Michie Wealth Management's Quarterly Investment Update

Wealth Management
Dominion Securities

Fall 2018

Does the "late cycle" have an expiration date?

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"We build our business on integrity and service. The highest compliment we can receive is the referral of friends, family and business associates. Thank you for your Trust."

Please see some highlights from a focus article included in September's Global Insight. If you would like to read the full article, please feel free access it through our team website (www.michiewealth.com) under the "Client Resources" section.

The US economy is now in its tenth year of expansion and, at 36 quarters, is within two quarters of being the second-longest on record. "Late cycle" is a term heard frequently these days to suggest the end of this amazing streak is near. In our view, a sole focus on time elapsed for this expansion is misplaced. Economic cycles don't simply die of old age. And, based upon the key indicators we monitor, the current cycle likely has room to run – at least several quarters, perhaps even years.

Where do we stand?
Of the four phases of an economic cycle – early, middle, late, and recession – each brings its own implications for markets and investment portfolios. Clearly the economy has moved past the early stage. Furthermore, it is safe to say the economy isn't in recession today, even though throughout the nine years of this expansion a recession has been the bogeyman may have felt was always lurking just around the corner. So that leaves us with trying to determine whether we are in the middle or late stage of the current cycle. As mentioned earlier, the easy, consensus call is "late cycle", but as with many things it may not be as clear-cut as that.

Two "mids" before a recession?
The broad characteristics for the middle and late stages of a cycle are both evident today. This expansion has been characterized by long periods of slow growth. Yet GDP for the just completed Q2 came in at a brisk 4.2%, the fastest pace in four years, largely a result of the fiscal stimulus provided by tax reform measures passed in late 2017. We know the Fed has a 2% target for inflation, but only recently has its favoured measure, core personal consumption expenditures (PCE), matched this number. Unemployment recently touched 3.8%, its lowest level since the 1960's but at the same time has failed to produce a surge in wage pressure. Finally, even after seven rate hikes since December 2015, Fed policy still cannot be classified as restrictive. The point to be made here is that by looking at these measure it is hard to say with confidence in which stage the economy is currently positioned – it still exhibits both mid- and late-cycle characteristics.

Global wildcards
The current environment, which features fast-changing trade disputes, the imposition of tariffs, and geopolitical concerns, poses a number of challenges for the global economy. The question in our view, is not so much whether any one of these would cause the US economy to dip into a recession, but whether they might accelerate the economy's path through the cycle lifespan. So far the answer has been "no". The US has displayed a high degree of resiliency in recent years as economic underperformance was unaffected by events in China on late 2015 and Brexit in 2016.

Timing is always everything
In our view, it is too early to become aggressively defensive with respect to either equities or fixed income. But thinking ahead of time about what such eventual defensive positioning would look like is always appropriate and highly recommended.

The ABCs of USMCA

After more than a year of discussions, negotiators from the US and Canada have arrived at an 11th hour agreement for Canada to join Mexico in an updated NAFTA deal, the USMCA.

While the agreement in principle raises the prospect of a new NAFTA deal, there are still a number of hurdles:

- The governments of US, Canada and Mexico still need to vote and approve the pact – something that may prove difficult in the US if the Democrats gain control of the House of Representatives after the mid-term elections.
- Complexities are often known to arise during the late stages of trade negotiations or during the ratification period.
- The details of certain chapters still need to be ironed out.

Due to these complexities, we are still budgeting for potential scenarios in which the negotiations do not go as smoothly as hoped. There is still a possibility that the original NAFTA pact remains in place and a remote possibility both the original NAFTA and USMCA are torn up.

Before going further, let's take a look at some of the key elements of the deal that have changed.

Autos

To avoid tariffs, and as previously agreed to between the US and Mexico, 75% of auto production must take place within North America (up from 62.5%), with 45% of labour being paid at least $16 per hour. In addition, Canada also agreed to a maximum quota on auto and parts exports. While the limits are 40% higher than current levels, the quotas don't present any current restraints. However, they could become problematic should auto exports grow in the future.

Blanket tariffs

The existing tariffs on steel an aluminum will remain in effect for Mexico and Canada, a detail that is a particular concern for Canada since we are the largest single exporter of these items to the US. Fortunately, side negotiations are currently ongoing that seem likely to free the countries from these barriers.

China

Revealing the level of animosity between US and China, the new agreement seeks to limit the ability of Canada and Mexico to negotiate a free trade agreement with China by requiring a country to give notice if it enters into trade talks with a non-market economy. This will also protect the negotiating power of the US by limiting China's ability to bypass the US tariffs by transporting goods through either country.

Dairy sector

Canada has made concessions to further open its dairy sector. Through the agreement, the US will gain access to 3.6% of the Canadian dairy market, a slightly larger chunk than the 3.2% allocated to Pacific CPTPP countries and to Europe in the CETA trade deal. The concessions are a short-term disadvantage for Canada's dairy industry but do benefit Canadian consumers.

Trade dispute mechanisms

Canada managed to protect the trade-dispute mechanism that it holds near and dear, representing its biggest win in the negotiations.

Sunset clause

Although the details around the sunset clause are still blurry, it appears to be similar to what Mexico originally negotiated. This means the USMCA is subject to an official review by all parties after six years (notably, after President Trump will have left office) but is guaranteed to exist for 16 years.

Who wins?

From a high level, all three countries win as they seemingly avoid destruction of one of the world's most successful trading arrangements and eliminate a great deal of uncertainty.

President Trump wins in that he has technically "killed NAFTA", if only in name, proving he can successfully negotiate a trade deal.

He can now turn all of his trade aggressions towards China.

Canada wins in that it did not concede as much as originally feared. The key dispute mechanisms remain in place, the auto sector quota is well above current export levels, the sunset clause is weaker than originally envisioned and a smaller portion of the dairy sector was opened than feared.

Mexico comes off slightly less well given its auto sector will have to pay substantially higher wages in certain circumstances. That said, the country will enjoy largely unrestricted aces to the US market, ensuring its large trade surplus will most likely continue

It's important to note these positives primarily stem from the agreement exceeding low expectations, rather than actually improving current trade relations. While the new deal can be perceived as slightly worse for economic growth compared to NAFTA, the immediate risk-on response from financial markets is a reassuring response.

Overall, it's a deal North America can live with, and for now, that's good enough.

No asset in your estate can be as emotionally charged as the family cottage

The following article has been written by Leanne Kaufman, head of RBC Estate & Trust Services and President of Royal Trust Corporation of Canada and The Royal Trust Company.

Cherished tradition is deeply steeped in every aspect of our family cottage, largely because my children are the 5th generation making the annual trek up north. Up to this point, both our island and the original family cottage have remained in the hands of descendants. But in many instances, rising costs, geographic inconvenience, and general practicality mean not every family member can or wants to own a property generation after generation.

Anyone who currently owns a cottage has undoubtedly given careful consideration to if, when and how to pass it on to the next generation. Ideally, conversations should begin early and be held frequently with both family members and professional advisors. But if you haven't started yet, here are some considerations to help with future conversations.

Managing family relationships

Cottages are often one of the most emotionally charged assets in any estate. While affordability can become a major point of stress, normal family dynamics and grievances can also become a factor in co-owner conflicts. In owners, governance should be put in place to ensure a common agreement around things like allocation of expenses, shared versus exclusive use, and avoiding sale of an interest to someone outside of the family.

Several structures can be used to establish governance with co-ownership agreements, trusts and corporations being the most common. But even with best efforts to ensure equality and governance around ownership, things can go awry. I recently heard a story about a fifth generation group of family cottage owners who had thoughtfully structured a corporate entity with share ownership, a board of directors that met regularly, and carefully defined share ownership rights. Even with all of the vigilant planning and careful consideration, family conflicts ended with them cross-examining each other in court and the legacy land being put up for sale.

Ensuring affordability

If you've considered passing your cottage on, then you've likely thought not only of who wants it, but also of who can afford it. The truth is that property values continue to skyrocket, impacting carrying and tax/capital gains costs for you and your spouse, and for your estate after you pass away. Future expenses, such as major capital repairs (a new roof or dock, for example) and escalating property taxes and utility bills, make cottage ownership a stretch for many.

One way to help ease this burden is to establish an estate-funded maintenance trust, or other fund, from your estate, assuming it is sufficiently large for this purpose. There may also be planning opportunities, such as use of the Principle Residence Exemption, setting up a structure that gifts any future growth in the value of the property to the next generation or changing the ownership of the cottage generally. But, note, there are complex rules associated with this kind of tax and probate planning that require the knowledge and advice of a competent legal and tax professional.

The consequence of doing nothing

If you do absolutely nothing with respect to your cottage in your estate planning, then it falls into the general assets of your estate and may become the executor's job to have the conversations about which beneficiaries want or can afford to keep the cottage, or to make the decision to sell – which may place your executor in an awkward position.
You should also think about your future plans should you lose mental capacity (due to age related dementia, as an example). Without proper planning, your named power of attorney (or court-appointed decision maker) may be in a position of having to sell your family's beloved cottage in order to fund your long-term care needs. These considerations should also be part of your broader planning conversations with your professionals.

No matter your circumstances, as a cottage owner, open dialogue with your next generation is critical, otherwise, it may be a recipe for conflict for those you leave behind. As a colleague recently advised me, despite the best intentions, "be careful because you may end up having to choose between the cottage and your family relationships."

UPCOMING EVENTS

Role of an executor
November 27th
7:00PM – 9:00PM
Oshawa Golf & Curling Club
160 Alexandra Street
Oshawa, Ontario

Please RSVP to Terri Osmond at terri.osmond@rbc.com or 905-434-6611.

Seating is limited and we encourage you to respond early.

Is your pet in your Will? Four tips for your estate plan

Many Canadians experience the joys of having a pet. In fact, 8.8 million cats and 7.6 million dogs were considered household pets in 2016. So, it's not surprising when it comes to estate planning, Canadian want to make sure their pets are well cared for after they're gone.

What are some of the considerations for including your pet in your estate planning? At present, Canadian common law considers pets to be personal property. Therefore, they do not have the capacity to receive gifts made in Wills by their owners.

Here are four ways to include your pet in estate planning:

1. Testamentary gift – make a gift in your Will of your pet to a trusted individual, along with money to enable the beneficiary to care for your pet during your pet's life.
2. Pet trusts – What about creating a trust specifically for your pet? A trust is where a third party holds funds for the benefit of your pet.
3. Pet foster programs – Another option is to check with your local Humane Society for a "foster" program, allowing a pet parent to enter into an agreement where a search is carried out for a suitable caregiver or steward following the owner's death.
4. What if you become ill? – You may want to consider putting instructions in your enduring power of attorney for property which survives your incapacity, and enables your appointed attorney to manage assets and property, including your pet.

When it comes to planning for the care of pets in your estate plan, it's important to speak to a legal counsel and seek advice around the laws applicable in your jurisdiction.

Team Announcements

After 43 years in the financial industry, including almost 12 years with the Michie Wealth Management Group of RBC Dominion Securities, Geoff will be retiring at the end of this year.

Our team has spent the entirety of this year preparing for Geoff's departure, ensuring that every client of the Michie Wealth Management Group is taken care. Nick and Jason will continue to provide the high level of service that you have become accustomed to over Geoff's tenure.

Please join us in congratulating Geoff and an extremely successful career and wishing him all the best in his retirement!

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