RBC Dominion Securities Inc.

COOPER | WEALTH MANAGEMENT

SPRING 2016

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Market Outlook & Commentary

"Abnormally good or abnormally bad conditions do not last forever."
– Benjamin Graham, *Security Analysis: Principles and Technique*

Graham's observation has been proven yet again by the actions of the North American stock markets during this first quarter of 2016. After a brutal beginning to the year, our U.S. and Canadian equity markets have rallied smartly and are now in positive territory.

One of the principal drivers of the recovery was the recovery in oil prices. From a low around $27 USD, we have now recovered to the low $40's. At $27, no one makes money, not even the sovereign producers such as Saudi Arabia, because the cost of drilling replacement barrels is in the range of $50 for almost all major producers. OPEC did not reduce production in the face of falling oil prices in an attempt to drive for-profit producers to cut production. They were successful to a degree, forcing major companies to reduce their exploration and drilling budgets by billions of dollars to conserve cash. This reduced spending will result in higher oil prices in the next few years as oil production drops. Fortunately, the demand for oil has remained steady; so with the global daily oversupply narrowing below 1.5 million barrels per day, the only short-term barrier remaining to achieve higher oil prices is the approximately 4.3 billion barrels currently in storage in North America. These barrels represent a major overhanging barrier to oil price appreciation. There is a high degree of doubt among analysts that this inventory can be cleared within the next couple of years and bringing them to a consensus view that oil prices will stay "lower for longer." However, there are signs from OPEC that they would like to get oil back to at least $50 per barrel to go to at least a breakeven production cost. Their willingness to cooperate, or at least talk about cooperation, has driven oil's rally so far, and suggests oil could rise approximately 25% from here if they are successful. Regardless, the inventory overhang will have to be dealt with before a sustainable oil price over $50 can be achieved.

In fixed income, the European Central Bank (ECB) took further aggressive quantitative easing measures by expanding their monthly bond purchases by €20 billion and now including corporate bonds, lowering their benchmark rate to -0.40% and providing low

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cost refinancing for bank loans. While the ECB continues to aggressively stimulate, we expect U.S. bonds to continue to be in high demand by international investors, thereby keeping U.S. interest rates down. In Canada, we do not expect any rate increase until the economy, and notably oil prices, stabilize. The absence of selling pressure on rate-reset preferred shares has brought bargain hunters back to the perpetual preferred market, which has led to a rally to start the year. We expect the preferred share market to continue to improve as the year proceeds.

The U.S. dollar has shown weakness since the start of the year, with the rally in oil and postponement of further interest rate increases. While it is tempting to reduce U.S. holdings, there are two important reasons to retain it: 1) The U.S. dollar is still the global safe haven in terms of crisis. That insurance factor is important in every portfolio. 2) U.S. multinationals will have improved profits from the weakened dollar, driving stocks higher.

The hope of the ECB stimulus is to encourage people to borrow and banks to lend. If Europeans decide to pay down debt or buy more attractive assets instead, particularly U.S. stocks for growth and currency hedge, the Eurozone economy will remain weak but stock markets could be poised to continue their seven-year bull run.

Our portfolio continues to focus on strong companies and generating above-market cash flows via our covered call program. As always, if you have any questions or would like to review your portfolio, please give us a call.

Yours truly,

Walter Harmidarow & the Cooper Wealth Management Team of RBC Dominion Securities

2016 Tax Changes

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

On December 7, Finance Minister Bill Morneau held a press conference to talk about a number of tax measures pledged by the Liberal Party and introduced a Notice of Ways and Means Motion (NWMM) to implement some of these changes.

Highlights of the NWMM include:

1. Reducing the second personal income tax rate to 20.5% from 22% effective on January 1, 2016, and for subsequent taxation years.
2. Introducing a 33% personal income tax rate on individual taxable income in excess of $200,000, effective for the 2016 and subsequent taxation years.
3. Returning the Tax-Free Savings Account (TFSA) annual contribution limit to $5,500 from $10,000 and reinstating indexation of the TFSA annual contribution limit, effective for the 2016 and subsequent taxation years.

Changes to Federal Personal Tax Rates

The Government will lower the 22% federal personal tax rate to 20.5% on taxable income between $45,282 and $90,563. If your income is above $90,563, this is expected to provide a tax savings of almost $680.

The Government will introduce a new high federal personal tax bracket that will be subject to a tax rate of 33% on taxable income above $200,000. This new rate is 4% higher than the existing highest federal personal tax rate of 29%. If your total taxable income is less than or equal to $217,000, your overall tax bill will not increase because of the tax cut in the lower bracket. However, if your income is above this threshold for 2016, you will face an increase in your taxes payable.

The change to the tax rates is effective January 1, 2016.

Consequential Changes Due to the New Higher Personal Tax Rate

The following proposed changes are consequential changes to other tax rules that either use or are affected by the change to the top personal income tax rate.

Tax Payable by Trusts

The income and capital gains earned and retained in a trust, other than a graduated rate estate or a qualified disability trust, is taxed at the top individual marginal tax rate. With the introduction of the new tax rate of 33%, the tax rate on income retained in a trust will be 33% for 2016 and future tax years. Graduated rate estates and qualified disability trusts will continue to benefit from graduated rates.

Investment Income of Private Corporations

Generally, corporate tax rates are lower than personal tax rates. Therefore, refundable taxes are imposed on investment income earned in a private corporation to discourage individuals from holding their investments in a private corporation to defer paying income tax. Because of the proposed new 33% personal tax rate, it is also proposed that refundable taxes and the related refund rate be increased effective January 1, 2016 as follows:

- The refundable additional tax on investment income of Canadian Controlled Private Corporations (CCPCs) will be increased by 4 percentage points (to 10.67% from 6.67%);
- The refundable portion of tax on investment income of CCPCs will be increased by 4 percentage points (to 30.67% from 26.67%);
- The refundable tax on portfolio dividends received by private corporations will be increased by 5 percentage points (to 38.33% from 33.33%); and

- The rate at which refunds are made out of a private corporation's pool of refundable taxes previously paid (known as "Refundable Dividend Tax on Hand") when it pays taxable dividends will be increased by 5 percentage points (to 38.33% from 33.33% of dividends paid).

These changes to corporate tax rates on investment income were necessary to preserve integration so that an individual is somewhat indifferent to earning investment income personally versus through a corporation. The effect of these changes is that it will be more costly to continue to hold investments in your corporation.

However, in a few provinces if you are at the highest tax bracket there is still a deferral of tax if you do not need these funds personally for a long time. For example, if you earn interest income in a corporation in Ontario the new corporate tax rate is 50.17%. However, if you were to earn this income personally and you are at the highest tax bracket you would pay tax at 53.53% – a very small deferral of tax. If you need these funds personally, however, it will cost you more than 53.53% in overall corporate and personal tax.

Investment Income with Family Members

Family income splitting is the bread and butter of tax planning in Canada, but many Canadians are not taking advantage of simple income-splitting opportunities that have already been acknowledged by the Canada Revenue Agency (CRA) as acceptable strategies. For example, if you have a lower-income spouse or lower income children or grandchildren, given the new top personal tax rate, now is a great time to consider setting up a prescribed rate loan for income splitting investment income from non-registered accounts.

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Changes to Federal Personal Tax Rates

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It is important to understand the impact of the "attribution rules" in the Income Tax Act if you plan to split income with your family members. These rules have the effect of attributing taxable income back to the family member who supplied the capital for investment so that, in effect, no tax savings are achieved. The attribution rules may be avoided by making a prescribed rate loan to a properly structured family trust or directly to a spouse using a formal loan agreement. The family trust or your spouse would pay you annual interest on the loan. Then you would include the interest you received as income on your tax return. If this strategy is properly implemented, the tax savings should more than compensate for the additional tax you pay.

Family Trust

If you have children, grandchildren, nieces or nephews with little or no income, then you may wish to consider establishing a family trust to shift investment income that would otherwise be taxed in your hands at a high marginal tax rate to the hands of your lower-income family members.

Each person, regardless of age and depending on your province of residence, is able to earn in the range of $7,500 to $11,000 of interest income, $15,000 to $22,000 of capital gains or $21,000 to $50,000 of eligible dividends tax-free in 2015 if they have no other income in the year. The income earned in the family trust can be used to pay for your child's expenses (private school fees, lessons, gifts, etc.) that you may have been paying all these years with your after-tax dollars. Parents and trustees should speak to a qualified legal or tax advisor for further advice and guidance on this matter before using trust income to pay for a child's expenses.

If structured properly, a family trust can allow a parent or grandparent to split income with their lower-income family members. Speak to our team about the RBC Family Trust solution to take advantage of this annual income-splitting opportunity.

Spousal Loan

If you have a lower-income spouse, consider establishing a spousal loan to shift investment income and capital gains to them. This will allow you to take advantage of your spouse's lower marginal tax rate. The strategy involves you transferring funds to your lower income spouse through a formal loan arrangement at the CRA prescribed interest rate. Your spouse is then able to earn investment income on these funds and pay taxes at their lower marginal tax rate.

Team Update

We would like to welcome Nicole Curry and Mishelle Madigan to our Hamilton team. Nicole and her two children enjoy spending time outside and being active; Nicole also leads a Girl Guide group. Mishelle enjoys hiking with Ramona, her Great Dane.

Thank You!

It has been our pleasure to help you with your investment needs over the years, and we'd like to take this opportunity to personally thank you for your support.

We especially want to thank those of you who have been kind enough to refer your friends and family to us. Our business is still growing and we continue to welcome the opportunity to meet new people.

Once again, thank you for your support and we look forward to serving your future investment needs.