RBC DOMINION SECURITIES

# PEARLSTEIN'S CORNER

SPRING 2016


416.733.5257 mark.pearlstein@rbc.com www.markpearlstein wealthmanagement.com

**Mark Pearlstein**

VP, Portfolio Manager & Wealth Advisor


## ...Negative Interest Rates In Canada? Five Things You Need To Know

A roller coaster is the best way to describe the first three months of the year. North American stocks dropped by 10% and bounced back. Oil rose 50% off its bottom. **Yet, one of the asset classes that grew the most was government bonds paying negative interest rates.** It doubled in size. The law of supply and demand applies even in challenging times; there were more buyers than sellers of `sub-zero' bonds.

**In a bizarre world where many central bankers and politicians think that adding more to a growing debt pile and repressing interest rates are ways to get consumers to spend, here are five questions to help investors understand what in the real world is going on as it relates to your money.**

### 1. How much federal government debt in the world is paying negative interest?

It increased from 3.5 trillion dollars to 7.0 trillion dollars - almost 1/3rd of all government debt – in three months. The size of the Canadian economy - all goods and services produced - is 1.5 trillion dollars. **So, this `sub-zero' debt grew more than two Canadian economies.**


### 2. How do negative interest rates happen?

Here is one way. In Canada, if you invest $100 in a guaranteed investment certificate (GIC) with a bank for four years, each year you earn $2.50 on your investment, 2.50%. At maturity, you receive $110: your investment plus interest of $10. But, **in Germany right now, instead of earning $2.50 per year, it costs 50 cents in negative interest per year to own a GIC, or $2. At maturity, you receive only $98 back!**

### 3. Why would anyone want to invest in a guaranteed investment certificate (GIC) and know they will lose money?

As a fixed income manager in Germany with a choice of buying German, Greek or Italian bonds (GICs at the government level), you could make a completely rational decision to preserve your capital by buying only German bonds. The reasons are Greece is bankrupt and in Italy 1/5th of all bank loans aren't being paid interest by borrowers. **Better to lose a little bit of money rather than potentially lose a lot. So, right now, there's more demand for German bonds than Greek or Italian bonds since the German economy is the strongest in Europe.**

### 4. Could negative interest rates come to Canada?

**They could …but at this point it's unlikely**. Right now 5-year government of Canada bonds are paying under 1%. A possible tipping point would be if another global recession occurs. However, lowering rates in Canada to 'stimulate' its economy will do very little to get more companies and individuals to borrow because overall there is **dearth of new borrowers in Canada and the world. In other words, the global economy is fragile because existing borrowers have too much debt now on a worldwide basis; there isn't enough demand for more borrowing.**

### 5. How do negative interest rates affect your money?

Global fixed income markets are a massive interlinked system of IOU's, 5-10 times larger than global stock markets. Money is always looking for a home for higher rates. So, some German money paying negative interest can end up Canada and earn 3% more with a click of a mouse. **If foreigners buy more Canadian bonds, this increases demand and prices and pushes down interest rates. The exact opposite would occur if German rates were higher than Canadian rates.**

**Negative and low interest rates have made stocks the only game in town for many investors. Demand for stocks is high as are their prices. At some point, there will be more sellers than buyers for stocks and their prices will fall, more quickly than most think, just like in January.** Selling some GICs or bonds when this happens will allow you to buy stocks when there is less demand for them at lower prices.

**Since supply and demand of interest rates are so interconnected with your money, call me to check if your portfolio is aligned with your lifestyle going forward. Or, please send this on to a family member or friend concerned about the impact of very low interest rates on their lifestyle.**


**Mark Pearlstein | T. 416-733-5257 | F. 416-733-5250 | mark.pearlstein@rbc.com**


RBC Wealth Management
Dominion Securities


# 2016 FEDERAL BUDGET

## A summary of the key tax measures that may have a direct impact on you.

Federal Minister of Finance, Bill Morneau, delivered the Liberal Government's budget on March 22, 2016. The budget focuses on growing the economy, creating jobs and strengthening the middle class.

Many of the budget 's tax measures are aimed at tightening perceived loopholes or inequalities in various aspects of the tax system. Several budget changes have been proposed to prevent tax evasion and improve tax compliance. The budget proposes to provide the Canada Revenue Agency (CRA) with significant financial support to improve its ability to collect outstanding tax debts.

### Restoring the age of Eligibility for Old Age Security (OAS)

The budget proposes to cancel the scheduled increase of the age of eligibility for OAS, guaranteed income supplement (GIS) and allowance benefits. In the 2012 budget, it was announced that starting in April 1, 2023, the age of eligibility for OAS and GIS would be increased from age 65 to 67 and the age of eligibility for allowance benefits from age 60 to 62. Other OAS changes announced in 2012, such as the ability to defer taking OAS for an increased OAS benefit, have not been changed.

### Consequential Changes due to the New Higher Personal Tax Rate

The budget proposes to make changes to other tax rules that either use or are affected by the introduction of the top personal tax rate of 33%. The budget proposes to:

- Provide a 33% charitable donation tax credit (on donations above $200) to trusts that are subject to the 33% tax rate on all of their taxable income;
- Apply the new 33% tax rate on excess employee profit sharing plan contributions;
- Increase the tax rate on personal services business income earned by corporations from 28% to 33%; and
- Amend the recovery tax rule for qualified disability trusts to refer to the 33% tax rate.

These measures will apply to the 2016 and subsequent taxation years. The increase to the charitable donation tax credit will be limited to donations made after the 2015 taxation year. In the case where personal services business income earned by a corporation is earned in a taxation year that straddles 2015 and 2016, the rate increase will be prorated.

The measure will also extend the proposed 33% charitable donation tax credit in Bill C-2 (which applies to donations made after 2015) to be available for donations made by a graduated rate estate during a taxation year of the estate that straddles 2015 and 2016.

### Income Splitting Credit (Family Tax Cut)

A non-refundable income splitting tax credit is available to couples with at least one child under 18 years of age. It was introduced to allow a higher-income spouse or common-law partner to notionally transfer up to $50,000 of taxable income to their spouse or common-law partner to reduce the family's total income tax liability by up to $2,000. The budget proposes to eliminate the Family Tax Cut for 2016 and subsequent taxation years.

### Conclusion

Prior to implementing any strategies, clients should consult with a qualified tax advisor, legal professional or other applicable professional.

Please connect with Sam Kim at 416-733-5246 or sam.kim@rbc.com for more information.

RBC Wealth Management
Dominion Securities