

ODLUM BROWN REPORT

03 2023



A Path to a Brighter World

The following is adapted from Murray Leith's remarks at Odlum Brown's 29th Annual Address. To view a recording or read the full transcript, please visit odlumbrown.com/address23.

On the heels of a tough 2022, stocks have had a remarkably strong start to 2023. The Canadian and U.S. benchmarks were up 7.2% and 7.4%, respectively, through to February 15.

Investors are more optimistic for three reasons: (1) China's economy has reopened; (2) Europe has thus far had a mild winter, which has taken a lot of pressure off energy prices and softened their energy crisis; and (3) the U.S. economy is holding up as inflation trends down.

With inflation continuing to come down from high levels, investors are also hopeful that the end of the monetary tightening cycle is in sight. To that end, after the latest 25-basis-point increase in the bank rate to 4.5%, the Bank of Canada suggested that they may be finished with rate hikes. South of the border, the federal funds rate is 4.75%, and the futures markets are pointing to only two more 25-basis-point increases, followed by lower interest rates later in the year. Investors are starting to believe the U.S. Federal Reserve won't raise interest rates much more and that we might not have a recession.

While that is certainly possible, we don't think it is probable. We also don't think a recession is a bad thing. It's the tough medicine that will curb inflation and put the economy on a much healthier footing.

We are emerging from a 40-year decline in interest rates that ended in 2022. For nine of the last 14 years since the financial crisis, the Fed has had a zero interest rate policy (ZIRP). Indeed, the fed funds rate was pegged at zero from 2009 to 2015, and again in 2020 and 2021 in response to the pandemic. Never in U.S. history has the cost of money been so cheap

for so long. The Bank of Canada also lowered interest rates to zero during the pandemic.

Howard Marks, co-founder of Oaktree Capital Management, an expert manager of corporate debt and someone I admire, likened the impact of falling interest rates to the people-mover conveyor belts at airports. You cover ground a lot faster on a moving sidewalk. In similar fashion, when interest rates are falling, asset prices tend to rise faster than underlying fundamentals. Over the last few decades, we've had a lot of help from the conveyor belt.

Lower interest rates stimulate the economy and create new jobs in three important ways: (1) they encourage consumers to borrow and spend; (2) they motivate business leaders to expand businesses and launch new ones; and (3) they inflate asset values, magnifying wealth, which leads to greater spending.

Unfortunately, there are three damaging effects of low interest rates that fester: (1) they encourage excessive risk taking and debt, and we have unprecedented debt in the world today; (2) they promote a misallocation of capital toward unproductive activities; and (3) they cause inequality, as wealthy people own a disproportionate amount of the assets that are inflated by low interest rates.

If we fix the inflation problem, and more importantly learn from our mistakes, then we begin to quell these negative consequences. We get off an unsustainable path, and we start building a stronger economic foundation.

There is a short-term cost to putting the world on a firmer foundation. We will probably have a recession, and that likely will come with higher unemployment and lower corporate profits.

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Investing for Generations®

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Odlum Brown Limited
Suite 1100 - 250 Howe Street
Vancouver BC V6C 3S9

Main 604 669 1600
Toll Free 1 888 886 3586

Kelowna 250 861 5700
Victoria 250 952 7777
Chilliwack 604 858 2455
Courtenay 250 703 0637
Langley 604 607 7500

Email information@odlumbrown.com



Odlum Brown Limited



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@Odlum_Brown



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MAKING A DIFFERENCE
FOR CLIENTS FOR

100 YEARS

Annual Address Presentations Are Now Online!

Thank you to everyone who joined us at one of this year's Annual Address presentations. This year was extra special as we were able to return to our in-person format and celebrate Odlum Brown's 100th anniversary with clients and friends across BC.

For those who were unable to attend or would like to revisit the presentation, a video recording and transcripts are now available at odlumbrown.com/address23.

We also invite you to share your Odlum Brown story or nominate a new community partner via the QR code below.



They say “turkeys fly when the wind blows,” and, boy, did a lot of turkeys fly during the pandemic. People are greedy by nature, and when they hear others are making money in Bitcoin and meme stocks, they pile in. Similarly, venture capitalists have raised billions of dollars for companies with questionable business plans and little or no profits.

The boom in speculation has contributed to a shortage of workers and wage inflation. Don't get me wrong, I want my children to have better-paying jobs. But prices and the cost of owning a home have gone up faster than wages. The average person's real income, adjusted for the cost of living, has actually declined. That is why so many people are angry and why we're seeing greater political polarization.

Many of the turkeys that took off during the pandemic are now having to lay people off because the easy money has ended, and the businesses don't generate enough cash flow to pay their employees. While I feel sympathy for those workers, it's a positive step for our economic foundation. Many of those jobs were unproductive. Every business owner knows how tight the labour market has been. The good news is that it will get better as laid-off workers find productive jobs elsewhere.

Investors naturally think a recession is bad for the stock market, and they are both right and wrong. Timing is the issue. The stock market is forward looking, and it rises and falls in anticipation of what is going to happen in the future. In fact, stocks tend to drop the year before a recession and rise in the year of a recession. That doesn't always happen, but it is what happens most often. A decent year for stocks in 2023, despite a recession, would be consistent with history.

What's exciting to me now is that I once again see a path to a brighter world. We start making the world better when we stop doing the things that make it worse. Raising interest rates to combat inflation means the end of an era of monetary mismanagement. It means we stop instigating negative unintended consequences. We stop encouraging more and more debt. We stop inflating bubbles and the misallocation of resources. And we stop fueling inequality.

It also means that savers can once again earn a decent return on bonds, and as portfolio managers, we can utilize fixed income to better balance portfolios.

The authorities used the lessons from the Great Depression to avert disaster during the financial crisis and, more recently, the pandemic. They overdid it this time, but they are determined to set the world straight, and we are confident they will.

Despite this, worries persist that stocks will perform poorly if we have a recession. Further downside is possible, and investors may be inclined to sell. Consider these four reasons not to:

First, as mentioned, the market is forward looking; it discounts bad news in advance. When the bad news finally arrives, investors are normally focused on the recovery ahead.

Second, a ton of froth has already been expunged from the stock market. Most of the speculative turkeys that flew to the moon in 2020 and 2021 have experienced corrections of 70-90%. Even the huge and profitable so-called FAANGM stocks – Facebook (Meta), Apple, Amazon, Netflix, Google (Alphabet) and Microsoft – were down an average of 40% last year. Valuations of the great businesses we own in the Odlum Brown Model Portfolio¹ range from outstanding to reasonable. We believe they will be bigger, more profitable and more valuable three to five years from now.

Third, we believe investors would be wealthier if they treated their stocks like their home. For most people, their home is their most valuable asset because they hold it through thick and thin. They don't make the mistake of selling it when headlines are negative. At the beginning of the pandemic, I thought we were in for a long and nasty recession. If we had made a wholesale shift out of the market at that time, our Model Portfolio wouldn't be up more than 35% since the end of 2019 – and that is despite last year's drawdown.

One final consideration: Odlum Brown and our clients have prospered over the last 100 years despite World War II, the Great Depression, the inflationary 1970s, the 1987 crash, the bursting of the dot-com bubble, the financial crisis and the pandemic. Preserving and growing wealth is not about the economy. It's about building a trusted relationship with your advisor, having a sensible long-term plan and, most of all, sticking to it.



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

¹ 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.

Staying Ahead of Property and Related Taxes

In addition to paying your basic annual property taxes each year, have you checked whether you need to make additional tax filings or pay further taxes?

Whether you own a principal residence, a recreational property, a rental property, a property left vacant for part or all of the year, or a property outside of BC, it can be daunting to stay on top of all of the tax filings and deadlines which may impact you. The following table highlights some common property-related tax topics to be aware of:

| SELECTED TAX TOPICS FOR OWNERS OF PROPERTY LOCATED IN BC | | | | | | |
|--|---|---|--|---|--|---|
| | Empty Homes Tax ⁱ | BC Speculation and Vacancy Tax ⁱⁱ | *New* Underused Housing Tax ⁱⁱⁱ | Home Owner Grant (HOG) | BC Property Tax Deferment ^{iv} | Principal Residence Exemption (PRE) ^v |
| Tax Authority | City of Vancouver | Province of BC | Federal | Province of BC, municipality or participating First Nation | Province of BC | The Canada Revenue Agency |
| Frequency | Annual | Annual | Annual | Annual | Annual | Per transaction |
| Automatic Renewal? | No | No | No | No | Auto-renewal can be selected. | N/A |
| How to submit required information | Online vancouver.ca/eht-declare One declaration required per property. | Online https://www.etax.gov.bc.ca/SVT Phone 1-833-554-2323 toll free or 1-604-660-2421 outside North America. Each owner/interest holder must annually declare. | Affected owners must file the "UHT-2900 Underused Housing Tax Return and Election Form," available at Canada.ca. ⁱⁱⁱ | Online https://www.etax.gov.bc.ca/btp/HOG Phone 1-888-355-2700 (option 3 for automated self-service). For taxes payable to a First Nation, check instead with the First Nation. | Online All registered owners must agree within 28 days of the application date. Additional supporting documentation may need to be submitted. | A sale must be reported on Schedule 3 of the taxpayer's T1 personal tax return. The principal residence designation can be made on form T2091 to claim the PRE. |
| Geographic Area | City of Vancouver (excludes property on a First Nation). | See endnotes. ^{vi} | Canada (some exclusions, including for certain vacation properties). ⁱⁱⁱ | Anywhere in BC, if meeting eligibility criteria. | Not available if tax is payable to a First Nation, or is leased from a First Nation, municipality or the Crown. | A property "ordinarily inhabited" by an eligible person (even outside Canada). |
| Tax Impact | The tax rate is 3% of 2022 assessed value for the 2022 reference year; 5% of 2023 assessed value for the 2023 reference year. | The tax rate is 2% for foreign owners or "satellite families," or 0.5% for Canadian citizens or permanent residents not part of a "satellite family." ^{vi} Tax credits may reduce tax payable. ^{viii} The tax rate for a corporation, trustee or business partner is the highest rate applicable if they held the property individually. | The tax rate is 1% of an affected owner's proportionate share in the value of the property. Many Canadian citizens and permanent residents qualify as "excluded owners" who do not have to file a UHT return. | The HOG reduces property tax for eligible homeowners. Additional grants may be available to eligible seniors, veterans or people with disabilities. If eligible, the regular HOG is up to \$570 for properties in the Capital, Metro Vancouver or Fraser Valley Regional Districts that are assessed up to \$2,125,000 in 2023. It increases to \$770 for all other areas of BC. A partial HOG may be available for properties valued up to \$2,239,000 or \$2,279,000, based on location. | Property tax deferral offers eligible homeowners access to a low-interest-rate government loan to pay their annual property taxes. The rate until March 31, 2023, is 1.7% for the regular program (3.7% for the families with children program), charged as simple, not compound, interest. | The PRE can reduce or eliminate the taxable portion of a capital gain on eligible property. The PRE is calculated as: [(1 + # of years as a PR) ÷ # of years owned] x the capital gain. ^k New anti-flipping rules for 2023 and later tax years can deny access to the PRE for certain dispositions, and gains would be taxed as business income, not capital gains, while losses would be denied. ^l |
| Penalties | Late filing penalty of \$250. Late/unpaid taxes are subject to a penalty of 5%, plus daily interest on arrears and the tax sale process. A false declaration may be penalized up to \$10,000 per day. | Late/unpaid taxes are subject to a penalty of 10% of the unpaid tax, plus interest on arrears. Providing inaccurate or incomplete information can carry a penalty of up to \$2,500 (\$5,000 for gross negligence), plus interest. | Failure to file a UHT return by April 30, 2023, carries a minimum penalty of \$5,000 or \$10,000, even if no tax is payable by an affected owner, plus daily interest on unpaid taxes. Additional penalties may apply if the UHT return isn't filed by December 31, 2023. | N/A | N/A | Penalties and interest may be assessed by the CRA for incorrect, late and/or gross negligence with tax filings. |

Tax Relief

While tax relief may be available through exemptions or reduction, these can vary widely between each tax program. For example, while the exemption for a principal residence under the Empty Homes Tax is determined per property, exemptions for the BC Speculation and Vacancy Tax or for the Underused Housing Tax are determined per owner, so any non-exempt co-owners pay these taxes based on their percentage ownership. In addition, life changes such as a medical event, work relocation or death impacting one or more property owners may also alter the tax exposure for the property. The links in the endnotes can be used to access more details for each program.


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Reserve or Treaty Lands: Holding a rental, speculation or vacation property on reserve or treaty lands may be more tax-effective since these are not included in the taxable regions for the Vancouver Empty Homes Tax, BC Speculation and Vacancy Tax, or federal Underused Housing Tax.

Rental Homes: Owners who do not live in a home as their principal residence but rent part or all of it out at least six months per year in periods of one month or longer may be exempted from the City of Vancouver Empty Homes Tax, BC Speculation and Vacancy Tax, and federal Underused Housing Tax (check tenancy requirements with each program).

Since significant penalties can result from failing to comply with tax and declaration requirements, consider seeking professional tax advice to manage your tax exposure. For more information, please contact your Odlum Brown Investment Advisor or Portfolio Manager.

| DEADLINE | HOMEOWNER ACTION, IF APPLICABLE |
|--|---|
| February 2, 2023 (passed) | <input type="checkbox"/> Make a 2022 declaration for the City of Vancouver Empty Homes Tax. <input type="checkbox"/> Pay City of Vancouver Advance Tax Notice amount. |
| March 31, 2023 | <input type="checkbox"/> Make a 2022 declaration for the BC Speculation and Vacancy Tax. |
| April 14, 2023 | <input type="checkbox"/> Pay City of Vancouver Empty Homes Tax (for 2022 declarations). |
| April 30, 2023 | <input type="checkbox"/> File 2022 T1 Personal Income Tax Return to report disposition of a principal residence. <input type="checkbox"/> File 2022 annual return for the Underused Housing Tax (UHT), claim a UHT exemption and/or pay UHT. |
| Early May to July 4, 2023, once property tax notice received | <input type="checkbox"/> Apply for 2023 Home Owner Grant to avoid 5% late-payment penalty. <input type="checkbox"/> Apply for, or manually renew (if no automatic renewal), 2023 BC Property Tax Deferment. <i>See endnote regarding deferring City of Vancouver taxes^{vii}</i> |
| July 4, 2023 | <input type="checkbox"/> Pay 2023 rural property taxes. For other properties, confirm the payment deadline with the municipality or First Nation. <input type="checkbox"/> Pay BC Speculation and Vacancy Tax (for 2022 declarations). |
| December 31, 2023 | <input type="checkbox"/> Final deadline to apply for 2023 Home Owner Grant (<i>penalties apply</i>). <input type="checkbox"/> Final deadline to apply for 2022 Retroactive Home Owner Grant. <input type="checkbox"/> Final deadline to defer 2023 property taxes (<i>penalties apply</i>). |
| July 3, 2024 | <input type="checkbox"/> Final deadline to make a late declaration for 2022 City of Vancouver Empty Homes Tax. |



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

ⁱ vancouver.ca/home-property-development/empty-homes-tax.aspx
ⁱⁱ gov.bc.ca/gov/content/taxes/speculation-vacancy-tax/faq-speculation-and-vacancy-tax
ⁱⁱⁱ canada.ca/en/services/taxes/excise-taxes-duties-and-levies/underused-housing-tax.html
^{iv} gov.bc.ca/gov/content/taxes/property-taxes/annual-property-tax/defer-taxes
^v canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/income-tax-folios-index/series-1-individuals/folio-3-family-unit-issues/income-tax-folio-3-1-f3-c2-principal-residence.html. Ask your Odlum Brown Investment Advisor or Portfolio Manager or visit our Client Centre for a copy of our article, "The Principal Residence Exemption."
^{vi} For 2022 declarations (due March 31, 2023), impacted regions were generally: Capital Regional District; Metro Vancouver Regional District; Districts of Lantzville and Mission; Cities of Abbotsford, Chilliwack, Kelowna, West Kelowna and Nanaimo; and UBC and the University Endowment Lands, with exemptions for islands accessible only by air or water such as Salt Spring Island, Juan de Fuca Electoral Area, Southern Gulf Islands and Bowen Island, per the following: <https://www2.gov.bc.ca/gov/content/taxes/speculation-vacancy-tax/how-tax-works/taxable-regions>. The geographic regions subject to the BC Speculation and Vacancy Tax in 2023 for declarations due by March 31, 2024, are expanding to include North Cowichan, Duncan, Ladysmith, Lake Cowichan, Lions Bay and Squamish, per <https://news.gov.bc.ca/releases/2022FIN0028-001137>.
^{vii} <https://www2.gov.bc.ca/gov/content/taxes/speculation-vacancy-tax/how-tax-works/terms-definitions/untaxed-worldwide-earner>
^{viii} A credit up to \$2,000 is available for Canadian residents; foreign owners/satellite families may reduce their 2% rate to as low as 0.5% through a 20% credit on BC income.
^{ix} The '1+' in the calculation allows a property to be covered for one extra year when there is overlap with another eligible property but isn't available if the taxpayer was a non-resident of Canada in the year of purchase.
^x grantthornton.ca/insights/flipping-a-house-your-gain-could-be-fully-taxable-under-proposed-new-rule
^{xi} City of Vancouver residents with advance and main property tax payment deadlines should pay the advance notice amount to avoid the 5% late-filing fee, then defer the main notice amount. In subsequent years, the advance notice amount will be \$0.

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