The Dream Achiever

DD HUMES

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"The true investor welcomes volatility"

~ Warren Buffett

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Federal Budget 2018

On February 27, 2018 the Liberal Government read their third federal budget. There were no significant changes to the average investor. The budget focused more on gender equality, fiscal responsibility, small business tax changes and EI parental benefits.

The big news in this budget was the release of the Canadian Controlled Private Corporation (CCPC) tax changes with regards to passive income. During the consultation period the government heard that its proposals from July 2017 would have taxed investment income at extreme tax rates and the complexity of tracking pre and post grandfathered assets would be too much of a burden. The government has decided to take an entirely different approach using two measures which would be more targeted and simpler.

The first is the restricting of the Small business deduction (SBD) rate for adjusted aggregate investment income over $50,000. The second is limiting access to refundable Taxes for larger CCPCs through the RDTOH system. Call us with any questions!

FundEX INVESTMENTS INC.

It's windy out there!

Spring is all about change. The winter that often never seems to end melts away and the muddy ground turns green with growth. In our December newsletter we said that we needed to be ready for a change in the abnormally low volatility we had been experiencing in 2017 and in the first quarter of 2018 that came our way like a big gust of wind.

Here is an example of this change in wind pattern: In calendar year 2017 there were only 8 days where the market moved more than 1% either up or down but in the first 3 months of 2018 we had 23 such days! In 2017 there were no days where the market moved over 2% whereas so far in the first 3 months of the year it has already happened 6 times!

In the first quarter of 2018 the Canadian TSX composite finished down 4.52%, the American S&P 500 was down 0.76%, MSCI World was down 1.15%, and Citi Canadian Government Bond Index was up 0.42%.* The CAD$ dropped 2.69% in the quarter versus the USD$ (rate on March 31st was $0.775 CAD/USD). The result of this move in currency is that your unhedged foreign holdings would have benefitted.

In summary, in Q1 global equity markets declined. The quarter started with most equity markets fast off the blocks in January with a continuation of the yearend U.S. momentum based on ongoing strength in economic data, robust earnings, and confirmation of the tax reform package. There was a stumble at the first hurdle in early February with a recovery at the end of the month. In March this recovery was interrupted by concerns over a potential trade war between the US and China with the implementation of tariffs. The US initially announced tariffs on steel and aluminum which has since escalated into both countries adding other import tariffs. The number of goods in question is currently small but tensions are rising.

The February selloff was not from weak economic data, but rather strong numbers from the U.S. wage growth which appeared to accelerate from 2.5% to 2.9% year over year, a significant jump over just one month. This had investors worried that US interest rates would have to rise faster than the economy could withstand and had some investors running to the exits and the S&P 500 dropped just over 10% in 10 trading days. However the next month's data showed wages were only growing at a more gradual 2.6% year-on year, making the February selloff seem unjustified. At the same time US companies were reporting strong earnings and analysts were revising their earnings estimates upwards for the year as companies started to communicate the effect of the tax cuts on their earnings.

With regards to interest rates, they continue to move upward at a controlled pace. In January the Bank of Canada raised rates 25 basis points to 1.25%. The Bank U.S. Federal Reserve under the new leadership of Jerome Powell again raised rates in March by 25 basis points to a range of 1.5 to 1.75%. It did not alter its overall rate projection of three hikes for 2018. The market is beginning to believe that rates will increase closer to the Fed outlook which explains the rise in US government bond yield this quarter. Should the market fully believe that the increases will go in lock step with the Fed expectations we could see rates move even higher.

On February 28 there was the release of the 2018 Federal Budget which we've outline in the left margin of this letter. Quebec delivered a third balanced budget on March 28 with no major changes to the average investor as spending went towards education, infrastructure, and the health and social services sectors.

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Market Overview Continued

In our last newsletter we talked about investors rushing to try and get into cannabis or cryptocurrencies as they were reaching all-time highs. Since that time you have one of the largest cryptocurrencies down about 65% and one of Canada's largest cannabis stocks has lost about a third of its value from those highs. As we mentioned, capital preservation on the downside is important to us so these are not the types of sectors we would have you exposed to.

The current bull-run (advance without a 20% decline) is now at 108 months making it the second longest run in history behind the 115 month run Oct 1990 – March 2000. A bull run will not die of old age, but some of the inflationary pressures might, so it's something we need to keep an eye on.

The volatility that we have been experiencing in the markets is likely to continue. NAFTA talks should continue to heat up. As many of you are aware we have been adding a bit more global exposure to the portfolios as we want them to continue to act as your windbreaker during these gusty days. As always, we are here to answer any questions or concerns that you may have with regards to your personal situation.

Planning items

- **Tax Return deadline:** April 30, 2018
- **RRSP Contribution Room for 2018:** Please provide us your room for the 2018 tax year when you receive your 2017 Federal Notice of Assessment. The maximum limit for 2018 is $26,230. You may need to adjust your automatic savings plans for the coming year accordingly.
- **Registered Education Savings plan (RESP) contributions:** Quebec beneficiaries get the added 10% QESI grant from the provincial government increasing the overall grant to 30%! 2018 room now available.
- **Tax Free Savings Account (TFSA):** A new $5500 of room available since January 1, 2018. Total room since 2009 is $57,500.
- **Conversion to RRIF account:** Those of you who turn 71 years of age in 2018 (born in 1947) will need to convert their RRSPs into RRIF accounts before the end of the year. We will be in contact to assist you on how to get that done if you haven't done so already.
- **Your Annual Review:** It is important to inform us of any changes taking place in to see the effects on your plan.
- **$2K pension deduction:** Those who turn age 65 in 2018 or older and not already receiving recognized pension income.

The Planning Corner – What is an ETF?

An exchange-traded fund (EFT), is a marketable security that tracks an index, a commodity, bonds, or a basket of assets such as an index fund. Similar to a mutual fund an ETF gets you diversification with one purchase, however they differ in that they trade like a common stock on a stock exchange along with the costs of purchases and sales via the exchange. ETFs experience price changes throughout the day as they are bought and sold. ETFs typically have daily liquidity and lower fees than mutual fund shares. Because it trades like a stock, an ETF does not have its net asset value (NAV) calculated once at the end of every day like a mutual fund does.

ETFs have been around since 1993 but only started getting used significantly about a decade later. Traditionally ETFs have been index funds, but in 2008 the US Securities and Exchange commission began to authorize the creation of actively managed ETFs.

Like all index investing, you need to monitor any overweights that may occur within an index. For example the TSX is very concentrated in just a few sectors so a passive TSX ETF will be as well. At one point in time the single stock of Nortel made up one third of the TSX benchmark!

Many of the fund companies we work with (eg. BMO, National Bank, Mackenzie, Dynamic) now offer mutual funds using ETFs as underlying assets which would also include actively traded baskets of ETFs, active ETFs, or some hedged ETF index solutions. Many of these are slightly cheaper than some of the non-ETF fund equivalents but do not guarantee outperformance. Let us know if you have any questions about ETFs and if adding exposure to ETFs in your portfolio is something you personally wanted to explore.

*Source: Morningstar Canada