ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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Happy Holidays!

From all of us at Odlum Brown, we wish our clients, friends and partners the very best for a safe and healthy holiday season, and a happy and prosperous new year.

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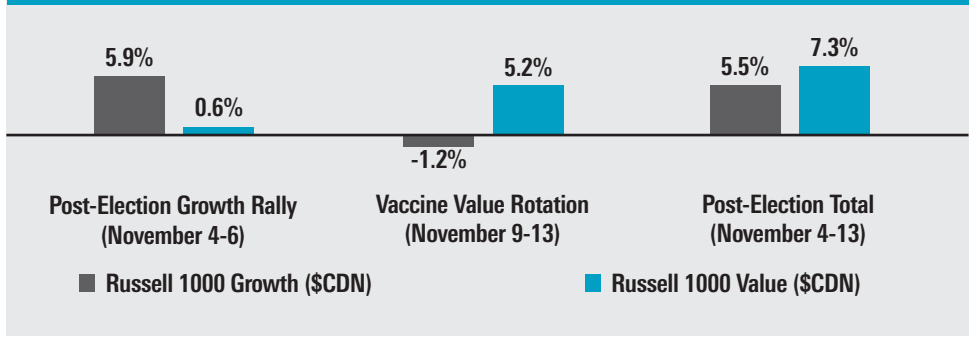
Light at the End of the Tunnel

Despite the controversy around the U.S. election and the worrisome spike in COVID-19 cases, stocks have moved higher. In fact, the rate of appreciation has accelerated recently. Since Americans went to the polls on November 3 through to November 13, the main Canadian and U.S. equity benchmarks rose 4.7% and 6.4%, respectively.

What's interesting, remarkable and downright encouraging is the shift in market leadership that occurred over those eight trading days. Advances in the first three days were led by growth stocks, while the gains over the latter five days were dominated by value stocks. The shift, highlighted in this chart comparing the performance of the Russell 1000 Growth and Value indices, suggests that there is light at the end of the proverbial tunnel and reason to believe that there is a stronger economy on the horizon.

POST-ELECTION PERFORMANCE – GROWTH VERSUS VALUE



In the three days immediately following the election, the Russell 1000 Growth Index shot up 5.9%, while the Russell 1000 Value Index rose an uninspiring 0.6%. The much-anticipated Democratic sweep of the White House and both chambers of Congress didn't materialize, and with that fears of increased regulation, significant deficit-expanding government spending and tax hikes faded. With the Republicans likely to maintain control of the Senate, it will be much tougher for the Biden-led government to enact bold initiatives, including a much-needed COVID-related fiscal stimulus bill in the near term. Not only will it likely take longer to get additional support where it is needed, but individuals, businesses and state and local governments will probably receive less aid than hoped.

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While it's hard to handicap whether popular growth stocks or depressed value stocks will outperform over the next few months, the odds are very good that out-of-fashion stocks will stage an impressive comeback over the next few years. Leadership will likely broaden from the narrow group of so-called FAANGM stocks – Facebook, Apple, Amazon, Netflix, Google and Microsoft – that have dominated market performance in recent years.

While that is bad news for the economy, it renders growth stocks more attractive for two reasons. First, the relative appeal of growth stocks increases in a slow-growth world because growth is scarcer; the premium for companies that can deliver growth in an anemic economic environment tends to increase. Second, less fiscal stimulus probably means the monetary authorities will keep interest rates ultra-low for longer and inject more liquidity into the financial system. Mathematically, the valuations of higher growth businesses benefit disproportionately from lower interest rates.

The optimism around growth stocks halted abruptly on Monday, November 9, with promising vaccine news from Pfizer fuelling a significant rotation from growth to value stocks. The moves that day were massive, and for the week the Russell 1000 Value Index surged 5.2% as the Russell 1000 Growth Index dropped 1.2%. While the enthusiasm toward value stocks has faded somewhat since, much as it did following other false starts for value stocks earlier in the year, the recent and sudden shift in investor sentiment felt different.

Companies that have suffered the most from lockdowns – airlines, cruise ships, retailers, hotels, restaurants, energy firms and banks – experienced unprecedented one-day upward moves in their share prices. While we remember many days when stock prices dropped dramatically, we can't think of a single occasion when the outsized moves were so broad and to the upside.

This remarkable market action was possible due to the extreme valuation spread between the so-called "stay-at-home" growth stocks like Amazon, Netflix and Microsoft, which have benefited from lockdowns, and the "get-out-and-about" value stocks, which have suffered. Moreover, the rotation was encouraging because it was a signal that there will eventually be a return to normalcy.

We are not suggesting it's time to break out the champagne, as there are many factors that could undermine the economic recovery and rattle investor sentiment in the near term.

While the preliminary test results indicate that vaccines being developed by Pfizer Inc. and Moderna Inc. are more effective than many hoped, the U.S. economy still has an urgent need for additional government support. President-elect Joe Biden is urging Congress to approve stimulus legislation before he takes office, yet President Donald Trump is more focused on fighting the 2020 election results than governing. Lawmakers have not passed new aid in months, and as the virus again overwhelms hospitals and forces state and local officials to restrict economic activity, Republicans and Democrats have not budged from their divided positions on stimulus. With earlier aid programs running out, the stalemate creates a very real risk that the economic recovery will relapse in the near term. Indeed, data from credit card companies suggests that consumer spending is waning even as the holiday season approaches.

As of this writing, President Trump is refusing to concede the election, and his administration isn't coordinating with the Biden transition team on important matters such as national security, the COVID-19 pandemic and vaccine distribution plans. The safety of the promising vaccines has yet to be established, and the lack of a smooth government transition undermines public confidence in the approval process. That's disturbing, as the success of the vaccines is dependent on their effectiveness, safety and widespread adoption.

While pandemic, political and economic uncertainty could bring near-term stock market volatility and weakness, it's equally possible that stocks will remain buoyant as investors focus on the prospect that vaccines and better treatments will ultimately help society return to normal. There is light at the end of the tunnel, and in our view it is only a question of when the world gets past the pandemic, not if.

The stock market is forward looking, and analysts are increasingly anticipating better economic growth and stronger corporate profits in the latter part of 2021 and into 2022. We think their optimism is warranted.

While it's hard to handicap whether popular growth stocks or depressed value stocks will outperform over the next few months, the odds are very good that out-of-fashion stocks will stage an impressive comeback over the next few years. Leadership will likely broaden from the narrow group of so-called FAANGM stocks – Facebook, Apple, Amazon, Netflix, Google and Microsoft – that have dominated market performance in recent years.

Because we have long advocated a balanced and diversified approach, we are not recommending any bold shifts in portfolio strategy. Our Odlum Brown Model Portfolio[1] holds both growth stocks and value stocks, including businesses that have been helped and hurt by the pandemic. With a modest tilt toward stocks with value-type characteristics compared to a blended 50/50 Canada-U.S. equity benchmark, we are well positioned to benefit as the light at the end of the tunnel brightens.

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[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.

Year-End Tax Tips and Deadlines

With December upon us, here are a number of tax considerations and deadlines to remember for the 2020 tax year. Please note that December 31 is a Thursday this year.

DON'T MISS THE 2020 DEADLINES!

Item	Deadline	Notes
Tax Installments	December 15	To avoid interest and penalties
Tax-Loss Selling	December 29	To reduce 2020 net taxable capital gains
Charitable Donations	December 31	To receive a charitable donation tax credit
Carrying Charges	December 31	To deduct from 2020 income
Income Splitting	January 30, 2021	To pay accrued 2020 interest on spousal loans
Repayment of CERB	December 31	To exclude CERB amounts that exceeded your entitlement, on 2020 T4A slips
RRSP Contributions	March 1, 2021	To deduct against 2020 income
If you turn 71 in 2020	December 31	For contributions to your own RRSP and converting to a RRIF or annuity; see notes 6 and 7 regarding spousal contributions.
RESP Contributions	December 31	To receive 2020 enhanced Canada Education Savings Grants; see note 9 if beneficiary turned age 15 in 2020.
RDSP Contributions	December 31	See note 10 regarding government grants and bonds.

Payments, Expenses and Other Transactions

1. Tax-Loss Selling

Tax-loss selling entails selling investments with unrealized capital losses before year-end to offset capital gains realized during the year. Any remaining unused capital losses can be carried over to offset capital gains from the three preceding years or in any future year. While this strategy may be advantageous from a tax perspective, ensure that tax-loss selling makes sense from an investment perspective as well.

To ensure that your capital losses can be reported in the 2020 tax year, trades on Canadian securities exchanges must be placed no later than December 29, 2020, as trades typically take two business days to settle. Different dates may apply to foreign exchanges.

Beware of "superficial loss" rules. The capital loss on an investment will be denied if you buy an identical investment during the period that begins 30 days before and ends 30 days after the sale settlement date and you still own that investment at the end of the period. These rules also apply if the identical investment is purchased by or transferred to your RRSP, RRIF, TFSA, spouse or a company controlled by you or your spouse.

If you are caught by the superficial loss rules, the denied loss amount is generally added to the adjusted cost base of the identical investment purchased, in essence deferring the loss until the ultimate year of disposition.

2. Charitable Donations

The first $200 of annual donations are eligible for a 15% federal tax credit, plus applicable provincial credit (5.06% in BC). The federal donation tax credit increases to 33% to the extent that the individual has taxable income in the highest tax bracket (in excess of $214,368 for 2020). When combined with the applicable provincial tax credit, this portion of the donation could be worth between 47.5% and 54.0%. Otherwise, donations in excess of $200 are eligible for a 29% federal tax credit which, when combined with the applicable provincial tax credit, could be worth between 43.5% and 50.0%.

3. Carrying Charges

Investment-related expenses, such as fees to manage non-registered accounts and charges and interest paid on money borrowed for most investment purposes (other than in registered accounts) must be paid by December 31 to be deductible in 2020.

4. Income Splitting

The deadline to pay 2020 interest on spousal loans is January 30, 2021. This should not be confused with pension income splitting rules which allow recipients of eligible pension income to allocate up to 50% of such income to a spouse or common-law partner, for tax purposes. Eligible pension income includes payments from a registered retirement income fund (RRIF) and life income fund (LIF) where the account holder is 65 years of age or older at the end of the year. It also includes life annuity payments from a registered pension plan at any age.

5. Repayments of Canada Emergency Response Benefit (CERB)

If you received CERB payments that exceeded your entitlement – for example, due to your income while claiming benefits exceeding the limit set per claim period, or due to claiming CERB through both Service Canada and the Canada Revenue Agency (CRA) for the same period – you can repay excess amounts by December 31 to reduce your 2020 T4A slip income amounts and simplify your 2020 income tax filing.

Contributions to Registered Plans

6. Registered Retirement Savings Plans (RRSPs)

The maximum RRSP contribution limit for 2020 is $27,230. If you contribute to a spousal RRSP, making a 2020 contribution by December 31 reduces the income attribution period for that contribution by one calendar year, versus waiting until 2021. If you have a considerable amount of contribution room or if you expect to be in a higher tax bracket in the near future, consider making the maximum contribution this year, but deduct the contribution over multiple years, depending on your expected taxable income and credits.

7. RRSP Contributions After Age 71

Although you can no longer contribute to your own RRSP after December 31 of the year in which you turn 71, you can contribute to a spousal RRSP if you still have contribution room and your spouse or common-law partner is not older than 71 in the year of contribution.

8. Tax-Free Savings Accounts (TFSAs)

There is no deadline for TFSA contributions. You must reach the age of majority (19 in BC) to open an account; however, the accumulation of contribution room starts at age 18. Unused contribution room is carried forward to future years.

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If you were eligible for a TFSA in every year since 2009 but have never contributed to one, you may have up to $69,500 in TFSA contribution room available for 2020.

If you plan to withdraw from TFSAs in the near future, consider making the withdrawal in December 2020, rather than in 2021. Since TFSA withdrawals increase your contribution room the following calendar year, this will enable an early re-contribution, as early as January 1, 2021, rather than having to wait until 2022.

9. Registered Education Savings Plans (RESPs)

The federal government provides a 20% Canada Education Savings Grant (CESG) of up to $500 annually ($1,000 annually, if catching-up past unused CESG room) for beneficiaries age 17 or younger at the end of the calendar year, up to a lifetime limit of $7,200 per beneficiary.

If your child turned 15 in 2020 and you have not contributed a minimum of $2,000 or at least $100 per year in any four years to the RESP, then December 31, 2020, is your last chance to contribute enough funds to maintain CESG eligibility on future contributions in 2021 and 2022 (ages 16-17).

The enhanced CESG (eCESG) is available to moderate-income families on the first $500 of annual contributions. Since eCESGs cannot be carried forward, contribute by December 31, if eligible.

10. Registered Disability Savings Plans (RDSPs)

RDSPs are tax-deferred savings plans that you can use to help provide long-term savings for an individual who is eligible for the disability tax credit. Lifetime contributions of up to $200,000 can be made by anyone until the beneficiary turns 59, but the contributions are not tax deductible.

The federal government provides assistance in the form of Canada Disability Savings Grants (CDSGs) and Bonds (CDSBs) until December 31 of the year in which the beneficiary turns 49:

- CDSGs up to $70,000 are provided on a matching basis, based on the contribution amount and the beneficiary's family income, subject to annual limits.
- CDSBs up to a lifetime limit of $20,000 are provided to low-income beneficiaries. No contributions are required to receive the bond, subject to annual limits.

Interested persons should consider opening/contributing to an RDSP by December 31 in order to receive government assistance for the current year and up to 10 previous calendar years, particularly if the beneficiary is age 49 by December 31, 2020.

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Odlum Brown's 27th Annual Address

Every year, we enjoy welcoming clients and friends across BC to our Annual Address presentation series. This year will be a little different, as we will be sharing our thoughts virtually.

In this new format, you will still hear from President and CEO Debra Hewson as well as Executive Vice President, Director, Investment Research, Murray Leith and his team of highly regarded Equity Analysts.

Your input, please! To help us prepare a thoughtful and relevant question-and-answer session in advance, we ask that you share what's on your mind with your Odlum Brown Investment Advisor or Portfolio Manager. We will look for common themes and do our best to provide useful insights that address our clients' most pressing questions.

Please stay tuned for more details, and we look forward to connecting with you in the new year.

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