INVESTMENT
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Mackie Research Capital Corporation

Personal Newsletter from Janice Honeyman

Spring 2018

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Volatility: Back Again

Volatility is back again. As the equity markets continue their ups and downs, investors would be prudent to remember that volatility is a common part of the markets.

Just how common? Over the past 25 years, the S&P/TSX Composite index fell in over 38 percent of the time, month over month.[1] Over a 40-year period, this reached almost 40 percent, demonstrating just how frequent downward market movements are.

More recently, however, equity markets have been relatively placid. In fact, in 2016 and 2017, the index fell in only 20 percent of the time, month over month. We have experienced an unprecedented bull market run that has lasted for almost nine years. During strong market times, equity prices can have the tendency to overshoot their underlying fair values and sometimes a pullback is necessary.

Longer-term investors should keep in mind that many of the positives that got us to our current financial market health are still in place: growth continues and every major economy globally is expanding, unemployment rates are at some of their lowest levels and corporate earnings continue to be strong. Even oil prices have continued their moderate climb, which may be good news for Canada's resource-based markets. South of the border, sweeping U.S. tax reform measures passed in December are expected to further stimulate growth.

What about your own portfolio? This is certainly not the time to worry or make abrupt changes. If your holdings are keeping within the objectives set out in your plan, you likely have few serious concerns. Of course, adjustments may need to be made along the way, but your investments are designed to meet your needs over the longer-term regardless of the normal periods of volatility that occur in the markets.

At the same time, it is worthwhile to remember that, more often than not, past periods of consolidation resulted in a snap-back to new highs, usually without warning. Seasoned investors may look for ways to turn lower prices to their advantage and build their portfolios, when others may be fearful to act. Downward movements should be welcomed by those looking to expand their investment positions.

Have patience and keep these things in mind as volatility returns and we weather the inevitable short-term swells of the markets.

Note: 1. S&P/TSX Composite index monthly close to 12/29/2017.

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In This Issue

Tax Season Again

Are We Paying Too Much Tax?

It is tax season once again. As the U.S. implements sweeping tax reform, a look back in time shows just how much Canadian personal income tax rates have risen over 10 years (see chart).

For 2018, Canada's highest combined personal income tax rate is 54 percent in Nova Scotia (NS), for income over $205,842. In the U.S., the highest combined rate is 50.3 percent in California, but this only kicks in at income over US$1 million. A taxpayer earning the top NS income threshold in U.S. dollars, around US$165,000, would only be taxed at a combined marginal rate of 41.3 percent in California. This means that a NS resident pays 12.7 percentage points more in tax, or over 30 percent, than their Californian counterpart. In fact, California is the only state with a higher combined federal-state top rate than Saskatchewan, the province with the lowest combined top rate.[1]

Are you doing all you can to reduce your annual taxes? The top marginal rates that apply to various forms of income remind us of the importance of structuring investments to take advantage of lower rates. As well, make sure you have maximized your tax-advantaged accounts or income-splitting opportunities with a family members, and use all the deductions and credits available to you when you file your income tax returns.

Combined Federal/Provincial Top Marginal Personal Tax Rates (%)

	2008	2018 Combined Top Marginal Tax Rate*			
Province	Interest & Regular Income	Interest & Regular Income	10-Year Change	Capital Gains	Eligible Dividends
BC	43.70	49.80	***+14.0%***	24.90	34.20
AB	39.00	48.00	***+23.1%***	24.00	31.71
SK	44.00	47.50	***+8.0%***	23.75	29.64
MB	46.40	50.40	***+8.6%***	25.20	37.79
ON	46.41	53.53	***+15.3%***	26.76	39.34
QC	48.22	53.31	***+10.6%***	26.65	39.83
NB	46.95	53.30	***+13.5%***	26.65	33.51
NS	48.25	54.00	***+11.9%***	27.00	41.58
PEI	47.37	51.37	***+8.4%***	25.69	34.23
NL/LB	45.00	51.30	***+14.0%***	25.65	42.62

Note: 1. All 2018 tax rates as of Jan. 1, 2018. Source: KPMG Personal Tax Rates.

Will Budget Changes Affect You?

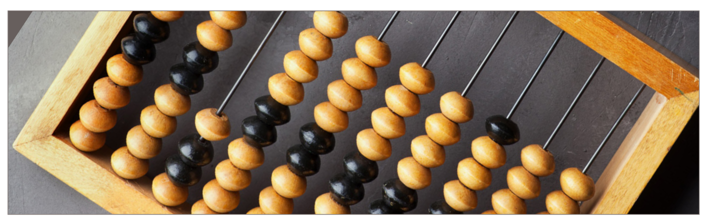
In Brief: Federal Budget 2018

On February 27, the third Federal Budget of the Liberal government was released.* The Budget anticipates a deficit of $18.1 billion for 2018-19 and no timetable to balance the books. Consistent with previous years, the themes of this Budget focus on innovation, gender equality — including the introduction of a new *Employment Insurance Parental Sharing Benefit* — tax fairness and integrity.

From a personal and small business tax perspective, the Budget did not propose any changes to personal or corporate tax rates. However, two areas are worth mentioning that may impact tax planning for Canadian business owners and high-net worth individuals:

Taxation of Private Corporations — As expected, the Budget addressed changes to the tax treatment of passive income earned in Canadian-controlled private corporations (CCPCs). The Budget now proposes a more simple approach to limit perceived tax-deferral advantages from holding passive investment income, gradually reducing access to the small business tax rate for CCPCs that have significant passive investment income. As well, there are proposed limitations on the ability for CCPCs to receive refundable taxes on payments of eligible dividends.

If a CCPC (and associated corporations) earns more than $50,000 of passive investment income in a given year, the amount of income eligible for the lower small business tax rate will be gradually



reduced. The small business deduction limit is proposed to be reduced by $5 for every $1 of aggregate investment income above the $50,000 threshold, such that the business limit of $500,000 would be reduced to zero at $150,000 of investment income. This measure will apply to taxation years beginning after 2018.

Trusts: Expanded Reporting Requirements — The Budget proposes enhanced income tax reporting requirements for certain trusts on an annual basis. New reporting requirements will require certain trusts to file a T3 return where one does not currently exist, and to report the identity of all trustees, beneficiaries and settlors of the trust. This will apply to "express trusts" (i.e., generally trusts created with the settlor's express intent) that are resident in Canada and to non-resident trusts currently required to file a T3 return, with exceptions for specific types of trusts. This measure is expected to apply to returns filed for the 2021 and subsequent taxation years.

For greater detail on Federal Budget 2018, see www.budget.gc.ca.
*At time of writing, measures are in proposal stage and may not be enacted into law.

Planning Ahead

Do You Have an RESP Withdrawal Strategy?

Spring may be an exciting time if you have a student waiting to receive post-secondary school acceptances. If you have opened a Registered Education Savings Plan (RESP), it may be a good time to think about withdrawal strategies.

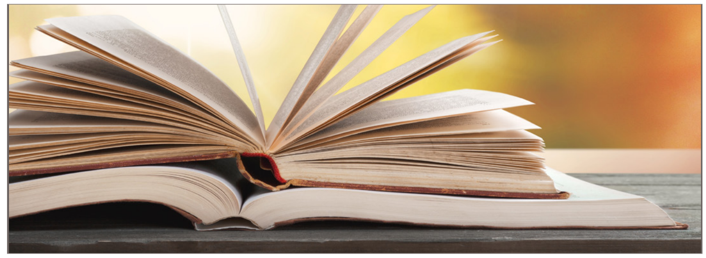
Recall that the RESP has three components: i) original contributions; ii) grants paid by the government, such as Canada Education Savings Grants (CESGs); and iii) accumulated income payments (AIPs), income/gains on contributions and grants. Grants and AIPs may be paid to the beneficiary in the form of an Education Assistance Payment (EAP), which is taxable in the student's hands. Original contributions can be withdrawn tax-free at any time.

Why Have a Withdrawal Strategy?

The RESP can generally remain open until the end of the calendar year that includes the 35^{th} anniversary of the plan's opening. If funds are not used, there may be financial consequences. Unused grant money must be repaid and there may be a 20 percent penalty tax on top of the regular income tax due on AIPs. As such, consider giving some forethought to your RESP withdrawal strategy:

When a child qualifies for the EAP...

Structure withdrawals early to minimize taxes. EAPs are taxable in the hands of the beneficiary. Once a beneficiary starts a qualified program, begin drawing EAPs to, at a minimum, use the child's "basic personal amount" tax credit each year. This is a non-refundable tax credit, so unused amounts cannot be carried forward. Plan ahead to minimize taxes. Consider that the tuition tax credit can offset EAP income and can be carried forward indefinitely, but other sources of income, such as a summer job, may impact the student's marginal tax rate.



Exhaust EAPs first. When withdrawing funds, you must specify the amount considered to be the EAP versus a refund of contributions. Exhaust EAPs first; contributions can be paid tax-free at any time.

Draw down EAP funds before enrolment ends. There are no restrictions on the use of EAP monies, as long as the child is enrolled in a qualifying post-secondary program. (An initial limit of $5,000 applies for the first 13-weeks of full-time enrolment.) EAPs can only be made until six months after the student ceases enrolment, so if (s)he drops out it may be beneficial to withdraw as much as possible to avoid tax penalties on unused funds.

When a child does not qualify for the EAP...

If beneficiaries are at least 21 years old, AIPs may generally be made to the plan owner starting in the 10^{th} year following the year the plan was opened. To avoid penalty tax on AIPs, consider this option:

Transfer AIPs to a parent's RRSP account. This can be done if a parent has available Registered Retirement Savings Plan (RRSP) contribution room (subject to certain conditions). If no RRSP room is available, one option may be to delay collapsing the RESP for a few years (if permissible) to build up the parent's RRSP contribution room. With this transfer, grants must be repaid.

Rising Rates and Your Portfolio

Interest rates have been held at historically low levels for many years, helping to support economic growth and propping up the housing market, much to the chagrin of retirees who would like to depend on interest for income. But what is in store as rates continue their gradual rise?

Many investors understand the inverse relationship between interest rates and bond values. As interest rates rise, the capital value of existing bonds goes down. Here's why: Consider an investment of $100 in a 10-year bond that pays a 2 percent coupon. If interest rates rise to 3 percent, you wouldn't be able to sell the same bond at its $100 face value, because you could buy a new bond for $100 with a higher coupon rate. As such the bond's market value will decrease to offset its lower interest rate.

We manage this change in different ways. In a rising rate environment, it is important to keep maturities of bonds relatively short to protect capital. As bonds mature, the capital can be reinvested in new bonds that provide higher interest rates. A laddering approach, with maturities spaced over time, may also help to manage interest rate changes and offer predictability in generating future income streams. Various types of bonds (government, investment-grade, high-yield, etc.) may perform differently when interest rates are rising or falling so depending on the investor's particular situation, diversifying across fixed income investments may help to provide protection.

A rising interest rate environment can also affect equity markets. A popular belief is that rising rates put downward pressure on stocks. But this shouldn't be cause for alarm. Interest rates typically rise during a strengthening economy, which easily can offset any softness over the longer term.

Remember that fixed income plays an important role, helping to preserve capital and create diversification for your investment portfolio. Please call if you would like to discuss.

Beyond the Hype: Perspectives on Bitcoin

Bitcoin continues to garner much attention, after a year in which the cryptocurrency gained over 1,800 percent and skyrocketed to a value of almost US$20,000. It is difficult not to pay attention when it seems as though everyone is jumping on the blockchain bandwagon.

In January, KFC Canada offered a "bitcon bucket" of chicken, which sold out hours after it was made available. Ironically, it cost $20, yet the average bitcoin transaction fee was estimated to be around $35. Eastman Kodak, which became financially distressed after the rise of the digital camera, announced its intention to create a digital currency Initial Coin Offering (ICO). Recently, CNBC reported that people were refinancing their homes in order to purchase Bitcoin.

Bitcoin was launched in 2009 with the belief that a decentralized, digital currency could displace banks and traditional money. Since then, other digital copycat currencies have emerged to cash in on the Bitcoin bonanza, including Ethereum, Ripple and Litecoin.

But here is some perspective on Bitcoin, which should lend investors to caution:

Underlying Value — There is ongoing debate as to whether Bitcoin has an underlying value, since it is simply the product of open-source software. Those who believe it lacks intrinsic value compare it to other assets: stocks represent ownership interests in companies that produce goods/services with tangible value; traditional currencies are considered a store of value because they provide stability, can be traded for future goods/services and are backed by a legal, political and economic system. The introduction of new digital currencies due to low barriers to entry also puts into question Bitcoin's value.

Volatility — Bitcoin has been subject to wide price swings since its inception. In 2017 alone, it dropped by over 30 percent on more than five occasions.

Lack of Security — Bitcoin is susceptible to cyberattacks. In 2014, Mt. Gox, a Bitcoin exchange that handled almost 70

percent of trading volume, was hit by a cyberattack and almost $500 million of Bitcoin was stolen. In these situations, there is limited legal recourse and it is almost impossible to have funds returned.

Control — It is believed that around 40 percent of all Bitcoin is held by 1,000 users, known as Bitcoin "whales". Whales have been known to coordinate their moves, which can manipulate price.

Changing Regulation — Regulators globally are starting to impose rules on cryptocurrencies, which continue to change the landscape. South Korea, believed to be the third largest cryptocurrency market, now taxes digital currency exchanges and has imposed regulations to curb speculation.

Blockchain Technology – Here to Stay?

The "blockchain" technology underlying digital currencies is expected to have a promising future in the financial services industry. Blockchain is a decentralized digital ledger that records transactions without the need for a financial intermediary. It is considered a highly secure way of transferring data because it is open-source and cannot be controlled by a single entity. It does this by creating an indelible record that can be distributed but not copied and its authenticity can be verified by a community of participants. Many believe that this technology has the potential to provide better security at lower costs.

The Bottom Line

While investors may be tempted by the potential for high returns, the high risks associated with Bitcoin remain apparent.

https://www.cnbc.com/2018/02/01/january-was-bitcoins-worst-month-on-record-heres-how-to-stay-calm.html

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