GUARDIAN CAPITAL

Amplify

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IN THIS ISSUE

Creating Positive Change

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As vaccination efforts continue to progress, we are all looking forward to our communities opening back up and being able to spend time in person with our families, friends and colleagues.

This prolonged pause in our daily way of life has prompted many to re-examine what matters most to them, including the way they invest their money. We continue to see an increased focus on Responsible Investing (RI) as more clients look to align their financial assets with their personal values and beliefs.

While considerations of Environmental, Social and Governance (ESG) factors have been part of Guardian's investment process for many years, in 2019 we undertook our journey to formally integrate RI principles throughout all of our investment strategies.

We recognize the RI landscape is evolving rapidly and will endeavour to continuously improve our ESG practices in the years ahead. These efforts are being advanced by our Responsible Investing Oversight Committee and are led by Michele Robitaille, who assumed the role of Managing Director, Head of Responsible Investing in May.

More information on how we are engaging in the RI process can be found here:

Guardiancapital.com/responsible-investing
Creating Positive Change brochure

On a closing note, we'd like to acknowledge the incredible work being done by the many charities and non-profit organizations across Canada, at a time when the demand for their services has never been greater.

We hope you enjoy this issue of Amplify.

A Messina

Anthony J. Messina

BILL S-222

A Step Forward for the Charitable Sector

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Much has been written about the outdated charitable regime rules in Canada and the need for modernization and reform. This question is complex and often we find the analysis being done doesn't speak to what changes could really assist registered charities in the work they do. Too often, simplistic ideas are made which don't reflect the complexity of the work done, and support provided, by the charitable sector. These issues have been amplified during the COVID-19 pandemic because marginalized and smaller organizations have struggled to a greater extent. The existing rules arguably perpetuate a regulatory framework that promotes the divide between the haves and the have nots of the charitable sector, which is not a desirable result in current times.

That is but for one development. There have long been calls for changes to rules which govern how charities work with organizations that are doing good work but don't happen to be registered as charities in Canada. A bill to modernize that framework was introduced by Senator Ratna Omidvar earlier this year. The charitable sector in Canada has watched with interest as these proposed amendments to the Income Tax Act make their way through the Senate as the changes proposed have the potential to break down barriers for Canadian charities working with other organizations, both in Canada and abroad.

In February, Senator Ratna Omidvar tabled Bill S-222, The Effective and Accountable Charities Act (the "Bill"). The Bill, if enacted, will bring age-old law and policy into the 21st century at a time when charities, non-profits and grassroots organizations need support more than ever. The proposed reforms have been met with applause by sector organizations, their stakeholders and the communities they serve. The Bill has passed first and second reading and appears poised to pass in the Senate. From there, it remains to be seen whether the House will take up the

Bill, but there are advocates on standby to introduce it when the timing is right.

The Bill addresses a set of rules in the Income Tax Act ("ITA") that pose challenges for charities across the spectrum—both big and small, whether operating domestically or abroad. This is the "own activities" requirement imposed by the ITA and the "direction and control" rules required by Canada Revenue Agency ("CRA") policy.

The current law requires that Canadian charities spend their resources only on their own charitable activities and maintain "direction and control" over the non-charities they work with. Specifically, the law requires that a charity devote its resources to charitable activities "carried on by the organization itself." CRA interprets this section of the ITA as permitting a charity to operate in only two ways: (1) carry out its own charitable activities; and/or (2) make gifts to qualified donees (which are limited, for the most part, to other Canadian registered charities). Consequently, if a Canadian charity wishes to work with a charity abroad or a Canadian non-profit organization, neither of which are qualified donees, it must establish direction and control over the activities of the partner organization such that they are the charity's "own activities."

Why does this outcome present challenges for charities and the organizations with which they work? The charity transferring its funds to carry out charitable work must abide by a laundry list of ill-defined requirements that are inconsistent with the practical reality of how organizations work together. As a result, the onerous requirements imposed by these rules channel donor dollars away from charitable work, towards administrative fees spent on compliance.

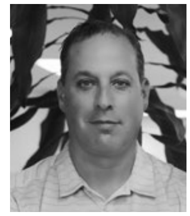
The Bill proposes to amend the ITA to remove the requirement that the activities be the charity's "own" and instead enables charities to make transfers to non-charities so long as the charity takes reasonable steps to ensure that the transferred resources are used exclusively for a charitable purpose. To ensure accountability, the proposed legislation requires a charity to conduct due diligence on the organizations it plans to collaborate with. The charity must collect the information "necessary to satisfy a reasonable person that the resources will be used for a charitable purpose," including information on the identity, experience and activities of the partner organization.

These amendments would allow charities to operate far more efficiently while holding them to an objective standard to ensure that collaboration with other organizations is done in furtherance of charitable purposes. Importantly, the Bill modernizes the current regime, bringing it in line with the laws of the United States, United Kingdom, Australia and New Zealand, all countries with comprehensive and robust charities regulation.

The Bill follows on and seeks to implement recommendations made in June 2019 by the Special Senate Committee on the Charitable Sector, led by Senator Omidvar and Senator Terry Mercer, which published a report following a study of the impacts of current federal and provincial legislation on charities and non-profit organizations. As noted, the reform proposals have received broad support from sector organizations and stakeholders. Shortly after the Bill was introduced, a group of 34 charity law experts wrote an open letter endorsing the principles in the Bill.

The COVID-19 pandemic has highlighted the need for organizations to join efforts to better serve their beneficiaries. It is time for reform to enable Canadian charities to more efficiently and effectively engage in charitable work, both in our own backyard and across the globe. We will continue to watch the progress of this Bill and hope for success at making these needed reforms a reality.

Endowments: A "How-To" Guide



Bradley Offman
Chief Executive Officer
Spire Philanthropy

Charitable endowments are still a hotly debated topic in Canada's charitable sector. In addition, the word "endowment" itself is a loosely defined term whose formal definition is often a fleeting one (and one I will not expand upon further). Generally, and simply, it is probably easiest to define an endowment as an organization's savings account – the funds that the organization will not require to fulfill its immediate needs.

There is also a wide spectrum of opinions on where endowments fit into an organization's fundraising strategy. At one end, some charities do not actively fundraise for an endowment. At the opposite end, you will find organizations that see endowment building as an important and integral part of their strategic development.

Between these two highly diverse opinions sit the vast majority of charities. Whether a charity should or should not build an endowment is not the focal point of this article. Instead, we will focus on the pragmatic aspects of endowment building – the "how-to" of getting started.

The vast majority of organizations with whom I have spoken share some common opinions on endowments:

- *They would like to have an endowment fund.*
- *If they have an endowment fund, they would like it to increase its capacity.*
- *They are unsure what steps – both strategic and pragmatic – they need to take to create or build an endowment.*

There are a number of fundamental steps that an organization must contemplate during the establishment and growth of its endowment.

1. **Strategic Focus:** The decision to move forward on endowment building
2. **Structure:** Building the organizational structure around endowment building
3. **Fundraising:** Bringing in the funds that will form part of the endowment
4. **Investing:** Investing and monitoring the endowment

Part 1 – Endowment as Strategy

Endowment building often stems from a strategic imperative to build long-term stability for the organization. It can also result from simply wanting to provide donors with a vehicle to leave a long-term legacy to the organization. Endowments do not build themselves nor, typically, do they build quickly. Patience and strategic nurturing lie at the core of any successful endowment program.

Part 2 – The Infrastructure of Endowment Building

While having the unmitigated support of an understanding board of directors (BOD) is critical to the endowment-building process, building a cohesive infrastructure is equally critical. Proper governance is an important aspect of endowments; proactively anticipating, rather than reacting precipitously, should be the governance mantra.

The organization must put in place an appropriate structure to receive and administer endowed gifts of cash and property. Again, since the concept of endowment is a broad-based and loose one, the approach must account for flexibility and donor preferences.

Part 3 - The Funding of Endowments

Like all fundraising initiatives, it is best to approach endowments with a sound business mindset. The organization should evaluate whether endowment building is the best use of organizational resources. While I would suggest that endowment building requires more of a fundamental cultural change in the organization's fundraising culture than a massive cost expenditure, it is undeniable that it will eat into the organization's human and financial resources.

Endowment fundraising is not easy. Many organizations have elected to fund their endowments through deferred gifts (e.g. bequests, insurance) of cash or property. In fact, this fundraising practice formed the foundation of many large Canadian endowments, most notably in the community foundation sector. Endowments, however, can be funded with more traditional and immediate gifts of cash, securities and other assets.

Part 4 - Investments

Congratulations! You have received your first endowed gift – or perhaps the first in a very long time. Now comes the task of figuring out what to do with the money. Do you buy something secure like a Treasury Bill or a cashable GIC, or do you buy securities? Neither, I would suggest, is an appropriate investment strategy for a charity.

There are many nuances when it comes to investment management and a "one-size-fits-all" strategy simply does not apply here. There are regulatory and fiduciary considerations when it comes to investment management and the organization's BOD should be aware of them. Generally speaking, much of the regulatory basis for charitable investing stems from the provincial Trustee Acts or the charity's constating documents.

So, who makes the investment decisions? Sometimes, organizations form a separate investment committee to report directly to the BOD. Alternatively, the BOD itself is directly involved in the process. Based on the investment experience of the organization's staff, there may or may not be input from them. Regardless of the constituents, once you establish your decision-making structure, the question then turns to the actual management of the money.

There are dozens of credible investment managers (IM) in Canada. So how do you choose one over the other?

Here are important questions to ask when evaluating potential managers:

- *Does the IM have experience working with charitable clients, including charities of a size and/or scope similar to yours?*
- *Does the IM understand the unique regulatory requirements of charities?*
- *What fees are payable to the IM?*
- *What are the past performance figures?*
- *Does the IM have a strong focus on managing charitable endowments?*
- *Does the IM have the capacity to offer a socially responsible or impact investment option?*

Considerable time and attention should be paid to the appointment of an investment manager and a charity may want to consider a more formal RFP (Request for Proposals) process.

Endowments, when appropriately managed and resourced, can provide a charity with a sustainable source of funds. While some charities will not embrace endowments, I would suggest that this distaste is often rooted in a fear of an endowment's potential complexity. However, when approached properly with thorough research, an endowment can bring stability, diversified funding and more options for donors.

Bonds! What are they good for?

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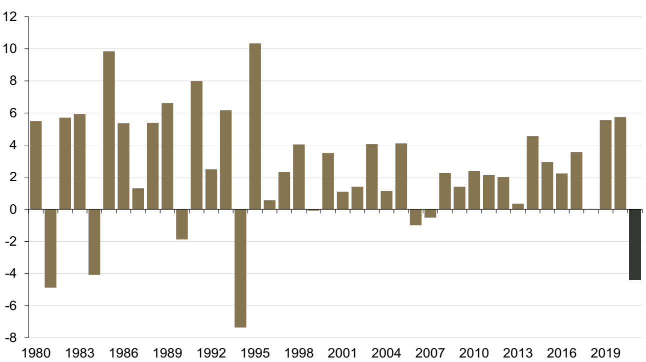
The year so far has been a challenging one for bond investors. Even though bond markets stabilized over the last two months, the weakness at the outset of the year (because of the sharp rise in market interest rates), resulted in the broad benchmark FTSE Canada Universe Bond Index (Index) turning in its worst year-to-May performance in 27 years and the third-worst first five months of a year for the Index over the last four decades.

Historic performance, just not in a good way

(FTSE Canada Universe Bond Index total return, year-to-May; percent)



Data to May 31, 2021; Source: Bloomberg, Guardian Capital

While persistent risks posed by the ongoing pandemic cloud the economic outlook, the broadly improving growth momentum and signs of firming inflationary pressures would seem to suggest that the path of least resistance for interest rates over the coming months is higher still.

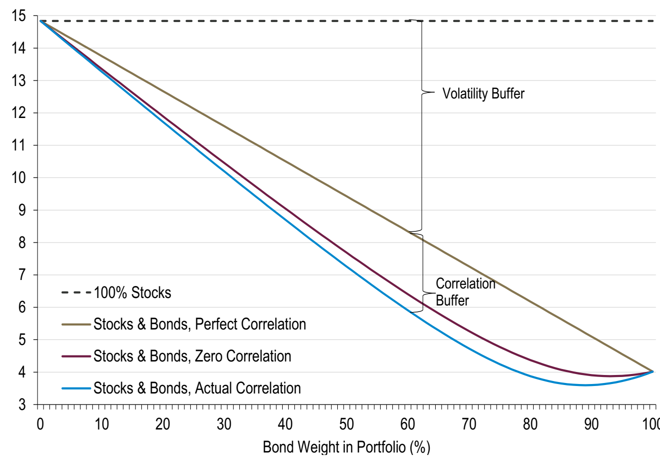
Given the inverse relationship between interest rates and bond prices, this backdrop may reasonably lead investment committees to question whether there is any benefit to holding bonds at all. To that end, it is important to note that asset mix decisions should be dependent on more than just return generation — and despite headwinds for the asset class, bonds remain an important part of a well-diversified balanced portfolio.

Hedging your risks

For one, bonds still offer tremendous diversification benefits for a stock portfolio by virtue of their comparatively lower degree of volatility—the presence of bonds, even if perfectly correlated with stocks, would still effectively halve portfolio volatility in a traditional 60/40 portfolio.

Relatively lower volatility of bonds matter most for overall portfolio

(expected standard deviation of portfolio returns, annualized rate)



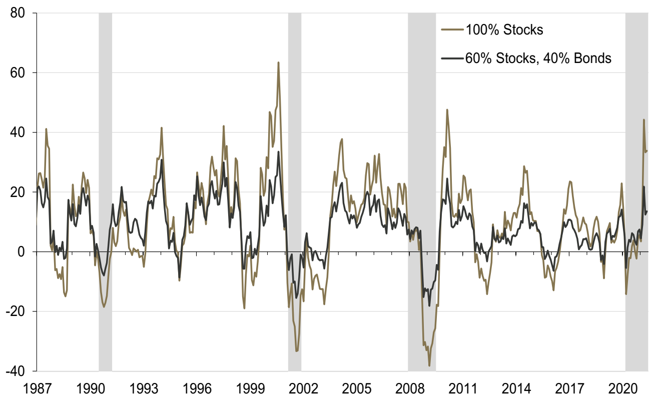
Stocks=S&P/TSX Total Return Index; Bonds=ICE BAML Canadian Government Bond Total Return Index; based on annualized performance over the 25 years ended May 31, 2021; Source: Bloomberg, Guardian Capital

Secondly, while it may be the case that correlations have increased of late (bond prices and equity prices moving together), the diversification benefits are most notable when things take a turn for the worse. For example, while the S&P/TSX Composite Price Index plunged almost 40% from February 19-March 23, 2020, the ICE Bank of America Merrill Lynch Canadian Government Bond Index was up 3% over that span (and the broad Index was down a marginal 1%).

The ability of bonds to offer this "disaster insurance" for portfolios helps to mitigate large and unexpected declines and provides investors with value — all while also receiving income.

Bond provide a buffer against stock declines

(portfolio total return; per cent, rolling 12-month basis)



Stocks=S&P/TSX Total Return Index; Bonds=ICE BAML Canadian Government Bond Total Return Index; shaded regions represent periods of US recession; data to May 31, 2021; Source: Bloomberg, Guardian Capital

Finally, rising interest rates only really impact those looking to trade their fixed income holdings. For investors intent on holding bonds until maturity, there is no real impact (a bond's par value and coupons are fixed).

Further, rising interest rates serve to benefit these investors, who hold until maturity, since they can reinvest the proceeds from maturing bonds at higher coupon rates, resulting in higher cash flows on future purchases.

In other words, while the performance of the fixed income portion of balanced portfolios may disappoint over the near term should the increasingly buoyant economic forecasts come to fruition, it is best for those with longer time horizons to think of bonds as an equivalent to the vaccines that appear ready to improve the quality of life drastically in the coming months. That is, they may provide a bit of short-term discomfort, and there is the temptation to forge ahead without them, but ultimately, it is in the best interests of investors' long-term well-being to hold bonds to keep portfolios healthy for years to come.

There will undoubtedly be an equity sell-off in the future, but investors rarely eschew stocks simply because their near-term prospects turn negative. The benefits of buying stocks at a discount are obvious — everyone loves to buy things on sale. While bonds are currently "on sale," none of the benefits of income, diversification and capital protection have disappeared. They remain, as ever, an important part of well-diversified, balanced portfolios.

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