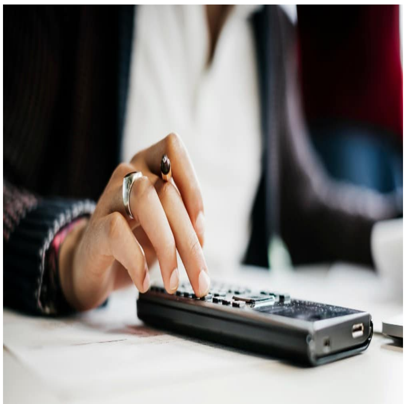

Don’t Count on CPP to Increase 7.7% in 2023

Description

Inflation is running hot this year. Canada’s most recent CPI reading showed a 7.7% increase in the price level — the highest in 39 years. The Canada Pension Plan (CPP) is supposed to be inflation-indexed, and benefits generally do rise a bit every year. However, it would be tough for the plan to increase benefits by an amount commensurate with the inflation rate next year.

In this article, I’ll explore why a 7.7% CPP benefit hike would be difficult to achieve in 2022 and what you can do if you’re worried about not getting enough benefits.

Why a 7.7% increase would be hard

It would be difficult for the CPP to increase benefits by 7.7% next year, because most asset prices are falling this year. The CPP invests in a number of different asset classes, including

- Stocks;
- Bonds; and
- Private equity.

Stocks are down this year. The TSX is down 10.5%, and the S&P 500 is down nearly twice as much. The tech-heavy NASDAQ is experiencing a truly historic bear market. Some individual sectors, like energy, are doing well. But the markets as a whole aren’t.

Next we have bonds. Central banks are raising interest rates this year, and that’s having the effect of pushing bond prices lower. True, the yields on newly purchased bonds are rising, but old bond investments are taking a hit.

Finally, we have private equity. It’s harder to gauge how this is doing, because there are no public quotes for P/E investments. But private equity is based on the same concept as stocks — partial ownership in businesses. So, it is likely suffering to some extent as well.

When we look at all the factors above, it appears unlikely that the CPP portfolio is sitting on positive returns this year. Two of the big three asset classes are confirmed to be down, the third is probably down too. One factor that could mitigate the losses is hedging. Funds that use hedging strategies are doing better than average — for example, Ray Dalio's biggest fund gained 32% in the first half. But it's not clear how much hedging the CPP is using, if any.

Should you invest to make up for it?

If you're concerned that your CPP benefits won't cover your expenses next year, you may consider investing your money to make up for the shortfall. By holding diversified index funds in tax-sheltered accounts, you can grow your savings and earn dividends that pay your expenses.

Take **iShares S&P/TSX 60 Index Fund** (TSX:XIU) for example. It's a diversified index fund that holds the 60 largest Canadian companies by market cap. That's more than enough diversification to significantly reduce the risk in your portfolio. The fund has a relatively low 0.16% fee, so you won't lose all your gains to the fund's managers. The fund has delivered positive if modest gains over the last 10 years. Finally, it has a 2.5% distribution yield, so you can get $2,500 in annual cash back on a $100,000 position. Overall, it's one fund among many that you can consider to grow your wealth and supplement your CPP benefits.

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Date
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