GLOBE INVESTOR

Canadians still sitting on large cash balances

As inflation and interest rates rise, so does pressure to find use for stashes hoarded during the pandemic

TIM SHUFELT
INVESTMENT REPORTER

More than two years into the pandemic, Canadians' wallets are still stuffed with cash.

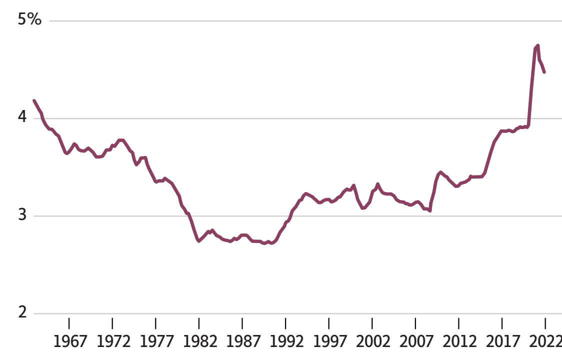
There is currently about $113-billion worth of physical money in circulation in Canada, up by nearly 25 per cent from prepandemic levels. As a share of the overall economy, that's more cash floating around than at any time since the early 1960s.

So much for the cashless society.

Most of the recent buildup of cash occurred in the early stages of the pandemic, when disastrous outcomes of all sorts suddenly seemed much more realistic than they previously had.

But cash holdings are still well above trend, even after being relatively stable for the quarter-century prior to the pandemic.

Cash in circulation in Canada as a share of nominal GDP



SOURCE: BMO CAPITAL MARKETS

Two years ago, there was little harm in stashing a bunch of cash for peace of mind. With interest rates near zero, it wasn't as though a person could earn anything respectable in a savings account or fixed income investment. And with inflation nearly non-existent, there wasn't much erosion to cash holdings from rising prices.

Big changes are afoot on both fronts. Inflation in Canada has averaged about 6 per cent in the first three months of 2022, while the yield on five-year Government of Canada bonds is higher than 2.8 per cent for the first time since 2011.

"People are now realizing they're making a negative-6-per-cent-return on their cash," said Kurt Rosentreter, a portfolio manager at Manulife Securities.

"Everyone's revisiting cash balances, but I'm not sure they know what to do with it yet." That will probably depend on why they held cash in the first place.

In the spring of 2020, with most of the country in lockdown and many grocery-store shelves stripped bare, many Canadians likely thought they needed to have some cash on hand just in case, said Doug Porter, chief economist at Bank of Montreal.

"I think a lot of people were thinking of worst-case scenarios and how they might protect themselves, which I don't think is irrational at all," Mr. Porter said.

As the pandemic dragged on, household finances at the national level actually improved, in part thanks to government income support. Consumers found themselves flush with cash, with nowhere to spend it.

Travel wasn't an option. And bars and restaurants were shut down on and off through subsequent waves of COVID-19 infections.

Many businesses stopped accepting cash altogether, with contactless payment seen as a safer option. Cash transactions in Canada fell by 16.5 per cent in 2020 from the previous year, according to Payments Canada.

Many found a use for their excess cash in home-improvement projects. "Let's be honest, that's certainly a sector that has long been associated with quite a bit of underground activity," Mr. Porter said.

With the renovation boom showing signs of slowing down, some Canadians are now looking at other ways to deploy their cash reserves.

Fast-rising interest rates have emphasized the risk of elevated household debt, leading many to turn to debt-reduction plans. "I'm seeing more doubling of payments and more lump-sum paydowns on mortgages," Mr. Rosentreter said.

The flip side of higher borrowing rates is better returns for savers. The going rate on five-year guaranteed investment certificates is approaching 4 per cent for the first time in more than a decade.

"It's about time," Mr. Rosentreter said. "I'm almost seeing the stress levels go down with my retirees."

The current trends provide powerful incentives for putting cash to use, and could bring an end to elevated growth rates of cash holdings, Mr. Porter said.

"I would not be surprised to see that number come down a lot in the next year, as presumably and hopefully we put the pandemic behind us," he said. "People will realize they don't really need to hold on to that much cash and there is an opportunity cost to holding that cash."

Netflix and Shopify are struggling. The way ahead is anything but clear

DAVID BERMAN

OPINION

DEEP DIVE

Netflix Inc., the U.S. movie-streaming pioneer, and **Shopify Inc.**, the Canadian e-commerce giant, might not appear to have a lot in common. But they are now locked in a similar battle: trying to convince investors that they can still expand at a brisk pace.

If this week is any indication, the two companies are in for a tough slog – and investors will still have lots to consider as they weigh falling share prices against an operating environment that no longer looks as enticing as it did during the depths of the pandemic.

Netflix lost 200,000 subscribers in the first quarter of 2022, dashing expectations for 2.5 million new subscribers. That sort of reversal hasn't been seen over the past decade and it marks a dramatic shift from intoxicating growth during the recent lockdowns.

In 2020, when movie theatres closed their doors, the company added 37 million paid memberships. The gains brought the total global subscriber base to 200 million, even as streaming competitors flocked to the streaming space.

Last year, as *Squid Game* grabbed viewers' attention, the impressive pace of growth continued: The total number of paid memberships rose to 222 million, including 8.3 million net new subscriptions in the fourth quarter – driving Netflix's share price to a record high of just over US$700 in mid-November.

And now? Netflix's share price has plummeted 70 per cent over the past five months, including a 35-per-cent free fall on Wednesday. The stock is now trading at its lowest level since December, 2017, or more than two years before the pandemic began.

Shopify has suffered a similar rise and fall.

Netflix lost 200,000 subscribers in the first quarter of 2022, dashing expectations for 2.5 million new subscribers. DADO RUVIC/REUTERS

The share price of the Ottawa-based company, which provides software for small and mid-sized businesses to sell their products or services online, rocketed during lockdowns when consumers were largely limited to making online purchases.

In 2021, online sales coursing through Shopify's platform – or gross merchandise volume – increased by 47 per cent from 2020, to US$175-billion.

As investors bet that the pandemic spurred a permanent shift toward online shopping, Shopify blossomed into Canada's most valuable company. From early 2020 to late 2021, market capitalization, or the value of the company's outstanding shares, increased by about $90-billion.

Over the past five months, though, these gains have disappeared. Shopify's share price has fallen 73 per cent from its record intraday high of $2,223 – also in mid-November – amid compelling evidence that consumers still like stores.

According to the U.S. Census Bureau, online sales fell to 12.9 per cent of total U.S. retail spending in the fourth quarter of 2021, down from a high of 15.7 per cent in mid-2020. Investors will get a look at the first-quarter figure for online sales when it is released on May 19.

Todd Coupland, an analyst at CIBC World Markets, said in a report this week that web traffic to Shopify e-commerce sites declined 6 per cent in the first quarter and 9 per cent so far in April.

To be fair, Shopify and Netflix are suffering from more than concerns about growth. Rising interest rates amid surging inflation have weighed on the valuations of many technology companies, pushing down the Nasdaq Composite Index since mid-November.

The big question now is whether the two struggling stocks can make a comeback.

Some valuation ratios suggest that the stocks are certainly cheaper today. Netflix shares traded at 9.6 times sales in 2021, according to Morningstar; the ratio is now just 3.3. Shopify's price-to-sales ratio has fallen from 41.4 in 2021 to 13.3.

Yet despite lower valuations, neither stock looks like a bargain on this measure, which adds to the dangers of buying into a severe sell-off – or holding on – amid uncertainty over growth.

Bill Ackman, the Pershing Square hedge fund manager, dumped his Netflix shares at an estimated loss of US$400-million this week.

There is a bullish case here, though: While both companies are suffering lockdown hangovers, they are leaders in areas that are enjoying enormous popularity.

Shopify is building an e-commerce ecosystem, including payments and warehousing, and it is expanding through acquisitions. Netflix is exploring an advertising-supported version of its streaming service and – note to my mother – may be able to extract more revenue from existing customers by cracking down on password sharing.

Is that enough to entice investors back to either stock?

Analysts at Credit Suisse argued this week that Netflix remains the clear leader in movie streaming and operates in a massive global market with untapped customers. But, the analysts added, "defining a 'safe' entry valuation is challenging until estimates have clearly bottomed."

Both Netflix and Shopify have suffered similar declines from their November peaks. They may remain joined at the hip for some time.

How parents can use the new Tax-Free First Home Savings Account to help their kids

ROB CARRICK

OPINION

PORTFOLIO STRATEGY

Parents who want to help their adult children get into the housing market should start getting to know the new Tax-Free First Home Savings Account.

The FHSA was promised by the federal Liberals in the last election campaign and a 2023 launch was confirmed in the federal budget earlier this month. We await draft legislation to find out exactly how the FHSA will work, but it already has potential to become a go-to savings tool for both home buyers and their parents as well.

"The FHSA is a great deal for people who can afford to do it," said Jamie Golombek, managing director of tax and estate planning at CIBC Private Wealth.

A few key points about the FHSA: Anyone 18 and older can open an account and contribute up to $8,000 a year to a maximum of $40,000. Contributions generate a tax deduction, like money added to a registered retirement savings plan. Withdrawals of contributions and investment gains are tax-free, just like tax-free savings accounts. FHSAs can remain open for 15 years and the money transferred on a tax-free rollover basis to an RRSP or registered retirement income fund if not used to buy a house.

A big question for parents is whether there will be zero tax consequences for a parent, grandparent or someone else who gives someone money for an FHSA contribution. This is already the case with TFSAs, so there's an encouraging precedent.

Let's assume parental gifts to be used for an FHSA contribution are treated similarly to TFSAs. In that case, some strategizing will need to be done about when to start gifting money for this account. The seemingly obvious answer is at age 18, so as to begin taxfree compounding as soon as possible.

But if you start an FHSA when a child is 18, you're basically saying they have to buy a house by the age of 33. Remember, FHSAs must be closed after 15 years if the money isn't used to buy a house.

> CIBC Economics issued a report last fall saying parents gave their kids just more than $10-billion in down-payment help during the previous year.

Another consideration in when to start an FHSA is whether an adult child has taxable income that can be used to exploit the tax deduction these accounts offer.

"If the child doesn't have a substantial income, or really any income, then the FHSA is not going to be helpful," Mr. Golombek said.

An income of at least $20,000 to $25,000 might be a good point to start in giving a young adult money for an FHSA, he said.

Parents may want to use FHSAs even if their adult kids are iffy on home ownership. The reason is that unused FHSA assets can be transferred into an RRSP, regardless of whether the RRSP holder has contribution room. Essentially, parents would be subsidizing an adult child's retirement, if not a house purchase.

During the last federal election campaign, the Liberals said the FHSA would be available to people under age 40. This limit wasn't mentioned in the budget, but it may yet resurface in the draft legislation to come.

The reason is that under current rules, FHSAs could be opened by a confirmed long-term renter, or anyone else, and then transferred tax-free to an RRSP after 15 years. In essence, the FHSA could be used for an end run around RRSP contribution limits.

For now, parents who want to help their adult kids buy a home can advise them not to use the federal Home Buyers' Plan, under which up to $35,000 can be withdrawn from an RRSP tax-free to buy a first home. First off, the HBP can't be used in conjunction with the FHSA. Second, the withdrawal must be repaid into the RRSP over 15 years. When the money is withdrawn in retirement, it's taxed as regular income.

"The Home Buyers' Plan is just an interest-free loan to yourself," Mr. Golombek said. "The FHSA is better by a million times."

CIBC Economics issued a report last fall saying parents gave their kids just more than $10-billion in down-payment help during the previous year, which was 10 per cent of total down payments in that period. Close to 30 per cent of first-time buyers got this help, which averaged $82,000.

Mr. Golombek's suggestion for parents who want to help their adult kids save for a home and have more than the maximum $40,000 that can go into an FHSA is to supplement with a TFSA. "We've been saying for years that gifting funds for a TFSA is a wonderful way to transfer wealth from one generation to the next."