explanation of underperformance stems from the aforementioned lack of information to create an efficient price, and as excitement for the issue settles, the price also settles, and perhaps not in the way investors had hoped. Moreover, many firms will launch an IPO in an upward trending market to secure a good price, but as market sentiment falls, or perhaps economic events cause stagnated returns, the new issue will see downward pressure on its price. Finally, the third, and arguably most frequent cause of underperformance is the firm undertaking value destroying projects that are ultimately reflected in the price seen by shareholders.

While it is important for institutional, and at times retail investors to participate in IPOs, high risks are present and perhaps greater than that of an investment into seasoned securities. As such, it is extremely important to conduct appropriate research, ensure the industries in which your investments are held are well understood, and that you are paying a fair price for your investments to achieve your goals and obtain long term capital appreciation

Written by Adam Prittie, Associate Investment Advisor



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Client Seminars and Upcoming Activities

- Due to Covid-19 we have postponed our in-person seminars and client events until further notice as the safety of our clients and staff is always our first priority. We will continue to host our monthly ZOOM seminars in the new year.
- The new provincial COVID-19 restrictions prohibit us from having clients in the building. Our branch is considered essential and therefore some staff will always be present to handle any inquiries and business needs. We are continuing to do reviews via ZOOM and telephone depending on your preference.

Sincerely,

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