EPISODE 70:

Fee-only Financial Planning, Home Country Bias, and Big RRSPs

[INTRODUCTION]

[00:00:05] Benjamin Felix: This is the Rational Reminder Podcast, a weekly reality check on sensible investing and financial decision making for Canadians. We are hosted by me, Benjamin Felix, and Cameron Passmore.

We really appreciate the comments on the rationalreminder.ca site. They keep flowing in –

[00:00:21] Cameron Passmore: I want to highly one that I appreciate. I got one that said I should stop interrupting guests, which I'm going to go back and try to identify where I did that, because I feel horrible if I did do that because I'm super conscious about that. When I listen to people do that on podcast, it does bother me. So I appreciate that feedback.

[00:00:39] BF: I think you did it one time in an interview with Wes. I don't think you do it all the time.

[00:00:43] CP: So that was after the West interview?

[00:00:44] BF: I think so. Yeah.

[00:00:45] CP: I feel bad, because Wes was such a nice guy. Apologize to Wes.

[00:00:48] BF: It was not a big deal.

[00:00:50] CP: Anyways, we do appreciate that feedback.

[00:00:52] BF: I like the comments on the rationalreminder.ca site because other people can see them and I just think that's cool. Nobody commented on – Well, the one comment, it was on YouTube that you're talking about. There are a couple actually. But on the site, nobody commented on the Wes episode. I find people comment more on our episodes than on guest episodes for whatever reason.

[00:01:07] CP: Yeah, I'm not sure what that means.

[00:01:09] BF: The Wes episode is pretty technical. People probably just had nothing to say.

[00:01:13] CP: People here loves it. The team loved it.

[00:01:15] BF: I loved it too.

[00:01:16] CP: Anyways. One of the things we wanted to highlight this week is that our team is growing and we thought we'd use this platform to get the word out if anyone out there has something in mind for perhaps a plan for one of the positions. We're looking to bring, one of them is, personal insurance in-house.

[00:01:30] BF: This is a big one for us. We do give insurance recommendations all the time when we're doing financial planning, just their often insurance needs. Right now what we've been doing as long as I've been here is working with a third-party to write the policies. We say you should probably have as much insurance, here's the person to talk to and then they go and do it.

But just from the perspective of, I guess, controlling the client experience is the best way that I could describe it and maybe some efficiency too. We're very seriously considering bringing insurance in-house. Now, we're already insurance licensed. So it's like bringing it in-house. What does that actually mean? I think what it really means to us is finding a person who fits with our philosophy and culture and doesn't want to jam permanent policies to everybody.

[00:02:16] CP: Yeah. This isn't a sales position. Somebody doing the right thing for the clients based on our philosophy on insurance. If you're interested, let us know.

[00:02:23] BF: It's not a sales position. This is a situation where we're saying to the client you need insurance. We just want to be able to have someone that's really good at, I guess, product, maybe with a good planning knowledge to just write the insurance policy.

[00:02:37] CP: Do great work and not focus on sales.

[00:02:39] BF: So we're looking for somebody like that to join the team.

[00:02:40] CP: We're also open to any financial advisors out there who might want to join our team. Prefer if you have some experience, some credentials. Don't necessarily have to have a client book. We're not looking to add someone with a big book necessarily.

[00:02:53] BF: I think philosophical alignment, cultural alignment, those are the biggest things we're looking for. Yeah, definitely advisors with experience, preferably credentials. Yeah, we'd love to hear from you.

[00:03:02] CP: Lastly, we're going to be posting a position shortly for a marketing leader in our team. Someone to help out with podcast, YouTube, social channels, a lot of creative work.

[00:03:13] BF: Yeah. We're doing so much stuff with content and we have someone that we're working with now within PWL, but shared across the firm as a whole and just – We're doing so much of this stuff and we're enjoying it and we think our clients are getting a lot of value from it. So we're look to bring somebody directly within our team so that we can have just more help with optimizing the stuff that we're doing.

[00:03:34] CP: Good episode today. Something a little technical, but still content.

[00:03:38] BF: Oh! As if today is the only time we're a little technical. Come on.

[00:03:39] CP: Oh, it will take a little long. If you have feedback on the length of the episodes, we'd love to hear that too. Vince convinced that longer is better. We'll give our data on that.

[00:03:48] BF: On the YouTube channel, there were a bunch of comments saying the length is great. So I conclude the length is great.

[00:03:55] CP: All right. Enjoy the episode.

[EPISODE]

[00:04:03] BF: Welcome to episode 70 of the Rational Reminder Podcast.

[00:04:07] CP: So we'll kickoff this week current topic with a question from a listener.

[00:04:10] BF: Yeah, we had a really thoughtful question that came in from a listener. I paraphrase, but Cameron, do you want to read it?

[00:04:15] CP: Sure. It goes, "I have always managed my family's finances and I have a strong interest in personal finance and investing, but no formal education in the field. My spouse has no interest and no desire to learn. Listening to the episode with Wes Gray, which we had on last week, I realized that there is a ton of information that I don't know. What if we weren't invested in the right way or we aren't saving enough? What do you recommend for the average investor who doesn't want to pay thousands of dollars for advice?"

[00:04:41] BF: It's a really a good question.

[00:04:43] CP: Yeah, and it's something that I think the industry struggles with as well, is how do you give broad base advice without having necessary linked or they don't have a large enough portfolio to generate enough revenue, the service that people do deserve.

[00:04:54] BF: Yeah, and I think one of the challenges too is that the fee-only planners, or a lot of the fee-only planners, some of them. Anyway, it's not cheap. It can be thousands of dollars for a financial plan.

[00:05:03] CP: I think you and I are guilty of thinking that investing is a lot more straightforward than it really is to people because you don't live it all the time. There are so many messages coming at you from all different angles that how would anyone who's not in the field know what their best way to invest is, not necessarily the right way, but the best way.

[00:05:22] BF: Yeah. I mean, I think one of the other challenges is that as a do-it-yourself investor especially when there are a lot of messages now about how easy it is, it is easy to become overconfident. I'm not saying people can't do it. You can, for sure, but it is easy to get overconfident.

[00:05:38] CP: But there are so many parts to it more than just investing. You have taxes, insurance, how much to save, asset allocation, asset location, tradeoffs and rebalancing. I mean, things we've talked about for 70 episodes now. There's a lot to stay on top of not just know and understand, but to stay on top of on a regular basis.

[00:05:58] BF: Even having just on the investing side, like yes, the planning is a huge piece of it. Another interesting piece of the planning is saving too much. We had a guest that's coming up in a couple of weeks. One of the things that he talked about, he's a personal finance blogger and does his own investing, but he does meet with a fee-only financial planner every now and then just to get a second set of eyes.

One of the biggest takeaways for him is that he realized he was over-saving. He had reached the point of financial independence and he could have been using more of his money to enjoy lifestyle with his kids and with his family and they ended up allocating more money toward that as supposed to saving. That's again something that someone who's doing it on their own, you might end up over-saving. That's one of the big question marks.

[00:06:39] CP: Yeah, and to have someone externally take a look at your situation and perhaps give you that feedback could be very valuable to your enjoyment out of life.

[00:06:45] BF: Yeah. I think that, like in this question specifically, it was interesting because one spouse is super into this stuff. They've got their head in it. They're the one thinking about it. They're the one directing the family's financial decisions, while the other spouse has limited knowledge and zero interest in learning about it. That can create an interesting dynamic.

[00:07:04] CP: Yeah. So what do we recommend is the question.

[00:07:08] BF: Yeah.

[00:07:09] CP: I mean, it's easier to say by VGRO or VBAL, one of the pre-constructed balanced ETFs, that can take care of a lot of the investment side of it, especially for relatively smaller accounts.

[00:07:20] BF: I think just on the line of thinking that I was just talking about where there's this asymmetrical knowledge between spouses in a relationship, but one of them is directing the finances, but they're not necessarily a professional. I think just having a third-party with expertise say, "Yes, you should be doing this thing." That takes a ton of pressure off of the spouse that is the financial leader.

As I was thinking about this, it made me think of what Ted Seides said about David Swensen a whole ago where Ted explained that what David was so good at was having good investment ideas, which is obviously important, but being able to communicate why they were doing those things to the stakeholders. So it's like the Yale endowment is able to be a good long-term investor largely because David is so good at communicating why they're doing what they're doing to the stakeholders.

[00:08:06] CP: Which causes better adherence by the stakeholders, which is a concept that Doctor Morris Summers talked about.

[00:08:12] BF: Yeah, that's right. I think when we're talking about a couple or a family, like if someone's maybe helping their parents too, that ability to communicate, that's hard, but it's also hard to do when you're coming from a place where you don't necessarily have formal training. As this listener question pointed out, I think it is useful to have somebody else look at your stuff that doesn't necessarily have to be a firm like PWL, like we generally have fairly complex clients with fairly large pools of assets to invest, and that's not everybody.

[00:08:43] CP: But there are some good fee-only planners out there.

[00:08:45] BF: Yeah. So there are a few that I usually mention when people ask me about this. There's Spring Financial Planning in Toronto. In Ottawa we have someone named Jean Realm who's in an accountant, but is also a CFP that does fee-only planning. Then we've had on the podcast in the past, Rob Engen who has a fee-only planning service and he's also got his blog, Boomer & Echo. So you can kind of see how he thinks about stuff through his blog.

But as we were preparing to talk about this or answer this listener question, I reached out to Rob just to say, "Hey, we're going to mention you on the podcast," and I thought it might be kind of neat to have Rob maybe offer a discount on his planning service to listeners of the podcast

just because we're talking about it and he's been a past guest. Just to be clear to everyone, we have nothing to gain from doing this and Rob is not paying us or anything like that.

[00:09:34] CP: Yeah, there's no comp sharing going on here at all.

[00:09:37] BF: Anyway, yeah. So we have a message from Rob that we'll play for you now before we move into the next part of the episode.

[00:09:42] RB: Hey, Cameron and Ben, it's Rob Engen from Boomer & Echo. Thanks for the opportunity to just speak to the listeners of the Rational Reminder Podcast about fee-only financial planning. I'm extremely passionate about providing objective, unbiased advice for Canadians. I don't sell products or get paid commissions to refer you to someone who does.

Instead I offer sound financial advice to help you get out of debt, budget and manage your spending, invest for the future and decide on big picture questions like whether to pay down your mortgage or invest. How much to save to meet your retirement goals? When to take CPP? The most common, do you have enough money to retire?

I work with clients across the country to put together and implement a financial action plan based on your identified goals. You'll get unlimited access to me by phone or email while you work through your plan. At the end of the year, we'll review the entire process together to ensure you're on the right path.

My ideal clients are looking for advice on cash flow management, simplifying their investments, prioritizing multiple financial goals and preparing for retirement. I know my limitations as a planner, so if you have complex financial needs involving corporations, trusts and the like, well, you're better off giving Cameron and Ben a call.

A typical financial planning session cost $1,200 for couples, but I'm pleased to offer a $200 discount for listeners of the Rational Reminder Podcast. To get in touch, you can head over to boomerandecho.com or send me an email, robengen@gmail.com.

[00:11:04] CP: Okay. Now we're on to current topic number two. Last week I had the pleasure of attending the Dimensional Fund Advisors Advanced Conference in Charlotte, North Carolina.

This is something they do annually for a group of Canadian advisors that work with Dimensional funds. Something I've gone to now I think 16 or 17 years in a row. This is something we go at our own expense just everyone knows. It's not some sort of a mutual fund junket at all. It's really to go and to learn, and there's a lot of learning that happens that everyone in these conferences, and this year was no different.

[00:11:37] BF: You think of a mutual fund conferences being, well, kind of like you just alluded to, as being sort of a sales conference where there's drinks and whatever. I've only been to one of these, but I think they don't feel salesy. I mean, they have academics presenting their work.

[00:11:52] CP: Yeah. It's a really conference about how they make decisions based on the dimensions of expected returns. I mean, the name of the company comes from a very deliberate spot. There's dimensions that explain expected returns and they work with academics who work tirelessly to try to understand and get better information around those decisions, and it's all about having the best possible decision to have the most reliable outcomes. So I thought of you often during the week, because so many people talk about increasing reliability of the outcomes. So there's Ben's favorite line in the business.

[00:12:24] BF: I asked you while you were there for today's episode if you could figure out what were your five biggest takeaways from that conference. What were they?

[00:12:32] CP: Number one I think is the fact that the world is running towards factors. Factors as a buzzword, we talked about this in the past. There's a factor zoo going on. There are now over 400 factors that they talked about, not each factor of course. They talked about there's now 400 factors out there and the reality is Dimensional has been at the forefront of factors. All factor is just a difference in expected returns and what causes that difference. Even in the forefront of this for the past 39 years since they were founded and now that the industry is kind of figured out indexing, it seems like the sales machine is kicking into different factors now. With all the research going on inside the database of returns, more and more factors are popping up.

[00:13:13] BF: When you say the investment world is running towards factors, what do you mean?

[00:13:16] CP: The number of factors, I don't know the number with me, but it's unbelievable the amount of factor or quasi-type factor funds that are coming out from a sales standpoint in the industry.

[00:13:25] BF: Interesting.

[00:13:26] CP: And Dimensional has been here since day one.

[00:13:28] BF: This is becoming a bit of a marketing pitch. Like you said, there are 400 different factors. They can't all be academically sound.

[00:13:34] CP: Yeah. And you hear through the academics and they're speaking, they talk about certain terms. Well, that's a term that's used in sales. It's not really a scientific or academic term. They're a scientist first. They follow the data, then Dimensional will take from that those findings and apply it to portfolios.

[00:13:49] BF: I've seen Fidelity have used factor in their marketing, but they talk about the fidelity factor, which is like their ability to be good active managers.

[00:13:59] CP: I guess. It's a great word, right?

[00:14:01] BF: Yeah, I guess so. Okay. What's the next one?

[00:14:03] CP: Next one. So Dimensional gives a framework for portfolio decisions, but the framework does not give guaranteed answers. You think about that. It's all about what past information and findings and past information can help you make better decisions going forward? It's not trying to predict what will happen. It's basically based on what is shown in the price, because the story is all about price. What do you expect those future returns will be?

But it doesn't mean it's guaranteed. You could have a great process and a great understanding of these factors, but you could have less and great outcome, which we talked about.

[00:14:34] BF: Like value for the last decade.

[00:14:36] CP: Value for last decade. Exactly. This brings me to my number three, point number three, and this was said so many times. It goes back to the question, has the value factor gone away? Is it now dead? Because value premiums has not been what was expected for the past decade, which is not unexpected. We've always known that could happen. But they said so many times, if stocks have different expected returns, then there must be a value premium. It's like gravity. It's un-debatable. If every stock has kind of the same expected return, which I think most people say, "It can't be possible." Then there has to be a value premium.

[00:15:11] BF: You can frame it however you want. We talk about value as being a risk premium. Some people talk about it as being behaviorally driven. But no matter how you slice it, I think it's pretty much consensus at this point that securities are priced differently. Whether that's rational or irrational differences in pricing, it doesn't matter. We know that there are differences in the way that the market price is different types of assets.

[00:15:33] CP: They talk about how much more valuable it is to have exposure to these premiums inside their kind environment where you've got the highest possible exposure to the different factors on a live daily basis as supposed to value ETF might be rebalanced once or twice a year, because you never know when the premium is going to show up. So being there all the time is so important.

[00:15:53] BF: Yeah. It's the same thing we talked about with the equity premium, where if you missed the – I don't remember what the exact statistics are, but if you miss the one best trading day in the year, your annualized performance drops out substantially.

[00:16:03] CP: Personal highlight for me, number four, we got to see, and I've seen them a number of times now. Prof. Robert Novy-Marx, I think one of your personal academic heroes who's from the University of Rochester and discovered the profitability premium. He delivered a phenomenal presentation.

Kind of a sidebar, it's interesting to see the change in my own behavior going to this conference when I have to come back and talk about these things in the podcast. So much more engaged in a much more granular level than it would have been in the past. His presentation I thought was spectacular. He talked about what kind of information can you get from the data that will give you a cleaner read on the price signal. He was getting into a data. I can never replicate the

data. This is mind- blowing to me, but talked about looking at changes in profitability either on the short-term or the long-term and can you take from that data some statistically meaningful higher expectation of return going forward based on changes in profitability.

The bottom-line is no you can't, with my take away. But to be able to prove that mathematically that, no, just the level of profitability which is a good indicator of future profitability, all things being equal, like on book to mark, another criteria. You will have better expected returns.

[00:17:17] BF: Yeah, and we've talked about this in the past, but it's one of my favorite factors to think about because it's counterintuitive. Why would a more profitable stock have higher expected returns? But the answer is it's what you just said, is once you control for relative price, once you control for price-to-book. So two stocks that have the same price relative to their book value, if one of those two stocks has higher expected profitability but the same price relative to its book value, then its higher expected profits must be being discounted at a higher discount rate by the market. That’s where the additional risk is priced in, but it's counterintuitive to think about.

[00:17:53] CP: He talks about earnings surprises and how much you can clean up the signal with that information, and it doesn't matter a lot in large stocks, but in small stocks it does. But instead of it being a unique factor, they will use that at Dimensional in their trading. So there are earning surprises on small stocks. It will help them how they trade.

Another presenter talked about how they looked at these different factors and if something is short term yet meaningful but it causes too much turnover, so instead of it being a unique standalone fact that they will build a portfolio around, they’ll use in their trading information.

Now, again these academics don't work for Dimensional. They’re publishing papers in Journal of Finance and other places, but Dimensional, since they’re public and extract from this information to improve their portfolios. That’s the mandate.

[00:18:37] BF: So they’ve got their own research team and they're taking the academic literature and then they’re applying it to –

[00:18:42] CP: Well, that's the other cool thing. They have the whole 90-person department. I think there's over 20 PhD's and all kinds of crazy credentials in this group. But you think about the brainpower of 90 people. They throw in these papers that are published. Understand this paper, find out what information was not included in the release of that paper to get them to that findings. They're really testing a lot of these ideas. If it makes sense, they apply it.

[00:19:06] BF: Right, which I think they're thinking about with investment, which isn't a new factor. It was in the Fama and French 5 Factor Model and it was identified I think as early as 2006, at least by Fama and French. It was probably identified empirically before that. But theoretically sort of synthesized by Fama and French in 2006 and they're just now starting the roll it out.

I think the holdback with investment was that differences in investment between large companies are never going to be huge, because differences in investment relative to book value for a mega cap company, they're never going to be meaningfully different. But with a small cap company, it can be substantial. So I think that the way Dimensional is thinking about this is within the small-cap universe they're going to start using investment, aggressive investment, as an exclusion in portfolios.

[00:19:52] CP: They will also apply what they can learn. If something happens, an anomaly in the marketplace, they talked about a certain segment of Canadian stocks had a sudden drop in profitability. There was a little anomalous. So they went back to the research group, who then goes back to the academic, and they made decisions around that based on that evidence. So it's much different environment than say a pure index fund. I think to call it passive or index is just not a fair representation of what they do.

Last topic that is a big take away for me was on the fixed income side. A few points there, China, I had no idea is a huge player of the fixed income market with 10% of the global fixed income being from China.

[00:20:30] BF: So they issue a huge portion.

[00:20:32] CP: The issuers of that. Exactly. They have over $5 trillion of bond issues out there. Very hard to buy, hard to trade, hard to hedge. As we know, they like to hedge their foreign bond position. So they're not there yet, but looking actively at it.

Equity performance or signals from how the stocks at companies that issue bonds, how the stock performs helps them trade bonds better. They can often tell if a company's in trouble. It may not have the credit rating change up or the stock is plummeting. There's something going on there. So before they do any sort of bond purchases, they always like in the equity side. Clearly, technology helps them do this, but there is a lot of information sharing between the equity side and the debt side of the portfolios.

The last point is peer-to-peer bond trading is growing a lot. This is where you trade between mutual fund issuers or big portfolios and don't go through a dealer. So you're trading with another buyer or a seller directly. So it stays on the spread. Then a huge number of positions that are now traded peer-to- peer.

[00:21:31] BF: I think that's growing largely because regulatory changes have reduced the amount of fixed income that financial institutions can hold, right?

[00:21:38] CP: I'm not sure if that's the why or not. It's not here yet in the UK or Europe I believe, but it's coming soon. This is a United States phenomenon.

[00:21:46] BF: Interesting.

[00:21:47] CP: So that was my trip. It was amazing. It's amazing, impressive group of people and who are absolutely dedicated way more to information than trying to sell anything. There's no talk about – It's a completely foreign concept almost to them. Not that there not trying to build a successful business. They clearly are, but it's all about having the best possible portfolios they and they pick up these pennies everywhere. You can just imagine doing that. Basis point here, basis point there.

[00:22:12] BF: Yeah, it feels like they're seeking academic truths first and then implementing it in portfolios.

[00:22:16] CP: Absolutely.

[00:22:17] BF: Second.

[00:22:19] CP: Portfolio topic for this week.

[00:22:21] BF: Home country bias. This one comes up a lot especially when Canada's underperforming.

[00:22:27] CP: It came up last week at the conference.

[00:22:29] BF: Oh, yeah?

[00:22:30] CP: Yeah.

[00:22:30] BF: What was the context that came up at the conference?

[00:22:32] CP: That's a common question they got. How would you answer this? How much in Canada should you have?

[00:22:35] BF: Canada makes up just over 3% of the global stock market by capitalization. Most Canadians have way more than that. I think Bangor did a study and found that Canadians on average have 60% of their equity allocation in Canada.

[00:22:50] CP: I think, virtually, every county in the world has a home bias except for one Scandinavian country I belief.

[00:22:54] BF: Oh, interesting.

[00:22:55] CP: Yeah.

[00:22:55] BF: But yeah, you're right. The US is half of the global market. No other country is anywhere near that. If you live anywhere – Well, even Americans do have home country bias, but in a county like Canada where we're 3% of the market, well, anything over 3% his home

country bias. Most index model portfolios like us, Canadian couch potato, [inaudible 00:23:17] model portfolios, while simple, the Vanguard asset allocation need to have. Everybody's doing close to a third in Canadian equities, which often times, especially now when Canada's underperforming, people have a lot of questions about.

[00:23:30] CP: Yeah. I think this isn't purported to be the best portfolio. You will only know the best portfolio in hindsight. It's just a reasonable mix of all the different factors that we're going to talk about to get to that decision.

[00:23:40] BF: Yeah. A couple of different ways to think about it. Vanguard did a paper this year where they looked at from a mean variance perspective, like from minimizing volatility and maximizing expected returns perspective, how much do you need to allocate outside of your home country to get the maximum benefit? So they've got their own modeling software that they use to build this. They did that and then they also use historical data to do the same thing. But they found there's sort of a sweet spot in terms of volatility reduction, which is around 50% of your overall allocation.

[00:24:12] CP: Amazing.

[00:24:13] BF: So if your goal is mean variance optimization and you still want to have half your allocation in Canada, which is interesting.

[00:24:19] CP: I wonder what causes that. Any idea what the main driver is? The level of volatility and the timing of volatility and you're rebalancing. Is that what's doing it?

[00:24:26] BF: Good question. I don't know, and they didn't dig in to the why in the paper. They did dig into one of the not whys, which was currency. They found currency had a very little contribution to that.

[00:24:34] CP: Okay. So.1 is 50%.

[00:24:35] BF: Yeah. Starting .50% from a mean variance perspective, which is not a good way necessarily to make portfolio decisions because, like you said a second ago, we don't really

know what the future is going to look like. Past mean variance does not indicate future optimal mean variance.

So the other piece of that though, and I guess that's kind of part of what I was just saying, is that long-term stock returns are largely driven by economic factors. If a country does poorly from an economic perspective over a long period of time, it stock returns probably aren't going to be very good. AQR had a paper in 2011 where they looked at global diversification. I think the paper was called something like a global diversification works bracket eventually. But the argument is basically global diversification might not improve your volatility in the short term, like when stuff crashes, correlations tend to increase. A lot of people say, "Well, diversification is useless."

But their argument in the paper was that, yes, that's true, and maybe that's a behavioral component. Maybe people panic. Although that wouldn't be an efficient market. I guess it could, just risk premium is increasing. But anyway, short-term correlations might increase. But over the very long term, it's going to be the economic factors that affect your outcome. So betting on one country is effectively a bet on that economy, which isn't necessarily a good bet.

Based on that, we start maybe thinking about dialing back from the 50% in Canada that the mean variance says we should have.

[00:25:56] CP: Okay. So number two is less.

[00:25:58] BF: Yeah, started 50%.

[00:26:00] CP: Less than 50.

[00:26:01] BF: And then maybe less. But then there's two things that start to push us back toward maybe more, like maybe we say, "Okay, economic factors." So we go back to market cap weight, maybe, maybe not all the way down. But then you add in costs. Owning Canadian stocks as a Canadian is cheap.

[00:26:18] CP: In terms of MERs.

[00:26:19] BF: In terms of fees. You can buy XIC for 6 basis points. Now, you can buy XUU –

[00:26:25] CP: TSXs capped index.

[00:26:26] BF: Right. Thank you. You can buy XUU, so total US stock market ETF, seven basis points. Still super cheap. When we start getting outside of North America, so XEF, which is international developed invest to a market index, 22 basis points. Then XCC emerging markets, these are iShare funds, 26 basis points.

[00:26:47] CP: It's still really cheap. These fees are so cheap. They're less in the HST on some mutual funds.

[00:26:54] BF: Yeah, absolutely, but a meaningful difference. Then the other piece of cost is trading expenses. Trading outside of North America tends to be a little bit more expensive and that shows up in the trading expense ratio, which is small, but two basis points.

[00:27:09] CP: Yes, it's been reasonable. Two basis points.

[00:27:11] BF: That's a third. That's a third of the cost of XIC. XEF and XCC both have –

[00:27:15] CP: Yeah, but the much bigger issue than these fees is taxes.

[00:27:18] BF: Yes.

[00:27:19] CP: Taxes are the elephant, but it's certainly a big issue going on here.

[00:27:23] BF: Yeah. Yeah, a little bit more expensive to own stocks outside of North America, really, in terms of fees. But yes, taxes is where the numbers start to get bigger. Canadian dividends received by a Canadian taxpayer are taxed at a favorable rate. But as it grows up in a tax credit, but the effective tax rate ends up being lower than the tax rate on regular income.

In Ontario in 2019, an eligible dividends, that's a dividend paid by a large public company. Usually, they pay eligible dividends. The individual taxpayer is going to pay tax at 39.34% at the

highest rate. You compare that to a foreign dividend, which is tax as regular income, which you're going to pay tax at 53.53% on.

[00:28:07] CP: So 13%, almost 14% more.

[00:28:10] BF: So we can kind of think about this in terms of basis points if we use XICs yield times the tax rate as the sort of baseline and then see how does the tax drag compare.

[00:28:22] CP: What's the yield on that?

[00:28:23] BF: For XIC, I can't remember. It 2.86 I think.

[00:28:26] CP: 2. Something present. Yup.

[00:28:27] BF: But you take that times the tax rate and then we can compare that to the yield on international and US stocks times the respective tax rates, which is both 53.53%. I found that with international developed we might have an extra 26 basis points of tax drag just from dividend yield times tax rate. With emerging markets, it's about 30 basis points.

Now, U.S. equities are interesting because even though they're taxed at the full tax rate, the yields are much lower, like US stocks are yielding 1.8%. From that perspective, at the highest rate, it's actually a little bit more tax efficient to own US stocks than it is to own Canadian stocks, but Canadian stocks are more tax efficient than international and emerging markets stocks. That changes if we go down in the tax brackets. So at the highest rate, US stock is a bit more efficient. If we go down to their bracket for income between 97,000 and 150,000, then Canadian stocks become more tax efficient than even US stocks with their lower yields.

Now, that's tax cost in a taxable account. That's tax drag due to dividends that you're going to receive from equities. The other piece of that though is in a nontaxable account we also have tax to think about.

[00:29:34] CP: This is something that so few people know about.

[00:29:37] BF: Yeah, it's definitely not the most common knowledge.

[00:29:39] CP: Recoverable foreign withholding tax.

[00:29:41] BF: Right. If you're investing in an RSP or TFSA account, when you receive dividends from foreign companies, there are taxes withheld before you receive the dividend. That's a cost. That's a cost to you. In a taxable account, when you receive a foreign dividend, taxes are withheld, but you get a credit for the foreign withholding tax which you can recover when you file your Canadian tax returns.

[00:30:05] CP: There's the key.

[00:30:07] BF: In a nontaxable account the same thing happens, the same withholding tax is applied, but because it's a nontaxable account in Canada, you don't get to use that tax credit to offset your Canadian taxes.

[00:30:17] CP: There's no slip issue for those dividends.

[00:30:19] BF: That's right. Now, this ends up being a pretty substantial cost. If we look at XUU, that's the iShares Canadian listed US equity ETF. So it's a ETF of US equities that's listed on the Canadian stock exchange. If you hold down in your RSP or TFSA, you're going to have somewhere around 27 basis points of unrecoverable foreign withholding tax.

Now, that's a cost that you do not have with Canadian equities. If you own Canadian equities in your RSP or TFSA, there's no foreign withholding tax obviously. US equity is about 27 basis points. With XEF, so that's international developed, it's around 22 basis points of unrecoverable foreign withholding tax in the RSP or TFSA account. Then XEC, XEC is a little bit different. We're getting into the withholding tax weeds here, but I guess that's where we are.

[00:31:05] CP: We might want to make this its own on subject going forward some time. It's worth knowing. But go ahead.

[00:31:11] BF: Yup. XEF holds international developed stocks directly. So when those foreign stocks pay a dividend, they're paying a dividend to a Canadian ETF and they withhold tax appropriately. That tax is gone. That's it.

[00:31:28] CP: But it's only one level.

[00:31:29] BF: One level. With XEC, it's different, because XEC holds a US listed ETF of emerging market stocks.

[00:31:37] CP: XEC is a Canadian listed ETF that owns a US listed ETF that owns emerging market stocks. The emerging market stocks pay a dividend into the US listed fund, there's withholding tax there. The US listed fund pays a distribution to the Canadian listed fund. There's a withholding tax there.

[00:31:53] BF: Correct.

[00:31:54] CP: In the registered account, both of those are unrecovered.

[00:31:56] BF: Correct. So in a taxable account even with XTC, you're going to lose one level of withholding tax. That first level.

[00:32:01] CP: From the emerging market stocks paying to the dividends to the US based ETF.

[00:32:06] BF: That's gone. In the nontaxable accounts, you're losing both levels. I figure between the two levels in a RSP or TSFA, you're probably losing around 70 basis points.

[00:32:14] CP: Must be at least that much, because some of them have high distribution rates.

[00:32:17] BF: It's 70 basis points. I ran the numbers yesterday.

[00:32:19] CP: So it's a big number.

[00:32:20] BF: Yeah. Now if we look across the different asset classes, US stocks is 27 basis points, international about 22 basis points, emerging markets 70 basis points. Big numbers. When we start talking with a total cost of ownership of an asset class, for someone who's investing in either a taxable account or a nontaxable account, I guess depending in your tax rate

for the taxable account, we have pretty meaningful additional costs of ownership just by owning foreign assets.

So on our dial of how much home biased we want –

[00:32:49] CP: So we back up now?

[00:32:49] BF: Yeah, this is pushing as back up –

[00:32:51] CP: A little bit more than where you were last time.

[00:32:53] BF: Wherever that was, which is totally subjective. Now, I think it's important to point out that on the form withholding tax, you can do something to get around some of that. If you own a US listed ETF side of your RRSP, the level of form withholding tax applied by the US is gone. At Canada US tax treaty, they will not withhold tax to dividends paid to specifically a Canadian RRSP account.

[00:33:17] CP: That's right, because US listed ETF.

[00:33:20] BF: Which means you're buying in US dollars. So you're adding some complexity to your portfolio to save those basis points. So it's not free. Then the other thing is if we're talking about the asset allocation ETF's, those are all Canadian listed ETF's. So you don't get to take advantage of the elimination of the US foreign withholding tax if you're using the asset allocation ETF's. Now this isn't a bad thing. I don't want everyone to run out and buy US listed ETF's to reduce their foreign withholding tax. You can do that, but it definitely increases your complexity especially when you start thinking about stuff like rebalancing across different currencies. It's not something that you can't do. It's just a hassle.

[00:33:55] CP: So we talked about fees, taxes, withholding taxes, all of these things tend to favor Canadian stocks. Diversification tends to favor diversifying away from Canadian stocks. Do you expect different equity risk premiums between these different areas?

[00:34:08] BF: So that's the question. That's the big question. If we expect the same equity risk premium across every asset class, we know that economic factors are going to drive long-term

performance. So we still know diversification is important. But if we assume the same expected return before costs and taxes, then you would definitely have a bias toward owning Canadian equities.

[00:34:27] CP: Based of these other factors we've already talked about, all things being equal. If you have the same expected return and you do it for cheaper, you would do more Canadian in your portfolio.

[00:34:33] BF: That's exactly right, which pushes us toward more Canada, but then again that long-term economic drivers of returns maybe pushes us more towards diversification. But in either way, in either direction, there's no optimal answer. It's not a simple question.

[00:34:48] CP: To me the big issue is behavior and what's going on inside the world of the Canadian markets. So I pulled some performance numbers just before coming in here, because 've seen this play out I think three times now over my career. So last 10 years ending December of this year, in Canadian dollars, net of inflation, the S&P 500 for the 10 years ending December 2018, 12.4% Canadian net inflation. TSX, 6.2. Okay? So you have roughly a 6% spread the last 10 years ending last December.

For the 10 years prior to that, the S&P 500 Canadian dollars real return, -5.6% compounded. The TSX, 3.10. So you have almost a 9% spread there. Did Canada outperformed from the US by almost 9% per year? So I think a lot of these questions come up during a period of recent underperformance, because I know 10 years ago, "Why do you have so little in Canada?" You would hear that often. By the way, over that whole period, the whole 20 years, S&P 500 compounded 3% real Canadian dollars, TSX 4.6 real Canadian dollars. 50% better return per year.

[00:36:03] BF: Yeah, it's interesting. I think that from the behavioral perspective, the challenge with Canadian equities for Canadian investors that were in Canada. If Sweden does exceptionally well for a decade –

[00:36:16] CP: Why doesn't that bother us?

[00:36:17] BF: No Canadian investor is going to wish they had more in Sweden. But in Canada, you can't not notice. We're here.

[00:36:23] CP: Especially the banks. We have lots of people love doing lots of bank stocks.

[00:36:27] BF: Yeah. You can't ignore Canadian equity returns when you're in Canada, which makes that – I think it increases the behavioral risk if you go, say, market weight in Canada 3%, there will inevitably be a period of time where Canada does exceptionally well. I think that the risk of then increasing your allocation after outperformance is pretty high.

[00:36:46] CP: There is all that to say. We're comfortable having a third in Canada. Isn't that some sort of efficient frontier? No. It does seem like a reasonable point. It seems reasonable to me.

[00:36:56] BF: Yeah. I mean, you have the mean variance thing, which says say go half and then you have the costs. You have the taxes, the behavior. I think Ken French, I heard him do an interview quite a while ago, but he talked about how the logical thing to do is start with the market portfolio. Start with market cap weights, then tailor your allocations based on preferences, regulatory considerations, tax considerations, costs. So there is no right answer. As long as you start with the market portfolio, there is no right answer. Yeah, I agree. I think a third in Canada is, I mean, fine. Who knows? But it's pretty good.

[00:37:32] CP: Okay. Good to move on?

[00:37:34] BF: Yup. The planning topic we have for this week came from a listener question. It's a good question. It's can you have too much in an RRSP? I guess the question is really if you have RRSP room, is there ever a point where you should not use it? Say your TSFA is maxed and you're choosing between do I put my money into the RRSP or do I put it into a taxable account? Is there ever a point where you would choose the taxable account?

[00:37:59] CP: You took this question I think properly and going down a more rational way. The way I took it was – Because I had this question before. If I get too much of my RRSP, what if the government changed tax laws and then come after people that have large RRSPs? Which may be more irrational, kind of emotional reaction to it.

[00:38:17] BF: That's a valid question though. We kind of touched on that in the analysis that we're going to talk about here. I think step one in thinking about this question is just realizing that if we look at the RRSP and TSFA. Forget about the taxable account, even though that's what really matters here. But if we just look at the RRSP and the TFSA, they are going to deliver assuming the same tax rate. So if we assume at contribution and withdrawal your tax rate is the same. There RSP and the TFSA are going to deliver the exact same after-tax result.

[00:38:46] CP: This is key.

[00:38:46] BF: It's key. If we walk through an example of re-assume that the tax rate is 50% constant now and that withdrawal and we contribute $100,000 to an RRSP. Now, this is what I'm about to say, is one of the things that people really get lost on. If we contribute $100,000 to a TFA – Or return RRSP. Sorry. We have to compare that to $50,000 being contributed to a TFSA, because the $100,000 that went into the RRSP was a pretax contribution. If we instead chose to put those into a TFSA, we would've had to pay income tax first at our assumed 50% tax rate.

So you've now got half of the amount, which is fine. We're taking $100,000 in the RRSP and comparing it to $50,000 going into the TFSA.

[00:39:27] CP: I can hear listeners right now saying, "Yeah, but that $100,000 RSP contribution triggered a big refund and I'm going to get the compounding on that refund."

[00:39:35] BF: We can't think about the refund. The refund shows up in the fact that we could only put $50,000 into the TFSA. We already have the refund.

[00:39:40] CP: Now I can still hear people say, "Yeah, but then there's a refund. I'm making money in that refund."

[00:39:45] BF: The refund is reflected in the fact that the TFSA is half the value of the RRSP.

[00:39:49] CP: I agree with you. I just know what people are thinking right now out there.

[00:39:52] BF: It's tricky to think about, because practically what happens is you receive after-tax dollars on your paycheck. You put those after-tax dollars in your RRSP and you get a tax refund when you file your tax return. But to think about this logically, we have to think about it as a true pretax contribution, which is because of what I just described, probably isn't reality for most people. I mean, when you get those tax savings back, I guess ideally you would reinvest them in the RRSP to make the math exactly the same as what we're talking about. But even if you get those dollars back into your income and, whatever, spend them or save them or whatever, you still made a pretax contribution from an economic perspective.

Okay. So $100,000 in the RRSP. Assuming a 50% tax rate must equal $50,000 in the TFSA. That's a starting point. So if we take this and invest it for 20 years, it's earning a 5% return. The RRSP turns into $265,329. TFSA turns into half as you'd expect, $132, 664. Now, this is the key, if we withdraw from the RRSP at that same 50% tax rate, we have the exact same amount because you lose half the tax.

[00:40:57] CP: Have to.

[00:40:57] BF: So the way the math works, constant tax rate, you are completely indifferent between the RRSP and the TFSA. Now, if the RRSP withdrawals made it a higher tax rate, say, tax rates go up to 60%. Like you said, the government changes them, as people get worried about, then the RRSP does give you a worse outcome than the TFSA.

Now on the flipside of that, and this is how people generally think about or hope to use RRSPs. If the withdrawal from the RRSP in the future has made it a lower tax rate, say 30%, the RRSP gives you a big advantage over the TFSA. So following our example, that a 30% tax rate at withdrawal, the RRSP gives you $185,730 versus the $132,664 for the TFSA.

[00:41:38] CP: Because you're paying 20% less tax.

[00:41:41] BF: You've deferred your income tax to a year when you had a lower tax rate, which is what you want to do with the RRSP. Okay. So RRSP, TFSA, tax rates are equal, outcomes are equal. Now, forget about the TFSA. How does the RRSP compare to a taxable account? Now, because the taxable account you're going to pay tax on over time on income, like if you're receiving dividends, kind of like we're just talking about with the home country biased

discussion. You’re going to pay tax in the income every year and you're going to pay tax on the deferred capital gain in the future.

[00:42:09] CP: When you sell in the future.

[00:42:11] BF: When you sell in the future.

[00:42:12] CP: Because there are two parts to the return. There’s income now and deferred capital gain later.

[00:42:16] BF: Right. So if we again take the $100,000 we could have put in the RRSP, it turns in a $50,000 that we can do something else with, say, we invest in a taxable account and we’re still going to use the 5% return assumption. We’re going to say it’s a 2% fully taxable income yield plus a 3% unrealized capital gain. So we’re not going to realize the gain until we finally sell the investment.

[00:42:37] CP: So, you’re keeping it simple for this example. No realize capital gains each year. 3% deferred. 2% taxable each year, 5% per year. That’s right.

[00:42:44] BF: So same 5% pretax return. So if we assume the same 50% tax rate, the after-tax annual expected return is 4% because you’re losing half of your 2% income tax.

[00:42:56] CP: That's right.

[00:42:57] BF: Now, if we do the same thing we did before fast-forward 20 years, after paying tax on the gain at the 50% tax rate, we’re left with just under $100,000 [inaudible 00:43:06].

[00:43:07] CP: Okay. So you grew this amount by 4% net per year. At the end, you paid tax in the capital gains. You're left with just under $100,000 after 20 years.

[00:43:17] BF: Correct. Now, in our $100,000 in the RRSP example, contributed at the 50% tax rate. Well, I guess that's reflected in the $50,000 in the taxable account. Anyway, to get that same $100,000 outcome from the RRSP, the future tax rate at withdrawal would've had to have been 63.5%.

[00:43:36] CP: There's the punch lines.

[00:43:37] BF: So 13.5% higher. So you make the contribution in the RRSP at 50%. As long as you withdraw at less than a 63.5% future tax rate, you are better off using the RRSP than the taxable account.

[00:43:50] CP: Wow! There is a good rule of thumb.

[00:43:52] BF: Now that's at the highest marginal tax rate.

[00:43:54] CP: You're basically saying that the future tax rate is 13% higher than the tax when the money went in. You are better off to do the RRSP.

[00:44:04] BF: Yeah, that's true at the highest marginal tax rate. The math changes a bit as we reduce tax rates just because the after-tax returns in the taxable account are going to get a bit higher as we reduce the amount of tax that you're paying each year. So that spread. That buffer gets a bit lower as we get lower in the tax rates. But at the highest rate, it's the buffer, I guess you'd call it, is 13.5%. So if you're tax the highest right now, which is realistically 53.53% in Ontario, it might be a bit higher than 13.5. So it's 14% or something. As long as you're withdrawing at lower than a 67% tax rate in the future, the RRSP gives you a better expected result than the taxable account.

[00:44:39] CP: Right.

[00:44:40] BF: Now, one of the challenges in this whole discussion is that we're talking about future tax rates, which we don't actually know and we can't know even if we knew your future income, which we don't. But if we did, we still don't know what tax rates are going to be in the future, which I think, Cameron, is one of the concerns that you are saying some people have.

[00:44:57] CP: Yeah, and we do so much planning around this for people that might have large RRSPs which they have to convert to RRIFs and how much income will that trigger for them and so much effort is put into making sure they don't lose their old-age security.

[00:45:09] BF: Yeah, but I think that where future tax rates and RRSP decisions start to get really important is when we start thinking about the RRIF. So at age 71 your RRSP has to convert to a RIFF, and then by the end of the year that you turn 72, you have to make your first minimum annual withdrawal from the RRIF.

[00:45:26] CP: Which is 5.4%.

[00:45:28] BF: It's currently 5.4% at age 72. Now, because you have to take that amount out of your RRSP, whatever that is, whatever 5.4% of the amount that's in your RRIF at the time is, it's going to increase your taxable income in that year by that amount. So when we're talking about future tax brackets, there's a point where the RRSP turns into a RRIF and starts jacking up your taxable income.

[00:45:50] CP: 71 is when you have to convert to a RRIF, but you can do it sooner if you wish.

[00:45:53] BF: Yeah. Also true and there –

[00:45:55] CP: And there may be a benefit too. So if you want to split your income, if you do it when you're 65, you can then split the RIFF income with your spouse at that point. It's an ability to shift income from you to your spouse.

[00:46:06] BF: Right. Now, where the OAS that you mention, Cameron, starts to become important is when we're talking about that RIFF, that RIFF minimum that can push your income up. If your income gets too high, you move into this sort of special tax bracket. It's not really a tax bracket, but on income above 77,580 in 2019, that's the threshold, you start to have your old age security clawed back. So old-age security is a government pension noncontributory. You get it just for being resident in Canada for 40 years to get the full benefit, but you start losing $0.15 of that for every dollar of income you have over 77,580.

[00:46:43] CP: The income can come from pensions, investment returns, capital gains, CPP, OAS, RIFF payments. All those things get added to your income.

[00:46:52] BF: The grossed up amount of Canadian dividends, which is tricky.

[00:46:55] CP: That's right.

[00:46:56] BF: Anyway, within this bracket of income where you can have OAS clawed back, it's kind of like having an extra 15% added to your tax bracket because you're having 15% of this OAS income that you would've had or that you did have clawed back.

[00:47:08] CP: Some people really don't like losing their OAS and other people view it as, "Well, my income is not high. So be it." It was a benefit. Not a right.

[00:47:16] BF: Right. So it's on income between 77,580. Then at the $126, 140 it'd fully clawed back. Where we start worrying about this with a large RRSPs is about exactly what we're talking about. If the RRSPs too big, then you're going to your start losing your OAS, which like you said, people get worried about.

Now, if we think back to what we just talked with the tax brackets, as long as the future tax rate is not 13.5% higher than the contributory tax rate, the RRSP still put you in a better position. So even with the additional 15% tax from, or effective tax from OAS, that's still a tough threshold to hit.

[00:47:51] CP: It's interesting. We ran the numbers on what it would take to get some of your OAS to be clawed back. All you have for income is your CPP maximum benefit, which is 11.54 a month and your OAS. If you RRSPs over 1.045 million and you're 72-years-old, the minimum payment will start to cheer away as claw back, and assuming you have no spouse to split the income with. To go back to the initial question, can you have too much in the RRSP? Well, if you have 1.045, you're not going to have OAS clawed back at that point.

[00:48:22] BF: So I looked at the Ontario and federal combined tax rates, +15% for OAS claw back at 77,580. That's when OAS claw back would start. Your effective tax rate from normal tax plus OAS claw back could be about 45%. At the top end of OAS, your effective tax rate including the claw back could be about 58%. Then above that amount, once OAS is fully clawed back, your tax rate drops back to 43.41%, which is the normal marginal rate at the level.

[00:48:50] CP: Marginal rate, exactly.

[00:48:52] BF: So if we're thinking about somebody contributing to the RRSP at a 50% tax rate, even in that worst-case scenario where you are at the top of OAS claw back, you're paying tax at a 58% rate. If we think back to the 13.5% heuristic that we've developed, the RRSP still put you in a better overall position than putting that money in a taxable account 20 years ago. The question is about can an RRSP get too big? I think that what the numbers here are telling us is that it's really hard for an RRSP to get too big, if it's even possible. You mentioned something, Cameron, that I think is really important, which is that you can split pension income.

When you start introducing the ability to split the RRIF income, that threshold for when is the RRSP too big basically doubles. That whole idea of getting up an OAS claw back and having a higher future tax rate, all of that is cut in half assuming your spouse doesn't also have a very large RRSP. If there are $2 million RRSPs, then the issues are the space.

[00:49:47] CP: Let's face it. If you have a big RRSP, you've done some things right. You've been pretty disciplined for a long time. You have good investment performance. You may have hit a couple of homeruns in your portfolio. Can you really have too big an RRSP really?

[00:50:01] BF: The question is really should you ever stop contributing to your RRSP?

[00:50:03] CP: Yeah, I guess so.

[00:50:03] BF: In concerns about getting it too big. I'm hesitant to say that the answer is yes, except for one exception that we're going to talk about in a sed. The other thing that just changed that we've talked about in the podcast is the ELDA, the advanced life deferred annuity, which allows you to allocate up to 150,000, or I think 25% of your overall registered plan to this deferred annuity that pushes that RRIF minimum out for that portion to age 85.

[00:50:25] CP: Right. It creates backend income for those who live that long, longevity insurance.

[00:50:30] BF: And you can defer more that incomes. So when we're talking about your tax rate getting too high, this helps to alleviate some of that.

[00:50:35] CP: But again, it's not going to be a big number. If you already have a large RRSP, it's not going to be huge.

[00:50:39] BF: Helps a bit though. But this is all pushing us toward can you contribute too much to the RRSP? I mean, probably, probably not. I think some of the things that people get worried about are huge taxable at death. If you have a very large RRSP and you die, yes, you're going to pay tax at the highest marginal rate.

[00:50:57] CP: Especially if you want to pass that asset on to your kids, your next-generation.

[00:51:01] BF: But if we're thinking about wealth efficiency, as long as that tax rate at death is not 13.5% higher.

[00:51:08] CP: Higher than what it went in at.

[00:51:09] BF: I was going to say it's unlikely that may not be true. We don't know if each tax rate is going to be –

[00:51:11] CP: Still, people see that number on their broker team. They like that amount. They want that amount to go to the kids often.

[00:51:16] BF: Yeah, but we have to remember that it was $50,000 it went into the TFSA for the $100,000 that went into the RRSP. Anyway, I think that we've made a bunch of assumptions to kind of run the numbers on this. For any person thinking about this, it's definitely case-by-case and there other factors that go into it.

[00:51:33] CP: Another one is GIS, and guaranteed income supplement.

[00:51:35] BF: So this is the exception. I said that there is one exception where you might not want to contribute to your RRSP at all, or too much at least. Yeah, GIS, like you said, guaranteed income supplement. When you have a low – I can't remember what the threshold is. It's low though, like 21,000 I think. You'll receive GIS, which is like OAS, but for low income seniors.

If you're receiving GIS, an RRSP withdrawal can make it go away, which can hurt especially when we consider that the low income person making that RRSP contribution didn't have much to save in the first place. For someone with a low income, that $100,000 going into the RRSP might be the same as $90,000 going into the – Well, 100,000, maybe not quite. $70,000 going into the taxable account or the TFSA. I think that's the one exception where if you have a low income now, expect to have a very low income in the future. The RRSP can actually be detrimental. But other than that, I'd be hard-pressed to find a case where I'd say, "No. You should stop using your RRSP."

[00:52:28] CP: Save away and keep the rule of thumb at 13.5%.

[00:52:31] BF: Even with pensions, which we mentioned. If have a big defined-benefit pension, again, you can split with your spouse. Pensions, like we've talked about RRIFs. The same discussion applies to having big pension.

Anyway, you contribute too much to your RRSP, probably not unless you've got a very low income and expect to have a very low income in the future.

[00:52:48] CP: Right. On to bad advice of the week.

[00:52:51] BF: All yours.

[00:52:51] CP: I found a good zinger this week. I think a lot of the listeners may have seen the article floating around from Bank of America that declared the end of the 60-40 portfolio. Did you see that article?

[00:53:01] BF: I saw that you post it. I did not read the article.

[00:53:04] CP: Oh, it's pretty funny. Maybe [inaudible 00:53:06] Carlson and animal spirits did a funeral for the 60-40 portfolio. He was very sad. Basically, the premise of the article was there's now 1100 stocks with a yield that are greater than global bonds. Therefore, it's pretty much a no-brainer to increase your allocation to equities.

But, there's the big but, the 60-40 is causing a bubble and therefore you must plan for the end of the 60-40 portfolio. So there was an article showed up in Forbes this week from Rob isbitts bits was the contributor to Forbes, who is an investment strategist and portfolio manager for high net-worth families with over 30 years of investment experience. You'd be happy hear this. He offered us a solution to this end of the 60-40 portfolio.

So his point in the article was that the Bank of America piece should serve as to accelerate the parade of potential solutions by financial advice companies, but many will be inadequate. Yes, I know. It's very sad. But he has a solution that he is been running for over seven years.

[00:54:07] BF: Oh, seven! Well, okay.

[00:54:08] CP: You could not have a greater contrast between my experience in Charlotte and reading this article. But anyways, he says you need to think less about owning positions and more about renting positions, because it's going to be highly volatile environments. Therefore you want to be able to work both sides of the volatility. So shorter holding periods with a more tactical mindset.

[00:54:29] BF: The 60-40s dead because –

[00:54:31] CP: There's more volatility. Is creating a bubble, and therefore you need to have alternatives to make money, I guess, either way the market goes. So he says what you need to do is seek out single inverse ETF's.

[00:54:43] BF: Oh, okay. Inverse.

[00:54:44] CP: So this way, so the markets go down. You can benefit from going down by buying an inverse ETF. So I guess it's short in the market on the way down.

[00:54:51] BF: That sounds pretty good.

[00:54:51] CP: The only single inverse. Not double inverse. He says you want to do this because, and I quote, "They just might help you stay retired."

[00:54:59] BF: Oh, interesting.

[00:55:00] CP: Yeah. So the 60-40 portfolio is now going to meet hedged equity. He says stop thinking about your stock bond mix and think more about your net equity allocation. Bottom line is that bonds are a very limited use and stocks will be highly volatile. You shouldn't be afraid to hold cash.

[00:55:18] BF: Oh, cash.

[00:55:18] CP: Yeah, as well. So I don't know how you decide what your tactical allocation is going to be. I couldn't find it in the article. That's what you have to do to protect yourself against the death of the 60-40 portfolio.

[00:55:29] BF: So bonds are dead. The 60-40 portfolio is dead, and the answer is single inverse. Not double.

[00:55:36] CP: Not the double. No. It’s the single inverse.

Anyways, after having [inaudible 00:55:41] last week present that they couldn't time basically anything they proved mathematically that you can't reliably predict what’s going to happen. Apparently, he can. So maybe we should put him in touch with Prof. Novy-Marx.

[00:55:53] BF: Hey, I’d say that was pretty bad advice. Nice one.

[00:55:55] CP: Nice one. There we go. Thanks for listening and we’ll see everybody next week.

[END]