ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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In Loving Memory of J. Anthony (Tony) Hepburn

It is with great sadness that we announce the passing of our dear colleague and friend, Tony Hepburn. Many of you will know Tony or recognize his name as a former President and CEO and Chairman of our firm, or even as your Portfolio Manager. To us, he has been the unwavering face of Odlum Brown for over 50 years, guiding us through the rough spots, celebrating with us the successes and consistently leading by example with his fair and gentle manner.

Tony immigrated to Canada from Scotland in 1960 to join Price Waterhouse Company in Montreal, and transferred to Vancouver two years later. In 1969, Tony joined Odlum Brown as Manager of Investment Research, and the firm gained a steward for life.

Tony was appointed President and CEO in 1978, and for 23 years oversaw Odlum Brown's evolution into the firm we are today. As current Chair Andy Eisenbock said at this year's Annual General Meeting, "I would argue that no one was more influential in the growth and success of Odlum Brown than Tony."

A staunch defender of the firm's independence, Tony expertly preserved our longstanding values while simultaneously adapting to a changing industry and evolving client needs. He may have made this look easy at the time, but I am certain looking back that it was anything but. Tony's vision and commitment played an integral role in the growth of Odlum Brown, and to this day is foundational to our continued success. During his tenure as President and CEO, the firm grew from 65 team members and four branches to 200 team members and six branches. Also during that time, Odlum Brown was first recognized as one of Canada's Best Managed Companies, a distinction we hold proudly to this day.

In 2001, Tony transitioned to the role of Chairman, a position he held for 17 years. In this role, Tony was a constant source of support, guidance and mentorship to me personally, and to many others. He was also instrumental in designing a robust and thoughtful succession plan to ensure Odlum Brown would be well positioned many years into the future.

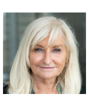
In 2018, Tony was appointed Odlum Brown's first Chair Emeritus in recognition of his long and distinguished service and continuing contributions to the firm. Indeed, Tony did not retire when he stepped away from the Chairman role. His passion for this firm, its people and, above all, his clients motivated him to continue managing a substantial asset base as a Portfolio Manager, serving clients with the utmost care until his passing.

I cannot overstate what Tony's support and guidance over all this time meant to me, to his clients, and to so many of us at Odlum Brown.

Tony was also highly influential within the Canadian investment community, embodying Odlum Brown's deeply held value of supporting the communities where we live and work. Through extensive volunteerism on numerous boards and advisory committees, both industry-related and philanthropic, Tony made a difference. Among other roles, he served as the Chairman and Governor of the Vancouver Stock Exchange, was a recipient of the Chancellor's Distinguished Service Award from Simon Fraser University and was elected a Fellow (FPCA, FCA) of the Institute of Chartered Accountants of BC (now the Chartered Professional Accountants of British Columbia).

Tony Hepburn determined long ago that Odlum Brown's path forward was to maintain both our independence and the level of service we provide – and he was absolutely right. For over 53 years, Odlum Brown benefited from Tony's leadership, wisdom and kindness. And although he is no longer here in person, that impact will be felt for years, for decades – for generations.

To the Hepburn family, and to all who knew and loved Tony, all of us at Odlum Brown offer our deepest condolences.



DEBRA DOUCETTE
President and Chief Executive Officer

Goldilocks and a Bear Market

At Odlum Brown's Annual Address in early March, we observed that the bond market was pricing in a "Goldilocks" economic scenario whereby modest increases in interest rates would temper economic growth enough to settle inflation, but not so much that there would be a recession. We had doubts about this "just right" fairy-tale ending, and hedged portfolios for either the possibility that economic growth and inflation would be hotter or colder than anticipated.

At the time, the annual U.S. inflation rate was almost 8%, up from less than 2% a year earlier, and the U.S. Federal Reserve had yet to raise interest rates. The federal funds rate was an ultra-low 0.25%, where it had been anchored since the beginning of the pandemic. The first 25-basis-point[1] increase in this administered short-term rate, which influences all other interest rates, would not happen until late March 2022. Moreover, investors expected this important interest rate would only need to be gradually increased by 25-basis-point increments, to a peak of around 2%, in order to precipitate a modest economic slowdown and bring inflation back to a 2% target.

As we feared, the Goldilocks scenario didn't pan out. The economy ran hotter than hoped, and inflation accelerated. The Federal Reserve had to get much more aggressive, and hiked its rate by 50 basis points in May, and an unusually large 75 basis points at each of its June and July meetings, bringing it to a range of 2.25-2.50%. The Bank of Canada raised its key interest rate in similar fashion.

As the pace of rate increases accelerated, stocks headed south. In fact, in June, the widely followed S&P 500 Index entered an official bear market, defined as a decline of more than 20%. Canada's main equity benchmark, the S&P/TSX Composite Index, held up better, falling roughly half as much, as strength in commodity prices buoyed resource stocks.

What is interesting and noteworthy is that longer-term interest rates peaked and stocks bottomed within a day of the Fed's supersized rate hike on June 15. The day before, U.S. and Canadian 10-year government bond yields peaked around 3.5% and 3.6%, respectively, and have since trended down to 2.7% and 2.8%. Those are big declines!

Since North American 10-year bond yields peaked, and through to mid-August, the S&P 500 Index produced an impressive total return of almost 15%,[2] reducing its year-to-date (YTD) loss to 7.2%. Over the same period, the Canadian equity benchmark rallied less than 4%, leaving its YTD decline at 3.2%.

The wide differential in the performance of these two stock markets can be explained by the differences in their composition. The American market has a much higher concentration of growth-type stocks, in sectors like Information Technology and Consumer Discretionary, which are more sensitive to changes in interest rates. The Canadian market is more geared toward value-type businesses, like those operating in Energy and Financial Services, which are more sensitive to changes in the economic outlook.

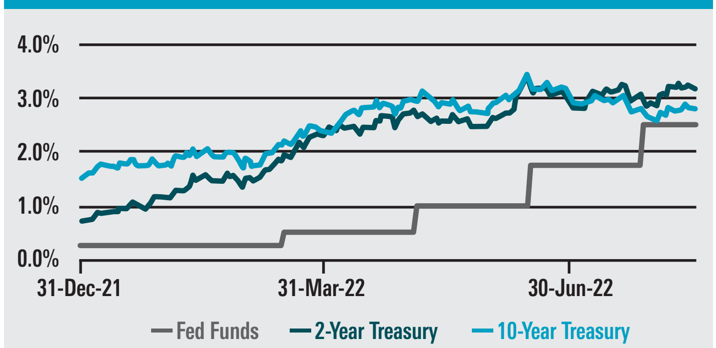
With long-term bond rates falling over the last two months due to increasing fears of recession, growth stocks have performed much better than value stocks, which explains why the S&P 500 Index rose much faster than the S&P/TSX Composite Index.

The hypothetical, all-equity Odlum Brown Model Portfolio[3] is balanced roughly 60/40 between Canadian and American-listed stocks, and has been less volatile than the benchmarks. Moreover, our security and sector selections have added value, such that the Model is back to even since the beginning of the year.

While the odds of a recession have increased, investors are once again discounting a Goldilocks scenario, believing that central banks can tame inflation with only another 125 basis points of rate increases and not much economic damage. In fact, the federal fund futures market is pointing to a peak in the U.S. federal funds rate of 3.6% in March 2023, and lower administered interest rates thereafter.

Normally, the interest rate on long-term bonds is higher than short-term bonds, but that relationship has reversed recently. The two-year U.S. Treasury yield (3.3%) is currently higher than the yield on the 10-year Treasury (2.8%). Such an inversion almost always foreshadows an economic recession.

U.S. INTEREST RATES



Source: Odlum Brown, Bloomberg

The recent performance of corporate bonds suggests that a recession, if it occurs, will be very mild. Not only have the yields on investment-grade and riskier high-yield corporate bonds fallen in sync with the drop in long-term government bond yields, but yield spreads have narrowed considerably as well. Expectations for corporate profits have also been fairly resilient.

Both Canadian and U.S. consumer price inflation moderated slightly from very high levels in July, which is an encouraging development. Nonetheless, we worry that inflation may be stubborn, and that central banks will have to tighten monetary policy by raising rates for longer, and more aggressively, than investors currently expect.

Because labour markets remain robust, some are optimistic that inflation can be tempered without much damage to employment levels and the overall economy. Sadly, we fear that is unrealistic. In the short run, it's unlikely that there will be a fairy-tale trade-off between economic growth and inflation. Either the economy remains buoyant and inflation persists, necessitating tighter-than-expected monetary policy, or economic growth, employment and corporate profits weaken and inflation abates.

Regardless of the near-term path for inflation, monetary policy and the economy, we are optimistic about the longer-term prospects for stocks. That is because we believe the inflation challenges of late will end a long period of monetary mismanagement.

In our view, central banks have been short-sighted, ignoring the negative and unintended consequences of overly accommodative monetary policies in the pursuit of maximizing short-term economic growth. For the better part of the last 30 years, cheap and easy money policies have encouraged excessive risk-taking and the buildup of debt, kept marginal businesses afloat and fueled income inequality through asset inflation. While asset inflation has been of great benefit to client portfolios, the accumulation of all these negative consequences over so many years has undermined the productivity, financial stability and social fabric of our society. These policies were never sustainable in the long run.

Consumers, businesses and politicians all understand and appreciate the destabilizing consequences of inflation fueled by overly accommodative monetary policies. As such, odds are good that monetary management will be more sensible and balanced in the future. That should create a stronger economic foundation and brighten the prospects for the businesses we own.

MURRAY LEITH, CFA
Executive Vice President and Director, Investment Research
@murrayleith

[1] A basis point is 1/100th of a percent.
[2] Measured in Canadian dollars and including reinvested dividends.
[3] The Odlum Brown Model Portfolio was established on December 15, 1994 with a hypothetical investment of $250,000. The Model provides a basis with which to measure the quality of our advice. It also facilitates an understanding of how we believe individual security recommendations could be used within the context of a client portfolio. Trades are made using the closing price on the day a change is announced. Performance figures do not include any allowance for fees. Past performance is not indicative of future performance.

Back to School – Spending RESPs

Families with children or grandchildren attending post-secondary education often have questions about how and when to access Registered Education Savings Plan (RESP) funds. In this month's report, we provide some tips and considerations on RESP withdrawals.

RESP withdrawal tips:

- Before requesting an RESP withdrawal, subscribers should have proof of the student's enrollment in a qualifying education program.[1]
- With the above-mentioned proof, RESP withdrawals will typically be approved as an Education Assistance Payment (EAP) or as a Post-Secondary Education Payment (PSE). If not approved (i.e., withdrawn for a purpose other than to pay for post-secondary education) an RESP withdrawal may trigger repayment of grants or bonds to the government.
- In most cases, clients with Odlum Brown RESPs can request whether they prefer to receive an EAP, PSE or a blended payment from both portions of a child's RESP when making RESP withdrawals.

Choosing Between an EAP or PSE

When eligible, withdrawals can consist of either EAPs from the income, growth and government assistance portions of an RESP; PSE payments from RESP contributions; or a blend of both EAPs and PSEs. The above-right table compares EAPs and PSEs.

What costs are eligible for EAPs?

Education Assistance Payments can be used for "reasonable costs" while enrolled in a qualifying education program, which may include:

- tuition;
- books;
- accommodation; and
- some transportation and general living expenses

EDUCATION ASSISTANCE PAYMENT (EAP)	POST-SECONDARY EDUCATION PAYMENT (PSE)
Must be enrolled in a qualifying education program at an EAP-recognized post-secondary institution.	
Paid from government grants, bonds, accumulated capital gains and income in the RESP.	Paid from the subscriber(s)' contributions.
Taxable (to the student).	Non-taxable.
Limited to $5,000 in first 13 consecutive weeks of enrollment (full-time) or $2,500 per 13 weeks of enrollment (part-time), unless a special request is approved.[2]	Unlimited, while eligible for EAPs.
Receipts may be required if EAPs exceed $25,268 per beneficiary, per year (2022 limit adjusted to the Consumer Price Index (CPI) thereafter).	

Tax and budgeting tips for students and their families

EAPs are taxable as part of the student's income. A student may pay little to no tax on an EAP, depending on their other taxable income, tax credits and deductions. PSEs are withdrawals of contributions made by the subscriber(s) and so can be withdrawn tax-free.

Some families may prefer to withdraw taxable EAPs early on to reduce the risk of repaying grants and bonds to the government if any unused funds remain in the RESP at the conclusion of the beneficiary(ies)' post-secondary education. As always, personalized advice is necessary in regards to your individual situation. For example, families with children who receive generous scholarships or who might not finish their studies may find this sequence of withdrawals attractive. A subscriber's contributions to an RESP can still be withdrawn, tax-free, after all EAPs are withdrawn, even if no beneficiary is enrolled in an eligible program.

Continued on next page

For additional student tax tips, visit getsmarteraboutmoney.ca.[3]

There are several budgeting tools available from the Government of Canada to help students plan responsibly, including “Budgeting for Student Life”[4] and the “Student Budget Worksheet.”[5]

Opportunities for student health care coverage

BC residents who are 19-24 years old and meet eligibility criteria can be covered by their parents’ Medical Services Plan (MSP) while in full-time post-secondary studies within or outside BC.[6] Health and dental benefits are often automatically included in a post-secondary school’s tuition. However, families who provide proof of external coverage (for example, through a parent’s group benefits plan at work) might be able to opt out of the school’s standard coverage. Do your homework to make sure that you understand each plan before opting out.

For more information about RESPs and planning for post-secondary education, please contact your Odlum Brown Investment Advisor or Portfolio Manager.

HEATHER RIVERS, BA, CFP®, FMA
Communications and Education Specialist
Odlum Brown Financial Services Limited

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[1] A qualifying education program can be at a designated institution in Canada or outside of Canada at a university, college or other educational institution providing courses at a post-secondary level. For Canadian programs, a minimum of 10 hours per week of instruction or work per week is required for full-time programs, or at least 12 hours per month if part-time.
[2] This limit reapplies if the student does not re-enroll for 12 months.
[3] getsmarteraboutmoney.ca/plan-manage/planning-basics/understanding-tax/students-and-tax/
[4] canada.ca/en/financial-consumer-agency/services/budget-student-life.html
[5] canada.ca/en/financial-consumer-agency/services/budget-student-life/student-budget-worksheet.html
[6] https://www.health.gov.bc.ca/msp/forms/mpmb09/intro.health

Odlum Brown in the Community

We are committed to supporting the communities where we live and work, and are proud to sponsor the following upcoming event:

Light Up Chinatown!
September 10-11, 2022
Vancouver, BC

Odlum Brown is proud to be a Platinum Sponsor of this free community event, celebrating the return of friends and visitors to Chinatown. The two-day festival will feature live entertainment, food trucks, lights, decorations and more! The lights and lanterns will act as beacons by creating vibrancy in the neighbourhood and a picturesque reminder of the unique and cultural history Chinatown holds.

For more information, visit chinatownfoundation.org/light-up-chinatown.

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