



Important Topic: Taxation

When evaluating any investment, it is always critical to consider the after-tax and after-inflation return. This final result is what matters.

Taxation

Simply, taxation is the percentage of your investment return that goes to the government. If a bond returns 4% and taxation is 53.5% then the government takes 2.14% and you get to keep only 1.86%.

Since the rate of taxation is so important and since it is different dependent on the form of the return – interest, dividends, capital gains, return of capital – understanding the type of return you receive from an investment is critical.

Tax Rates

- Interest is taxed at the same percentage as income – 53.53% for the highest income earners in Ontario (income over \$220,000).
- Eligible dividends are taxed at roughly 3/4 of this rate – 39.34% for the highest income

earners.

- Capital gains are taxed at half this rate – 26.76% for the highest income earners.
- Return of capital is generally not taxed when received, but lowers one's cost basis resulting in a larger capital gain when sold. This can therefore be described as a deferred capital gain.

The following investments, therefore, all have the same after tax return of 4.00%:

- Interest of 8.60%
- Eligible dividends of 6.60%
- Capital gains of 5.46%
- Return of Capital (sold - deferred - after 10 years) of 5.14%. It is the net present value of paying capital gains tax in the future

Conclusion

Focusing on taxation matters. The type of income you earn can have a significant effect on your net worth over time and on your ability to meet your goals.

Market Update:

June 2020 - The Rally Continues

The market has continued its rally, now in its 15th week.

We believe the rally is based on three important factors:

First, world governments have “built a bridge to 2022” – injecting trillions of dollars to help individuals and companies. These funds have helped prop up the economy and the market and there may be more coming.



Second, interest rates are low. The dividend on the stock index is now a multiple of the interest on bonds, leaving investors with a handsome incentive to buy into equities instead of bonds despite potentially higher volatility.

Third, data on the economy has been surprisingly positive spurring on optimism. While one may question whether an unemployment rate of 11% is reason to celebrate, it is good news if the market were expecting 13% or 14%. As discussed previously, markets respond primarily to whether news is better or worse than expected, and less so to whether the news is good or bad.

However, even given these factors, there are still significant unaddressed issues relating to Covid-19 and its effects on the economy. There are many unknowns still in play. Primarily, the questions for this summer are whether a second wave and/or worse than expected economic data, might lead to another market downturn? and whether it will be as significant as the one in March?

Setting aside the fact that a downturn is always possible (at any time, for any number of reasons), I personally do not believe that there will such a significant downturn as experienced

in March. I say this for three reasons.

First, the governments are likely to counter increasing fear with additional stimulus. Also, as it is an election year in the US, I expect to see both parties offering any number of stimulus packages.

Second, there is a tremendous amount of money sitting on the sidelines⁽¹⁾ and so any fall of note will likely find willing buyers who missed out on the last 15 weeks and are looking for a buying opportunity.

Third, and perhaps most importantly, governments are under considerable pressure to get the economy going again. The lost wages and number of companies fighting to survive is one set of issues (with a considerable number of organizations lobbying governments to keep businesses open) and the significant drop in government tax revenue is another.

The result appears to be a shift towards an emphasis on the economy over the health of our seniors and at risk population. While during the first wave we had an emphasis on saving lives at the expense of the economy, the next time around I believe there will be an equal emphasis on the economy, if not more.



Those that are at risk will probably be told to stay at home and remain diligent, and those who wish to go back to work will probably be permitted to, under certain criteria. (Please note that I am not commenting as to whether such action is morally right or wrong, only that it is a very possible path forward.)

In short, we may see a second wave and health crisis that overwhelms our health care system, but these may not impact the markets nearly as much if the economy avoids being shut down .. at least now.

Looking Forward

The markets are likely to remain quite volatile. There is still so much that we do not know and cannot predict. Any news of a possible vaccine, advances in treatment, lower unemployment, increase in economic activity, etc. will drive the markets higher, and any vaccine or treatment delay or failure, any increase in unemployment, and decrease in economic activity etc. will drive the markets lower. Such movements will continue and may be unsettling for some.

As for investing, we like the positions we hold. We are continuing to buy, though very selectively. While US Growth Large Cap continues to lead the way higher (NASDAQ setting a new all-

time high), almost every other asset class (any non-US, or non-Growth, or non-large cap) has not rebounded. Many stocks and bonds are still inexpensive, and we remain convinced that superior companies and investments will rebound in time, providing attractive long-term returns. We remain focused, selective and patient.

For the Quarter, the bond market was up 7.5%, the Canadian market was up 14.9%, the US market was up 19.2%, International markets were up 14.4%, the Emerging markets were up 13.0%, the Real Estate market was up 8.4% and the preferred market was up 13.2. (Reuters 6/30/20) ⁽²⁾

Year-to-date, the bond market was up 7.2%, the Canadian market was down 6.4%, the US market was down 4.4%, International markets were down 11.6%, the Emerging markets were down 4.9%, the Real Estate market was down 22.3% and the preferred market was down 11.8%. (Reuters 6/30/20) ⁽²⁾

Have a great month and let us know if there is anything we can do for you,

- Meir



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⁽¹⁾ Date from the June Axios newsletter.

⁽²⁾ Indexes shown

Bonds FTSE Canada Universe Bond Index™

Canadian Equity - S&P/TSX 60 Index

US Equity - S&P 500

International - MSCI EAFE Index.

Emerging Markets - MSCI Emerging Markets Index

Real Estate - Dow Jones® Global Real Estate Index

S&P/TSX Preferred Share Index

The information contained herein is current as of June 30th, 2020..

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