

## MAIN FOCUS THIS QUARTER:

### **What A Strong U.S. Dollar Means For Canadian Investors**

Source: *Mackenzie Investments*

#### **The U.S. Dollar's Rise**

##### 1.1 The U.S. Dollar Index

The U.S. Dollar Index measures the dollar's performance against a basket of other major currencies, including the euro, Japanese yen, British pound, Canadian dollar, Swedish krona and Swiss franc. After falling to its lowest point in late 2011, it began to climb again, rising above its 2006 levels in the longest consecutive run in 17 years.

With U.S. dollar cycles historically tending to last between six and 10 years, the current uptrend could persist for some time.

The U.S. dollar has experienced two bull runs since the Bretton Woods system dissolved in 1971. The first was triggered by a high U.S. interest rate policy in the 1980s designed to control inflation. The second started in the mid-1990s when U.S. information technology firms began to attract large global investment flows. These previous two bull runs saw rallies of 56% and 39%, respectively.

##### 1.2 Why is the U.S. Dollar Rising?

Investors around the world tend to gravitate to countries with faster growing economies, higher interest rates, or safer financial systems. As they invest in those countries, they have to buy their currencies, driving up their value in the process. It has been more than six years since the 2008 financial crisis and the U.S. economy is once again showing signs of strengthening. While still lagging behind expectations, it is now in better shape than most other advanced countries. It is expanding at its fastest pace in more than a decade, and U.S. unemployment has dropped below 6% and its 50-year average.

Moreover, the Federal Reserve has ended its program of quantitative easing (its rapid expansion of the money supply, intended to stimulate economic activity). With inflation under control, the Fed now seems ready to raise interest rates, possibly as early as 2015. The near-zero rates of recent years, which have driven investors to look outside the United States for higher-yielding assets, could be about to reverse course. As a result, global investment flows have turned back to the United States. This is increasing demand for the U.S. dollar, the world's primary reserve currency, and lifting its value to the highest level since the Great Recession.

Meanwhile, other major currencies around the world remain weak. The euro, the largest single component in the U.S. dollar index, slumped against the dollar in the second half of 2014. The euro zone continues to struggle, with its unemployment rate above 11% and GDP growth in 2014 below 1%. This has caused the European Central Bank (ECB) to drive interest rates close to zero. As the ECB embarks on a new round of monetary easing, which could widen yield differentials and make U.S. debt more attractive than European debt, the euro could fall further against the U.S. dollar.

Japan's economy, meanwhile, is still sluggish and has experienced only one quarter of real GDP growth above 2% in the past five years. The Bank of Japan's unprecedented quantitative easing has led to a worrisome government debt-to-GDP ratio that is well above 200%. Investment flows to emerging markets have slowed somewhat in a flight to quality caused by ongoing concerns over shaky economic and financial conditions overseas. Moreover, the Canadian dollar drifted lower in January 2015 after the Bank of Canada announced a surprise quarter-point cut in its key short-term lending rate, intended to offset the negative impact of falling

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### **Don't Forget: Important Deadline for Taxes**

**April 30th 2015:** Tax payment deadline for your balance owing for 2014 personal income tax. Payments are made to the CRA. This deadline is for all personal income tax filers including those who are self-employed.

# 2015 Spring Seminar

May 7th, 2015

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oil prices on the Canadian economy.

## THE IMPACT OF A STRONGER U.S. DOLLAR

### 2.1 U.S. Economy

A stronger U.S. dollar has many advantages for the U.S. economy. For one, it allows the government to pay down the national deficit, making U.S. debt more attractive to foreign investors. In 2014 this contributed to the largest annual rally in U.S. government debt in three years.

The dollar's rise also gives Americans more buying power, translating into cheaper imported goods and oil, which helps to keep consumer inflation in check. Crude oil prices have fallen significantly over the past year while the dollar has risen. That translates into a lower price for gasoline, which increases the real disposable income of the average American household. Less pressure on consumer inflation could help to delay (or at least slow the pace of) the Fed's long-anticipated interest rate hikes.

On the other hand, strength in the U.S. dollar can weigh on U.S. firms that export goods and services, or that generate a large portion of their revenues abroad. American exports become more expensive for consumers in countries whose currencies have depreciated relative to the U.S. dollar. As a result, foreign consumers tend to buy fewer American products. A strong U.S. dollar thus impacts the U.S. foreign trade deficit. It tips the balance negatively by reducing U.S. exports while increasing cheaper imports from other countries.

### 2.2 Canadian Economy

A weaker Canadian dollar can be beneficial for Canadian firms that source sales in the U.S. dollar but incur their costs in local currency. Generally, a weaker Canadian dollar boosts Canadian exports. However, Canada is a major resource exporting country. A strengthening U.S. dollar hurts global commodity prices that are denominated in U.S. dollars. When the value of the U.S. dollar increases, it takes fewer U.S. dollars to purchase these commodities and their prices tend to come down in the global marketplace. This is a disadvantage for the Canadian currency as well as for the Canadian economy. A large portion of corporate revenues and jobs in Canada depend, directly or indirectly, on resources such as oil and gold. The recent fall in oil prices, for example, has "significantly dampened the outlook for firms tied to the energy sector" (*Bank of Canada, Business Outlook Survey - Winter 2014-2015*).

## INVESTMENT OPPORTUNITIES

### 3.1 U.S. Equities

Historically, a strong U.S. dollar has been good for the U.S. economy. While a rising dollar can hinder U.S. export competitiveness, its impact on the equity market tends to be far less than many people assume. Currency fluctuations are just one of the factors affecting the U.S. stock market, but they are not as important as more fundamental economic factors, such as trends in corporate profitability and interest rate levels.

Many analysts anticipate that U.S. equity markets will continue their general upward trend as long as the U.S. economy slowly but surely becomes more robust. Corporate profits are now at a record high in the United States, the unemployment rate has fallen below its 50-year average and consumers have largely deleveraged, which all bode well for a sustained U.S. economic recovery. Moreover, a strengthening U.S. dollar helps to increase foreign demand for U.S. dollar-denominated assets, including U.S. equities.

What does all this mean for Canadian equity investors? It means that there are possible advantages to maintaining U.S. equity exposure in a portfolio, but only if investors buy U.S. companies selectively. American companies that conduct a majority of their business domestically stand to benefit most from a rising U.S. dollar. Such companies sell their products and services into an economy that is now strengthening relative to many others around the world. They also sell in U.S. dollars, which makes them no more expensive for domestic consumers to buy even though the dollar is rising. In some cases, these companies import their products or components, and these imports become cheaper with a rising dollar. Moreover, such companies are largely untouched by the foreign-exchange risk that multinational companies face when repatriating profits from sales overseas.

U.S. companies with these characteristics can be found in sectors like Utilities, Consumer Staples, Healthcare and Telecommunications. An example would be Costco, which operates an international chain of membership warehouses that carry quality, brand name merchandise at substantially lower prices than are typically found at conventional wholesale or retail sources. Costco derives 71% of its revenue in the United States and benefits from cheaper imports made possible by a stronger U.S. dollar. While Costco is a large-cap company, investors might consider looking also amongst mid- and smaller-cap companies, which, on average, tend to generate more of their revenues at home than larger-cap companies. An example would be Spectranetics, a firm that develops and manufactures single-use medical devices used in minimally invasive procedures within the cardiovascular system. Its sales in the United States account for 82% of its revenues.

While the dollar's strength signals improving economic conditions in the United States, it is also a disadvantage for some companies. Especially affected are those companies headquartered in the United States that derive a large portion of their revenues from overseas operations where currencies are weakening. Not only does a rising U.S. dollar make their exports costlier and less competitive overseas, but currency losses can weigh on their profits. Large U.S.-domiciled multinational companies, such as Coca-Cola and Nike, which conduct sizable business abroad, end up suffering when they convert their foreign earnings back into a higher U.S. dollar.

Oracle and IBM are two such companies that both reported significant currency losses in 2014 due to a strong U.S. dollar. As a result, they have had to revise their 2015 profit projections downward. Oracle, for example, said that without the impact of the U.S. dollar strengthening relative to foreign currencies, its reported total revenues for fiscal 2015 Q2 would have been up 7% rather than only 3%.

Another example is Mondelez International, Inc., one of the world's largest snacks companies and the maker of

Oreo cookies and Cadbury chocolate, which reported lower earnings in the last quarter of 2014 as a result of the rising U.S. dollar. Mondelez generates 80% of its revenue in foreign markets whose currencies have fallen relative to the dollar. Some U.S. companies can also see their market position eroded in other countries by a strong U.S. dollar. General Motors, for example, had to temporarily halt delivery of vehicles to its Russian dealers because the ruble declined so precipitously against the U.S. dollar in 2014. S&P 500 companies do not hedge a significant portion of their foreign earnings. The S&P 500 companies that provide details on foreign sales reported in 2013 that 46.3% of all sales were produced outside of the United States, with companies in the Information Technology sector registering the highest level at 56.6%.

### 3.2 Diversification Benefits

For Canadian investors, U.S. assets can be an effective diversification tool. In times when the U.S. dollar strengthens, Canadian investors will see their returns enhanced beyond whatever their underlying assets are returning when converted back into Canadian dollars. While it is very difficult to forecast the direction of the exchange rate, it is sensible to diversify a long-term portfolio's currency exposure to carry it through different market conditions with reduced volatility.

Another advantage to investing in U.S. equity markets is the opportunity for greater sector diversification. The Canadian market is dominated by just a few economic sectors, with 33% of large, publicly traded companies concentrated in Energy and Basic Materials. These sectors tend to weaken with strength in the U.S. dollar. U.S. equity markets have more companies spread across the various industry sectors, particularly those sectors under-represented in Canada, such as Information Technology, Consumer Discretionary and Health Care. For example, in the United States there are 335 listed companies in Information Technology alone, but only seven in Canada. Also, U.S. stocks are generally more widely spread out over the capitalization spectrum, from small to medium and large cap companies.

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## Tax Tips

Source: *Worldsource Financial Management Inc.*

Preparing your tax return can be a daunting task. We have compiled some tax tips and updates you may wish to keep in mind.

This edition of the Wealth Consultant features:

- Tax saving strategies between spouses
- Planning opportunities for 2015
- And more

### Universal Child Care Benefit (UCCB)

Beginning January 1, 2015, the UCCB is being increased for children under age six. As a result, parents will be eligible for a benefit of \$160 (up from \$100) per month for each child under the age of six. Under proposed changes to expand the UCCB, parents may also receive a benefit of \$60 per month for eligible children ages six through 17. Payments of the additional amount and expanded amount will start in July of 2015. Note that the Child Tax Credit will be replaced by the enhanced UCCB for the 2015 and subsequent taxation years.

### Child Care Expense Deduction

A tax deduction is allowed for child care expenses. In 2014, parents were allowed to claim child care expenses of \$7,000 per child under age 7 and \$4,000 per child aged 7 to 16. Beginning in 2015, these limits are being increased by \$1,000 each.

### Tax Bracket Increases

Most economists are of the opinion that there is a relationship between marginal tax rates and economic performance, believing that high marginal tax rates negatively impact, entrepreneurship, investment, savings rates, etc... A marginal tax rate refers to the additional tax an individual will owe to the government on the next dollar of income that they earn. Canada has relatively high marginal personal income tax in comparison to many G-7 countries.

### **Start Planning For 2015**

#### Increased TFSA Contribution Amount

The amount that you can contribute annually to your TFSA increased in 2013 by \$500 to \$5,500 and will remain at that level for 2015. For someone who has never opened a TFSA before and was at least age 18 in 2009, your total cumulative TFSA contribution room starting January 1, 2015 is now \$36,500.

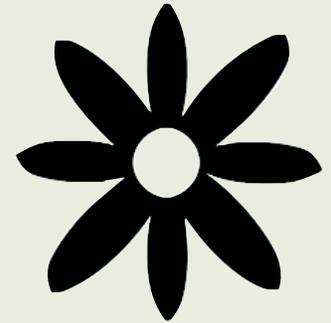
#### Contributing to a Registered Retirement Savings Plan (RRSP)

The maximum RRSP deduction limit for 2014 is \$24,270. However, if you did not use your entire RRSP deduction limit for the years 1991- 2014 you can carry forward unused RSP contributions to 2015. In 2015, the maximum RRSP deduction limit increases to \$24,930.

### **New For Your 2015 Taxes**

#### Family Tax Cut

Through Canada's Economic Action Plan, the federal government created the Family Tax Cut, a new federal non-refundable tax credit of up to \$2,000 for couples who have children under the age of 18. This tax credit is effective for the 2014 tax year. As this tax credit allows for the transfer of up to \$50,000 from one spouse to the other, it will



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benefit families where one spouse earns significantly more than the other. In order to benefit from the Family Tax Cut, each spouse must file a tax return.

#### Children's Fitness Amount

Since its introduction in 2006 the Children's Fitness Tax Credit (CFTC) has allowed parents to claim up to \$500 of the cost associated with "strenuous" activities for children under 16 (or under 18 with a disability). Historically, this tax credit has been structured as a non-refundable tax credit. A non-refundable credit may not be used to reduce taxes owing to less than zero. While the CFTC remains a non-refundable credit for 2014, the amount of eligible expenses has increased to \$1,000. Beginning in 2015, this credit changes to a refundable tax credit. Unlike a non-refundable tax credit, a refundable tax credit is not limited to an individual's tax liability. Thus even if you do not owe any tax, you still receive the tax savings that are associated with the tax credit.

#### Search and Rescue Volunteers Tax Credit

The 2011 budget introduced the Volunteer Firefighters Tax Credit while the government's 2014 Economic Action Plan announced a 15% non-refundable Search and Rescue Volunteers Tax Credit on an amount of \$3,000 for ground, air and marine search and rescue volunteers. This credit will be available to search and rescue volunteers who perform at least 200 hours of service during a year. Individuals who perform at least 200 hours of combined eligible search and rescue services and volunteer firefighting services in a given year will be able to choose between the Volunteer Firefighters Tax Credit and the new tax credit.

#### Adoption Expense tax credit

The maximum eligible adoption expense that qualifies for this tax credit was boosted to \$15,000 in 2014, up from \$11,669 in 2013. In 2015 and subsequent years, this credit will be indexed to inflation.

#### **Split, Share, Combine**

The following tax savings opportunities and strategies can be either transferred or combined between spouses. Doing so may help you realize more tax savings.

#### Split Income With Your Spouse

As withdrawals from all registered plans are taxable, minimizing the tax associated with the withdrawal should be the goal of all savers. One of the best ways to accomplish this is through the use of a spousal RSP, which allows a spouse in a higher tax bracket to allocate a future tax liability to a spouse in a lower tax bracket. While Canadians have been able to split pension income with their spouse's since 2008, they can only split income from a RRIF or from an RSP annuity provided the recipient spouse is over the age of 65. Thus for those Canadians who plan to retire or semi-retire before normal retirement age, spousal plans can still be advantageous.

#### Medical Expenses

Spouses can combine the medical expenses that they have incurred for themselves as well as for those of a dependent child (under the age of 18) on the return of the lower earning spouse. That's because this non-refundable tax credit is based on those eligible medical expenses, (such as dental bills and prescription drugs etc.) that are in excess of the lower of 3% of the taxpayers (lower earning spouse) net income or \$2,171. A 15% federal tax credit is available on expenses above this amount to a maximum of \$10,000. The list of eligible medical expenses now includes the cost of designing a therapy plan for someone who qualifies for the disability tax credit and the cost of service animals that help those afflicted with severe diabetes.

#### Charitable Donations

While the first \$200 of charitable donations claimed is eligible for a 15% federal tax credit, donations in excess of \$200 are eligible for a 29% federal tax credit. As a result, spouses may want to combine their donations in order to take advantage of the higher tax credit on donations in excess of \$200. Donations can also be carried forward for up to 5 years allowing individuals who donate smaller amounts to combine and claim their donations in a single year to also take advantage of the higher tax credit on donations in excess of \$200.

Note that the 2013 Federal Budget also introduced a tax credit for first time donors to charity (defined as individuals who have not donated to charity since 2007). This new super credit supplements the charitable donation tax credit with an additional 25% tax credit on up to \$1,000 in cash donations, entitling donors to a 40% federal tax credit for donations of \$200 or less, and a 54% federal credit for the portion of donations over \$200.

#### Sharing Your CPP

Sharing your Canada Pension Plan retirement pension with your spouse may also result in tax savings. The portion of your pension that can be shared is based on the number of months you and your spouse lived together while you were still contributing to the CPP.

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