The Market in Review

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This week's articles and insights

1. *Racing the 3rd Wave*
2. *Death and Taxes*
3. *Taxed to Death*
4. *Re-Opening Winners*

"He's spending a year dead for tax reasons."

— Douglas Adams, The Hitchhiker's Guide to the Galaxy

Your Index Report

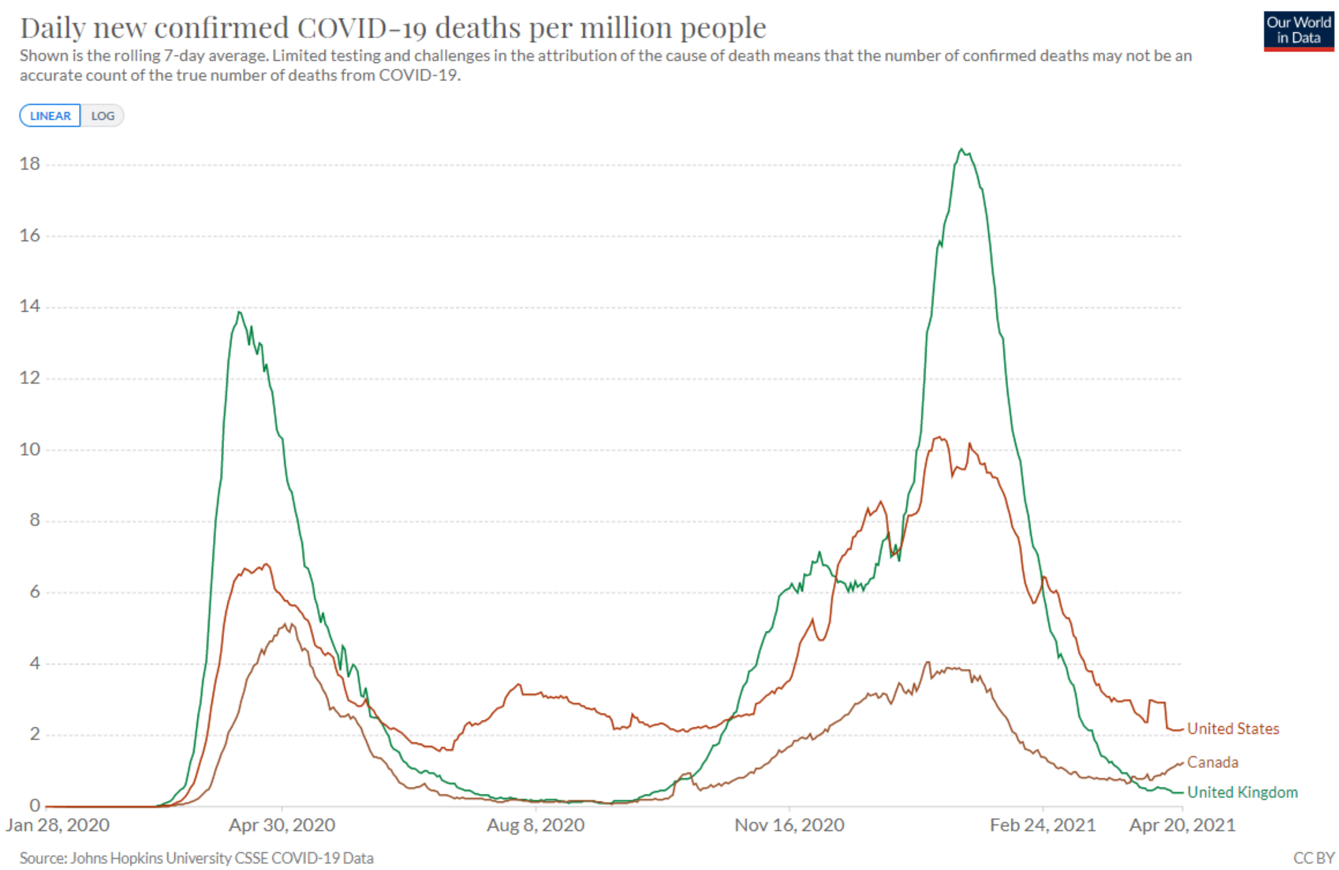
	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	33,816	- 0.65%	+ 10.49%
S&P 500	4,135	- 0.85%	+ 10.09%
TSX	19,032	- 1.50%	+ 9.17%

Racing the 3rd Wave

We are now ending the 2nd wave of the Covid-19 pandemic. The path of the 1918-1919 Spanish Flu was similar, in that the 1st wave was the least deadly and spread the slowest, and the 2nd wave saw mutations that made everything worse. Our 2nd wave has come in two mini-waves as a result of "variants of concern" arriving from the UK, South Africa, Brazil, and now India. These have slowed the re-opening in many countries.

There was a 3rd wave in 1919 that affected millions but burned itself out fairly quickly.

In 2021, there may be no 3rd wave in those countries with the most successful vaccine programs. Our most vulnerable segments of the population are now protected, and death rates are declining in Canada and plummeting in the UK, Israel and the U.S. Yes, there are more infections because the new variants are more transmissible, but the younger people getting it are recovering better. This is great news, and evidence that the programs – be they masks and social distancing or vaccines – are working.

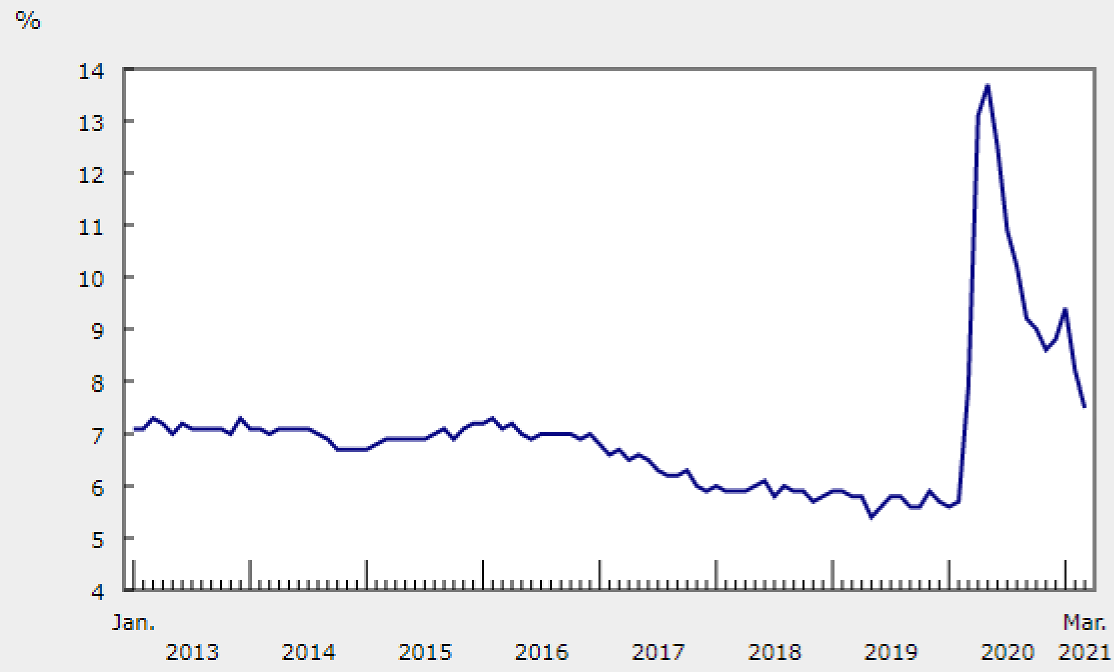


Economically, there continue to be lingering distortions.

Food prices are higher due to Covid-19 labour shortages and stocking-up in parts of the world.

- Corn is at its highest price since 2013.
- Soybeans and wheat are at their highest price since 2014 thanks to Chinese buying.
- The CRB Food Index touched its highest point in nine years.

Employment is at 7.5% and is improving, but will we ever get back to where we were just 14 months ago? Many jobs today are still supplemented by government supports, which will end in months.



Source(s): Labour Force Survey (3701), table 14-10-0287-01.

Stocks are expensive based on traditional metrics due to anticipation of recovering earnings and the flood of stimulus money. April starts a new earnings quarter and so far, the numbers are quite good. This helps to reduce the overvaluation we have seen.

Meanwhile, Canada's central bank is printing less money to buy back its bonds. This is good news so we can see the end of the money madness, but it also signals the end of the “free money” party. The Canadian dollar strengthened, as a result.

Death and Taxes

The two topics most suitable for this time of year are death and taxes. Death because it’s the Covid era, and taxes because it is tax time.

We’d avoid both, if only we could.

On the subject of Covid-19, here are a few interesting points learned this week:

- The original Wuhan coronavirus strain is a thing of the past. “The exact sequence is now a relic. The virus it represented is gone, replaced by many, many, many subsequent generations” (source: The Atlantic). It has been supplanted by mutated variants from the UK, South Africa, Brazil, and now a doubly-mutated version from India.

- While coronaviruses do mutate, they do so much slower than influenza (the flu) viruses do. This means we should be able to use the same vaccines much longer, with small tweaks annually.

- There may be only a limited number of mutations Covid-19 can attempt before the virus itself becomes unviable. Scientists are modelling combinations with supercomputers in advance of them actually occurring so we can prepare new vaccines in anticipation of future variants.

Taxed to Death

Enough about the virus. Let’s talk about taxes.

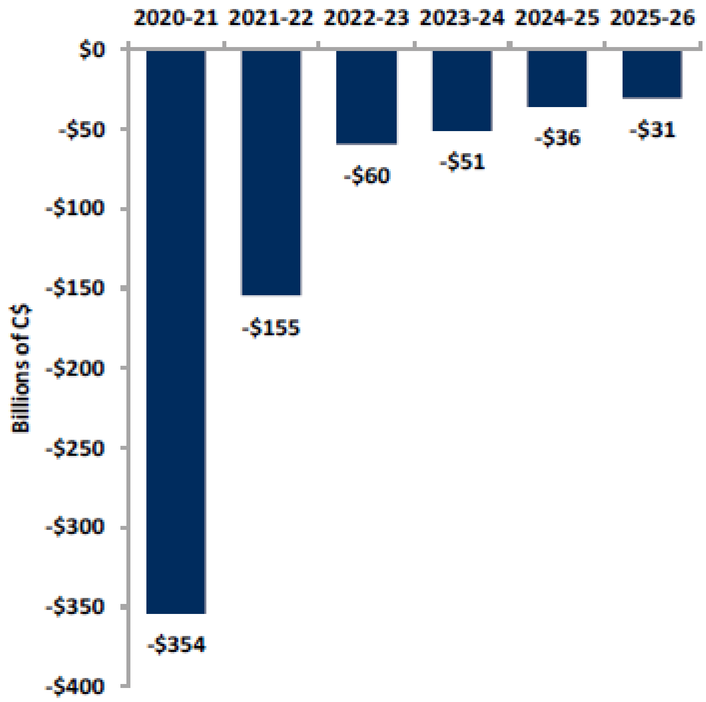
To no one’s surprise any longer, we continue to see governments everywhere ramping up spending to an alarming degree. The numbers are so large, they are incomprehensible.

For example, Canada’s accumulated debt now exceeds $1 trillion. A stack of one trillion $1 bills would reach 68,000 miles, or a third of the way to the moon.

Source: allfreedownload.com

Meanwhile, despite a recovering economy and an end in sight to the pandemic, governments continue to spend. Here in Canada, our deficit this year will be approximately $354 billion, which is 14 times the $25 billion deficit in 2019. The new budget introduced yesterday announced new taxes that will generate a grand total of $3.5 billion – *just 1% of what is being spent*.

The never-ending budget deficit:



Source: Department of Finance

We all know they can't do this forever. There is a cost – we don't know how we will pay it, just that we will pay it.

Actually, that is not completely true. We are starting to see how tiny taxes are expanding into bigger ones. Here's a little story.

My brother, sister, and I own 10 acres of undeveloped land in B.C.'s interior. By undeveloped, I mean "dirt" – it has never had a building on it in its history and was used for grazing and limited farming in the past. We pay annual municipal taxes and prefer that it remain as raw land for now. And we sort of *have to* – the land is locked inside what is called the Agricultural Land Reserve. We are allowed to farm the land only, and build one house to live in.

Except we may not be able to leave it alone much longer. The B.C. government created a new tax several years ago called the Speculation and Vacancy Tax. It was a response to empty condominiums in Vancouver owned by absent foreigners. They were taxed an extra amount until they rented out their empty condos to locals.

“The speculation and vacancy tax is designed to turn empty homes into housing for British Columbians, and ensure foreign owners and those with primarily foreign income contribute fairly to B.C.’s tax system.”

The Speculation and Vacancy Tax has now been applied to vacant land. We are essentially told we must rent out our “empty homes” on farmland that forbids building them in the first place!

Absurd, right? Well, not when your budget is so deep in the red that you need to find revenues everywhere and anywhere.

In the US, the administration is likely to raise corporate taxes, personal income taxes, reinstate the estate tax, tax the internet giants, and add new carbon taxes. In Canada, it is “all of the above” plus higher luxury taxes, property purchase taxes, as well as keeping a hungry eye on principal residences. In Canada, gains on your home are completely tax-free. Maybe not for much longer.

Tax rates on the richest are climbing, to no one’s surprise. Here in British Columbia, the tax rate on the top income earners was 43.7% just seven years ago. Today it is 53.5% - a 22% increase. Can it get worse? In 1971, taxes on incomes over $400,000 were **<u>80%</u>**. So, yes, it can get worse.

What can anyone do?

- Split income with a spouse or family members if you can.
- Take advantage of Tax-Free Savings Accounts and RRSPs in Canada, or 401(k) plans and Roth IRAs in the U.S. They allow your money to compound tax-free.
- Earn dividends instead of interest where possible. In both Canada and the U.S., qualified dividends are taxed at a lower rate than salary or interest income.
- Capital gains are also taxed at a lower rate in both countries.

“Government's view of the economy could be summed up in a short phrase: If it moves, tax it.”

- Ronald Reagan

Warren Buffett followed Ronald Reagan's advice: he keeps his own money from 'moving'. Warren doesn't need money, so his company Berkshire Hathaway (**NYSE BRK**) pays no dividends. He prefers to let it compound inside, becoming long-term capital gains instead.

For most people, finding a growing company that pays a dividend is the best of both worlds. You get regular tax-reduced income and growth in your principal over time.

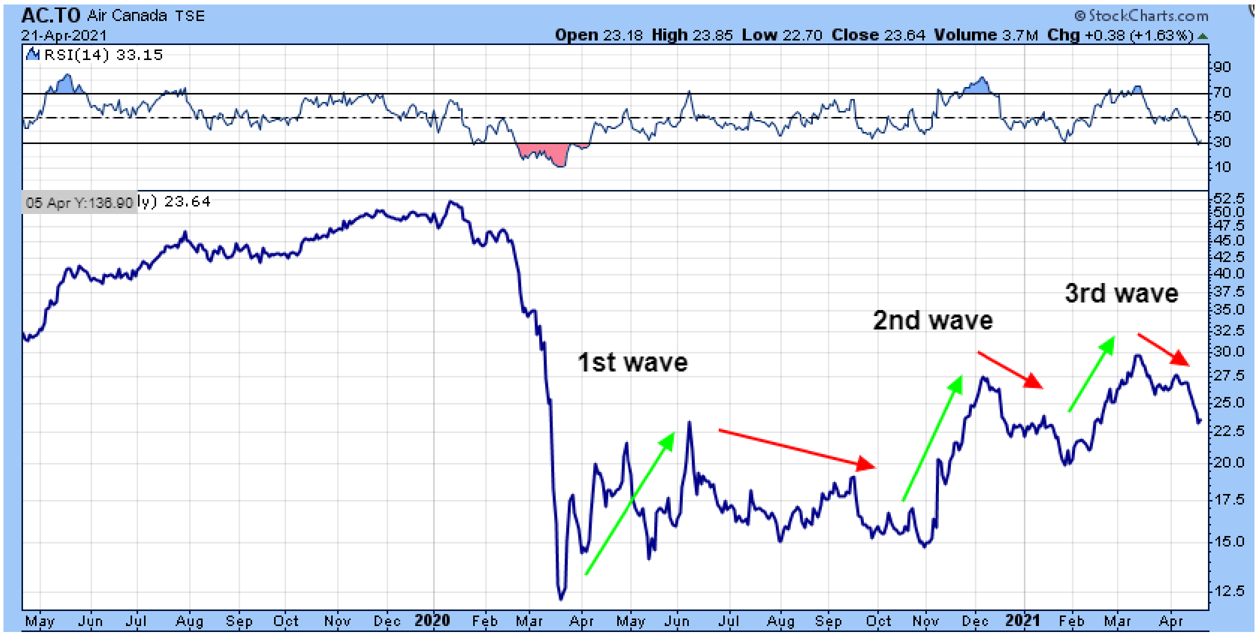
There are no easy answers for the years ahead. Taxes on income, homes, purchases, investments, and death will rise. More than ever, it will pay to get good tax advice each year.

Re-Opening Winners

As mentioned above, governments are committed to pouring gasoline on an expanding fire through continued stimulus payments even as the economy improves. Stocks are expensive and stretched, and yet the advance is broad and strong. This is a healthy sign.

The 2021 economic "grand re-opening" of the world has been delayed, however, due to new outbreaks as described above.

Here is a chart of Air Canada (**TSX AC**) - a company in one of the most affected sectors. It has risen and fallen on repeated hopes of re-opening, followed by despair when a new outbreak occurs:



There are many industries where the re-opening benefits are happening already, and they should accelerate further as the world gets back to normal.

For example, a company we hold in portfolios is Stryker (**NYSE SYK**), the world's largest artificial hip, knee, spine, and shoulder company. A new knee or hip is suddenly a low priority surgery when hospitals are filled with Covid-19 patients.

Thanks to the success of the vaccines, however, we are seeing the backlog of people needing knees being pushed forward. Stryker recently hit new all-time highs, and it could continue.

Merck (**NYSE MRK**) is another example. It makes most of its money off cancer drugs, and it has suffered during the pandemic as cancer surgeries and treatments were postponed. It is another beneficiary of the Grand Re-Opening - not as apparent to investors as an airline, but still a beneficiary.

Another company in the news recently is Rogers Communications (**TSX RCI.B**), the cable and wireless phone company. In the US, the telephone business is closer to a duopoly with AT&T (**NYSE T**) and Verizon (**NYSE VZ**) dominating. In Canada, Telus (**TSX T**), BCE (**TSX BCE**), and Rogers form a triopoly of dominance. Fully 90% of all wireless, landline, and cable subscribers use one of these three companies.

Rogers is poised to get larger as they are bidding to buy Shaw Communications (**TSX SJR.B**), the western Canadian cable company. Rogers stock went up the day the merger was announced, then fell right back down. We have had a number of calls asking what to do.

Rogers will emerge stronger once they digest Shaw. Cable services offered by Shaw, which include cable TV, internet access, e-mail, and video-on-demand, are very profitable. The larger Rogers will have a footprint that extends from coast to coast across Canada, as a result. They will likely have to divest Shaw's wireless phone business, but expect Rogers to try very hard to win those customers back. Once they have wires into your home for cable, they will work to sell you everything else that can be delivered electronically.

Rogers is also a re-opening story. The company owns the Toronto Blue Jays, a valuable sports franchise with no Toronto fans in attendance right now. And, Rogers wireless makes a nice profit off roaming charges when you travel with your cell-phone in foreign countries, an activity denied to Canadians for the last year. Both sports and travel will improve going forward, which will benefit Rogers.

As a result of this favourable merger and improved earnings from re-opening, Morningstar sees Rogers worth $67 from under $62 today. Add in the 3.25% dividend and we could see an 11% return in the next year on a very stable and safe stock investment.

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http://www.dividendvaluepartners.com

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Prices shown as of April 22nd, 2021

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