Serber Speaking

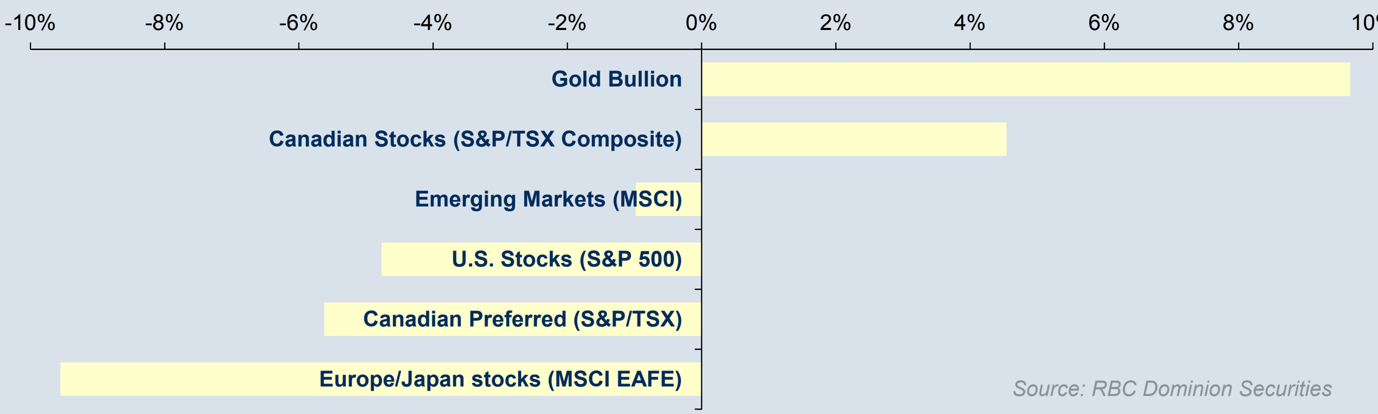
David Serber
Vice President, Portfolio Manager and Wealth Advisor david.serber@rbc.com

Commentary for the quarter ending March 31, 2016

A Rebound for Canada, eh?

As we remarked in our last newsletter, the more exposure one had outside Canada last year, the better. For the first quarter of 2016, the opposite was true. Canada boasted a top-performing stock market last quarter, as can be seen in the chart below. Rebounds in beaten-up sectors such as Oil & Gas (plus seven percent) and Gold mining stocks (plus 41 percent) led the charge for the TSX. The appreciation in the Canadian dollar (up six percent vs. the U.S. dollar) blunted returns from non-Canadian bourses such as the U.S., Europe and Japan, contributing to their negative returns for Q1.

Performance by Asset Class: January 1 to March 31, 2016 (in Canadian $)



Source: RBC Dominion Securities

Is this the beginning of a Canadian bull market? I think not. Rather, I consider it a bounce after Canadian markets and the Canadian dollar became oversold on a very pessimistic outlook in late 2015. At the time, the oil price had fallen below US$30 per barrel (from US$100 as recently as July 2014) and some observers were forecasting an even lower price going forward. In the event, the oil price bottomed in February at US$26 and recovered in March, closing out the quarter at $38. Investors breathed a sigh of relief that Canada had dodged the bullet of an ever-lower oil price and moved money back in our direction.

So, where are things headed?

Let's begin with gold, the best performing asset on the chart for Q1. Gold has caught a tailwind, which I think may continue for the balance of 2016. Many central banks (Europe and Japan, chief among them) are exploring ever-more aggressive ways to stimulate growth and have deployed, for the first time ever, negative interest rates. A consequence, and perhaps part of the intention, of such aggressive monetary stimulus is to weaken a country's currency, making its exports more competitive. However, when many countries devalue their currencies at the same time, demand for gold, a form of "currency" which cannot be devalued at will, should go up. At the same time, gold mine supply is contracting, down nine percent year-over-year in Q4 2015 (See *Gold Demand Trends: Full year 2015* at www.gold.org). Our average Managed portfolio is currently sitting at about eight-percent exposure to gold (four percent in bullion and four percent in gold stocks) which positively impacted results for Q1.

Elsewhere in the global economy and financial markets, the dominant trend is uncomfortably slow growth. On the global stage, the U.S. economy is putting up the best performance. As a result, U.S. stocks have been top performers over the past few years and are now at the point of being somewhat over-valued. Shifting a bit of U.S. exposure toward Europe and Japan, both relatively under-valued now, makes sense. An even more aggressive play would be into China, where recent stimulus measures should bear fruit later this year, and equities are cheap. Buying inexpensive out-of-favour assets is often, but not always, a good recipe for long-term returns.

U.S. economic strength has also allowed the Federal Reserve to begin raising interest rates, contrary to the trend almost everywhere else. Given global linkages, however, the Fed's ability to raise rates materially will be severely limited. As a result, both U.S., Canadian and global interest rates will remain depressed. Current 10-year Government of Canada bonds yield about 1.25 percent. Five-year GICs yield about two percent. For fixed-income investors, the best alternative right now is Canadian preferred shares, which are down some 25 percent over the past year or so. At current prices, I forecast preferred dividend yields of five to six percent per year for the next five years with only moderate risk (but not zero risk, mind you).

On the currency front, the Canadian dollar gained some six percent against the greenback last quarter -- part of the oversold bounce already discussed. I believe the recent high of US$0.78 for the Canadian dollar will represent a price ceiling for the coming months and I expect to see it trade in the 72-cent to 78-cent range. To achieve an exchange rate higher than 80 cents will require a materially stronger Canadian economy and/or a higher oil price.

Speaking of Oil: After its strong move from its February low of US$26 a barrel to its March high of US$42, I expect the oil price to back and fill over the coming months in the US$30 to US$40 range (currently at US$38). In the second half of 2016, the oil price will likely move higher into the US$40 - US$50 range. This forecast of a higher price is predicated less on an increase in demand and more on a contraction in supply. After the plunge from US$100 to US$30 over the past two years, oil companies have cut back on drilling and exploration. Since oil wells naturally deplete, an absence of drilling for new wells will lead to a reduction in supply that, demand holding constant, will lead to a higher oil price. That said, the oil-price ceiling is now around US$60 per barrel, as this is the price level at which an increasing number of U.S. shale oil producers can dial up production at decent profit margins. This ready supply response to a rising oil price effectively puts a lid on the oil price for the foreseeable future.

Pulling it together

Given the above analysis, my outlook for the balance of 2016 is neither particularly bearish nor bullish. Equity weightings in our Managed portfolios are at neutral within their minimum-maximum ranges. I am comfortable with our eight-percent gold weighting and may look to increase it a bit as the year unfolds. We currently have a slight underweight in energy, and I am a buyer of energy companies on any weakness in their share prices in the second quarter. Within fixed income, I continue to favour Canadian preferred shares, which now represent almost 50 percent of the fixed-income portion of our Managed portfolios. While 2016 was off to a rough start, with a slightly negative return for Q1, I expect results will improve as the year progresses, with overall returns for 2016 in the four-to-five percent range.

It's Tax Preparation Time!

It's that time of year again. We are always here to help our clients and their accountants with tax preparation. Here are some top tips this year:

1. "My Account at CRA." If you haven't already, consider signing up for My Account online at CRA. You can easily find useful info such as your RRSP and TFSA contribution room. Also, starting with the 2015 tax year, you can see all your T-slips that have been submitted to CRA. This can be helpful if you are looking to cross-check that all T-slips are accounted for on your tax return.

2. T1135 Foreign Income Verification is required for taxpayers who had over C$100,000 in foreign investments at any time in 2015. We have a report, available on request, which provides details for completion of this tax form. Just let us know and we can generate it for you or your accountant, if required.

(416) 974-3530 Toll-free: (800) 766-1034 david.serber@rbc.com www.davidserber.com

Wealth Management and Financial Planning

Federal Budget

The Liberal government tabled its first budget on March 22nd. From a fiscal balance point of view, the theme of the budget was "spend more faster." Despite the Liberals' election pledge to run a deficit no higher than $10 billion, the budget anticipates a $29 billion deficit for both this year and next, and a total deficit of $100 billion over the next four years. The government's economic bet is that fiscal deficits will spur private investment and spending, thereby increasing employment and jump-starting the Canadian economy.

If the wager pays off, Canada will be in good shape four years from now. But I am somewhat uncomfortable with an unseasoned administration making a $100 billion bet with other people's money. That said, there are many economists who argue that deficit spending is an appropriate policy in an environment of insufficient private demand. I suspect this argument may hold water, but only if the deficits are incurred for properly strategic, productive spending. Unfortunately, economics is not an exact science, and only time will tell.

Budget measures to pay attention to

The budget makes a slew of technical tax changes too long to review. But here are two actionable items:

1. Realized gain on the sale of Structured Notes sold after Sept. 30, 2016 will be deemed regular income, not a capital gain. Since the tax rate will effectively be double if you sell a Structured Note after September 30th, we will be contacting all clients in the coming months to discuss selling Notes they may own with unrealized gains.

2. The tax rate on income over $200,000 goes up four percentage points in 2016. As a result, clients with income over $200,000 should observe the following guideline when preparing their 2015 tax returns: Accelerate income, defer deductions. This means, if you have flexibility with your income, you should increase your 2015 income and reduce it in 2016. Also, deductions from income will be worth more in 2016. For example, if your income is over $200,000 in both 2015 and 2016, and if you contributed to your RRSP in 2015, you should not claim the RRSP deduction on your 2015 tax return. Rather, you should wait and claim it on your 2016 tax return. According to the example at right, the deduction is worth $11,966 on the 2015 return but $12,964 on the 2016 return. Would you rather have $12,000 now or $13,000 in a year from now? (Hint: the second one is correct).

Defer your RRSP Deduction

If your income is over $200,000

Value of deduction, based on 2015 maximum contribution of $24,930.

If deducted in 2015 (48% marginal tax rate)	$11,966
If deducted in 2015 (52% marginal tax rate)	$12,964

Tax planning is an important component of Wealth Management. Call or email me to discuss tax planning opportunities, or any other topic that's on your mind!

Until next time, best regards,

David Serber