ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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Cooperation Despite Dysfunction

In mid-April, the Vancouver Canucks shocked the hockey world by beating the Scotia North Division-leading Toronto Maple Leafs in their return from a team-wide COVID-19 outbreak. With 22 players and four staff having tested positive for the virus, and many requiring bed rest, there were many who questioned whether the team was fit to play after a 25-day pause and only one practice. But they did play, and they won! Go, Canucks, Go!

The players celebrated their win like they had won the Stanley Cup – and so they should have. Their victory, while small on the surface, is symbolic of humankind's resolve and ability to rally together and adapt under pressure to make the best of a tough situation.

While the pandemic has caused much hardship and tragedy, it's been remarkable how far the world has come in its fight against the deadly disease. Not only have vaccines been developed and rolled out in record time, but the global economy in general, and the stock and real estate markets in particular, are considerably stronger than anyone expected when the world went into lockdown last year.

Despite heightened social unrest and polarized politics around the world, individuals, corporations, institutions and governments have risen to the challenge and worked cooperatively, or at least more supportively than might have been expected, to put the world on a healthier path. It's human nature to help each other in a crisis.

Indeed, politicians put their differences aside so that governments could provide the support that individuals and businesses needed. And they didn't disappoint. In fact, the collective governmental response to the crisis has been so great that it has assuaged our biggest concern about the outlook – that social unrest and dysfunctional politics would render governments ineffective.

Prior to the pandemic, we were cautious regarding the medium-term economic outlook because we worried that politicians wouldn't be able to agree on the fiscal policies we'd need during the next inevitable economic downturn. Both fiscal and monetary policies can resuscitate economies during recessions, but for decades it has been central banks and their accommodative monetary policies that have fueled the recoveries. Governments have been too dysfunctional to be meaningfully helpful.

In the fall of 2019, with yields on government bonds negative in much of Europe and Japan, and otherwise extremely low in North America and elsewhere, we recommended reducing risk and raising cash in portfolios, as we reasoned that monetary policy would be much less effective during the next recession. Governments

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In support of

BC Children's Hospital™ Foundation

BC Children's Hospital Foundation – Jean Up May 2021 Throughout BC

This May, BC Children's Hospital Foundation is on a mission to help kids get out of their hospital gowns and back into their jeans. Formerly Jeans Day, Jean Up is now in its second year as a month-long, fully digital initiative, making it easier than ever to participate.

Odlum Brown is proud to be the School Match Sponsor of Jean Up, matching donations made through schools' fundraising pages up to $30,000 throughout the month of May. Support for this initiative will fund everything from innovative research and equipment to specialized care that's tailored to the unique needs of kids. For more information, visit jeanup.ca.

would necessarily have a much bigger role to play in the next downturn, and yet we wondered if that would be possible or popular.

Ideally, governments should take advantage of economic expansions to improve their finances, but most didn't do that during the last cycle. Instead, they expanded deficits and increased debt, and therefore entered the downturn in a weakened state. Deficits naturally increase during recessions, as tax revenues decline and spending on benefits and services (i.e., unemployment insurance) increases. In addition to these natural cyclical pressures, there is ongoing secular pressure on government finances due to the rising cost of providing entitlements to an aging population. Consequently, we worried that governments would struggle to justify and finance discretionary deficits when we'd need them most.

Our concerns proved to be moot, as the magnitude of the COVID-19 crisis inspired cooperation despite dysfunction. Not only was the speed and scale of government and central bank responses unprecedented, but the support is ongoing.

It hasn't been a typical recession. Aggregate personal income normally declines during a recession alongside employment, but this time it went up thanks to government relief payments. Moreover, credit usually tightens in a downturn, but this cycle it got cheaper and easier to secure due to extremely accommodative monetary policies. Rather than a credit contraction, we have had a credit bonanza.

More importantly, society's attitude about government deficits and debt has shifted in the face of the pandemic. There is fairly widespread agreement that governments need to do whatever it takes to navigate us through the crisis, even if it means huge deficits and ballooning debt. There is also greater awareness regarding inequality and more support for policies that seek to address it.

While we still have longer-term concerns regarding the consequences of rising global debt, the important thing is that authorities did what was absolutely necessary in the face of the pandemic. Reassuringly, there is still tremendous stimulus in the economic pipeline and considerable pent-up demand that will be unleashed as the world opens up in the months ahead. It's reasonable to expect a robust economic recovery well into 2022.

Nonetheless, it's important to curb one's enthusiasm for the stock market. Markets are forward looking, and it's probably fair to say that they have already discounted a decent amount of the good economic news. Think about it in the context of the S&P 500 Index. This index recently reached a new high and is up almost 30% since the end of 2019, and yet earnings expectations haven't recovered nearly as much. The one-year forward earnings expectation for S&P 500 constituent companies today is up less than 8% from where it was in December 2019.

The reason for this disconnect is that investors are willing to pay more today for a dollar of future earnings than they were before the pandemic. That may be perfectly reasonable given that interest rates are modestly lower and the economic outlook is brighter. Having more faith in the capacity of governments to do the right thing in the near term is another factor that may justify higher valuations. Still, higher valuations will make it more difficult to sustain high returns. Investors would be wise to ensure their portfolios are well diversified and not overly concentrated in popular and pricey securities.

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2021 Federal Budget Highlights

On April 19, 2021, Canadian Deputy Prime Minister and Minister of Finance Chrystia Freeland delivered the government's 2021 Federal Budget, forecasting a deficit of $354.2 billion for the 2020-2021 fiscal year[1] and $154.7 billion for 2021-2022. Here is a brief overview of some of the notable proposals.

Personal Tax and Benefit Measures

Extensions to Canada Recovery Benefits

Three types of federal benefits were introduced effective September 27, 2020, to replace the Canada Emergency Response Benefit (CERB) to assist workers ineligible for Employment Insurance who had their income reduced by at least 50% due to COVID-19. The government proposes extending these benefits to September 25, 2021:

- The **Canada Recovery Benefit** would offer benefits at a lower weekly rate ($300 versus $500) to new claimants after July 17, 2021, or to claimants who have already received 42 weeks of benefits.
- The **Canada Recovery Sickness Benefit** offers up to four weeks of benefits to eligible workers.
- The **Canada Recovery Caregiving Benefit** would offer up to 42 weeks at $500 per week, per eligible household.

Tax treatment of COVID-19 benefit repayments

While the 2020 tax filing deadlines are not extended, automatic interest relief on outstanding tax is offered until April 30, 2022, to qualifying individuals with taxable income of $75,000 or less in 2020, after filing a 2020 income tax and benefit return. Individuals must have received an eligible COVID-19 benefit to be eligible. Individuals who repay a federal COVID-19 benefit before 2023 will have the option to claim a tax deduction for the repaid amount for either the year of repayment or the year in which the benefit was received.

Canada Workers Benefit (CWB)

The CWB is a federal refundable tax credit for employees earning low and modest income. Changes in the CWB's phase-in rate, phase-out income thresholds and income exclusions will help low-income Canadian workers to access higher benefits.

Increased Old Age Security benefits for Canadians aged 75 and older

For Old Age Security (OAS) pensioners who will be age 75 or over as of June 2022, the budget proposes to provide a one-time payment of $500, payable August 2021, followed by a 10% increase to OAS benefits effective July 1, 2022. The enhanced benefits will be indexed to inflation for future years.

Student loan relief

The one-year interest accrual moratorium on the federal portion of Canada Student Loans and Canada Apprentice Loans that was introduced in the government's 2020 COVID-19 financial package is proposed to be extended until March 31, 2023. Additionally, the budget proposes to increase repayment assistance for single individuals earning $40,000 or less. The current income support threshold is $25,000 per year or less.

Luxury tax on cars, boats and planes

Budget 2021 proposes a luxury tax on sales of select new cars and personal aircraft priced at over $100,000 and on boats over $250,000. The luxury tax will be calculated at 20% of the value in excess of the thresholds, or 10% of the full price, whichever is less. It will apply to both leasing contracts entered into and purchases made on or after January 1, 2022. GST/HST will apply to the final sales price of the property, including the proposed tax.

Disability Tax Credit (DTC)

Currently, the DTC is a non-refundable tax credit available to individuals with severe and prolonged physical and/or mental impairments, as well as individuals on life-sustaining therapy. The DTC has come under scrutiny in recent years for being too restrictive in its eligibility requirements. Budget 2021 proposes to enhance eligibility for the DTC by expanding the list of mental impairments considered for qualifying applicants. Furthermore, the budget proposes to reduce the minimum frequency of life-sustaining therapy from three times per week to two.

> **"Budget 2021 proposes a new 1% tax on the value of non-Canadian-citizen, non-resident owned vacant or "underused" residential real estate... It is unknown at this time how such a tax would interact with BC's Speculation and Vacancy Tax."**

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Unproductive use of Canadian housing by foreign non-resident owners

Budget 2021 proposes a new 1% tax on the value of non-Canadian-citizen, non-resident owned vacant or "underused" residential real estate. While not expressly defined, the government is considering "underused" residential properties as those which are not leased to one or more qualified tenants for a minimum period in any calendar year. Reporting will be incumbent on the non-resident beginning in 2023. The government will be accepting comments from stakeholders on the application and administration of this tax in the coming months. It is unknown at this time how such a tax would interact with BC's Speculation and Vacancy Tax.

Charities and Foundations

Annually, a registered charity is required to disburse a minimum amount on charitable programs and gifts to qualified donees. The purpose of this "disbursement quota" is to ensure charities and foundations are using assets for their intended purpose. Budget 2021 proposes initiating public consultations with charities in hopes of increasing the disbursement quota for 2022 and future years.

Business Tax and Other Measures

Extensions to COVID-19 measures for businesses

Two federal subsidy programs for businesses would be extended until September 25, 2021, and a new Canada Recovery Hiring Program (CRHP) would be introduced:

- The **Canada Emergency Wage Subsidy (CEWS)** supports employers of all sizes across all sectors. For claim periods between December 20, 2020, and July 4, 2021, the maximum subsidy rate of 75% of an employee's eligible pay (with limits per employee) is available if revenue dropped 70% or more. Budget 2021 extends CEWS at reduced subsidy levels beginning July 4, 2021, and would require public corporations to repay amounts for periods starting after June 5, 2021, if their 2021 executive compensation exceeds 2019 levels.

- The **Canada Emergency Rent Subsidy (CERS)** assists eligible Canadian businesses, non-profits and charities who have seen a drop in revenue due to the COVID-19 pandemic with a subsidy of up to 65% of eligible expenses (such as commercial rent, mortgage interest or property expenses). The base support would be gradually reduced starting July 4, 2021, to September 25, 2021. The additional 25% Lockdown Support top-up to organizations that are significantly restricted by a mandatory public health order would remain.

- The **Canada Recovery Hiring Benefit (CRHB)** is a newly proposed subsidy of up to $1,129 per employee per week to help hire new workers. Individuals, eligible partnerships, non-profits, registered charities and Canadian-controlled private corporations can claim up to 50% of the incremental remuneration paid to eligible employees from June 6 to November 20, 2021, if eligibility criteria such as reduced revenue are met.

Administration and Implementation

The budget proposes a change in rules for electronic filing and certification of tax and information returns and includes additional funding to support CRA's audit and tax collecting activities.

Budget 2021 can be viewed online in its entirety on the Department of Finance Canada's website[2] and is subject to parliamentary approval.

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[1] Ending March 31, 2021
[2] budget.gc.ca/2021/home-accueil-en.html

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