Manulife Securities

ROYDS REPORT

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Individual Taxpayers Shoulder More Tax Burden Than Corporations and Canadian Debt

After the US election, some people were concerned about the US stock market, because Joe Biden got in as president and said he would raise corporate taxes (to 28%) that Trump cut (from 35% to 21%). Eric Reguly had an interesting article in the Globe and Mail (Apr 10/21) on the subject. He talked about how in the days of Reagan and Thatcher, taxes were cut on corporations on the premise that, if their tax load was lighter, they would have more money to plough back into the economy to increase employment, productivity and salaries, and would thus end up generating more tax revenue that way. It turns out that what happened when corporate taxes were cut by Reagan, Thatcher and Trump was that the saved money was used for share buybacks, higher compensation packages for executives and high cash reserves. This helped investors, but tax savings were not poured back into the economy and jobs were not created by the savings. So taking some of those tax savings back is not expected to hurt the economy. And it addresses the problem where a "Decades-old trend has seen corporate [tax] rates cut to the point that any balance with individual taxpayers is long gone". In the 1960s Canadian corporate tax revenue equalled about 60% of personal tax revenue, but now corporate tax revenues are only about 30% as much as personal tax revenue. The tax burden has been put on our shoulders more to relieve the burden on businesses. This helps the really rich get richer and the middle class falls further behind. If stocks we own make a little less in the end because companies start paying their share of taxes and we, middle class investors, pay less in personal taxes, our net worth growth may end up the same. And hopefully all the super valuable high tech companies, like Facebook, that are making money outside the US by presenting advertising to international citizens will have to start paying taxes in every country, where they are making money through their digital presence. Some governments are trying to address this issue, but it's complicated and will be a while in coming.

Another tax change announced for Americans was the doubling of capital gains tax. A similar move was expected in the Canadian federal budget presented in April, but it didn't happen. There's speculation that it

won't be announced for Canada until next year. There's also a proposal to increase personal taxes for those making over $1,000,000/yr in the US. Of course the majority of Amercians are in favour of it, because it doesn't affect them. Does anyone remember when England introduced income taxes on the rich of 89%? That's when the Beatles and a lot of other wealthy people emigrated for a few years. And Canada isn't immune from thinking that the rich need to keep paying more and more. One national politician is proposing a 100% tax on assets over $1 Billion. How quickly might we see Shopify and every other big start up in Canada move south of the border. If the US had ever done something like that, we might never have seen companies like Walmart, Hershey's, Facebook, Apple, Johnson & Johnson, Fidelity, Amazon, Netflix, Tesla etc develop. And when Goldman Sachs needed help to survive 2008, there could never have been someone like Warren Buffett around to bail them out.

On a positive note, US Federal Reserve Chairperson Janet Yellen is lobbying the world to adopt common business tax rates to put an end to companies moving their headquarters from country to country depending on where they can pay the least tax.

Buffett

The first weekend in May is when Warren Buffett, often called the greatest investor of the last 60 yrs, always holds his annual meeting for Berkshire Hathaway, which has been accessible virtually since COVID. We'd like to share with you two important points from the summary of his meeting by Advisor Analyst.

- In the early decades (starting in the 1950s), finding great stocks to buy was as easy as shooting fish in a barrel, because other investors didn't have access to the same financial information Buffett or his partner, Charlie Munger, had, nor did they have the same educational background to analyse the information. When other investors became more sophisticated, that advantage waned. But Buffett's company, Berkshire Hathaway, still had an advantage over others in that it had billions at its disposal. So when a private company, especially those owned by a founding family, wanted a buyer, especially a buyer who would keep operating the company the way it had been run, Buffett was one of the few who had enough cash on hand and had a hands off management style to meet the sellers' requirements. So, Buffett got his pick of companies to buy without competing for them on price. Then as recently as 2008, Buffett's cash reserve of billions or a fraction of a trillion meant that cash strapped companies in the finanical crisis who needed a cash rich saviour went to Buffett and he could get them at bargain prices. This led to a 60 yr unmatched record of 20% compound returns. As Buffett and Munger say, "Weak competition is the key to investment success." However, in the last decade, when Buffett has managed too much money to look at any deal worth less than $50 Billion, he hasn't been finding any fish in the barrell. His returns of the last decade are around 12%, and have brought his long-term average down to a mere 19%. [And indeed we agree that competition has been fierce. Only the most brilliant of individual stock pickers or teams of well-trained researcher-analysts have a chance to outperform.]
- With 1 month US Treasury Bills paying only 0%, low interest rates have essentially "eliminated gravity" for stock prices. If your choice is making nothing loaning out money or buying stock to make something, the limit on stock prices is pretty much the highest price that will still allow you to make a little something. In the long-run though, gravity should return through higher interest rates and stock prices will then drop. [More on this in the next section]

More About Interest Rates

Canada and the US are diverging on interest rates, which doesn't happen all that often. The Bank of Canada is already starting to buy fewer bonds. This is called Quantitative Easing Tapering. The BoC was buying bonds to add liquidity to the market during the COVID downturn/recession. In case too many people were selling their bonds to raise cash for their businesses, and for the Government of Canada to be able to sell bonds to help pay for stimulus packages, the BoC had cash ready to make sure there were more than enough buyers for all the bonds for sale. By ensuring this high degree of liquidity, bond sellers got good prices for their bonds. Remember that bonds work like teeter totters. If the price goes up, the interest rate or return goes down. So, by keeping prices for bonds high, the BoC kept interest rates low. This saved businesses and individuals with debt from having to pay more interest at a time when their cash flow was impaired, and it allowed those with bonds or other fixed income assets to be able to sell them for a high price when they needed cash to keep functioning.

Now that the Bank of Canada has announced it will taper off buying bonds, interest rates would drift higher as bond sales fetch lower prices (since buyers may no longer outnumber sellers). And furthermore, the BoC indicated in its April policy meeting that it might raise interest rates on its overnight lending rate to banks in 2022, which is earlier than had previously been indicated. This is one of the other tools the BoC has to influence interest rates in the country. This contrasts with the US Federal Reserve guidance that it won't increase rates until 2024. Why the different in interest rate plans between the two countries? And what are the implications? These are important questions for investors and all Canadians.

First, a higher interest rate in Canada supports the Canadian dollar, as do higher oil prices. In fact, the US dollar has depreciated versus the Euro, the Yen and the Canadian dollar. Secondly, it signals to the world that Canada is doing better economically. Indeed the BoC forecast for GDP growth, which includes lots of recovery from a low production period during COVID, is now 6.5%, which is higher than forecasters' expectations of 6%. Canadians have already recovered 90% of the jobs that were lost during COVID, while Americans have only recovered 60% of their job losses. Thirdly, it signals that the US is not afraid inflation will be too strong anytime soon. A higher interest rate might slow economic growth, thus preventing an overheated economy where prices get pushed up. And with an estimated $1.5 Trillion USD in *extra* savings in Americans accounts as a result of 2020 stimulus payments, there is a risk of high purchase demands causing inflation in the US. However, the US Federal Reserve would like a little more inflation than there had been. So inflation may be less in Canada going forward than in the US. So, the US's low interest rates may provide extra economic stimulation leading to a pick up in employment and inflation, but the BoC seems to feel that we are already on the road to better employment and want to head off a spike in inflation. Source: Mackenzie Investments May 2021 Market Insights

Housing

Housing prices continue to soar, especially for larger homes with lawns, outside of the GTA. Ian McGugan wrote a 2 full page article in the Globe & Mail on May 1, 2021, on the subject. The following are a few insightful excepts. "The recent gains in home prices, at least until January, were largely a mechanical response to falling interest rates and tight supply, says Stephen Brown, senior economist at Capital Economics … he points out that five-year fixed mortgage rates fell by half between February, 2019 and February, 2021 … the decline in borrowing rates boosted the price they [homeowners] could afford by 22 per cent. Since January, prices have been more detached from fundamentals [more on this later] … an assistant professor at the Ivey Business School in London, Ont., says the biggest single factor behind the rapid gains over those five years was an unexpected jump in Ontario's population that created a persistent mismatch between supply and demand. During that period, the province added nearly a million people, many of them foreign students and temporary foreign workers. The increase was out of all proportion to the 600,000 or so newcomers in the previous five years… Policymakers were caught by surprise and failed

to ensure the province's supply of housing was in line with the influx of people". Further to that point about housing prices becoming more detached from fundamentals, "the recent mania reflects financial and psychological factors. Ultralow interest rates are key. So is the growing pool of cash that is building up in family savings accounts as opportunities for spending dwindle in a locked down economy. Added to that is the plausible theory that more and more people will be working remotely and so will require more living space. Finally – and perhaps most important of all, there is the you-only-live-once attitude that seems to feed on itself when too many bored consumers are cooped up at home for too long. …John Pasalis, the economics researcher and president of Realosophy Realty [said] "But the irrational component, what makes it a bubble, … is that these crazy outliers are becoming the norm. Everyone is feeling they need to spend $30,000, $40,0000 or $50,000 more than what comparable homes sold for three of four weeks ago just to get in to the market. … Housing starts surged 21.6 per cent in March to a record annualized pace of 335,000 units. If that trend continues, home buyers may begin to have more choice and the current buying fever could gradually abate. … Canada's real estate market now stands at the intersection of two ugly possibilities. In one scenario, home prices plunge. In another, they continue edging higher. Either outcome carries unsettling consequences. The most dramatic danger is the first scenario: a market crash. Over the past 30 years, countries such as the Unites States, Japan, Spain and Ireland have suffered through home price collapses. In each case, a devastating recession and a multiyear slump quickly followed. … But supporting further real estate gains result in pain of its own. Take the effect on productivity, for instance. Today's lofty home prices discourage people from moving to the most expensive locales, cities such as Toronto and Vancouver. These superstar metropolises are centres of economic activity. They are also stunningly productive. Yet rather than welcoming new residents and new housing, they zealously protect the character of many existing, residential neighbourhoods through zoning restrictions and other initiatives that prevent new construction from rising to meet potential demand. As a result, only a limited number of workers get to participate in those highly productive local economies. … In a renowned 2019 paper called Housing Constraints and Spatial Misallocation, [professors] estimated that exclusionary zoning shrunk the pace of growth in the United States by about 36 per cent from 1964 to 2009. Simply increasing housing supply in hot spots such as New York, San Francisco and Silicon Valley would have boosted average annual earnings for the entire country in 2009 by US $3,685 a person…At the very least, high home prices are breeding social stress as young Canadians shell out increasingly obscene sums to old Canadians for the privilege of owning a house. Two decades ago, the all-in cost of owning a single-family detached home ate up 40 per cent of an average household's income, according to Royal Bank of Canada calculations. By October, 2020, buying the same home required an excruciating 55 per cent of income. …home prices are rising far faster than fundamental factors, such as income or rents. …Prof. Moffatt notes… that big recent gains mean even a double digit home price correction would simply reverse the advance of the past few months, punishing recent buyers but not making homes that much more affordable." So, if interest rates rise, we may see some of Buffett's "Gravity" affecting home prices. And with a long-term solution of an increase in supply, home prices could end up being stagnant, at best, for a decade or more till incomes catch up to make them affordable over the long term.

Owning real estate to live in is one thing. Having an "investment property" is quite another. People can hardly believe it when we show them a chart from 1998 to 2020 showing that despite high housing price appreciation, the housing market has not kept up with even the Canadian stock market, let alone the US market. There really are better opportunities out there for people's money, rather than jumping into this real estate bubble.

How Bad is Canada's Debt Problem?

Many Canadians are looking for a plan to reduce the Canadian debt, especially those who get their education on Facebook and believe the nonsense going around that Canada has the worst debt level of any

major country and that we're on the road to becoming a third world country like Argentina. On **Apr 27, 2021, S&P, one of the 2 large credit rating agencies in the world, just reaffirmed Canada's triple A credit rating, the highest rating you can get. Canada was in such good shape debt-wise before the pandemic, that the country could afford to spend to help individuals and companies survive the lockdowns and closures.** If the plan for more affordable child care pans out for the rest of Canada the way it did in Quebec (raising the participation rate of women in the workforce), it could boost the economy quite well, and the government might be able to recoup about 150% of every dollar spent on affordable daycare. That will be helpful to reduce the debt. Another important fact that most Canadians aren't aware of is that **almost 40% of all Canadian government debt is owned by the Bank of Canada, a branch of the government**. So, the Canadian government owns a lot of their own debt in the form of bond ownership. Our net debt is only 60-65% as much as the gross debt reported in the news. And the cost of servicing this debt, while interest rates are so low, is less than the cost of servicing the debt was 5 yrs ago before the COVID spending. Lastly, Canada's debt level (compared to GDP) is no where near as bad as that of most developed countries, which have not crumbled under the weight of their debt. So, don't lose sleep over Canada's debt level. It is affordable for us and was increased to prevent business and personal bankruptcies that could have led to a multi-yr recession, which would have been far worse for the country and Canadians.

Collector Coins Takes on a Whole New Meaning

Some are suggesting that in 10 years there will be no more cash transactions. Everything will be paid for digitally (debit or credit). This could reduce the opportunity for people to underreport their incomes and level the tax playing field between those who receive T4s or those who completely report their business or labour-for-cash-income and those who don't report their real income.

Bitcoin, in its present format, is not the "currency" expected to replace cash. Last year, the carbon footprint caused by all the electricity Bitcoin used was more than the carbon savings of all the cars Tesla sold. **Bitcoin had the equivalent electricity usage of 12 million homes** and the rate of electricity usage is quickly doubling. Competitors with greener footprints are expected to eclipse Bitcoin, if Bitcoin doesn't change the way it does Bitcoin mining. These days many of the holders of Bitcoin are holding it as a commodity that they think will increase in price and have no intention of ever using it as currency. That might not end well for them (Source: BNN Bloomberg News, Apr 27 2021)

Value Investing

For the last decade the market has favoured growth. We just finished (if it is over!?) the longest period ever where growth investing outperformed value (on average). We are lucky that our Growth At a Reasonable Price (GARP) strategy has a foot in each camp. Still anyone who has worried about reasonable prices at all has appeared to be behind the times. AdvisorAnalyst.com published this in April, ""Where ignorance is bliss, 'tis folly to be wise," wrote the British poet Thomas Gray. One of these days, perhaps sooner than later, stocks will stop going up and the importance of understanding what you own will reassert itself. For the time being, though, investors who used to think of themselves as wise may continue to look foolish."

The Bull Versus the Bear

Some say that an upward moving stock market is considered a bull market because a bull sweeps up with its horn when attacking. A bear, associated with a falling stock market, attacks or defends itself by sweeping down with its paw. Regardless of which might prevail in a physical fight, here's how they have each fared in the stock market. The bear market returns were each followed by the bull market returns shown (according to a Bloomberg chart just sent out by Dynamic – although we note that some of the downside

appears to be calculated on a month end basis. So instead of taking the COVID downturn from Feb 19 to Mar 23, which would have been a 35% drop, it appears to have been shown from Feb 1 to Mar 31, having the gains of early Feb and the recovery of late Mar offset some of the peak to trough numbers. If you only looked at your statements every month-end, this is what you would have seen and experienced).

Year	Duration	Bear	Bull
1957	12 months	-21%	268%
1970	17 months	-22%	74%
1975	8 months	-30%	278%
1983	12 months	-39%	253%
1987	6 months	-23%	39%
1991	12 months	-20%	203%
1998	4 months	-27%	109%
2001	21 months	-43%	168%
2008	9 months	-43%	195%
2020	2 months	-22%	34% so far

Even though if you go down 43% you need 75% recovery up to get back to your starting point, or if you go down 22% you need 28% to get back to even, every recovery so far has taken the market to new highs. If there's a chance of missing the recovery, one is better off not to get out of the market even to avoid the bear market. The drops may never be comfortable (although they get easier to live with the more times you experience them), financially speaking it's worth the pain for the tremendous gains afterwards.

On Jan 29, 2021 the Globe and Mail reported that 1 in 5 seniors will suffer elder financial abuse at the hands of family, friends or caregivers. If online and phone scams are included, the number are even higher. The president of a national seniors' advocacy group says that it's worse because of COVID, because adult children who have lost their income are asking parents for support, even if those parents need that money themselves. And with social distancing, many seniors Epidemic of Elder Abuse
are more isolated and may be easier targets for caregivers. If you are being pressured to give your money away, don't feel guilty about saying no. And if you ask us to send you money that doesn't fit your normal living pattern, don't be surprised or resentful if we inquire about the withdrawal. We are trying to make sure you aren't being taken advantage of. If you are ever in doubt about sending money somewhere or giving it to someone, you can always stall and take more time to think about it and call us to get a second opinion. And, if you have designated a trusted contact person with us, we may be able to call them for help, if we feel you are not acting characteristically and might be being pressured to do something not in your own best interest. Awareness is your first line of defence though. And remember, you are responsible for your own financial well being first and you are not responsible for your kids/friends and caregivers.

New Information about Longevity, Alzheimer's and COVID Severity

Doctors and pharmaceutical companies aren't the only ones who know what constitutes health risks. Insurance companies do extensive studying of factors than can lead to longevity or conversely to death. After all, every insurance policy issued is a bet about how long it will be before the insurance company has to pay out the death benefit.

The Chief Underwriter of Manulife Financial (Manulife Securities Incorporated's parent company) hosted a webinar in April 2021 about **one factor that significantly increases a person's chance of a) not exhibiting**

the symptoms of Alzheimer's (despite having the same brain changes as people who do exhibit symptoms), b) living longer, and c) having 80% less likelihood of dying from COIVD once infected. That factor is activity. For examples, **80 yr olds who do 2 minutes per day of exercise with 1 pound weights live longer**. **Women over 70 who take at least 4000 steps a day have major mortality rate improvements**. Strength training helps at any age. So it may not take much time and certainly not much money to really improve your chance of living longer or of surviving a COVID infection.

What Will the World Look Like in 2030?

Capital Group presented their views on what the world will look like in 2030. Here's what seems to be coming:

- Health Care Innovation Reaching Warp Speed – growth of remote patient monitoring advice (29%/yr?), breakthroughs in diagnositics capabilities
- Cure for Cancer - current huge growth rates in research and recent scientific developments , plus genetic testing related therapies and China's increasing spending on curing Cancer could bring more huge breakthroughs this decade
- Cash will be a thing of the past
- Covid will be remembered as a turning point, like Pearl Harbour was**. In 1941, 75% of the U.S.'s artillery was horse-drawn.** Yet 4 yrs later the world was in the atomic age and a period of growth and transformation had begun for the US. Covid seems to be leading to a much more digital, data centred an virtual world and it could have sparked deep social change
- Semi-conductors will be Everywhere - Robotics, autos, and consumer electronics are now using semi-conductors, just like cell phones and computers and the growth in usage is ever-expanding
- Wearable Technology will expand – glasses than provide simultaneous translation, memory joggers in your ear about approaching people your glasses recognize, medical monitoring etc
- Digital Entertainment – streamed entertainment could just get bigger, virtual reality technology could replace in person concert and sporting event attendance at a fraction of the cost, and video game usage will keep exploding
- Remote work – less frequent commutes if people only work 2 or 3 days a week, de-urbanization of companies and workers could alter urban real estate prices, restaurants could turn into massive kitchens where people would cook for themselves being guided by chefs to make dining a participative experience
- Green autonomous Vehicles with Hybrid of Hydrogen Engines could hit the Fast Lane – complete with infotainment systems, advanced navigation, long-range radar, image sending cameras etc, and capable of receiving updates over-the-air, so cars get outdates less quickly
- The World will be powered by renewable energy

These are themes many of our fund managers are investigating and investing in.

Hope you all have had your first (or better yet both) Covid shot, or at last are scheduled for it. In person visits could return his year. In the meantime, there's Zoom and phone calls. So we hope you accept meeting requests and call or email us when you have anything to discuss.

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