

# ODLUM BROWN REPORT

## 04 2021



## Human Nature 101

**When it comes to investing, we can be our own worst enemy. We are emotionally wired with instincts and biases that naturally cause us to make mistakes.**

Learning about our human shortcomings in my university psychology and sociology courses was enlightening, yet losing my own hard-earned cash yielded more impactful, lasting lessons.

In my final year of university, I had the opportunity to make a quick buck – to turn \$500 into \$4,000 almost overnight – by participating in a pyramid scheme. Despite a gut instinct that it was too good to be true, and a sound understanding of why such money-making systems collapse faster than most expect, I let envy, greed and the fear of missing out (FOMO) get the best of me – and my wallet.

The get-rich-quick scheme was called the airplane game. For \$500, you joined an “airplane” as a “passenger” at the bottom rung. Already on the airplane were four “flight attendants,” two “co-pilots” and a “pilot.” Once the pilot collected \$4,000 from all eight passengers, they would retire, and the group would split equally into two airplanes, with each co-pilot becoming the pilot of the new airplane and promoting everyone up a level – thus looking

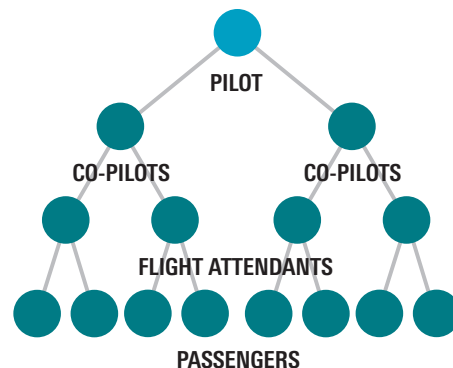
for eight new passengers to join for \$500 each. The goal was to become a pilot oneself, collecting the \$4,000, an eight-fold return on investment.

Pyramid schemes ultimately fail because they require an ever-increasing number of participants to keep going. And unlike interest or dividends on an investment, the numbers compound against the odds of success in an exponential manner. In the airplane game, the first iteration requires one airplane and eight passengers, then two airplanes and 16 new passengers, then four airplanes and 64 new passengers, and so on such that 33 million new passengers are needed by the 23<sup>rd</sup> iteration of the game. That was more than the entire population of Canada back when I played, and thus the reason for my doubt and hesitancy to do so.

Nonetheless, watching so many others make easy money made me envious. I didn’t want to miss out. So, I parted with my \$500 just as the game lost momentum. It was a hard lesson, as \$500 was a significant amount of money for me to lose at the time.

This lesson about human nature has been top of mind lately, as uber-accommodative government and central bank policies have fuelled a highly speculative market environment. Everyone seems to have a neighbour, relative or friend with a “hot” investment idea that has the prospect for supersized gains.

While we don’t think there is a general stock market bubble waiting to burst, we do think there is a bubble in speculation. What worries us most are the expensive and popular stocks, sectors and themes: Tesla, clean energy, Bitcoin, funds with returns of more than 100% in 2020, IPOs that double in price on their first day of trading, and so on.



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Odlum Brown is pleased to be the Presenting Sponsor of the BC Hospitality Foundation's (BCHF) #HospitalityHustle, a free, province-wide initiative to set healthy goals and connect with our community.

This virtual event encourages individuals to set a fitness or wellness goal, and train toward it. From March 15 to May 30, participants in the #HospitalityHustle can share training milestones on social media and create a supportive network focused on healthy goals that help keep them physically and mentally strong. On May 30, the event concludes with a virtual dance party, and all participants are invited to celebrate their success.

Individuals or teams can further challenge themselves to raise funds for the BCHF, a registered charity that supports those in the hospitality industry facing financial crisis due to a health issue. Prizes will be awarded to the top fundraising team and overall fundraisers.

Through this sponsorship, Odlum Brown Limited is proud to support owners and workers in the hospitality and tourism industry who have been adversely affected by the pandemic. For more information, visit [bchospitalityfoundation.com](http://bchospitalityfoundation.com).

I can't help but wonder what will happen to the speculative activity if, and more likely when, governments and central banks throttle back their extraordinary support for the economy. Will there be enough money and investors to support lofty valuations?

Much like the technology mania in the late 1990s, many of today's best-performing stocks have a lot of future potential but little or no current earnings. We are not saying that there aren't exciting businesses and powerful new secular trends. There absolutely are. But the level of speculation in the market is getting a little extreme. Perhaps a lot extreme.

If history is a guide, the hot and popular stocks and themes will remain so for some time, maybe much longer than we think. But in the fullness of time, the odds are not good that this pricey bunch will provide decent returns.

Don't let envy, greed and FOMO override sound judgement and an appreciation that investments have risks.



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## OB Model Portfolio – Good News and Bad News

COMPOUND ANNUAL RETURNS* (Including reinvested dividends, as of March 15, 2021)							
	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	20 YEAR	INCEPTION**
<b>Odlum Brown Model Portfolio</b>	<b>4.7%</b>	<b>26.5%</b>	<b>8.5%</b>	<b>10.5%</b>	<b>12.6%</b>	<b>11.3%</b>	<b>14.3%</b>
<b>S&amp;P/TSX Total Return Index</b>	<b>9.3%</b>	<b>42.7%</b>	<b>10.0%</b>	<b>10.5%</b>	<b>6.6%</b>	<b>7.3%</b>	<b>8.6%</b>
<b>S&amp;P 500 Total Return Index (\$CDN)</b>	<b>3.6%</b>	<b>33.7%</b>	<b>13.5%</b>	<b>15.2%</b>	<b>17.1%</b>	<b>7.2%</b>	<b>10.2%</b>

\* Except for YTD period. \*\* December 15, 1994.

**The good news is the economy and stocks are in better shape than we anticipated. Compared to their respective pre-pandemic peaks on February 20, 2020, the Canadian and U.S. equity benchmarks yielded total returns of 9.4% and 12.8% through to mid-March 2021, measured in Canadian dollar terms. The bad news is we haven't kept pace with the benchmarks; our Model is up 5.7% over the same period.**

Historically, our long-term, benchmark-beating record has been achieved by losing less during market setbacks and underperforming in fast-rising markets. While that general pattern held true around the pandemic crash and subsequent recovery, the cumulative outcome has been less favourable than past market cycles.

We were more cautious than usual during the pandemic-induced crisis this past year. We raised cash prior to the market crash, and we were slow to deploy it as economies and markets recovered. Moreover, we sold a few higher-risk stocks at depressed prices in and around the height of the storm. Those actions cost us, as we locked in some losses and missed out on some opportunities by holding cash that didn't generate much return. Like an insurance policy that wasn't needed, playing it safe didn't pay off.

While we can't get our insurance premiums back, we will adhere to the approach and discipline that have delivered market-beating performance in the past. Our approach is not flashy, but it works.

One of the keys to accumulating wealth is not permanently destroying capital by chasing and overpaying for speculative stocks. As described in the previous article, there is an enormous amount of highly speculative activity in the market lately, and it's reminiscent of the dot-com bubble at the turn of the century. While it's hard for price-conscious investors like us to keep up in such markets, history teaches that it is better to be safe than sorry. The best way to avoid the fallout when the inevitable bubble bursts is to not participate in the speculative activity.

Underperforming in the short term can and will fuel many unpleasant emotions, including frustration, regret and envy. However, if the past is a guide, discipline will yield relief and rewards.

We own many great companies that are reasonably priced, and we remain confident that our collection of businesses will outperform the general market over time.



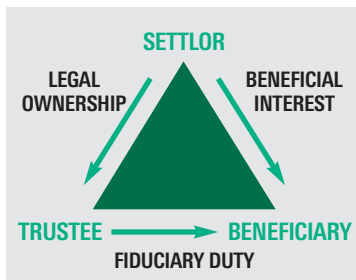
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The Odlum Brown Model Portfolio is an all-equity portfolio that was established by the Odlum Brown Equity Research Department on December 15, 1994, with a hypothetical investment of \$250,000. It showcases how we believe individual security recommendations may be used within the context of a client portfolio. The Model also provides a basis with which to measure the quality of our advice and the effectiveness of our disciplined investment strategy. 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.

# Trust Basics

After building wealth over your lifetime, it is worth considering how trusts might protect your wealth for you and future generations to enjoy.

A trust is established when someone, a settlor, gives legal title of their assets to a trustee, to hold for the benefit of another person or group of persons called beneficiaries. Trusts essentially separate legal title of property from its beneficial interest. While a trust deed often documents the settlor's intentions, a trust relationship can exist without one.



Trustees have a fiduciary duty to manage trust property in the best interests of the beneficiaries. Although trustees can be individuals, a corporate trustee may provide impartial, capable and ongoing service.

## Types of Trusts

Trusts may be set up during the life of a settlor (inter vivos – “between the living” in Latin) or as a result of that individual's death (testamentary). Common inter vivos trusts include alter ego, spousal, joint partner, charitable remainder and family trusts. Testamentary trust examples include your estate, and individual or family trusts arising from your will.

### Alter Ego, Spousal and Joint Partner Trusts

An alter ego trust is established initially for your (the settlor's) lifetime benefit, whereas a spousal trust is initially for the lifetime benefit of your spouse or common-law partner. A joint partner trust is initially for the lifetime benefit of both you and your spouse or common-law partner. Any remaining trust assets can pass to residual beneficiaries of your choice, outside of your estate, following the death of the lifetime beneficiary(ies).

You (and your spouse, if a joint partner trust) must be at least age 65 to establish the trust and transfer assets to the trust on a tax-deferred basis (i.e., rollover). Once the trust is established, you retain all rights to the income and capital while you are alive, and benefit from continuous trust management and protection against undue influence over trust assets if you became incapacitated. Further, your chosen beneficiaries gain prompt access to the trust assets following your death.

### Taxation of Trusts

A trust can earn income and deduct any income it allocates to a beneficiary during the year. Any net income remaining in a trust is generally subject to the top marginal tax rate and, as a result, the general goal is to allocate net income to beneficiaries such that the trust reports no net income. However, certain trusts are eligible for graduated tax rates. For some trusts, on every 21<sup>st</sup> anniversary of the trust's settlement date, the trust is deemed to have disposed of all of its property for income tax purposes, triggering capital gains tax. Strategies may be available to limit or defer this tax.

### The Need for Advice

Since planning considerations are complex, you should obtain professional tax and legal advice before enacting any estate or trust planning. Topics to consider with your advisors include the following:

**Investment management** – Taking direction from the trustee(s), your Odium Brown Investment Advisor or Portfolio Manager can continue managing your non-registered funds within a trust account.

**Privacy** – Instead of distributing assets upon death through a will that may become public knowledge when probated, inter vivos trusts allow assets to pass to beneficiaries privately. This may be useful for situations such as blended families or making unequal distributions to residual beneficiaries.

**Protection from adverse claims** – Unless assets are transferred with fraudulent intent, trust assets are generally protected from will variation, creditor and/or family law claims against the deceased's estate.

**Income tax deferral** – Settling assets to certain types of trusts (e.g., family trusts and testamentary trusts created for beneficiaries other than spouses or common-law partners) is done at fair market value, which may accelerate income taxes on accrued gains. Such trusts are also deemed to have disposed of trust property and recognize accrued gains every 21 years.

Alter ego and joint partner trusts, on the other hand, can continue deferring unrealized capital gains on trust property until the death of the settlor (or until both spouses have passed, in the case of joint partner trusts).

**Income splitting and capital gains exemptions** – While income earned on trust assets may be attributed back to the settlor of the asset for tax purposes, using trusts may allow capital gains or income to be taxed in the hands of beneficiaries at a later date. Eligible beneficiaries may be able to claim the Lifetime Capital Gains Exemption when the trust sells qualifying private company shares, which could multiply the total exemption available per family.

**Probate fee minimization** – Probate fees, which vary by province, may be reduced by holding assets in an inter vivos trust. Seek professional advice regarding whether the costs for a trust might exceed the probate fees saved.

**Charitable giving** – If you use a trust for charitable giving, immediate or future donation tax credits may be available.

**Continuous management by trustees** – Once you transfer assets to an inter vivos trust, the trustees control the assets and decisions for the trust, as well as the allocation of income, even if you become incapacitated or pass away. This allows continuous access to an inter vivos trust's income and capital by its trustees for the benefit of the beneficiaries.

In contrast, assets that pass through your estate are often inaccessible by your executor, trustees and beneficiaries until probate is granted – a court process that may take several months or longer.

**Power in multiple jurisdictions** – In some situations, using an inter vivos trust might preclude using multiple powers of attorney and/or wills to deal with assets located in other jurisdictions (for example, property in other provinces or countries).

**Not all assets can be held in trusts** – For example, RRSPs, RRIFs, TFSA's, RDSPs and RESPs.

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**Costs** – Legal and accounting professionals are typically involved in setting up trusts. Initial costs are impacted by the types of assets to be re-registered, as well as the number of locations or institutions involved. After a trust is established, ongoing accounting, tax filing (for T3 returns) and professional trustee fees can add to costs over the life of a trust.

**Other taxes** – Property transfer tax may apply when real estate is transferred to a trust. Holding a property in trust can negatively impact access to the BC home owner grant and, if the property is held entirely in trust, to property tax deferral in BC. Furthermore, principal residences held by a trust can lose their exemption from capital gains tax depending on the type of trust established. Other negative tax implications can result if trustees are not Canadian residents.

**Settlor cedes control over property** – Trustees, not the settlor, control trust property. Trustees follow applicable trust law and the terms that the settlor provides in the trust deed. Trustees manage and oversee the trust assets for the benefit of the beneficiaries. Any ability by the settlor to dictate the actions of the trustee or the use of assets can result in negative tax consequences.

If you are a U.S. person or are contemplating having trustees, beneficiaries or trust assets in a foreign jurisdiction, you should also consult with cross-border tax and legal professionals.

To better understand how trusts could complement your estate, incapacity and tax planning goals, please contact our Odlum Brown Financial Services Limited team through your Odlum Brown Investment Advisor or Portfolio Manager.



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## Important Information for Clients

**March 31, 2021, marked the end of our 98<sup>th</sup> fiscal year. Following each year-end, Odlum Brown Limited undergoes an independent audit of its financial records and internal controls. As a client of Odlum Brown, you may receive a request to confirm information for one or more of your accounts; this is known as the audit confirmation process.**

The confirmation process is an important step taken by our auditors to confirm directly with clients the accuracy of their account details. If you are selected, you will receive a request directly from our auditor.

Remember, it is always a good practice to first reach out to your Odlum Brown Investment Advisor or Portfolio Manager before responding to any request for your financial information. Please visit our online Client Centre at [odlumbrown.com](http://odlumbrown.com) for more details on the audit confirmation process.

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