

ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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2019 Federal Budget Highlights

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Different Doesn't Always Make a Difference

COMPOUND ANNUAL RETURNS¹ (Including reinvested dividends, as of March 15, 2019)

	YTD	1 YEAR	3 YEAR	5 YEAR	10 YEAR	20 YEAR	INCEPTION ²
Odlum Brown Model Portfolio	9.8%	1.7%	9.5%	9.7%	14.9%	13.3%	14.5%
S&P/TSX Total Return Index	13.4%	6.2%	9.6%	5.6%	10.1%	7.2%	8.3%
S&P 500 Total Return Index (\$CDN)	10.7%	7.1%	14.1%	15.3%	17.0%	5.2%	9.7%

¹ Except for YTD period. ² December 15, 1994.

Equity markets have had a strong start to the year, with the Canadian and U.S. equity benchmarks up 13% and 11%, respectively through to mid-March. The positive shifts in investor sentiment and stock prices since the end of 2018 are remarkable. Fears of an economic recession have morphed into optimism that the global economic expansion will continue. We are at a loss to find material factors that explain the dramatic change in attitudes. From our perspective, we are neither overly excited, nor fearful about the outlook. With most stocks reasonably priced, and some deeply discounted, we believe prospective returns are attractive.

While the Odlum Brown Model Portfolio* has enjoyed the stock market's rising tide, we haven't kept pace with the S&P/TSX Total Return Index recently. Year-to-date, the Model has underperformed by more than three percentage points; and compared to last year, it has lagged by more than four percentage points.

Investing is a humbling affair at times, and we are at one of those junctures. Some stocks in our Model have performed very poorly. XPO Logistics, Kraft Heinz, Coty, ING Groep N.V. and Colfax are among the worst. Canadian energy investments have been a huge disappointment as well, with companies like Peyto and Cenovus well off their highs. Likewise, U.S. housing-related stocks, such as homebuilder TRI Pointe Group and timber owner Weyerhaeuser, have weighed on our results.

We wish we owned fewer of the stocks that have gone down and more stocks like Rogers Communications, Visa and Starbucks, which have performed very well. We know clients feel the same way.

However, we've owned frustrating stocks before, and our patience has yielded satisfying rewards. Not all of the recently disappointing companies will recover and do well, but if history is a guide, the odds are very good that many will be top performers down the road.

We would love to outperform all the time, but realistically, that will never be the case. We often challenge the crowd mentality and purposefully position our portfolio differently than the general market in order to achieve above-average, long-term results. Being different is a part of our philosophy and has yielded the expected rewards over time. Yet, a number of times along the way, periods of poor absolute and relative performance have rattled our nerves and tested our resolve. Most great money managers have shared similar experiences.

Warren Buffett is arguably one of the world's best investors. Shares of his company, Berkshire Hathaway Inc. have underperformed the S&P 500 Index in 16 of the 53 years since he's been at the helm. That's 30% of the time, and is similar to our experience. As highlighted in the table on the following page, our year-over-year return has been less than the Canadian benchmark in seven of the last 24 years, roughly 29% of the time.

Perspective is important when considering relative performance. Prior to 2018, we bettered the performance of our benchmark for seven consecutive years. That represented the longest winning streak in our Model's 24-year history. Over the last 10 years, the Model has risen 302% and more than quadrupled in value. The S&P/TSX Total Return Index is up only 161% over the same period. Nonetheless, a good long-term record doesn't change the fact that it feels lousy when we are not keeping up. It's hard on everyone when the investment winds aren't blowing our way. As Director of Investment Research, I ask our analysts a lot more questions. Our advisors wonder if our research team has lost its mojo. The conversations clients have with their advisors are not as fun, and more time

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We believe focusing on quality businesses and being patient with disappointing holdings during tough times (unlike the often emotionally driven crowd) makes us different, and will make a difference again.

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YEAR-OVER-YEAR PERFORMANCE					
Date	OB Model Portfolio		S&P/TSX TRI		Spread
March 15, 2019	1.7%		6.2%		-4.6%
March 15, 2018	7.0%		3.9%		3.1%
March 15, 2017	20.5%		19.2%		1.2%
March 15, 2016	-2.0%		-6.2%		4.2%
March 15, 2015	23.5%		6.6%		17.0%
March 15, 2014	26.8%		14.4%		12.3%
March 15, 2013	18.0%		6.2%		11.8%
March 15, 2012	9.9%		-5.5%		15.4%
March 15, 2011	10.2%		15.8%		-5.6%
March 15, 2010	39.9%		49.0%		-9.1%
March 15, 2009	-21.7%		-35.2%		13.5%
March 15, 2008	-13.4%		5.6%		-19.0%
March 15, 2007	13.7%		9.4%		4.2%
March 15, 2006	22.7%		26.5%		-3.8%
March 15, 2005	24.5%		17.2%		7.3%
March 15, 2004	46.9%		36.2%		10.7%
March 15, 2003	-17.6%		-18.4%		0.7%
March 15, 2002	19.0%		2.3%		16.7%
March 15, 2001	34.5%		-14.8%		49.3%
March 15, 2000	31.9%		42.8%		-10.9%
March 15, 1999	-0.3%		-9.1%		8.7%
March 15, 1998	35.9%		21.1%		14.8%
March 15, 1997	30.9%		27.6%		3.2%
March 15, 1996	13.7%		20.1%		-6.4%

Source: Bloomberg, Odium Brown.

is spent talking about the equities that are not doing well rather than those that are. It's natural to have doubts, and to feel nervous and uncomfortable when results fall short of the benchmark. It's human nature to want more of what is going up and less of what is going down. Humans are instinctively wired to act on those emotions and make changes – to sell what is not working and buy what is popular and performing well. Unfortunately, doing so often sets the stage for poor performance and further disappointment down the road.

When we reflect on previous periods of poor relative performance, there are some common themes. It's often late in the economic cycle and there's usually a fairly clear delineation between what investors love and what they hate; between very expensive and very cheap stocks. We typically underperform when we hold on to our out-of-favour stocks.

In 2000, we didn't keep pace with our benchmark because we were overweight in Canadian stocks, at a time when investors loved American stocks in general and technology stocks in particular. Before and after the 2008 Financial Crisis, we didn't keep up because we favoured high-quality U.S. growth stocks, when Canadian resource stocks were popular and expensive. Our patience, along with the resolve to adhere to our discipline and stay focused on the long term is what set the stage for the solid recoveries we experienced following those periods of poor relative performance, and we are confident this strategy will yield rewards again. Nonetheless, we caution that it's harder today to make a difference by being different. Investors are not manic like they were in other cycles, and consequently fewer equities are materially underpriced.

The high-quality growth businesses we own are popular and yet reasonably priced. While we don't expect "reasonably priced" businesses to meaningfully beat the market over the long term, it seldom makes sense to sell great businesses unless they are excessively priced. We have selectively taken some profit and added to our out-of-fashion holdings, as we strongly believe that group will outshine the market over the next few years. Still, we think it would be a mistake to overemphasize today's unloved equities, since most are lower-quality businesses.

We believe focusing on quality businesses and being patient with disappointing holdings during tough times (unlike the often emotionally driven crowd) makes us different, and will make a difference again.



MURRAY LEITH, CFA

Executive Vice President and Director, Investment Research

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* The Odium Brown Model Portfolio is an all-equity portfolio that was established by the Odium 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.

2019 Federal Budget Highlights

On March 19, 2019, Canadian Minister of Finance Bill Morneau delivered the government's 2019 Federal Budget, forecasting a lower than expected deficit of \$14.9 billion for the fiscal year,¹ which will increase to \$19.8 billion for 2020. Here is a brief overview of some of the notable proposals.

Budget 2019 can be viewed online in its entirety on the Department of Finance Canada's website² and is subject to parliamentary approval.

Personal Tax Measures

Introduction of the Canada Training Credit

Off the heels of the recent elimination of the Education and Textbook tax credits, the 2019 budget proposes a Canada Training Credit—a refundable credit aimed at providing tax incentives for Canadians to expand education and training. Effective 2019 onward, Canadians will accumulate \$250 annually (upon filing their tax returns) in a notional account. To be eligible, a taxpayer must be between the ages of 25 and 65, be a resident of Canada throughout the taxation year and have employment or self-employed earnings of \$10,000 or more for the year. Individuals earning in excess of a prescribed amount (\$147,667 for 2019) will not be eligible for the credit.

Upon incurring training or education costs, an individual will be entitled to receive the lesser of:

- 50% of their eligible tuition and fees; and
- The balance accumulated in the notional account up to \$5,000.

Increased withdrawal limit for the Home Buyers' Plan

The Home Buyers' Plan (HBP) provides first-time home buyers with the opportunity to withdraw, on a tax-deferred basis, a limited amount from their RRSP. Budget 2019 proposes to increase the current per person withdrawal limit from \$25,000 to \$35,000, subsequent to March 19, 2019.

The budget also proposes to eliminate the first-time requirement for disabled individuals and individuals who were living apart from their spouse or partner, due to a marriage breakdown, for at least 90 days. These changes are effective after 2019.

Amendment to the change-in-use rules

When an individual converts the use of a property from personal to income earning and vice versa, they are deemed to have disposed of the property and to have immediately reacquired it at fair market value. This can trigger a capital gain. Under current tax rules, an election can be filed to deem that the change of use has not occurred and potentially extend the time that the property is eligible as an individual's principal residence, but only where the change of use impacts the entire property.

Budget 2019 proposes to extend the availability of the election to partial changes of use for owners of multi-unit residential properties.

Employee stock options

Employee stock options generally receive preferential tax treatment via a deduction equal to 50% of the taxable benefit received, so long as specific criteria are met. Budget 2019 proposes to put a \$200,000 annual cap on the stock option grants (based on the fair market value of the underlying shares) eligible for this preferential tax treatment for employees of 'large and mature' firms. Employee stock options granted by start-up companies will receive an exemption. As of the budget date, a detailed definition of 'large and mature' firms has not been provided.

Automatic enrolment in the Canada Pension Plan (CPP)

Commencing in 2020, the budget proposes that CPP contributors age 70 or older be automatically enrolled to begin receiving benefits by that age. Generally, individuals begin receiving CPP benefits at age 65. However, CPP benefits can be applied for as early as age 60, with a 0.6% reduction for each month benefits are received prior to age 65. Further, CPP can be deferred until age 70, with a corresponding increase in benefits of 0.7% per month taken after age 65.

Changes to Registered Disability Savings Plans (RDSP)

An RDSP is a tax-deferred investment vehicle which allows contributions to be made to an account for a



Proposed Tax Measures at a Glance

Personal

- Introduction of the Canada Training Credit
- Increasing the withdrawal limit for the Home Buyers' Plan
- Amendment to the change-in-use rules for multi-unit residential properties
- Limits to the beneficial tax treatment of employee stock options
- Automatic enrolment in the Canada Pension Plan (CPP)
- Changes to Registered Disability Savings Plans (RDSP)
- Expanding the annuities eligible for certain registered plans
- New and expanded personal tax credits

Business and Other

- Accelerated deductibility of zero-emission vehicles
- Changes to excise taxes on cannabis
- Update on intergenerational business transfers

No change to personal or corporate tax rates.

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beneficiary who is eligible for the Disability Tax Credit (DTC). Income within the RDSP grows tax free until it is paid out to the beneficiary and reported as taxable income in their hands. However, it is sometimes the case that the beneficiary loses the DTC. Currently, legislation requires that the RDSP be closed by the end of the first full year in which the beneficiary was not DTC eligible. This could result in significant adverse tax consequences. Furthermore, certain government grants received by the RDSP must be repaid.

Budget 2019 proposes to allow the RDSP to remain open (albeit without the ability to receive additional contributions and with some remaining tax consequences on distributions to the beneficiary). The amendments will be in effect for years ending after 2020.

Expanding annuities eligible for registered plans

The budget proposes to allow Canadians to invest in two new annuities through certain registered plans:

Advanced Life Deferred Annuities – These are life annuities which begin to provide income at age 85, ensuring an annual guaranteed level of income each year. Such annuities can be effective at delaying income, and the associated tax, until later in retirement.

Variable Payment Life Annuities – These annuities provide income payments based on the underlying performance of the fund. This option will only be available under pooled registered pension plans and defined contribution registered pension plans.

These proposals may provide additional flexibility in the income needs of retirees.

New and expanded personal tax credits

Budget 2019 proposes to introduce a non-refundable tax credit for digital subscriptions to Canadian digital news organizations. The credit is valued at up to \$75 annually.

The budget also seeks to enhance the ability of Canadians to donate cultural property by eliminating a requirement that such property be of 'national importance.'

Business and Other Tax Measures

Accelerated deductibility of zero-emission vehicles

Budget 2019 proposes to increase the rate at which businesses can depreciate zero-emission vehicles acquired after March 19, 2019. Currently, passenger vehicles are limited to a Capital Cost Allowance (CCA) rate of 30% per annum. Furthermore, there is a \$30,000 limit on the cost of a vehicle for which CCA can be claimed. Under the new proposal, the cost limit would be increased to \$55,000 and the CCA rate would increase to 100% in the first year for eligible vehicles. The accelerated CCA rate would decline to 75% and 55% in 2024 and 2026, respectively.

Excise taxes on cannabis

Budget 2019 proposes to tax cannabis goods a duty of \$0.01 per milligram of THC contained within a given product. The duty will be assessed against the licensee of the product and not the end consumer.

Update on intergenerational business transfers

While no new legislation was proposed with respect to intergenerational business transfers, the government announced during the budget release that it intends to continue to consult with farmers, fishermen and business owners to formulate and update tax rules to better facilitate such transfers.



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¹ Ending March 31, 2019

² https://www.budget.gc.ca/2019/home-accueil-en.html?utm_source=FIN&utm_medium=Home-e&utm_campaign=CAbdgt19

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