Nexus Notes

June 2021
Vol. 26, No. 2

Featuring:

Summer Vacation

Nexus and the ESG Integration Approach

The Money Tree – A Twenty-Year Nexus Testimonial

The Great Transition – A Tax Efficient Withdrawal Strategy

Women & Wealth: Navigating Life's Changes

Invest *Thoughtfully*™

NEXUS

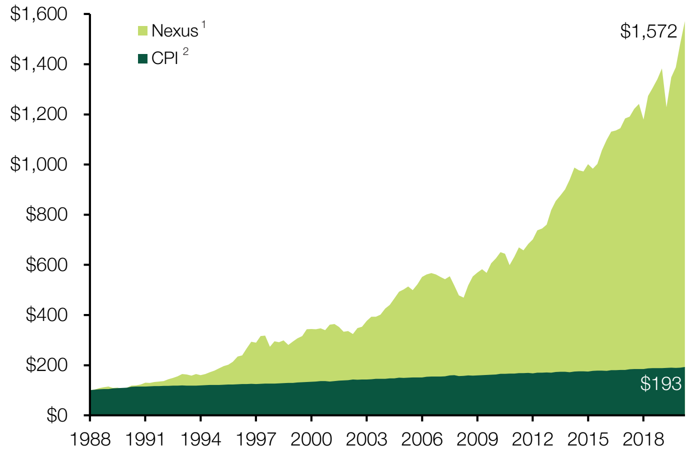
Our market-resilient investment strategy focuses on long-term results, providing investors with peace of mind through all stages of life.

Building Value for Clients

Since its establishment in 1988, Nexus has pursued an investment approach which concentrates on real growth in client wealth over the long term.

The chart illustrates the impact of this long-term investment thinking – a $100 investment in a balanced portfolio in 1989 has grown to $1,572 at March 31, 2021.

$100 Investment with Nexus in 1989



NEXUS

nexusinvestments.com

1 "Nexus" reflects the performance of a composite of Nexus accounts managed to a balanced mandate (until September 30,1997) and the Nexus North American Balanced Fund (thereafter). Returns shown prior to the deduction of investment management fees.

2 CPI is the "all-items" Consumer Price Index for Canada, not seasonally adjusted.

Nexus Notes

June 2021
Vol. 26, No. 2

In this issue:

To download a copy of this issue, or to access more resources go to: nexusinvestments.com/insights/nexus-notes-quarterly/

The Nexus Notes newsletter is published and distributed by Nexus Investment Management for the purpose of providing relevant information to our clients and other interested parties. For additional copies, or to be removed from our mailing list, please contact our office.

Publication Mail Agreement 40033917

FROM THE EDITOR

Summer Vacation

Summertime and vacations go hand in hand. The season is linked with feelings of relaxation and recreation. As kids, we saw the arrival of summer as freedom from school and regular routines. As adults, it's a time for patios, barbecues, and being outdoors, as if we are recharging our batteries for the next winter that's coming. It's also the high season for traveling. We've even come up with the endless summer, a dreamy idea that, with enough time and money, you could migrate around the world between northern and southern hemispheres following summer seemingly forever.

Last year lacked some of these qualities, as our ability to travel was restricted due to the pandemic. As for this summer? At the time of writing we are just starting to see activities and businesses opening back up. There are even discussions on how and when borders will open again to accommodate travel. While we welcome the good news, this summer will still be far from normal.

We recently hosted an event as part of our Women & Wealth series. The content centered around navigating life's transitions, and we welcomed Dr. Amy D'Aprix to share her insights on change and how to manage through transitions. Of course, the topic of retirement was on the list of things covered. Dr. Amy pointed out that many people view retirement as one long vacation, a bit like an endless summer. But in reality, most people will experience retirement as different stages of life.

Typically, the first stage will involve many vacation-like activities. But retirement will start to take on a more day-to-day quality at some point. This is why Dr. Amy emphasizes the importance of maintaining a sense of purpose in your life. Here is where goals and planning can play a role, and this should go beyond just financial aspects. Of course, with the prospect of longer lifespans and the reality that you could spend a third of your life in retirement, being financially prepared is necessary. In fact, in this issue Dianne White provides a framework for withdrawing your money in retirement. But thinking beyond the financial elements is also important. And while planning certainly includes cash flow, tax, and estate considerations, fundamentally, it involves thinking about the future. And that includes imagining what your life might look like beyond the vacation stage. This isn't about trying to create a blueprint for your future. Instead, it's about considering where you might find purpose for yourself as you move through these new stages. You can read an overview of Dr. Amy's discussion under the Inside Nexus section.

Also, in this issue, Devin Crago describes the various approaches investors take when evaluating Environmental, Social and Corporate Governance (ESG) considerations and some of the pros and cons of these different methods. He also provides insights into Nexus's approach to ESG investing.

High quality stocks and a long time horizon are two key factors that contribute to Nexus's success. Jim Houston introduces us to The Money Tree, the lived-in experience of a 20-year Nexus client, and how these success factors contributed to the growth of their wealth.

Whether it's investing or otherwise, we don't know what the short term will bring, including how much we'll be able to do this summer. But I hope you enjoy the warm weather that comes with the season and you're able to capture some of those feelings of relaxation and recreation.

Brad Weber
CPA, CA, CFP

INVESTMENTS

Nexus and the ESG Integration Approach

by Devin Crago, CFA

At Nexus, we think Environmental, Social and Corporate Governance (ESG) considerations are a helpful input to our investment decision-making process.

There are several ways investors approach ESG, and each way has its own pros and cons. Some investors take an exclusionary approach, which simply means not investing in industries like tobacco, firearms or alcohol. Others move to the other end of the spectrum and try “impact investing,” which seeks to create a positive ESG impact with financial returns as an ancillary consideration.

Our approach to building ESG into our process is known as “ESG integration,” meaning, we incorporate material ESG considerations into our overall analysis of the merits and risks of an investment.

We think ESG integration makes sense—in theory. It improves our ability to identify hidden risks and opportunities in our portfolios. For example, ESG can push us to think more broadly about risks like carbon taxes for airlines or community relations for pipeline companies—and, crucially, how these risks might affect shareholder returns. It can also stimulate us to think about opportunities on which our holdings can capitalize, like participating in the growth of renewable energy infrastructure. In addition, we think ESG integration enhances our search for high-quality, well-run companies that are focused on the long term.

In short, the ESG integration approach doesn’t cost us anything in terms of foregone investment returns, and it gives us the benefit of improving our decision-making process.

In practice, we now have available tools—ESG analysis from Sustainalytics and new ESG resources from our Bay Street and Wall Street research providers—to undertake this research more effectively. However, despite investment opportunities and the latest research tools, the world of ESG comes with complications. Here are four main considerations.

The comparability of ESG data generated by companies

Unfortunately, the ESG data that one company reports isn’t always comparable to the data another company reports, simply because, over the years, various industries, countries and organizations have developed different voluntary ESG reporting standards.

Fortunately, the Sustainability Accounting Standards Board (SASB) and others are working to bring a higher level of consistency and comparability to ESG reporting. The aspiration is to bring ESG reporting standards up to the level of rigour demanded by traditional financial reporting standards.

More importantly, the SASB is also rightly focused on *materiality*. Materiality—a key concept across all of investing—recognizes that some ESG data (safety data for the software industry, for example) is not particularly relevant. By contrast, human rights and community relations are material for the mining industry, as problems in these areas could mean that a mining company has its social licence to operate revoked.

There is a long way to go to improve ESG data comparability, but progress is occurring.

How ESG rating firms interpret data

Even though we have access to far better ESG data than we ever had before, there is no universal truth in ESG ratings. You can have two ESG rating firms produce conflicting ratings on the same company. One will argue the company is well positioned and managing its ESG risks effectively; another will claim that same company is a laggard with inadequate management of ESG issues. The complication is, of course, that reasonable analysts can disagree about what the data tells you.

The *Wall Street Journal* recently put it like this: "Professional investors and rating services disagree widely on how to rate corporate responsibility. You could admire Tesla Inc. for reducing society's reliance on internal-combustion engines—or reproach it for squandering electricity on bitcoin and relying on batteries made with lithium, which can be hazardous and difficult to recycle."

As such, it's a matter of interpretation.

Complexity and tradeoffs in ESG

Some parts of investing are black and white: Company A has better profit margins than Company B. However, with regard to ESG, distinctions are not nearly as clear. There is inherently more subjectivity, and any assessment of a company's ESG characteristics naturally has to be made in a grey area.

For example, take Canadian energy companies operating in the oil sands. On the one hand, they're good. Society—hospitals, schools, farmers, you name it—need the energy they produce until alternative energy sources are widely available. On the other hand, they're bad, because oil sands operations are emissions-intensive and so is the eventual combustion of the fuel. On the other, other hand (wait, is there a third hand?), since we need to use oil for the foreseeable future, isn't it better to source it from a jurisdiction like Canada where environmental standards and human rights are upheld, instead of from another jurisdiction where there may be poor worker protection or non-existent environmental regulations? In other words, it's complicated.[1]

As investors, we need to do our best to apply good judgement in this grey fog. That means thinking about the many tradeoffs and rewards associated with an investment.

When it comes to ESG, the situation today is that if you want to own a company that everyone considers an "ESG Leader", you usually have to pay more. That puts you in the top right quadrant of the illustrative chart above, where the tradeoff for owning an ESG leader is paying a higher valuation. However, paying a higher valuation is often a risky proposition, as, even if the company does well, investors may receive a disappointing return, simply because they paid too much for the investment.

Then again, you may not want to own an "ESG Laggard" for a number of reasons. From an investor perspective, one of those reasons is the possibility of major share price downside if the company doesn't properly manage its ESG risks.

An alternative tradeoff is to buy an "ESG Improver", for which you pay a lower valuation. These companies aren't at the top of their ESG game yet, but they have plans in place and are improving.

When it comes to ESG at Nexus, we're willing to pay more for a company that's demonstrably managing its ESG risks and opportunities well. That's because it's an indicator of a high-quality company that's taking steps to reduce its risk and enhance shareholder returns. However, we need discipline and good judgement to ensure we don't overpay for an ESG leader with a huge valuation that isn't justified by the fundamentals of the business. After all, being good at ESG doesn't unequivocally deliver superior shareholder returns. Sometimes, the companies that aren't there yet—but are improving their ESG profiles—offer the most attractive combination of tradeoffs.

In his recent letter to shareholders, Jamie Dimon, CEO of JPMorgan Chase, made some interesting points about the tradeoffs required to solve climate change: "The fact is we're long past debating whether climate change is real. But we need to acknowledge that the solution is not as simple as walking away from fossil fuels. We will need resources such as oil and natural gas until commercial, affordable and low-carbon alternatives can be developed…. We can agree on the need to make our energy system much less carbon intensive. But abandoning companies that produce and consume these fuels is not a solution…. Instead, we must work with them."

These are complex, dynamic problems involving plenty of tradeoffs. Again, however, things are improving.

Fund "greenwashing"

Fund managers, too, have contributed to the complications. Some have created new ESG-branded funds that make misleading or overstated ESG claims, in the hopes of attracting clients. Others have gone so far as to simply rebrand an existing fund by adding words like *green*, *ESG* and *sustainability* to a fund prospectus (or even the fund name), even if there has been no discernible change in the way the fund is managed.

Greenwashing, as it's known, is disingenuous, and regulators, such as the SEC, are taking this seriously. The SEC recently noted that it had found that several investment firms were misleading investors by falsely claiming adherence to sustainability-friendly policies. While there's proof this behaviour is occurring, it remains challenging to decipher who's honest and who's bluffing in the subjective world of ESG marketing claims.

Despite these complications, at Nexus, we see the integration of ESG considerations as a way to help us build a better-quality portfolio without sacrificing shareholder returns. Although we remain cognizant of all of these challenges, we do think thoughtful incorporation of ESG criteria is improving our decision-making process. And that should serve our clients well over time.

1) Of course, this ongoing complication doesn't preclude humanity from transitioning toward cleaner sources of power. However, these energy transitions usually take time, as we explored in a 2020 article titled *The Transition to Cleaner Sources of Power*.

INVESTMENTS

THE Money Tree

A Twenty-Year Nexus Testimonial

by James E. Houston, CIM, FCSI

In 2001, a then twenty-year veteran of the Bay St. investment industry who had received a pretty healthy post-"tech boom", pre-"tech wreck" bonus, pre-paid his mortgage to the maximum allowed and sent the balance to be invested at Nexus. At the time, Nexus did not have a $1 million minimum!

He knew one of the investment team members and had been told about Nexus's disciplined, quality, North American-focussed equity approach. It sounded a bit sleepy, but he recognized that it was very "uncorrelated" to the free-wheeling approach that had shaped his personal investing. At the time, he admitted that he was making the investment partly "to save himself, from himself." Knowing that his profession gave him lots of exposure to the ups and downs of the equity market, he chose to put the money into the Nexus North American Balanced Fund, which held both equities and investment grade bonds.

In the meantime, he traded his own portfolio and made a number of hedge fund investments. Being "in the know" on Bay St. should surely have given him a leg up. But year after year he would send reams of trading activity reports to his tax preparer which showed meagre positive returns, and in a few cases, net losses. At one point, it prompted his accountant to ask, "Aren't you in the investment business?"

While the wily veteran knew that Nortel was ridiculously overpriced at $124, it was surely a steal when it pulled back to $36. Those shares were subsequently sold for about a buck.

Then there were the hedge funds. One was a long/short "Opportunities" fund with a spectacular record when purchased. However, when the financial crisis hit in 2008/09, and the fund was down 60% or 70% from its highs, the fund holders were given the choice to redeem at those depressed levels or give up their redemption rights for a 12-month period. More like an "oops" fund than an "opps" fund. Another hedge fund was invested only in energy names, both long and short. Somewhat put off by the hedge fund experience, our hero decided to exit this one too, even though after paying the standard "two and twenty" fees each year, the value of his investment had gone nowhere. He was worried when he discovered that to redeem out of the fund, he had to give 60 days' notice, and that the fund would be cashed out at the following quarter end. Nothing like having to wait nearly three months to see what you'll get for your fund units. (As it turned out, in the interim, something big happened in the Middle East, and he actually made some money, for which he took full credit.)

Meanwhile, the investment at Nexus just kept "doing its thing". The Rule of 72 says that if you divide your annualised return into 72, it will tell you approximately how long it will take for an investment to double in value. Between November 2001 and February 2021, the Nexus Balanced Fund has had an annualised return of an even 8.0%, before fees. At that rate of growth, the Rule of 72 suggests that the investment would double after 9 years, and that it would quadruple after 18 years.

Somewhere along the way, the 20-year Nexus client took out enough money to purchase a country property. Yet even so, the value of his remaining investment is still more than what he originally put in.

Steady compounding of returns is not very exciting, especially in the early going. But it's rather like watching a newly planted tree in your back yard grow from month to month, with time, it will be as tall as your house.

And in case you hadn't guessed, the 20-year Nexus client is me.

Note: past performance is not an indication of future results.

WEALTH / TAX PLANNING

The Great Transition –

A Tax Efficient Withdrawal Strategy

Dianne C. White CPA, CA, CFP, TEP

The change from "saver" to "spender" is what I call the great retirement transition. Figuring out how to draw on your retirement savings to meet your spending needs can be a daunting task. At Nexus, this is something we help clients navigate.

Consider a typical married couple, each with pensions, CPP, OAS, RRSPs, non-registered accounts and TFSAs. There could be 12 possible sources of retirement cashflow to tap into. For many, there are even more if, for example, an investment holding company or rental property is thrown into the mix. The biggest expense you will face over the course of retirement is income tax. To help mitigate the total tax you pay, a tax-efficient withdrawal strategy will not only generate the cashflow you need, but also maximize the after-tax wealth that gets passed on to your heirs. Tax bracket management becomes a key part of any withdrawal strategy as it will help minimize and smooth out taxes paid over the entire retirement time horizon and upon death.

Some believe that drawing down RRSPs first is the best strategy. Others believe drawing down non-registered assets first makes more sense. Both can be right depending on the client's situation. Most often, the best way to create retirement income and draw on your accounts is a mix of both, and this mix may change at different stages of retirement. Every client's situation is unique, but there are three steps to consider in order to develop a tax-efficient withdrawal strategy.

The first step is to put your retirement assets in buckets.

There are three buckets: taxable, tax-deferred and tax-free. Each bucket is filled up with different types of accounts.

Here is an example of a typical retiree's investment accounts allocated in the buckets.

TAXABLE	TAX-DEFERRED	TAX-FREE
Non-registered	RRSP / RRIFs LIRAs / LIFs	TFSAs

The second step is to understand the tax implications of withdrawals from each of the items in the buckets.

- RRSPs and other tax-deferred accounts are taxed at 100% of your marginal tax rate in the year that withdrawals are made.
- A non-registered account will be taxed based on how the account is invested and what type of income is generated each year. Typically, this is a combination of cash, bonds and stocks. Interest income generated each year is fully taxed at your marginal tax rate, whereas 50% of each year's realized capital gains are taxed at your marginal tax rate. The effective tax rate on Canadian dividends is more complicated, but these are also taxed at a preferred rate which is effectively less than your marginal tax rate.
- Then you have TFSA withdrawals which have no tax at all.

The third step is to have an idea of what your (and your spouse's, if applicable) marginal tax rate will look like each year throughout your retirement.

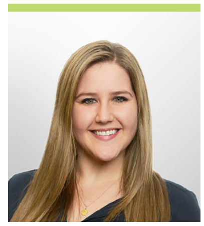
Your actual marginal tax rate from year to year is a significant determinant in considering *which* of your retirement savings to draw on and *when*.

The trick to withdrawing your savings in the most tax efficient way is to take money from the buckets with the highest tax liability at the lowest possible marginal tax rate, then top it off with money from buckets with little or no tax. When you are in a lower tax bracket, you should consider withdrawing from tax-deferred accounts, and when you are in a higher tax bracket you should consider withdrawing from non-registered accounts. As your TFSA can continue to grow tax free, it should be kept for emergencies or for your estate.

Putting together a retirement withdrawal strategy without considering all the above steps could result in higher taxes over your lifetime and in your estate or, even worse, it could impact the longevity of your hard-earned savings.

Women & Wealth:

Navigating Life's Changes



by Nicole Weiss

At Nexus, we believe in the power of financial literacy. Our Women & Wealth event series is designed to educate, engage and empower attendees to improve their financial knowledge, while also addressing some of the challenges that may often be unique to women.

Our latest Women & Wealth session in May was a virtual event featuring guest speaker Dr. Amy D'Aprix, who offered insight into the complexities of navigating life's changes. Change is the only constant in life and, as women, these changes or life transitions can have an enormous impact on our personal, professional and family lives. Some are exhilarating, and others more challenging. Throughout the session, Dr. Amy offered tips on how to flourish through transitions such as retirement, caregiving, aging & health, and relationship matters.

Thank you to those who tuned in live. For anyone who missed our event with Dr. Amy, but would like to watch a replay, you can find the full recording on our website. We have received tremendous positive feedback on the session, and we look forward to hosting more events as part of our series in the future.

We are pleased to announce that 2021 marks the five-year anniversary of our first Women & Wealth session, and past topics have included:

- Back to Basics (fundamentals of investing and financial planning)
- Leaving a Legacy (considerations for transferring wealth to the next generation)
- Navigating the Investment Landscape (in-depth look at the world of investments)
- Estate Planning Considerations (addressing the softer side of estate planning)

At Nexus, we are dedicated to helping our clients better understand their financial situations, and what they can do to meet their personal goals. Our Women & Wealth series explores a wide range of topics, and we welcome any suggestions you may have for future events.

Invest
Thoughtfully™

At Nexus, we offer thoughtful wealth planning and investment management with unparalleled personalized service to private clients and foundations.

Nexus Investment Management
111 Richmond Street West, Suite 801
Toronto, Ontario M5H 2G4

Tel: (416) 360-0580
email: invest@nexusinvestments.com

nexusinvestments.com

NEXUS