Weekly Updates Issue # 603

1. Weekly Markets Changes

[February 24, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,533.47 -305.2 -1.93%	2,367.34 +16.18 +0.69%	20,821.76 +197.7 +0.96%	5,845.31 +6.73 +0.12%	$0.7638 -0.04¢ -0.05%	$1,258.00 +22.00 +1.78%	$54.02 +0.38 +0.71%

2. Tax recommendations for this year's budget

[February 24, 2017] There's no shortage of economic challenges these days. So, in its upcoming 2017 federal budget, Ottawa has some work to do.

From the perspective of the C.D. Howe Institute, the government should focus on inspiring savers and investors. In its annual shadow federal budget, the organization makes a number of recommendations. Those include:

1. Set a credible path to balance and hold the line on transfers to other levels of government. Also, contain costs by shrinking or eliminating many tax expenditures, including boutique credits.
2. Help near-retired and retired Canadians by raising limits for RRSP and defined-contribution pension plan savers. Also, eliminate mandatory drawdowns from registered retirement income funds (RRIFs).
3. Encourage businesses to grow by replacing preferential tax treatment for small businesses. One option, says C.D. Howe, is offering temporary preferential treatment for young businesses.
4. Make Canada more attractive to high earners by raising the threshold for the top personal tax rate from $202,800 to $402,800.
5. When it comes to marijuana, discourage the black market and leave room for provincial levies by applying only GST.

The authors of the shadow budget are C.D. Howe's president and CEO William B. P. Robson, director of research Alexandre Laurin, and policy analyst Rosalie Wyonch. They want the federal government to cut the deficit while boosting growth.

In their report, the team notes, "This shadow budget ensures that, even with cautious economic forecasts and prudence cushions, the ratio of federal debt to gross domestic product will stabilize immediately."

They add, "Transforming election promises into a coherent fiscal plan is always a challenge in the transition from campaigning to governing," which is why a government's first budget often lays the groundwork for change but "marks time."

This second budget from Prime Minister Trudeau and Finance Minister Morneau, says C.D. Howe, "needs to rise to that challenge. To prevent endless demands of various stakeholders from driving spending and borrowing beyond responsible limits, Canada badly needs a serious federal budget framework."

Further commentary

Earlier this month, consulting firm Raymond Chabot Grant Thornton also offered up its recommendations. It says the focus should be on the competitiveness and productivity of businesses.

As such, the firm notes in a release that the 2017 federal budget should look at tax incentives, entrepreneurship, innovation and business immigration.

For example, one of its recommendations is that the government "abolish corporate income tax on the first $500,000 of an SME's taxable income, provided that the savings be invested in productivity, employment and innovation in a manner that avoids abuse. Investments could be subject to accelerated CCA, possibly grossed up in the year, or to a tax credit."

Further, the firm says, the government should "commit […] to amending tax legislation to make business transfers between family members more equitable, from a tax perspective, for all businesses in all sectors."

3. Canadian inflation fuelled by gas prices

[February 24, 2017] A surge in gasoline prices helped push Canada's annual inflation rate well beyond expectations in January to 2.1%, an increase that coincided with the implementation of new carbon-pricing policies in Ontario and Alberta.

Statistics Canada said Friday the 6.3% increase in transportation costs was the main contributor to the higher inflation rate, with gas prices experiencing a 20.6% boost across the country compared to the year before.

The overall inflation reading last month was stronger than December's rate of 1.5%, the agency's latest consumer price index said. However, excluding gasoline, the January inflation rate was also 1.5%.

The report also found that year-over-year inflation rates were higher in every province last month compared to a year earlier.

Nick Exarhos, director at CIBC World Markets, says in a research note, "Canadian inflation perked up in January, something we're going to see more of in 2017 as we lap weak year-ago gasoline prices."

In Alberta, the annual inflation rate hit 2.5% last month after an increase of 1% in December. Gas prices in Alberta climbed 33.9 per cent last month, a gain that Statistics Canada says was partly attributable to a new carbon levy in the province.

The agency said Ontario, which introduced a cap-and-trade program in January, saw a 20.4% year-over-year increase last month in gas prices.

Overall, a consensus of economists had predicted 1.6% inflation for January, according to Thomson Reuters.

Statistics Canada says consumers paid 2.1% less for food last month compared to a year earlier.

The agency said the Bank of Canada's three preferred measures for core inflation saw increases last month of 1.3%, 1.7% and 1.9%.

Still, today's inflation numbers won't influence the Bank of Canada as it makes its next rate decision, says Derek Holt, vice-president and head of Capital Markets Economics, in a report. He predicts, "The [BoC] will likely fully look through the headline spike in inflation for three reasons." One is the main driver of the increase was gas prices, while the others are "two of the three new core CPI measures trended lower again" and "seasonally adjusted month-ago CPI subcomponents were rather weak, ex[cluding] energy components."

4. Average home price in GTA surpasses $1 million

[February 23, 2017] For clients looking for single-family homes in the Greater Toronto Area, prices continue to climb.

In January, the average price of new single-family, low-rise homes–which includes detached, semi-detached, row and townhomes–increased to a new record of $1,028,395, reveals data from Altus Group.

A release from the Building Industry and Land Development Association (BILD) says prices of new ground-oriented homes grew 25% in just one year.

It adds the average price of a new detached home increased to an unprecedented $1,316,325 in January. Ten years ago the average price was

$444,368. Meanwhile, the average price of a new GTA townhouse was $879,619 last month compared to $328,989 in January 2007.

There were just 1,524 new ground-oriented homes available for purchase in builders' inventories at the end of January, a near record low. At this time in 2007, there were 18,400. Meanwhile, supply of new detached homes declined to 534, the lowest ever recorded in the GTA. Ten years ago there were 12,242.

The average price of new condominium apartments in stacked townhouses and mid- and high-rise buildings in the GTA reached $507,511 in January, also setting a new record. The average price per square foot reached an unprecedented $625. New apartment prices have grown 13% since January of last year, increasing by almost $60,000. A decade ago the average price was $322,569.

"Our industry is implementing provincial policy by building more condominium apartments and less ground-oriented housing," says Bryan Tuckey, president and CEO of the BILD, in its release. "A decade ago condominiums represented just 42% of available inventory compared to 88% in 2017."

After years of healthy supply, the number of new condominium apartments available for purchase began to decline. In January 2017 there were 11,529 new condominiums in builders' inventories across the GTA, which is a 10-year low.

Overall, there were 13,053 new homes in builders' inventories across the region in January compared to 31,461 a decade ago.

5. Another reason to pay more than the minimum on credit card balances

[February 23, 2017] Many Canadians say they don't have the funds to make RRSP or TFSA contributions. However, most Canadians have the funds for something else important to their financial well-being: paying more than the minimum amount on credit card balances.

And, while that kind of commitment helps pay off debt faster, it may also boost a person's credit rating.

Fully 88% of Canadians with credit cards "often" pay a greater amount than the minimum due, reveals a survey by TransUnion, a credit reporting company. (Only 7% of those polled weren't cardholders.)

TransUnion research finds that the more consumers pay beyond the minimum, the less likely they are to be delinquent in their payments.

That may seem like a no-brainer, but TransUnion's research is the first to quantify the finding.

It's good information for people to know if they hope to qualify for a mortgage or other loan, because the new research is expected to influence how lenders assess borrower risk.

"Even if [people] can't pay the full balance [on revolving debt], they may now find that lenders view them more positively depending on the amount they pay," says Todd Skinner, president of TransUnion Canada, in a release.

That influence on lenders is sure to interest Canadians, who appear keenly aware of their credit histories. A Leger poll finds that 83% of Canadians discuss their credit histories with their partners at least twice a year. Indeed, fully 86% know their partners' credit histories, though that figure drops to 78% for those with annual incomes less than $40,000.

One last finding from the TransUnion survey: 39% of Canadian cardholders don't know why it's important to pay more than their monthly minimum payments.

The Leger poll was conducted online between February 6 to February 9, 2017, and included 1,569 Canadians.

TransUnion's survey was conducted from December 7 to December 16, 2016, and based on a random sample of 1,010 Canadians age 16 and older.

6. Cash-strapped Canadians drop TFSA contributions

[February 23, 2017] When recent studies suggested Canadians weren't saving enough in their RRSPs, fingers were wagged at the possible culprit: the TFSA. Chances are Canadians instead allocate savings from their RRSP to their TFSAs, right?

Maybe not, says StatsCan, which noted that, although TFSA contributions are up, so are TFSA withdrawals. And, with about $0.47 withdrawn from TFSAs in 2013 for every dollar contributed that year, many Canadians aren't using the accounts to save for retirement.

But at least Canadians are saving. In 2013, TFSA contributions increased to nearly $16 billion from about $9 billion in 2009.

The bad news: like RRSP savings, TFSA savings are now declining — at least when it comes to contribution levels.

Canadians' annual TFSA contributions in 2016 are down about $1,000 compared to 2015 ($5,531 versus $4,592, respectively), reveals a BMO survey. The most cited reason: a lack of funds to invest (43%). Alternatively, 36% say they can't save because they need cash flow to cover expenses.

And, next year, survey respondents expect to contribute even less: an average of $4,325.

There is some good news: Canadians' knowledge of TFSAs gets a passing grade, though there's room for improvement.

For instance, almost 80% of respondents know cash investments are eligible in a TFSA, while 73% know mutual funds are eligible and 69% know GICs qualify. Further, about 64% know about the penalty tax for over-contribution or for withdrawing and recontributing within the same year.

However, one-third don't know the maximum annual contribution level ($5,500 for 2017).

For 2016, the table below shows the breakdown of TFSA contributions across Canada.

Region	Canadians who contributed less than $5,500	Canadians who contributed the maximum $5,500	Canadians who contributed more than $5,500	Mean contribution
National	39%	15%	7%	$4,592
Atlantic	36%	12%	12%	$4,312
Quebec	45%	17%	6%	$4,168
Ontario	37%	15%	6%	$4,771
Prairies	36%	10%	3%	$3,220
Alberta	40%	16%	8%	$3,849
B.C.	35%	17%	12%	$5,898

The BMO survey was conducted by Pollara between December 14 to December 19, 2016, with an online sample of 1, 500 adult Canadians. The margin of error for a probability sample size of 1,500 is ± 2.5% 19 times out of 20.

7. Tougher road ahead for telecoms

[February 23, 2017] Telecommunications companies have long been outperformers in Canada, compared to the broader TSX. But, going forward, that sector's growth is expected to slow.

So says Craig Jerusalim, portfolio manager at CIBC Asset Management, who adds, "Over the past decade, the telecom sector has [grown] over 150% on a dividend-adjusted basis, versus about 50% for the TSX. In fact, 2016 was only the second year in the past decade where telecom stocks underperformed the broader index on a total return basis."

Jerusalim, who co-manages the Renaissance Diversified Income Fund, says the main reason telecoms have outperformed is because of the oligopoly that existed in the Canadian marketplace, with BCE, Telus and Rogers dominating. In the U.S., there was a wider mix of strong players and new disrupters over the last decade.

Until recently, adds Jerusalim, the three Canadian giants weren't "willing to sacrifice profitability for short-term market share gains." And, when new companies tried to enter the space, they were either acquired or squeezed out, he adds.

"These [Canadian] telecom providers were able to constantly adapt to changing wants and needs, while continuously generating excess free cash, maintaining some of the best networks in the world and consistently grow[ing] dividends," he notes.

Increasing dividends regularly was a tactic all three of the companies used to grow share price and expand valuation multiples, says Jerusalim, who points out, "Some of the best buying opportunities for the telecom sector occurred when fear and uncertainty were at peak levels — specifically, when Verizon was threatening to enter the Canadian market [and] when regulatory pressures were elevated."

What to expect in 2017

Today's market environment is less promising for Canadian telecoms, says Jerusalim. "Valuations are at a richer starting point, interest rates are unlikely to fall further, the wireless and wireline markets are much more mature today, and the wireless sector now has a viable, well-capitalized fourth entrant in all major regions."

So, investors looking at telecom companies need to determine which providers can continue to generate excess free cash flow, while also investing in and building out networks to satisfy customer and investor demand, he adds.

Jerusalim identifies these three key themes going forward:

1. **Coaxial versus copper.** Because of their established coaxial networks, traditional cable companies like Rogers, Shaw and Quebecor have an advantage over telecom companies like Bell and Telus, says Jerusalim. This lets them provide high speeds at lower prices, he explains, adding, "[Companies] need to lay fiber directly into a home to compete with the speeds of cable networks, but the cost to do so is about $1,000 per home more than an existing coaxial network—thus lowering ROI."

2. **Buildout of digital ecosystems.** Companies are already building out their ecosystems. Take Telus, says Jerusalim, which aims to "become the backbone of the healthcare network in Canada [by] connecting doctors, hospitals and pharmacists, and facilitating patient care with electronic medical records." He's watching for companies that seek out niche markets.
3. **Impact of deregulation.** If U.S. President Trump's proposed deregulation policies succeed, says Jerusalim, a similar trend north of the border could occur, in regards to foreign ownership. "That would likely result in some big M&A activity," he adds. He suggests Rogers could acquire Shaw, and Verizon could snap up Telus. Jerusalim says the result would be "a heightened level of volatility that the sector hasn't experienced in a very long time."

What about media innovation?

Media is a shrinking piece of the telecom pie, says portfolio manager Craig Jerusalim of CIBC Asset Management. Still, key content is what drives performance, he adds, noting, "For companies like Rogers and BCE, sports [coverage] is still a sought-after entity. However, it's hard to compete against some of the really big players like HBO and Netflix" when it comes to television series and movies.

In the years ahead, telecom companies will focus on top-tier content rather than directly compete with these big players, he says. Consider Rogers and Shaw's pullback on Shomi after the offering failed to gain market share.

8. U.S. home sales hit 10-year high

[February 22, 2017] Americans shrugged off rising mortgage rates and bought existing homes in January at the fastest pace since 2007.

Home sales rose 3.3% in January from December to a seasonally adjusted annual rate of 5.69 million, reveals U.S. data from the National Association of Realtors.

However, sales remain 21.5% below the all-time peak in 2005, says Derek Holt, vice-president and head of capital markets at Scotiabank, in an economics note. And, though sales of single-family homes were up 2.6% from January 2016, the volatile condo sector drove much of the gain. Condo sales were up more than 8%.

A good sign, though, is that first-time buyers represent one-third of the market, says Holt, and foreclosures account for only 7% of total sales.

By some measures, the housing market has fully recovered from the bust that began in 2006. Yet its newfound health is creating its own set of challenges.

Just 1.69 million homes were on the market nationwide in January, near the lowest level since records began in 1999.
Last year, low mortgage rates helped offset rising home prices. Now, both are rising, which could hamstring sales in the coming months.

9. Ontario deficit down to $1.9 billion

[February 21, 2017] Ontario's finance minister says the province's deficit for this fiscal year will be $1.9 billion. That compares to the $4.3 billion the government had projected in last year's budget.
This lower deficit puts the government closer to presenting a balanced budget this spring.
Finance Minister Charles Sousa released the province's third-quarter finances today. They show revenue was $2.5 billion higher than projected and that the net-debt-to-GDP ratio has fallen to 38.3% from 39.6%.
The finances also show the government used $600 million of the previously $1-billion reserve. Expenses increased by $1.1 billion–spending that includes health care and an 8% rebate on electricity bills.
Spending on interest on the province's more than $300-billion debt was also lower than projected.

10. Does this genetic testing bill threaten the insurance industry?

[February 21, 2017] A genetic testing bill is winding through Parliament, keeping the Canadian insurance industry on tenterhooks.
Bill S-201, the Genetic Non-Discrimination Act, seeks to revise the Canada Labour Code and the Canadian Human Rights Act to make it illegal for employers, insurance companies and anyone else entering into a contract or providing goods or services to require anyone to undergo genetic testing or to disclose the results of a genetic test.
The bill was designed to protect Canadians from discrimination on the basis of genetic information. For example, a person who tested positive for the Huntington's disease gene could be fired or denied employment — or insurance — based on their test result. Proponents of the legislation, put forward in 2015 by Liberal Sen. James Cowan, have argued that fear of repercussions can prevent people from receiving genetic tests that may otherwise benefit them.
The insurance industry, however, disagrees with the bill. It argues the legislation would impede Canadians' access to insurance and severely compromise the industry's viability. In theory, someone who discovered that

her genetics put her at a greater risk of getting sick or dying early wouldn't have to tell her insurer and could purchase millions in life insurance at what are essentially discounted rates.

"The concept of equal information is absolutely at the core of insurance," says Stephen Frank, senior vice-president, policy, at the Canadian Life and Health Insurance Association (CLHIA). "The rule is, if we're going to offer you insurance, both of us need to understand the risk that we're taking, so that we can enter into this in good faith. And this type of approach would break that chain."

If the bill passes, argues the industry, the result would be higher premiums for everyone. "You'd have to write a lot of $300,000 policies to make up for a couple million dollars of unexpected loss," says Frank. He points to a Canadian Institute of Actuaries study that estimates the bill's passage would result in a 50% increase in premiums for women and 30% increase for men over time.

Others argue that the bill's potential impact is much less: the Office of the Privacy Commissioner of Canada, citing 2011 and 2012 studies, has concluded the legislation "would not have significant adverse impact on the viability of the life and health insurance industry," and that premiums would likely rise about 3% overall, an increase the industry could absorb.

Dr. Michael Hoy, an economics professor at the University of Guelph who specializes in insurance market information, says no one can predict the precise impact of such legislation. He says the insurance industry is justified in arguing that people possessing devastating genetic information would be prompted to buy more insurance.

"But the thing is," he continues, "there aren't very many people in the population who have such devastating information that they can keep [it] private from insurance companies." Given that applicants would still have to disclose personal and family medical histories, insurance companies would know if someone had a strong family history of, for example, breast cancer or Huntington's disease, and would rate policies accordingly.

"So, if you spread those extra costs across the entire insurance pool," continues Hoy, "they probably won't lead to very substantial increases. I'm not saying that 30% or 50% increases couldn't someday be a sensible set of assumptions, but I think that's very far down the road."

Toronto insurance consultant David Wm. Brown is less sanguine. "Genetic testing is at its embryonic stage. Eventually, we're going to be able to test for everything," he says. "If we get to that point, and applicants can have more knowledge than insurance companies on almost every question they ask, then it completely skews a system based on mutual disclosure of information."

Frank says insurers have voluntarily agreed not to ask applicants or existing policyholders to undergo genetic testing. And as of January 1, 2018, CLHIA members will no longer ask for results of genetic tests for policies under $250,000 — which accounts for approximately 85% of policies. Above that threshold, however, "we would still want to understand why you are asking for so much coverage."

He says the measures account for the importance of genetic privacy to Canadians. "It's a compromise that will allow the industry and the market to be sustained at a price point that people find affordable, but that will protect industry from being taken advantage of by people who have information they are not disclosing."

The legislation, as is, would not allow insurance companies to ask applicants for the results of genetic tests. Should the legislation pass in its current form, says Brown, it puts advisors into murky territory in terms of both disclosure and ethics. Insurance applications, he points out, ask agents directly if they know of any factors that might affect underwriting.

"If I know that somebody has had genetic testing, then I personally believe I am obligated to inform the [insurance] company that I do know that information. We have a certain fiduciary responsibility to both the provider and the purchaser, and I think anyone who wants to do the right thing has to disclose what they know. How [the legislation will] deal with that, I don't know," he says.

Liberal MP Randy Boissonnault has put forward several motions to amend Bill S-201, effectively removing the insurance industry from its scope. The amendments and the bill are up for vote in the House of Commons in early April.

In the meantime, the Genetic Non-Discrimination Act points to a more systemic problem for the insurance industry: a public that still sees insurers as predatory.

"It's a bit of a mis-perception from the advocates, that we use genetic tests as a way to say no," says Frank. "Insurers want to write business. We're in the business of covering people. So we're never going to be looking for reasons to say no."

Brown agrees. "People still don't understand the concept of insurance as a spread of risk among a common ground of people," he says. "All they see is, 'The bad insurance companies want to get more information in order not to pay claims.'" Bill S-201, he argues, could pass based on this emotional argument — a move that, ironically, could have negative repercussions for the industry and consumers alike. "We need to do a better job of explaining insurance to the public."

Have a nice and fruitful week!