Focus Newsletter

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Rate increases: The benefits of sound portfolio management

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It's that time of the year when you've put away the holiday decorations and your visitors have all gone home. You made it through another hectic season, and life is starting to feel a little more normal again. What does the new year have in store, and what can we learn from the one that just ended?

First of all, I'd like to take this opportunity to wish you a happy 2024, on behalf of all my colleagues here at Desjardins Securities. May the new year bring you happiness, prosperity and, most of all, health.

What are our takeaways from 2023?

Now, what will we remember about 2023? Everywhere we turned—TV, radio, online—rising interest rates were a hot topic. What we thought, not so long ago, would be a temporary measure snowballed into no fewer than 10 key interest rate hikes by the Bank of Canada over 16 months.

While borrowers have been under ever-increasing pressure to make difficult choices, many investors are taking a completely different view of the situation. There can be a silver lining to these rate increases for investors when it comes to managing their portfolio—and, most of all, the risks incurred.

> "It can be beneficial to rebalance your portfolio."

Know when to seize an opportunity

When the key rate skyrockets like this, it can be beneficial to rebalance your portfolio, especially if you're looking to maintain your market exposure while increasing the secure portion of your investments. In recent years, investors have tended to shy away from "safe" investments because of their anemic rates. But now it's not uncommon to see rates of 4, 5, or even 6% for these options. Of course, there are different factors that come into play, but here's the takeaway: rising rates are a golden opportunity for investors to safeguard their investments and lock in a certain peace of mind.

Your wealth manager: Always a safe bet

So what's in store for 2024? A Bank of Canada survey of economists and other financial market experts has suggested that rates might begin to fall in March 2024. But with inflation stubbornly staying higher than expected and keeping the pressure on Canadian households, we can't predict the future.

Remember, the best person to advise you and keep you informed about the current economic climate is your wealth manager. Please feel free to reach out to them if you have any questions.

Why your business needs a shareholder agreement

ALAIN SAINT-JACQUES
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Have you ever wondered if your business needs a shareholder agreement? If there's more than one shareholder, the answer is yes.

The business world is a complex place. Interests and dynamics are always changing, so a shareholder agreement is a must when it comes to ensuring business continuity and keeping your company running smoothly and profitably. But many business owners underestimate its value.

I highly recommend drawing up a shareholder agreement during the start-up process or as soon as a second shareholder joins the company. It's always easier for people to agree on things when things are going well. If this wasn't at the top of your list of priorities when you started out and things are still going well with your business partners, it's not too late to draft one now.

Shape the decision-making process

You can use a shareholder agreement to make it clear what happens if a shareholder wants to leave the business or if there's a conflict or another unfortunate event. Have you ever stopped to think what would happen if a shareholder fails to keep their commitments to your business or if they're away for an extended period of time and fails to meet their responsibilities? If you take the time to set the right ground rules, you'll have a clear roadmap to keep your business running smoothly and avoid any ambiguities that might affect its stability.

Manage change more easily

A shareholder agreement can help you and your business navigate major transitions like the retirement, disability or death of a shareholder, bringing someone new on board, or bankruptcy.

Here's an example. Mark and Eve are business partners. Mark dies suddenly. His wife stands to inherit all his assets. But she has never been involved in running the business. Mark and Eve didn't take the time to draw up a shareholder agreement. Now Eve might be stuck with a new business partner—Mark's wife. As Mark's sole beneficiary and the executor of his estate, his wife can typically make business decisions like appointing directors and officers if there's no shareholder agreement to say otherwise.

> "It's always easier for people to agree on things when things are going well."

It can also be complex to assess the value of a deceased shareholder's shares and figure out what happens next. What if Mark's wife doesn't want to be a shareholder in the business? Does Eve have the means to buy her out? When a shareholder dies and no shareholder agreement is in place, this can put a lot of pressure on the surviving shareholders—and put the business at risk.

Simplify conflict resolution

No matter how big or small a business is, every shareholder contributes their own skills, investment and vision. Different points of view can emerge, and conflict may arise if not properly managed. But things can quickly turn sour if there's a disagreement. But if you plan ahead, you can figure out the mechanisms you want to use to resolve a conflict—before it happens.

It's important to go through a notary or business lawyer when you draft a shareholder agreement. A shareholder agreement is a contract that governs the various aspects of owning, managing and operating a business, so it's essential to make sure it checks all the right legal boxes and protects the interests of all the shareholders.

3 questions about interest rates

MICHEL DOUCET
Vice-President, Investment Strategist and Portfolio Manager

Interest rates shape the financial landscape for borrowers and investors in different ways.

1 What causes interest rates to fluctuate?

When the Bank of Canada sees signs of high inflation or overheating in the economy, it tends to raise its key interest rate. Why? To maintain price stability by keeping inflation between 1% and 3%. That's the Bank of Canada's sole mandate.

When the key interest rate goes up, it has a ripple effect on interest rates across the Canadian economy. That means it costs more for people and businesses to borrow money, which puts the brakes on spending and reduces demand for loans. It also means there's less money circulating in the economy—which helps to ease inflationary pressure.

In other words, interest rate fluctuations are intended to strike a balance between economic growth and price stability.

2 What are the benefits of rate hikes?

High interest rates can open the door to attractive investment opportunities for investors. These include recently issued bonds. Bonds are essentially loans you make to a company or a government. By keeping them until they mature, you can generally expect to recover the amount you invested, plus the agreed interest. Bonds are often influenced by rising interest rates.

For the first time since 2007, the bond market is an appealing option to invest in compared to stocks. The benefits include a strong potential return, as well as less exposure to risk. Unlike stocks, which represent an ownership interest in a company and are more subject to market fluctuations, bonds can offer investors stability in a constantly changing financial environment.

3 What's the best way to navigate the rough waters of changing interest rates?

It's best not to focus on forecasts or get too attached to specific opportunities. As Ray Dalio, founder of Bridgewater Associates, points out, "There's always a lot more you don't know than you do know." That's why diversification is crucial.

> "There's always a lot more you don't know than you do know."

By diversifying your investments, you're reducing the overall risk of your portfolio—and strengthening your ability to withstand market fluctuations.

Investment opportunities can be complex to navigate. That's why it's important to reach out to your wealth manager. They can help you find the right investments for your financial situation and your goals. Your wealth manager can also help you build a solid financial plan with the flexibility to adapt to changes in interest rates and the economy—so you can stay on the right track.

What to consider when dealing with debt and high interest rates

CÉDRIK CAPPELLI
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With today's high interest rates and stubborn inflation, many people are wondering what the best way is to manage their debt. Here are some things to consider.

Let's look at an example. John, a father of two, has $150,000 left on his mortgage at a 2.75% rate, due for renewal in April 2024. He also holds $100,000 in unregistered investments.

Assuming a current marginal tax rate of 40% and 27% at retirement, John could prioritize how he invests his disposable income as follows:

1. **RESP:** 30% basic grant (20% federal, 10% Quebec) + 5% return = 35% (withdrawals taxed as part of student's income)
2. **RRSP:** 40% tax savings - 27% tax on withdrawal = 13% + 3.65% (after-tax return when withdrawn) = 16.65%
3. **TFSA:** 5% tax-sheltered return
4. **Non-registered investments:** 5% return - 40% tax = 3.75%*
5. **Mortgage:** 5-year fixed rate renewable in April 2024 = annual cost of 6.25%

Does it make sense to make a partial mortgage prepayment?

After maxing out his RESP and RRSP contributions, John wonders if he should cash in his unregistered investments and use the money to prepay part of his mortgage. "Why pay 6.25% interest on my mortgage if my investments are only earning 3.75%?" he figures.

* Assumes a dynamic portfolio and a 5% taxable annual return after tax-deductible fees of 1%.

At first glance, this makes sense. But that's not the only thing to consider.

- Would cashing in the investments result in a capital gain that would bring tax implications of its own?
- How does John feel about cashing in the value of those investments? How would this change his game plan for retirement?
- Does the current market suggest that now is a good time to sell the investments?
- If John doesn't prepay this lump sum on his mortgage, will he still be able to pay off his mortgage before he retires?
- How likely is it that mortgage rates will stay high for longer than the next 24 to 36 months? Is it a good idea to choose a shorter mortgage term?

What if John reorganizes his debt?

If John makes a partial prepayment when he renews his mortgage, he can take advantage of the opportunity to add a low-rate line of credit, too. If market conditions and loan interest rates become more favourable in the future, he could borrow the money he took to pay down his mortgage and use it to build his investment portfolio back up again. And the interest he pays to borrow that money could be tax-deductible.

Give yourself some wiggle room

If you're close to retirement, it can work to your advantage to add the flexibility of a line of credit to your mortgage because it'll be harder for you to qualify for this type of financing when you stop receiving employment income. You can use it as a temporary safety net to cover your expenses in case the value of your investments dips anywhere from 10% to 20% in the short term.

Remember, what's right for John might not be your best option. Talk to your wealth manager to see what scenario is right for you.

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