Nexus Notes

March 2022
Vol. 27, No. 1

Featuring:

Invest *Thoughtfully*™

NEXUS

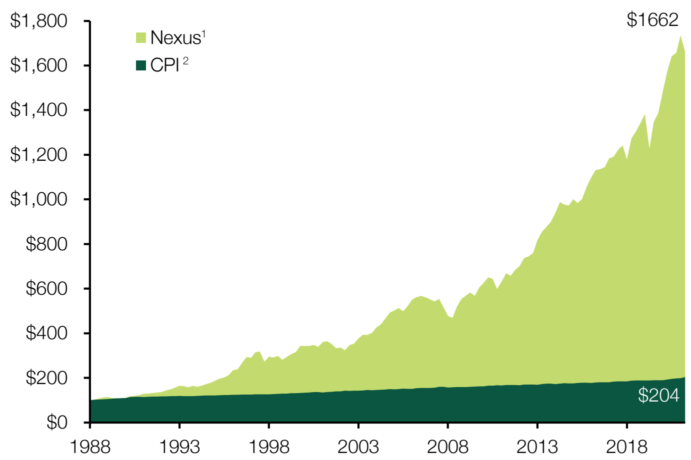
Our market-resilient investment strategy focuses on long-term results, providing investors with peace of mind through all stages of life.

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 $1,662 at December 31, 2021.

$100 Investment with Nexus in 1989



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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.

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FROM THE EDITOR

Stick to the Plan

We are only a few months into the year, and it feels like a lot has already happened. The pandemic has passed its second anniversary, although it's not the type of anniversary where celebrations spring to mind. But across the country, various vaccine and mask mandates are starting to be repealed, and the possibility of life after the pandemic seems more tangible. Even though we see countries worldwide opening back up and reducing travel restrictions, many of us are reluctant to get our hopes up after two years of successive waves of COVID.

Unfortunately, the world wasn't going to wait for one crisis to end before the next one began. And the Russian invasion of Ukraine is now the focus of much of the news headlines. Predicting the future usually doesn't come with a high success rate, so we will have to wait and see how these events will ultimately unfold. But the pandemic brought with it supply chain issues and higher inflation, and the war in Europe is only expected to add to those problems.

When the events of the world have you nervous, your instinctive reaction is to act. But resisting that urge and holding steady might be the only action you need to take. Jim Houston's most recent blog, "A Balanced Approach", cites this as probably the best solution when it comes to your investments, particularly if you are a balanced investor. It can be harder to do nothing than it sounds. But if you've taken time to build a plan for yourself, you've already put in the work to prepare for tumultuous times.

Regular readers of *Nexus Notes* know the importance we place on the planning process. No planner can forecast what the future holds, but a proper plan is made with the knowledge that history has shown that times of distress in geopolitics and the economy are normal. For better or worse, an unavoidable aspect of greater longevity is preparing financially and mentally for more of these periods of upset. Rather than be daunted by living to 100, it's better to develop an attitude that makes the most of the time ahead. We think that comes easier for those guided by a proper plan. And coming soon, our Living to 100 series will explore more about how longevity can affect your investments, wealth plan, and quality of life.

Fergus Gould's blog, "The Case for Openness," explores another aspect of how people react in challenging times, particularly over the long term. While an open society leans towards more prosperity, our inclinations when fear or uncertainty arises can lead us in the opposite direction.

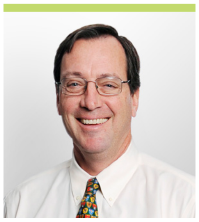
At the start of the pandemic, there was a lot of talk about the new normal, but it will most likely be the case of "meet the new normal, same as the old normal". Meaning that the world will keep on changing, and that change can feel scary because you can't control it. But what you can control is sticking to your plan and keeping your eye fixed on your goals.

Brad

Brad Weber
CPA, CA, CFP

A Balanced Approach

A Good Choice for Troubling Times and All Time



by Jim E. Houston, CIM, FCSI

Mercifully, there have only been a handful of occasions in my adult life when I have repetitively awoken to the task of discovering what sorts of horrors may have occurred around the world overnight. But we're in the midst of one of those periods now.

In the here and now, the Russian invasion of Ukraine is overwhelming and soul-destroying. Connecting its immediate horrific impact on Ukraine to its longer-term impact on the geo-political balance and the state of the global economy is incredibly difficult.

Supply chain disruptions, which were starting to show some improvement after two years of the COVID-19 pandemic, are now exacerbated by global trade uncertainty and broad sanctions imposed on Russia. These new disruptions have caused a spike in most commodity prices and record high prices for gas at the pumps. Inflation was already increasing at rates not seen for decades, and we appear to be at the start of a series of interest rate hikes being instituted by global central banks.

It's at times like these that investors often feel that they need to "do something" in their portfolio to address the quickly changing and uncertain environment. However, if you are a long-term investor with a balanced portfolio of quality equity and fixed income securities, you probably shouldn't do anything. There are plenty of other things to worry about, if you have the peace of mind that your investments are strategically designed to achieve your long-term objectives.

For years, interest rates have been mired in the low single digits, causing many people to question the benefits of fixed income in a portfolio. After taxes and inflation, the real return of bonds has been low or negative for some time, and dividend yields on broad equity market indices have been higher than those of most bonds. However, it is in tumultuous times such as today that the bonds in a portfolio rise in psychological value, even if they decline somewhat in nominal value. Behaviourally, not having one's portfolio fully subjected to the higher volatility associated with equities makes it easier to

"stay the course", and to avoid regrettable trades, which are often a result of strong human emotions that cause people to "sell low" and "buy high".

There is little question that over the long run, equities have outperformed bonds. From January 1, 1928 to December 31, 2021 the compound annual return of the S&P 500 (including dividends) was 9.6% (this and the following returns are based on US$ values)[1]. The annual return on U.S. Treasury Bonds over the same period was 4.7%. Thankfully, the resilience of equities after major negative world events has been proven time and time again. More recently, from December 31, 1940 to December 31, 2021, the S&P 500 rose at an annual rate of 11.0%.[1] Over this period, we experienced the attack on Pearl Harbour, JFK's assassination, the Crash of '87, the 9/11 terrorist attacks, the Great Financial Crisis of 2008/09, and the COVID-19 outbreak. If one looks now at a logarithmic scale chart of equity returns, these events are almost indiscernible wobbles in the big picture of long-term returns.

So, why would you ever own bonds if they might be a drag on long term performance? Because the relative stability of bonds dampens portfolio volatility, making it more likely that an investor will maintain their equity exposure and sleep better at night.

The Nexus North American Balanced Fund is designed to manage this issue. The Fund is managed to a 65% equity target. The balance of the portfolio is held in investment-grade bonds, with a small allocation to cash. The equities are comprised of approximately 40 North American equities managed in-house by the Nexus investment team, as well as an allocation to two global equity funds managed on our behalf by JPMorgan in London, U.K.

The active management of both the equities and fixed income components has yielded superior returns for the Fund compared to its passive benchmark (5% Canada T-bills, 30% FTSE Canada Universe Bond Index, 40% S&P/TSX Composite, 25% S&P 500 in C$). The Fund has also performed very well relative to its peers. In the most recent survey by Global Manager Research (GMR), of 126 Canadian-managed balanced funds, the Nexus North American Balanced Fund performed in the first quartile for each of the one-, three-, five- and ten-year periods ending January 31, 2022 (see chart).

The Fund established its first ten-year return number in August 2007 (the fund's inception date was August 1997). At that time, the Fund's 10-Year annual return was 7.2% annualized. At that rate of growth, a portfolio's value doubles approximately every 10 years. With the subsequent passage of each month since August 2007, a new month of performance was added to the ten-year total, and one dropped off from the back end. The average of the "rolling" annualized ten-year returns of the Fund from August 2007 to January 2022 is 7.6%. At its worst (lowest return) point, in January 2009 in the midst of the Great Financial Crisis, the Fund's annualized ten-year return was still 4.5% per year. This was comfortably ahead of the Fund's benchmark 10-year return at that same point of 2.9% per year.

At Nexus, the majority of our clients embrace a balanced approach to their portfolios. In many cases, we utilize a combination of our Equity and Income funds to best meet their specific personal and tax circumstances (and this combination of funds results in a portfolio that is substantially the same as our Balanced Fund). However, the Balanced Fund remains a simple and convenient way to save and invest for the long term. Not having to think about investment decisions frees up time to focus on other things. Let's hope the other things become less troubling soon.

Annualized Performance

Total Returns

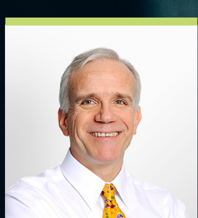
	1-Year	3-Year	5-Year	10-Year
Nexus North American Balanced Fund[2]	**15.5%**	**11.9%**	**9.4%**	**10.2%**
Benchmark[3]	13.6%	11.4%	8.9%	9.0%
GMR Median[4]	11.2%	9.8%	7.8%	8.5%
GMR Quartile Rank[5]	1st	1st	1st	1st

1) Source: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html
2) Nexus returns are shown prior to the deduction of management fees, but after deduction of all other expenses. Past performance is not indicative of future results.
3) Balanced Fund market benchmark is 5% FTSE Canada 91 Day T-Bill Index, 30% FTSE Canada Universe Bond Index, 40% S&P/TSX, and 25% S&P 500 (in C$); rebalanced monthly.
4) GMR Median returns are shown prior to the deduction of management fees, but after deduction of all other expenses. Past performance is not indicative of future results. Results from Global Manager Research Institutional Performance Report.
5) Quartile information ranks the Nexus Balanced Fund return within the range of returns for the Global Manager Research's Balanced Universe.

The Case for Openness

– An Open and Shut Case?

From time immemorial, mankind has been open. Open to new ideas, open to trade, and open to migration – the three critical ingredients for progress. Well, not always open and not everywhere, but more or less.



by
Fergus W. Gould, CFA

Three decades ago, after the collapse of the Soviet Union, western liberalism, with its key tenets of free ideas and free trade, was triumphant. Now, after a most unsettling period – September 11, the Global Financial Crisis, waves of refugees, global warming and COVID – we are seeing a rise of nationalism, populism, and calls for strong policy responses. Anti-free trade and anti-immigration are not fringe concepts – in some democracies they are policy. At universities, once lauded as the bastions of free speech and the free exchange of ideas, professors and students need to be circumspect. While The Donald may be gone for now and Boris may soon be, the underlying nationalistic sentiment and jingoism hasn't changed. Brexit and Putin remain. Are we seeing a shift from open to more closed? Where may this lead, and why?

The Case for Openness

Mankind has made extraordinary progress. As Johan Norberg in *"Open: The Story of Human Progress"* points out, in the last two hundred years, life expectancy has increased from less than thirty years to more than seventy.[1] Extreme poverty has been reduced from around 90% of the world's population to 9% today. Being poor used to mean undernourishment and stunted growth. Two centuries ago, the average male British worker was 13 cm shorter than a typical upper-class male. Today the difference is negligible. Both wear similar clothes, have access to healthcare, travel by powered transport and take vacations. And the progress is global. In the last 100 years, real GDP per capita in the West increased by a multiple of 7 times and ranges from 4 to 8 times across the various sub-regions in the rest of the world. Anthropologists put it down to humans' ability to cooperate – the sharing of ideas and trade are at the core. Simply put, nobody could ever live in a city or enjoy specialized goods and services without trade. Without shared ideas, there wouldn't be much to trade or other forms of progress. Similarly, we move for opportunity – perhaps for a job across town or on another continent. Along the winding path of history, more rapid progress has occurred in times of openness. Think Phoenician traders, Greek philosophers, Roman empire builders, the Dutch golden age, and our current world state. Starting in about 1800, we have enjoyed an almost unbroken increase in living standards. Outside of the Western world, openness drove the Persian Empire, China in the Song dynasty, Japan after the Meiji Restoration, and the Muslim world before the Mongol invasions.

Put another way, openness is a "win-win". Over time, we can expand the pie for all, rather than just claim a bigger share ("win-lose" or "zero sum"). Intertwined with openness are individual rights, such as private property and freedom of choice, and capitalism, with it's beautifully creative, sometimes destructive, and continuously scorned inequitable attributes.[2] The case for openness may seem to be open and shut, but not so. Now that openness has triumphed, we humans are doubtful and dissatisfied. Recently, Nexus hosted a webinar by Matt Ridley, author of *"The Rational Optimist: How Prosperity Evolves"*, but even his well-reasoned arguments generate "yes, buts" from many.[3]

Closed

Closed societies, closed minds, no progress or reversion. There are current examples (North Korea), and many in history, such as China after the cultural revolution and the Soviet Union. The Dark Ages were aptly named – following the rapid progress of the Western Roman Empire, and until the Renaissance, "centralised authority" – the Christian Church – increasingly dictated how to think. All ideas about life and death, good and evil, were commands from God. Other religions were supressed, astronomers flogged, libraries destroyed, and the 900-year old Plato's Academy for philosophers in Athens was closed. According to Anthony Gottlieb, "By the year 1000, medicine, physics, astronomy, biology and indeed all branches of theoretical knowledge except theology had virtually collapsed. Even the few relatively educated men, holed up in monasteries, knew markedly less than many Greeks had done eight centuries earlier."[4] The Persian Empire, China and Japan, have all had closed phases. These waves of openness and more closed seem to repeat.

Why?

What may have caused these waves and the recent tilt towards closed that we see today? Who knows, but there are some thoughts that are based on anthropology and human psychology.

"Humans" have been around for at least 300,000 years. For almost all of that time we were hunter-gatherers. There was no point in making anything that couldn't be carried with you. Small tribes lived together to protect themselves from danger and to hunt. Between tribes, it was largely a zero sum, "what you get, I lose", world. Hostility between tribes was normal. Small tribe sizes limited new ideas and made specialization difficult. With 290,000 years of hunter-gatherer and only 10,000 years of a more cooperative existence, it seems that our brain still has its innate tribal win-lose instinct. This part of the brain has a tendency to overwhelm our more cooperative win-win brain in times of adversity and uncertainty. Psychologists have conducted innumerable experiments to understand and validate this. Uncertainty makes us tribalistic – less tolerant of outsiders and less open to new ideas or free debate. Back in the day, this meant you listened to the person on the soapbox whose views you agreed with. Today, we simply dial up social media. Everyone self-selects the stories and platforms that reinforce their own views, amplifying the divide and the discontent. Today's "tribes" tend to be ideological subgroups, frequently within countries, that are slowly wedging themselves apart. Psychological research confirms that the same individuals can be conformists or individualists, depending on their frame of mind. Similarly, our attitudes to authoritarianism are not fixed. In uncertain times, most, even the more libertarian, prefer an authoritarian leader. It is also human nature to see the past as more settled and better than today (every generation has a yearning for "the good old days" – they remember the good and forget the bad), so the strong leader will take us back to better times. We saw that with Nazi Germany and Fascist Italy. Trump has been peddling *MAGA*. Across the pond, it's the good ship England that will once again set its own course. Putin wants to redraw geographic lines back to Soviet days and regain pride. In Canada, it seems we yearn for the warm hand of "good government" – perhaps one that is more focussed on an egalitarian sharing of the pie, rather than growing it.

In short, like wildebeest in the presence of a leopard, people who are feeling threatened want to be part of a larger group – their like-minded tribe. At these times, our instincts to grab more of the pie – more certain, closed or "win-lose" behaviour – overwhelms our desire to grow the pie, which requires longer-term, more uncertain open or "win-win" thinking. In the theme of *"You don't know what you got till it's gone"*, perhaps we can all benefit from a more thoughtful reassessment of the lessons from history?

1) This statistic, along with a number of others and the theme for this article comes from "Open: The Story of Human Progress", by Johan Norberg, 2020.
2) For a brief recap of capitalism's apparent woes 200 years after Marx's birthday, try this blog: Whither Capitalism? https://www.nexusinvestments.com/insight/whither-capitalism/
3) Here's John Stevenson's recap of Ridley's presentation https://www.nexusinvestments.com/insight/the-rational-optimist/
4) "The Dream of Reason: A History of Philosophy from the Greeks to the Renaissance", by Anthony Gottlieb, 2016.

Saving in my Professional Corporation

It's a Great Idea!

by Brad Weber, CPA, CA, CFP

The ability for professionals in Canada to incorporate their practice has existed for some time. Doctors, dentists, lawyers, accountants, and other qualifying professionals have realized various benefits from their ability to incorporate. The rules governing how a professional corporation operates do change over time, and the last significant changes were introduced in 2018.

Even though the rule changes have been in place for several years now, there still seems to be some uncertainty around their impact. One area of confusion is the effect of investment income on the small business deduction. When I sit down with some of my professional clients, they know that earning passive income in their corporation affects them. But they are unsure how and wonder if they should even be saving in their corporation and how much.

The Small Business Deduction

To help clarify the confusion around the passive income rules, I need to highlight a few points about professional corporations. First, what is the small business deduction? In simplest terms, the first $500,000 of income a corporation earns benefits from a lower tax rate. In Ontario, that tax rate is 12.2%[1]. You can compare this to the general corporate tax rate of 26.5%[1]. That lower tax rate results in more after-tax dollars available in your corporation to either invest back into the business or save for the future.

The Tax Deferral Opportunity

The second item to highlight is the tax deferral benefit. People have written whole articles on just this topic. So, to keep it brief, the tax deferral benefit makes saving in your professional corporation more favourable. Suppose you were earning $100,000 of income personally, and you were paying taxes at the top rate in Ontario of 53.53%. That would leave you with $46,470 after-tax, and we'll assume this is surplus income that you will save. If you earned the he ability for professionals in Canada to incorporate their practice has existed for some time. Doctors, dentists, lawyers, accountants, and other qualifying professionals have realized various benefits from their ability to incorporate. The rules governing how a professional corporation operates do change over time, and the last significant changes were introduced in 2018.

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The rules around passive investment income in a corporation reduce the tax deferral benefit over time. Passive income means investment income, such as interest, dividends, and capital gains. Once this passive investment income reaches $50,000 in a year, your small business deduction begins to be reduced. For every $1 of investment income earned over $50,000, your small business deduction is reduced by $5. Once investment income reaches $150,000, your small business deduction is eliminated. For example, if your professional corporation earns $100,000 of investment income, your small business deduction is reduced from $500,000 down to $250,000.

For example, if we use 5% as an average rate for return, the small business deduction could start being reduced once a corporation has accumulated $1,000,000 of investment savings. At around $3,000,000 in investments, it could be eliminated. Keep in mind these are just estimates – to give you an idea of the size of investments needed before the reductions begin. It's the *actual investment income* that matters, not the size of the assets. And that income could change year over year so that these asset ranges could be higher or lower depending on your circumstances.

The Tax Deferral Opportunity Without the Small Business Deduction

How does that affect your decision about saving in your professional corporation? When you have access to the small business deduction, you can defer taxes at the rate of 41.33%[2] in Ontario. But without that deduction, the tax deferral benefit in Ontario is still 27.03%[2]. That's still a decent amount of tax to be able to defer. If the small business deduction never existed, it would still be a good idea to use your professional corporation as a place to save for your retirement. Even with a large amount of passive investment income in your corporation, you are still benefiting from tax deferral by continuing to save.

The exact rules are more complicated than I've outlined here. There are other elements of how a professional corporation works that I haven't touched on, such as access to the lifetime capital gains exemption or the impact of making donations through the corporation. But a professional corporation can be a valuable tool for professionals, and you want to make sure it is integrated into your overall wealth plan to maximize its benefits.

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1) Across all provinces the small business rate varies from 9% to 12.2% and the general corporate tax rate varies from 23% to 31%.
2) Across all provinces the tax deferral benefit from the small business deduction range from 37% to 42.5% and at the general corporate tax rate from 20.37% to 27.03%.

NEWS FLASH

Putting Investors First with

Client Focused Reforms

by Nicole Weiss

New regulations, known as the "Client Focused Reforms", now apply to all firms that are registered to give investment advice and trade in securities. Among other things, these reforms address conflicts of interest and disclosure. While Nexus has always provided our clients with the proper disclosures, we do welcome the regulators' efforts to create standards that apply consistently to all participants in our industry for the benefit of all Canadian investors.

Perhaps the most noticeable effect of these reforms for clients will be the additional information we are now required to gather (and confirm annually) about our clients' personal and financial circumstances. Those who have used our wealth planning services will be familiar with these types of questions. Your Nexus relationship manager may spend some more time with you during your next meeting on some of these questions, and we thank you in advance for your understanding.

We want to hear from you!

At Nexus, we care about the experience of our clients and strive to not only meet your needs, but exceed them! Your feedback will help us improve our services, processes, and client communications.

An independent management consulting firm will be contacting you to conduct an anonymous and confidential questionnaire in April.

For each completed client response, we will donate $25 to a charity supporting humanitarian aid in Ukraine.

We greatly appreciate your taking the time (10 minutes) to help us better serve you.

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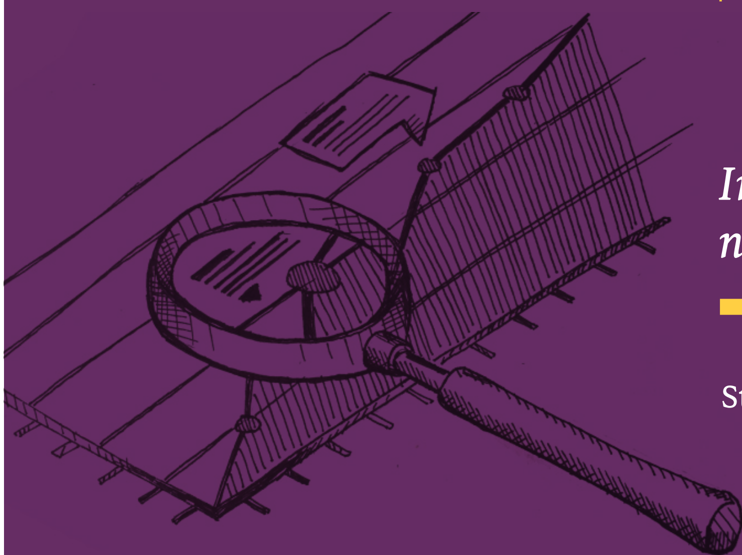
Coming soon from Nexus:

Living to 100



Insights on how to live your life now and well into the future.

Stay tuned!

Worth a Thousand Words…

A little humour makes the world a better place.

A regular feature in Nexus Notes is the inclusion of a topical and insightful editorial cartoon. While some may address more serious or controversial issues, we particularly delight in amusing reflections on our current society. We hope you enjoy.

"I'm still not comfortable eating indoors."

Image used with permission: Ellis Rosen, The Cartoon Bank/ The New Yorker Collection

Invest
Thoughtfully™

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

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