Nexus Notes

December 2023
Vol. 28, No. 3

Featuring:

No Time Like the Present

Capital Gains, Charitable Acts, and the New Alternative Minimum Tax

Cultivating Long-Term Wealth

Pearls of Wisdom

Invest *Thoughtfully*™

NEXUS

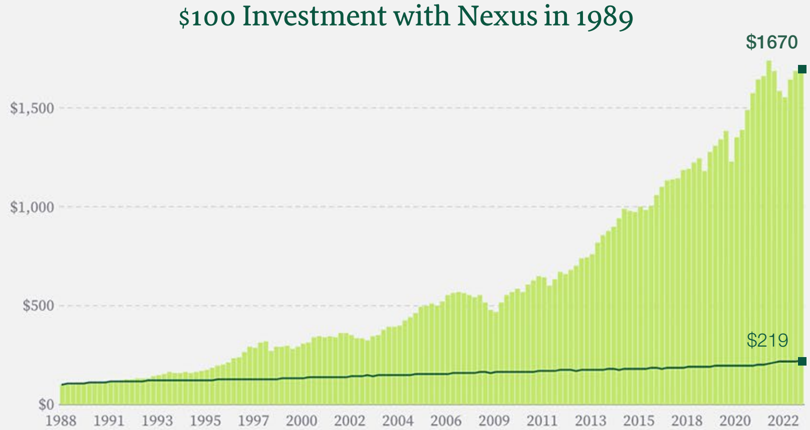
Our market-resilient investment strategy focuses on long-term results, providing investors with peace of mind through all stages of life.

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 $1,670 at September 30, 2023.

$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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Publication Mail Agreement 40033917

FROM THE EDITOR

No Time Like the Present

I recently heard one of my favourite quotes about planning. It can come in various versions, but to paraphrase, *'The best time to start planning was yesterday, the second best time to start planning is today.'* The gist is that you can never miss the opportunity to begin planning. However, there are times when a deadline comes along that you might want to take advantage of, which can be the case with taxes. As there is still time before the end of 2023, I wanted to highlight a few things that are new this year to consider before 2024 starts.

As previously announced, the new First Home Savings Account (FHSA) is available at Nexus. Opening an FHSA account this year should be added to your list of priorities. Those eligible have $8,000 of contribution room this year and could receive another $8,000 of room starting January 1st. By opening an account this year, you can contribute $16,000 in a relatively short time frame. However, unused FHSA contribution room accumulates in a different manner than the RRSP or TFSA. If you wait until next year to open an FHSA, you'll have $8,000 of contribution room, but you won't generate the next $8,000 of contribution room until January of 2025. Therefore, there is some incentive to get the account opened now.

Many of our clients already own a home, so an FHSA account may not benefit you directly. But if you have children or grandchildren who qualify, this could be an opportunity to provide them with a gift or financial assistance by funding their FHSA account. You will need to have the account opened in the name of the child or grandchild, and they'll be the ones to benefit from the tax deduction that is generated. But in terms of overall family wealth planning, the FHSA is a tool worth contemplating. As a reminder, to qualify, someone must be over 18, a Canadian resident, and considered a first-time home buyer.

Qualifying as a first-time home buyer doesn't mean you've never owned a home. In fact, the definition is that you haven't owned a home in the current calendar year or in the preceding four calendar years. This means that there could be other situations where someone might still qualify for an FHSA and the tax deduction benefits. You could even be older and now renting, but if you are under age 71, there could still be a planning opportunity. You don't even need to plan to purchase a home, as the contributions can ultimately be transferred into your RRSP or RRIF account.

Another consideration for the remainder of the year is the changes to the Alternative Minimum Tax (AMT) rules that come into effect in 2024. An entire article could be written on this topic, and Dianne White has done just that. While you can read more about the AMT changes there, (Capital Gains, Charitable Acts, and the New Alternative Minimum Tax), a noteworthy area to highlight is how the new rule changes could affect the tax credit you receive on large donations. The changes to the AMT regulations are complicated. And there are no good rules of thumb to adequately outline what the impact could be. It's best to evaluate your situation on a case-by-case basis. The new rules might not have the negative impact on many high-income earners as was feared, but people with more unusual circumstances, such as those selling a business, are more likely to be affected by these rule changes. The government is considering gathering feedback on the new AMT, but that doesn't mean there will be changes. For now, it is safe to assume the new AMT rules will stand as is and will be effective Jan 1, 2024. If you are thinking about making a significant donation soon, give us a call to determine whether or not you might be best served making that donation this year.

Also, in this issue, Denys Calvin discusses the idea that while the current higher rates available on GICs might look attractive today, these instruments may not align with the objectives of a long-term portfolio strategy.

Brad Weber
CPA, CA, CFP, CIM

Capital Gains, Charitable Acts, and the New Alternative Minimum Tax

If you regularly make charitable donations or perhaps sit on the board of a charitable organization, you might be wondering what all the hubbub regarding the new Alternative Minimum Tax (AMT) is about.

by Dianne C. White, CPA, CA, CFP, TEP

Recently, there have been a host of articles warning about the potential chilling impact the new AMT will have on charitable giving. The gist of the concern is that high net-worth/high income individuals who are philanthropic will lose the historic benefit of their charitable contributions and end up paying more in taxes, which might discourage large donations. Of course, tax savings aren't the reason to give to charities. However, there is often donation planning around a one-time financial event – like the sale of a business or sale of real estate and the new AMT rules could affect this planning. After crunching some numbers, it seems that certain circumstances are most likely to trigger the new AMT. These circumstances would include large capital gains, large donations of securities in-kind, and the combination of significant tax preferred income with large donations. The good news for Nexus clients is that most won't be affected by the new rules.

What is AMT?

AMT is a parallel tax calculation that allows fewer deductions, exemptions and tax credits than the regular income tax rules. The calculation applies a flat tax rate instead of progressive tax brackets. The idea is that every individual needs to pay a certain minimum amount of tax each year so you must pay the higher of regular tax or AMT.

If you do end up paying AMT because it is higher than your regular tax calculation, that excess tax can be recovered. The amount of AMT that is over the regular tax can be carried forward for seven years and offset against any future regular tax.

What is the difference between the old AMT and new AMT?

There have been a number of changes to the AMT rules, but these are the four most consequential that will increase income captured in the new AMT calculation:

1. 100% inclusion rate for capital gains (from 80%)
2. 30% of capital gains on donations of publicly listed securities (from 0%)
3. Only 50% of the tax credits, including charitable donation credits, will be allowed.
4. 50% of interest expenses and loss carryforwards are allowed.

A few other items to note: the flat AMT tax rate will be increasing from 15% to 20.5% but the basic AMT exemption is increasing from $40,000 to $173,000. Also, for the treatment of dividends, it is the same for the new AMT calculation as it was for the old, and will continue to use the actual amount of dividends received, rather than the grossed-up taxable dividend amount used in the regular tax calculations. The dividend tax credit is fully disallowed.

Who will be impacted by the new AMT?

The new AMT is focused on tax-preferred sources of income and deductions. If your adjusted income is below the $173,000 exemption, you won't be affected. The new AMT calculation also won't affect those high-income earners whose earnings mostly come from employment income, significant pension, interest and/or RRIF income. A typical Nexus client probably falls into this category, where they are earning enough income and paying enough tax at regular rates so that they will unlikely trigger the new AMT.

So, when is it likely to apply?

Taxpayers are most likely to be caught in the new rules in the following circumstances:

- If you are triggering capital gains at the top marginal tax rate then this will likely give rise to AMT under the new rules. This is because the most significant changes to the new AMT rules concern the treatment of capital gains. Under the regular tax system, only 50% of capital gains are included in income, but now will be adjusted to 100% under the new rules.

- If you are making a large donation-in-kind of securities from your portfolio – the dollar value of which is up to the limit of 75% of your taxable income in one year – then this will likely give rise to AMT under the new rules. This is because the new AMT rules require 30% of the capital gain on the donated securities to be included whereas under the regular tax system, none of the gain is included.
- Finally, if you have a combination of significant tax preferred income – like capital gains mentioned and/or dividends – ***and*** you are making a large charitable donation, you will likely be caught by the new AMT rules.

Let's look at one example. If you have $1m in dividend income from investments and you are making a large donation of stocks from your portfolio of $750,000, where the capital gain on the donated stocks is equal to the value of the donation, you will be paying about $90,000 in additional Federal tax as a result of the new AMT calculations.

The circumstances identified center around individuals solely receiving tax-preferred sources of income. If you were to introduce meaningful income taxable at regular rates into these situations, the impact of AMT could likely be eliminated.

If the new AMT applies to you, it's important to determine if you will be able to use the carry-forward feature to offset regular tax. If you are triggering AMT due to a one-time financial event, it is more likely that any AMT triggered can be used to offset regular tax in future years. If, however, most of your income is generated from tax-preferred sources like dividends and capitals gains, then the AMT may not get recouped. If you have the flexibility to accelerate your donation to 2023 instead of waiting until 2024, you should consider doing this. There are vehicles like Donor Advised Funds that allow you to make a large-scale donation in one year to get the donation tax credit but then spread your giving out to charities of your choice over multiple years.

Ultimately, if you find yourself in one of the above situations, careful planning is required and you should get some advice regarding your specific situation. Nexus can help!

From Vineyards to Portfolios: Cultivating Long-Term Wealth

by R. Denys Calvin, CFA

My wife and I have been stymied so far this summer in getting to the Niagara region for our annual weekend of cycling through the vineyards and orchards there. Perhaps that has left me ruminating more than usual about vineyards (though we're more fruit people than oenophiles).

During these ruminations it's occurred to me that there are parallels between a vineyard and an investment portfolio: both require regular, sustained cultivation effort over time by a "farmer"; both are long-term undertakings, with not much action in the short term, or even year to year, but plenty of impressive growth over the long haul; and both generate "output" that is important for other parts of our lives. With this in mind, I'm struck by how many people are "planting annuals" in their portfolios these days, rather than adding to their vineyard.

Huh? "Where on *earth* is he going with this?" you're wondering. Stay with me.

Stories abound in the media about investors who are so enamoured of the seemingly high interest rates available on money market instruments, GICs, and the like, that they are committing meaningful amounts of surplus cash to these sorts of short-term investments. (Indeed, we've heard the same from several clients.) I'm not talking about people's "rainy day" money, or that appropriate amount of liquidity that one sets aside to help "sleep at night" and thereby sustain the commitment to keeping long-term capital fully invested. I'm talking about those who are deliberately holding away from their investment portfolio cash that is actually part of their long-term capital. Usually this is "recently-arrived" cash — from selling a recreational property, a big bonus, or liquidating a successful private holding. Occasionally we hear of people actually removing capital from their long-term portfolio and redeploying it into short-term instruments.

The motivation is easy to understand. As we've noted frequently in our presentations and quarterly commentary, the world is rife with things to worry about, any of which could trigger a sudden and/or large pull back in markets. Seeking a safe haven against a possible storm until the uncertainty abates seems, on the surface, pretty appealing. At the same time, after many years of exceedingly low interest rates – which gave rise to the derisory expression "cash is trash" – the reappearance of 5-something percent interest rates is bound to attract, at a minimum, attention.

The problem, however, is that for as long as long-term capital is held aside in short term instruments, it's not really properly invested. It's unavailable to participate in the long-term growth of the main portfolio. It's like planting annuals rather than vines. Annuals flower quickly and look pretty for one season. But they die and must be replanted for next season. Moreover, if it takes many years of growth before vines mature enough to produce grapes (both quantity and quality), each year spent growing annuals instead of vines adds yet another year until the harvest is ready. By contrast, properly tended vines will grow gradually, building each year on the previous year's growth. And by "investing" long-term capital in vines at each opportunity, one neatly side-steps having to figure out the truly unknowable: when the time is just right to flip the field from annuals to vines.

Having identified the issue, it's reasonable to ask, "What should I do with additional long-term capital that I'm not immediately comfortable with adding to my portfolio?" Expressed differently, "If not annuals, then what?"

One way we tackle this at Nexus is by using our Income Fund as a transitional holding. To be sure, in many clients' portfolios it is a core component, serving as a highly cost-effective way to allocate part of a portfolio's capital to a diversified collection of investment grade bonds that can then act as "ballast", dampening the portfolio's overall volatility. However, we also often use the Fund as a form of "staging area" – for transitioning a portfolio's recently-added capital from a low proportion invested in equities to the portfolio's higher target proportion. Because the Fund itself can have up to 20% of its assets in income-oriented equities, client capital invested in the Fund is arguably more fully invested than if it were relegated to short term, near-cash instruments. In our "annuals-vs-vines" metaphor, the Income Fund is something of a "hybrid" that can be evolved over time into a full-fledged portfolio.

For reference, as a stand-alone investment the Income Fund has exhibited several appealing performance characteristics. First, the Fund has had negative returns for only 18 of the 239 different 12-month periods since its inception – i.e., only 7.5% of the time. Second, over the last 5 and 10 years, the Fund has had a quarterly downside capture ratio of less than 35%, but an upside capture ratio of more than 85% – which is to say, during 3-month periods when the Fund's benchmark, the FTSE Canada Universe Bond Index, has lost money, the Fund's losses have been 65% smaller than the benchmark's, but have been only 15% lower than the benchmark's returns when those 3-month returns have been positive. Third, over the last 5 years the Fund's returns have been approximately 70% less volatile month to month than those of the Equity Fund (and nearly 58% less volatile than the Balanced Fund's).[1] Indeed, they have even been 30% less volatile than the returns of its benchmark, which is notable, considering that nearly 20% of the Fund's portfolio has been invested in equity securities. Admittedly, absolute rates of return have been uninspiring lately – as a consequence of the run-up in interest rates in the last year or so. However, that same run-up in interest rates, which is the very reason money market instruments and GICs look interesting these days, is doing precisely the same for the short- and medium-term bonds held by the Income Fund.

This approach is just one way to address the temptation to plant annuals rather than vines. There are others. In any case, setting money aside, especially now that interest rates are higher, is an understandable temptation. But successful long-term investors need to maintain a match between their assets and their investment horizon. Today's attractive GIC rates do not insulate most investors from the risk to their portfolios of even moderate inflation. A well constructed portfolio that adheres closely to a sensibly chosen long-term asset mix is the best way to generate a bounteous harvest and fund a comfortable retirement.

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1) Measured as the annualized standard deviation of monthly returns over the 5 years ended June 30, 2023.

What is a Donor-Advised Fund (DAF)?

What is a benchmark?

Can I buy and sell stocks in my account?

Find answers to these questions and more...

Now Available Online: FAQs!

As part of our client survey last year, we learned from you that a convenient and trusted place to go for **Frequently Asked Questions** (FAQs) was important to you.

We're happy to announce that we now have some common **FAQs** available on our website that include things like: portal accessibility, our reporting, fees, and much more.

Check out our website at *nexusinvestments.com/FAQ*

As always, we're here for you. If you have any questions or concerns – or more feedback – you can contact your Nexus Wealth Manager at any time.

Pearls of Wisdom

by
Kathleen Peace, CFA, CFP

Reading is one of the principal occupations in our profession. As we digest a wide range of material, interesting ideas and surprising facts – some serious and some light-hearted – rise to the surface. We attempt to share a few of those with you in this issue of Nexus Notes.

Failing Well

Want to thrive? First, learn to fail. Most of us try hard to avoid failure – and tend to be embarrassed if things go wrong. But embracing our failures can be a crucial part of our personal growth. When Sara Blakely, the world's youngest female self-made billionaire, was a child, her father would routinely ask her: "How did you fail today?" He 'high-fived' her when she didn't make the cheerleading squad, and again when she lost her campaign for class president. Sara was trying things not with the expectation of success, but rather, 'for the experience and the stories and the people' she met. Want to try more things and learn from your missteps? Dr. Amy Edmondson, a professor of leadership at Harvard Business School, recommends that we: 1) Put our failures into context – no catastrophizing! 2) Learn how to pivot: don't wallow, but rather, move on or change direction. 3) Share your failures: humility and honesty are the 'two essential ingredients' of the 'fail well' mind set. New York Times, September 15, 2023 (https://www.nytimes.com/2023/09/15/well/mind/failure-mistakes-advice.html?).

Linking Happiness to Wisdom

Marcus Aurelius said that "The happiness of your life depends on the quality of your thoughts." Does this mean that we must avoid low-quality thoughts to be happy? A jump back into the archives of The Atlantic suggests this is indeed the case but with a twist: Our well-being is correlated with our ability for 'wise and pragmatic reasoning' that help us to navigate the 'important challenges in social life.'

As reflected in the chart, the older we become, the stronger the correlation: Wise

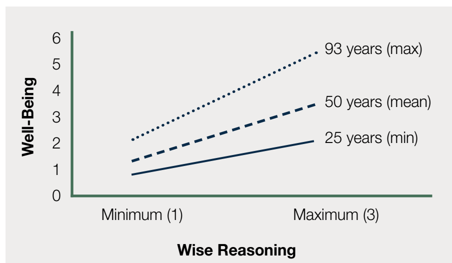


Figure 2. The association between wise reasoning and well-being as moderated by participants' age in a multivariate regression analysis. Simple slopes for the minimum (min), mean, and maximum (max) ages in the sample are shown.

seniors have higher well-being than their 'unwise' peers. As such, for the young among us, cultivating wisdom – and in particular, wisdom that leads to wise action - is a worthy long-term investment. Think of it as a virtuous circle: Acting wisely reduces conflict in your life, which fosters a sense of well-being, which makes it easier to act wisely, and so forth. Perhaps our stoic Roman Emperor was on to something. The Atlantic, August 9, 2012 (https://www.nytimes.com/2023/09/15/well/mind/failure-mistakes-advice.html?).

Take it Down a Notch

Are you giving it your all? Maybe that's too much. To be at our best, we would do well to dial it back a bit. The trick is to try for 85%, in other words, the 'Magic Number for Productivity.' At first blush, this notion is anathema to those of us raised on the age-old doctrine of relentless effort and hard work. But quite often, aiming for perfection in our work, health and personal development can backfire and burn us out. The recently increased ability to compare ourselves to others, fueled by social media and the like, can make achieving 100% an unrealistic and exhausting pursuit. In embracing our 85%, we may come to realize that sometimes doing a little less not only conserves energy but also fosters growth & resilience, and a more sustainable path to efficiency and productivity in all aspects of our lives. The Wall Street Journal, September 10, 2023 (https://www.wsj.com/lifestyle/workplace/try-hard-but-not-that-hard-85-is-the-magic-number-for-productivity-6b5aa875).

Worth a Thousand Words…

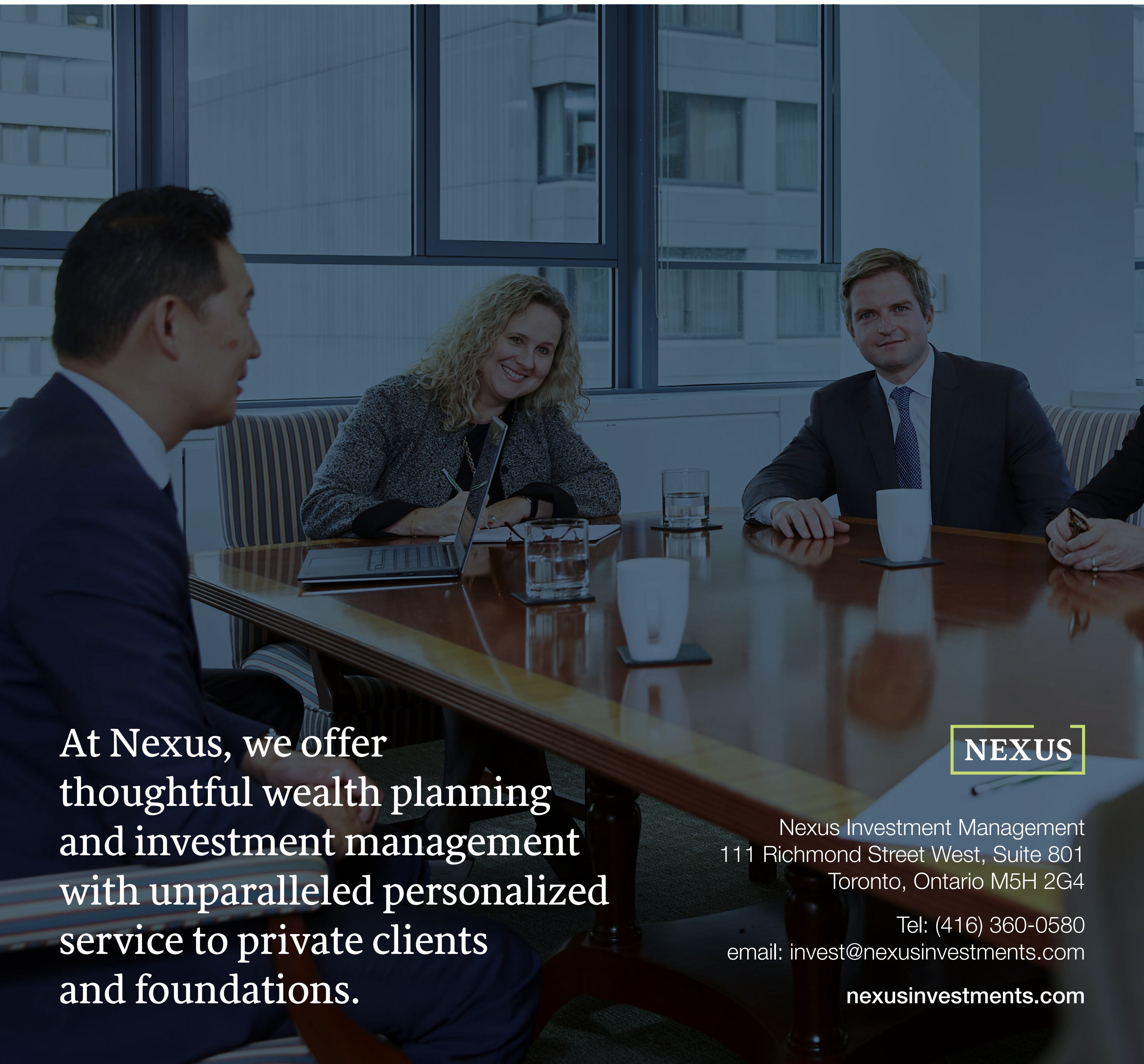
A little humour makes the world a better place.

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.

"Take your time. Now, look carefully—can you identify the broken bulb?"

Image used with permission: Jason Adam Katzenstein/ The New Yorker Collection/The Cartoon Bank

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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