Wealth Management
Dominion Securities

Wealth Management Review

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Your Summary of Account Guidelines is going paperless

This summary confirms your investment objectives, risk profile, and other important information relating to your account. It is provided to you whenever there is a change in your account information following a discussion with your Investment Advisor.

Going forward, if you already receive your account statements through RBC Wealth Management Online, you will now automatically receive your Summary of Account Guidelines there as well.

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Tight money

By Jim Allworth

As the expected U.S. economic downturn draws ever nearer, so too do the challenges it will present for equity investors.

With the U.S. Federal Reserve (Fed) pursuing one of its most aggressive rate hike cycles in history, U.S. credit conditions have become progressively more restrictive. We believe this "tight money" – which is intended to fight inflation – will eventually push the U.S. economy into recession. Canadian monetary conditions have followed a similar if not identical path and recessions in this country have typically aligned with U.S. economic downturns over the past century.

With just two exceptions, every U.S. recession for more than 100 years has been triggered by the arrival of tight monetary conditions. In our view, tight money has two components that are typically present simultaneously in the run-up to a recession.

The first is prohibitively high interest rates – high enough to induce those would-be borrowers who have a choice, to defer their borrowing plans. It just doesn't make sense to buy that building (or piece of equipment, or business, or new car, or home, or holiday) if one has to commit to a loan at such a punishing rate. Rising interest rates eventually cause something to "break." The dislocations in U.S. banking would suggest that the "prohibitive" threshold has been met.

The second tight money factor is an aggressive hiking of lending standards by banks, accompanied by a growing reluctance to lend even to those borrowers who meet the elevated standards.

Historic shift

Both of these factors have undergone a massive negative shift over the past 12 months. A year ago the fed funds rate was at just 0.25%, where it had been from the onset of the pandemic. Today it is at 5% – one of the steepest increases in history. Over roughly the same interval, the path followed by Canada's bank rate has been only marginally less severe. Meanwhile, over the past year, the majority of U.S. banks transitioned from a stance of repeatedly lowering lending standards to one that has featured four successive quarters of raising loan qualification thresholds for almost every category of business and consumer loan.

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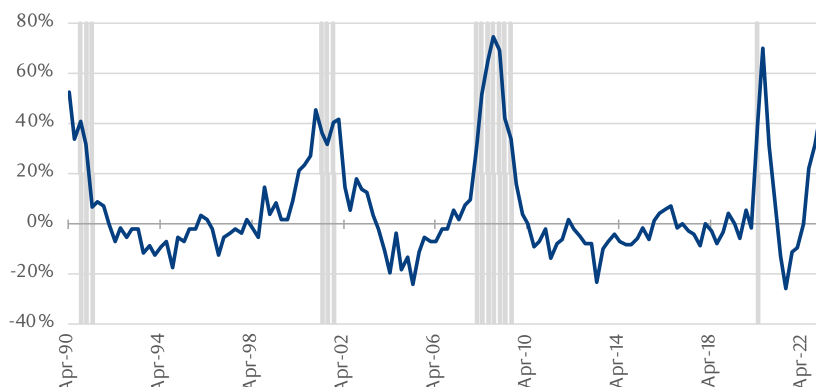
Net percentage of U.S. banks tightening standards for commercial and industrial loans



Source: RBC Wealth Management, U.S. Federal Reserve

The Fed's January Senior Loan Officer Survey also revealed that a majority of banks are reporting reduced demand for commercial and industrial loans as well as for credit card and car loans, presumably in response to much higher interest rates. Despite the very large interest rate increases already in place, the Fed has not ruled out further hikes later this year.

It is widely thought that the turmoil in the U.S. banking sector will push banks to tighten lending standards even further. Fed Chairman Jerome Powell alluded to this likelihood at the March press conference.

We expect all of this will be enough to tip the U.S. into recession by sometime in the second half of the year. While several reliable leading indicators of U.S. recessions have already signaled a downturn is on the way, one noteworthy precursor of recession has still to be heard from. Over the last 75 years it's always been the case that the fed funds rate has moved above the nominal GDP growth rate of the economy, usually shortly before or just as a recession is getting under way. (The nominal GDP growth rate includes the effect of price increases as distinct from the more commonly reported "real" growth rate, which does not.)

The nominal year-over-year growth rate of U.S. GDP peaked at a startling 17.4% in the first quarter of 2021 – aided mightily by comparison with the pandemic-induced deep decline in the same quarter a year earlier. Since then, the year-over-year growth rate has sagged to 7.4% as of the fourth quarter of 2022. By the third quarter of this year we expect it will be at or below 5%, putting the fed funds rate in the ascendant and strongly suggesting a recession would then soon be under way.

Canada's nominal GDP growth as of the fourth quarter of 2022 was a full percentage point slower at 6.4% and likewise looks set to fall below our Bank Rate by mid-year.

While it appears likely Fed rate hikes may peak this summer, we do not see any rate cutting showing up before late in the year. All major central banks including the Fed and the Bank of Canada have alluded to the danger of cutting before inflation has been convincingly contained.

Changes in monetary policy in either direction are thought by many economists to produce effects in the economy six to 12 months later. Just as last year's sharp sequence of rate hikes has only recently produced signs of economic slowdown, we believe that any start to rate cutting in late 2023 would be unlikely to turn the trajectory of the U.S. economy higher before the middle of 2024 at the earliest.

Invested but watchful

The stock market has been remarkably resilient in the face of U.S. and European banking missteps. It may be that the equity rally which began last October could have further to run. But at some point, the seeming inevitability of a recession arriving later this year could be expected to usher in another challenging period for equities, reflecting the declining expectations for earnings and eroding confidence in the future that typically comes with a period of economic retrenchment.

Equity markets usually turn higher before the associated recession ends. But in our view it would be too much to expect a new bull market to get started before that coming recession has even begun.

We believe leaning more heavily toward quality and sustainable dividends and away from specific individual company risks that may come home to roost in a recession continues to look like a good approach in a world where the precise timing of the economic cycle remains an open question.

For a more detailed discussion of our outlook for financial markets, ask for a copy of our current issue of *Global Insight*.

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.

Three ways to leave a legacy through charitable giving

Take a proactive approach to make the most of your family's charitable legacy

As Canadians, we support causes important to us in many ways, whether it's by giving our time, expertise, or money. But charitable giving is something that we often leave until the last minute, or that we do only when asked. By taking a more thoughtful approach, you can support causes important to you and your family, maximize tax incentives, and create an enduring legacy.

Here are three ways to take a more planned approach to charitable giving:

1. Make giving part of your life through regular cash donations or donations of non-registered securities

Cash donations are the most common way to make an impact on the communities you care about and it has never been easier. Many employers offer automatic payroll deductions and charitable organizations can set up pre-authorized debit options through your bank account or credit card. Not only does pre-planned giving help charities do their work; it also helps you plan your own monthly budget. And don't forget, when making a donation to a registered charity, you will receive a tax donation receipt which can be claimed on your tax return as a credit.

Here's another idea: If you are holding publicly traded securities (such as stocks) which have appreciated in value in your non-registered account (e.g. not held in an RRSP or RRIF) consider donating them "in-kind" to a charity. In return, you'll get a tax receipt equal to the fair market value (FMV) of the securities donated, and you will not be taxed on the capital gains accrued on those securities, as you would if you sold the securities during your lifetime.

How it can cost less to donate securities instead of cash

	Sell shares and donate cash	Donate shares directly
FMV of donation (a)	$50,000	$50,000
Adjusted cost base	$10,000	$10,000
Capital gain	$40,000	$40,000
Taxable capital gain	$20,000	$0
Tax on capital gain @46% (b)	$9,200	$0
Tax savings from donation tax credit (c)	$23,000	$23,000
Total cost of donation = (a) + (b) – (c)	$36,200	$27,000

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Charitable giving ... Continued from page 3

2. Arrange future gifts through your estate planning

Deciding how to distribute your estate in advance helps ensure your loved ones or important charities will be taken care of at your passing. There are many ways to achieve this goal. You can leave a set cash legacy, direct specific assets (publicly traded shares or land, for example) or bequeath a share of the residue of your estate to a charity or charities of your choosing. Outlining your charitable wishes through your Will has benefits. You can enjoy the use of your assets while you are alive, knowing that charities that are important to you will benefit in your Will.

Your estate will also receive an enhanced donation tax credit. Generally, you cannot claim a credit for donations exceeding 75% of the net income reported on your federal tax return in any particular year. However, in the year of death and the preceding year, you may claim donations of up to 100% of your net income.

Another way to provide a future gift, while benefiting from your assets during your lifetime, is by establishing a charitable remainder trust. You receive an immediate donation tax credit plus income from the trust throughout your lifetime. Upon your passing, the remainder of the assets in the trust will pass directly to the charity you name as the beneficiary (bypassing probate fees).

Here's another tax-smart way to make a future gift to your chosen charity: Donate a life insurance policy. You can donate a new or existing policy to a charity during your lifetime and receive a tax credit you can use immediately. Alternatively, you can defer the donation until you pass away, in which case your estate receives the tax credit. Either way, your chosen charity receives the life insurance benefit directly on your passing. What's more, it bypasses probate, which can reduce costs and maintain your privacy if desired.

3. Create a lasting legacy with a donor-advised fund

If you want to establish an ongoing charitable legacy, consider a donor-advised fund. A donor-advised fund is administered by a public foundation, and provides many of the same advantages as a private foundation, without the upfront costs, complexity and ongoing administration responsibilities.

With a donor-advised fund, you contribute a certain amount, receive a donation tax credit, invest your contribution, and then make grants to registered charities of your choice. You can also name a fund successor, such as one of your estate beneficiaries, who can continue your legacy after your passing. If you don't name a successor, the public foundation will continue to administer your fund and make grants consistent with your wishes.

So whether you're giving a little or a lot, there are many ways you can make a meaningful difference to causes close to your heart. Plus, you can take advantage of tax incentives to maximize your giving.

To learn more, please contact your Investment Advisor.

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