The Place to Achieve Wealth & Security for Your Family

Dear Client,

You can't judge a book by its cover. It's an adage that suits a number of situations, even investing. If we were to view the last quarter using just the three-month performance ending March 31, it would seem better than it actually was. Reading deeper into the novel that plotted equity, fixed income, commodity and currency markets, we see investors faced twists, turns, highs and lows, ending with a somewhat satisfying conclusion.

Challenges in the quarter

The Canadian economy faced ongoing challenges in the quarter in addition to job losses in the energy patch. While commodity prices firmed and our manufacturing economy improved, courtesy of a weaker Canadian dollar, this was offset by rising food prices – especially imported fresh vegetable costs, which are up 20% year-over-year! The S&P/TSX Composite Index performed well relative to its global peers, gaining 4.5% on the quarter including dividends, despite the impact of weaker commodity prices – specifically oil.

The Federal budget

As expected, the Bank of Canada kept its key overnight rate at 0.50% choosing to hand the baton to the new Liberal government in terms of providing economic stimulus. And based on the recently-announced federal budget, the new government is running with it. The Feds project to run deficits totaling almost C$120 billion over six years. Prime Minister Trudeau's government will add C$11 billion in annual spending for the fiscal year that begins April 1, which will result in a projected deficit of C$29.4 billion for the coming year. It marks a shift for Canada, which was home to an anti-deficit orthodoxy for three decades. Most economists would agree the timing is right to do this in support of a shifting economic base that needs to become less dependent on oil for revenues and investment.

Part of that spending may benefit you:

- OAS eligibility returns to age 65 – great news for folks born April 1, 1958 or later.
- The Canada Child Benefit replaces the Canada Child Tax Benefit and the Universal Child Care Benefit. The CCB is tax-free, unlike before, and the government says nine out of 10 families will receive more in child benefits than under the current system.

The bad news is, the government also took things away:

- Switches between corporate-class funds will no longer be tax-free after September 2016. If you are planning to change funds, let's talk about rebalancing prior to then.
- The promised small business tax cut has been frozen at 10.5%. If you're a business owner, let's talk about other ways to save tax.
- After September 2016, any gain on linked notes (which include principal-protected and principal-at-risk notes) sold before maturity may no longer be treated as a capital gain and instead will be treated as interest income.
- Starting in 2016, the income splitting tax credit (Family Tax Cut) that allowed couples with at least one child under 18 to notionally split income and reduce their total income tax liability by up to $2,000. Pension income splitting is not affected by this change.
- The Children's Fitness and Arts Tax Credits will be phased out by 2017.

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- There will no longer be education and textbook tax credits as of January 1, 2017, but the impact should be relatively minor.

Oil prices
We saw the price for "Texas tea" fall to a low of U.S.$26 per barrel during the quarter, as measured by the benchmark West Texas Intermediate price. The global supply issues have yet to abate in any meaningful way, though the price of oil did recover to U.S.$38 ending the quarter near where it started. The loonie, which is highly tied to the price of oil, gained 6.7% during the quarter to end at U.S.$0.769.

The U.S.
Stock markets performed less well in local and Canadian dollar terms. In the United States, the S&P 500 Index gained 1.4% when factoring in dividends in U.S. dollars. Adjusting for the Canadian dollar, U.S. equities were down -5.0%. The U.S. market continues to be volatile as companies struggle to grow profits. The remainder of 2016 will be very interesting if only from a political standpoint.

Overseas
Europe and Japan continue to struggle with weak to non-existent economic growth with their central bankers introducing the paradigm of negative interest rates. Imagine that, lending governments your money knowing you're not just forgoing interest payments but paying them for holding your money too! It remains to be seen if a negative interest rate policy will prove effective for an anemic economy. In the meantime, equity investors have voted with their cash. As measured by the MSCI Indices, European stocks fell -2.4% and Japanese stocks fell -6.4% in U.S. dollar terms. In Canadian dollar terms, the declines magnified to -8.5% and -12.3% respectively. The broader MSCI EAFE Index, a gage of collective international stock markets, fell -2.9% or -9.0% in Canadian dollar terms.

Bonds
Bonds continue to be a steady if not unspectacular performer in client portfolios. Canadian bonds gained 1.4% in the quarter as measured by the FTSE/TSX Universe Bond Index. With the Bank of Canada holding its key rate firm at 0.50% for now, an attractive interest rate continues to be an endangered species.

Looking forward
Market volatility may remain through 2016 if the start of the year is any indication. Yet, despite the current malaise, the investment environment is looking up. Misplaced fears of a U.S. recession are subsiding and U.S. business is improving. Oil may have bottomed alongside the TSX. If anything, volatility enables us to take advantage of market lows; adding to our positions on the dips through a regular investment plan. We continue to encourage balance between many asset classes – Canadian equities, U.S. and foreign equities, bonds and cash – as a diversified approach will help mitigate volatility while working toward our objectives.

As always, if you have any questions about the markets or your investments, I'm here to talk.

Regards,

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