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Federal Budget 2023

The 2023 budget is due this week (Tuesday afternoon) and we might finally see some of the tax increases expected the last few years: an increase to the GST rate nationally, an increase to the capital gain inclusion rate and an increase to income tax rates at the highest brackets (targeting higher income earners). Particularly interesting this year is the fact that inflation is still high with part of the reason being consumer spending in Canada. Raising the GST rate may serve to reduce spending and help the government get the inflation rate under control.

Income Tax Tip

Be very aware of the new report that affected individuals now must file with your taxes called the Underused Housing Tax (UHT) Return and Election Form. The UHT took affect January 1, 2022 and is a tax on the ownership of vacant or underused residential properties in Canada.

American Banking Fiasco

I refuse to call the bankruptcy of Silicon Valley Bank two weeks ago (and a handful of other banks so far) a crisis, when it appears to be mismanagement of the bank from my perspective. There are even comments being made that the new "work from home" culture contributed to the rapid decline. Yet the impact has rocked the markets worldwide and put a magnifying glass on other institutions - this is good for the health of the system. This is not 2008 all over again and the declines in Canadian banks present a short term opportunity to invest. With that said, never fall in love with any security, including Canadian bank stocks. Keep your investments diversified and never let one investment get overly large to create concentration risk.

Our Weekly Perspective About the World

Every week, our team meets to discuss world events, economics, politics, prices, taxation, inflation, market sentiment, competitor strategies and much more, to then translate fears and optimism into investment and financial planning strategy.

From debt levels, war and recession, there is a lot to be concerned about right now and we are monitoring it all.

Individually then, with each client, we inter-relate strategy and products with your goals, state of life, personality, financial state and other considerations. No one is the same and we customize each plan. Overall, we make calculated recommendations on strategies and products related to investments, debt, real estate, careers, achieving goals, protecting yourself and other factors that impact your life and your finances - provided you share your financial picture information with us. We offer a lot more than just investment management and are well known in Canada for our integrated planning and strategic viewpoint approach.

Weekly we review dozens of documents to learn about the world around us. This includes our own internal research as well as a mountain of third-party research, reports and tools at our fingertips from the likes of Blackrock, Royal Bank, Goldman Sachs, Morgan Stanley, TD Bank, Morningstar and Bloomberg.

Enclosed below are three documents I found particularly useful in early March as we watched the U.S. banking crisis unfold. They are written by experts on the Manulife Investments Team in Toronto and are worth a read.

U.S. Interest Rate Outlook:
https://www.manulifeim.com/retail/ca/en/viewpoints/asset-allocation/three-questions-for-fed-in-lead-up-to-march-meeting

Implications for Canada of the U.S. Banking Crisis:
https://www.manulifeim.com/retail/ca/en/viewpoints/asset-allocation/global-market-turmoil-what-does-it-mean-canada

Assessing the contagion risk from ongoing banking concerns to Asia (March 20)
https://www.manulifeim.com/institutional/global/en/viewpoints/market-outlook/assessing-contagion-risk-from-ongoing-banking-concerns-asia

Our team key takeaways from the activities in early March:

- Reduce any direct exposure to regional U.S. banks now and long term.
- Expect an acceleration of the slowing of the U.S. economy leading to a faster possible recession.
- Desirable market conditions for purchasing bonds and GICs with 5-10 years maturities and select stocks and equity ETFs, while avoiding purchases of Canadian real estate ahead of an expected decline through 2023.

From the Desk of Gerdi Lito, CFA
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Market risk vs. Business risk

The investment risk of any security can be split into two categories: market risk and business risk.

Market risk (known in literature also as systematic risk) is that part of the risk that comes from major factors that cannot be controlled by the management of a company. This includes (but is not limited to) pace of economic growth, inflation, interest rates, currency exchange rate, political intervention, natural and man made disasters.

Market risk is hard to predict (no one could predict COVID-19 or the war) and even when there are models that try to predict some of the factors (like inflation or interest rates) they can often be wrong (no one predicted inflation going this high in 2022). For this, it cannot be eliminated from a portfolio, you can only manage it up to a certain point, for example: avoid investing in countries with high political instability.

Business risk (known also as unsystematic risk) on the other side, is related to factors that can be controlled up to a certain degree by the management of a company including the business model, how the company is run, profitability, debt levels, competition strategy, pricing.

Unlike market risk, business risk can be managed and almost eliminated in a portfolio.

Diversification automatically reduces business risk as your money is not related to a single company or a few companies. Owning bundles of stocks like exchange-traded funds (ETFs) reduces this risk substantially as we buy tens if not hundreds of stocks in one product.

When selecting individual stocks for our portfolios we pay a lot of attention to the factors mentioned above (business model, quality of management, profitability, debt level, competition and more) to make sure the business risk is kept under control.

We monitor hundreds of securities daily to make and check all their quantitative and qualitative parameters for the securities that we include in our portfolios.

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Investor protection in Canada

The recent news of smaller U.S. bank failures has raised some questions about how investor money is protected in Canada. There are various institutions in Canada that were created to ensure your assets are safe.

Canada Deposit Insurance Corporation (CDIC)

What is CDIC?

- CDIC is a federal Crown corporation that provides deposit insurance against the loss of eligible deposits at member institutions in the event of failure of that institution.

Who are CDIC member institutions?

- Banks
- Federally regulated credit unions
- Loans and Trust companies
- Associations governed by the Cooperative Credit Associations Act that take deposits.
- For a list of CDIC member institutions please click here.

What is covered from CDIC?

- Savings and chequing accounts

- GICs and other eligible term deposits

What is not covered from CDIC?

- Mutual funds, stocks and bonds
- Foreign currency
- Cryptocurrencies

What are CDIC's coverage limits?

- If a CDIC member institution fails, eligible deposits at each CDIC member institution are protected to a maximum of $100,000 per separately insured category. For more information on coverage and insured categories, click here.

Do I have pay or apply for CDIC coverage?

- No, CDIC coverage is free and automatic. If your deposits are insured, CDIC will pay you automatically in case of a failure.

Canadian Investor Protection Fund (CIPF)

What is CIPF?

- CIPF is a not-for-profit organization whose mandate it is to provide protection if property being held by a member firm on your behalf is not returned to you following the firm's insolvency.

Who are CIPF member firms?

- Any investment dealer that is a member of IIROC (Investment Industry Regulatory Organization of Canada)

   - As an example, Manulife Securities is an investment dealer and a member of IIROC and CIPF.
- For a directory of CIPF member firms please click here

What type of securities are covered from CIPF?

- Cash
- Securities
- Futures
- Segregated insurance funds

What is not covered from CIPF?

- Losses resulting from:
   - a drop in the value of your investments for any reason.
   - unsuitable investments.
   - fraudulent or other misrepresentations that were made to you.
   - misleading information that was given to you.
   - important information that was not disclosed to you.
   - poor investment advice.
   - the insolvency or default of the company that issued your security.
- Securities held directly by you (for example, a share certificate that you hold)
- Other exclusions identified in the CIPF Coverage Policy.

What are CIPF's coverage limits?

- For an individual, the limits on CIPF protection are generally as below:
   - $1 million for all general accounts combined (such as cash accounts, margin accounts and TFSAs), plus

  - $1 million for all registered retirement accounts combined (such as RRSPs, RRIFs and LIFs), plus
  - $1 million for all registered education savings plans (RESPs) combined where the client is the subscriber of the plan.
- For more information on limits for corporations, partnerships, unincorporated organizations and trusts, click here.

Do I have to pay or apply for CIPF coverage?

- No, CIPF coverage is free and automatic if you have an account with a CIPF member firm that is used solely for investing in securities or in futures contracts.

From the desk of Frank Valicek, CFP, CIM
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Canada's inflation rate continues to decline.

Some much-needed good news emerged on March 21st with Statistics Canada announcing February's inflation rate decreased more than expected to a rate of 5.2%, down from January's 5.9%.

We are now well below the 8.2% peak in inflation that occurred in June 2022 signalling that all the Bank of Canada's interest rate increases are having their intended effect.

There is room for debate as to whether we will ever see the Bank of Canada's sweet spot of 2% in the short-term, but all expectations are for inflation to continue to decline significantly over the course of the year.

One troubling note is food inflation remains stubbornly high so its no wonder the executives of food distributors Loblaw, Metro and Empire were called before a parliamentary committee on March 8th.

More details can be found in the following articles from Yahoo Finance: Canadian Inflation eases to 5.2% in February and Global News: Grocery CEOs testify in Ottawa.

From the Desk of Evan Campbell
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Silicon Valley Bank Collapse

The prominent U.S. tech startup bank, Silicon Valley Bank, collapsed this month in what was the second largest bank failure in the United States since Washington Mutual in 2008.

What Happened?

Silicon Valley Bank (SVB) was somewhat unique within the industry as a large player in the tech startup ecosystem. During the COVID pandemic, SVB bought many long-term government bonds, when interest rates were low. Government bonds are usually a very safe investment, but the bank improperly managed the interest rate risk associated with this type of investment strategy.

As inflation rose and triggered a response from the federal reserve in the form of interest rate increases, the market value of these bonds declined and created an unrealized loss for the banks bond portfolio. This would normally not be a problem had the bank been able to hold these bonds to maturity.

However, in its 1st quarter 2023 Investor Letter, SVB announced sales of its bond portfolio to address liquidity concerns, realizing a $1.8 billion post-tax earnings loss. Credit ratings for the bank's bonds were downgraded by ratings agencies and depositors began to be cautious of a bank failure.

Because of SVB's status as a tech startup bank, many depositors were linked by venture capital firms, with larger than normal accounts held with the bank. In fact, over 93% of deposits within Silicon Valley Bank were over the $250,000 FDIC insurance protected limit.

Venture capital firms began to inform their start-ups of the increased risk of holding assets with the bank, causing a bank run at unprecedented speeds. Large amounts were withdrawn in a very short period, exacerbated by the efficiency of modern online banking and the account sizes of the bank's typical tech-startup clients, causing Silicon Valley Bank stock to plummet and the bank to fail.

What Next?

The Federal Deposit Insurance Corporation (FDIC) took over control of the bank, putting nearly $175 billion in customer deposits under the regulator's control. The fear of a more widespread banking system failure caused bank runs elsewhere, and another U.S. bank, Signature Bank, was also seized by regulators.

The FDIC announced that it would cover depositors of these banks above the FDIC limit, and give them access to all their money, effectively saving large depositors and startups from major losses because of uninsured cash deposits above the limit. These measures would only protect depositors, not investors in the Bank, would be covered by the Deposit Insurance Fund and recovered by a special assessment on banks, a measure that was enacted after the US Financial Crisis in 2008.

The FDIC also announced a new emergency lending program, the Bank Term Funding Program, to ensure liquidity in the event of increased withdrawals. This lending program offers loans of up to one year, allowing banks to pledge eligible assets (such as US treasuries) as collateral and value them **at par**. This would effectively allow banks with similar unrealized losses on interest rate sensitive securities to meet liquidity demands without selling these securities at a discount.

Sources used for the Silicon Valley collapse piece:
US Federal Reserve ,BTFP
US Federal Reserve, FDIC
New York Times
Silicon Valley Bank
SP Global

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