Weekly Updates Issue # 584

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1. Weekly Markets Changes

[September 30, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,725.86 +27.93 +0.19%	2,168.27 +3.58 +0.17%	18,308.15 +46.70 +0.26%	5,312.00 +6.26 +0.12%	$0.7618 +0.24¢ +0.32%	$1,318.80 -22.30 -1.66%	$48.05 +3.46 +7.76%

2. Will Deutsche Bank become the next Lehman?

[September 30, 2016] Germany's biggest bank is looking shaky and some investors fear it could collapse and endanger the wider financial system.

Some even wonder whether it might become the next Lehman Brothers, the U.S. bank whose failure unleashed the worst of the global financial crisis in 2008.

Experts warn against drawing such quick conclusions. Deutsche Bank's shares are down 51% so far this year and it's negotiating a multibillion fine in the U.S. that it could have trouble paying.

But it's exactly because it is so big and important that it is unlikely to be allowed to simply fail, the way U.S. authorities did with Lehman.

Here are some questions and answers about the bank and what it might mean for the rest of the world.

What's ailing Deutsche Bank?

The recent turmoil was triggered by a demand by U.S. authorities that Deutsche Bank pay US$14 billion to settle an investigation in mortgage-backed securities, the investments that turned out to be duds and helped trigger the global financial crisis. That sum is about the same as Deutsche Bank's entire market value as of Friday.

It's unlikely the bank would pay the full amount — industry peer Goldman Sachs paid US$5 billion in a similar investigation. But the fact that it could get hit with a big bill increased the possibility that it may have to tap investors to raise the cash. That would dilute shareholders' stakes and send shares down even farther.

Is that it?

No, Deutsche Bank also has more fundamental problems.

It is loaded with risky financial trades called derivatives and has struggled for years to turn its business around, particularly its investment banking unit. Before the financial crisis of 2007-2008, it earned much of its money from investment banking. New regulations have pushed banks to hold larger financial buffers and reduce their risky investments. That has made investment banking less profitable. And compliance with all the rules has imposed costs as well.

Like other European banks, its profit margins have been squeezed by record low benchmark interest rates. Low rates reduce the difference at which a bank can borrow money and lend it out.

The International Monetary Fund said in June that Deutsche Bank was the biggest source of systemic risk among the globe's big financial institutions.

Will it need a bailout?

It's too soon to tell.

One of the things that unnerved investors this week is that the German government has refused to say it would rescue the bank, if needed. But that's likely because there's a general election next year in Germany and politicians don't want to be seen promising taxpayer money to save a bank after spending billions during the financial crisis.

If push comes to shove, experts say, the German government would be under pressure to step in to help. Deutsche Bank is the country's biggest financial group and has links to many other banks. As such, it is considered systemically important _ its failure could conceivably endanger the stability of the European or even global financial system.

Yet new European rules on bank bailouts could limit the government's choices and expose investors to losses. The rules, which went into effect Jan. 1, are intended to protect taxpayers from failing banks. In some circumstances they require shareholders and creditors to take losses before a bank can turn to taxpayers.

Would its collapse be another Lehman moment?

That's the big question, but analysts say probably not.

Lehman Brothers was, like Deutsche Bank and other major financial groups, closely connected to other banks. But Lehman's finances were, by some accounts, far shakier. After Lehman imploded, inquiries showed that the company used accounting tricks to mask US$50 billion in debt, making it look like it was in better shape than it really was.

Deutsche Bank has passed a "stress test" this year that has required it to open up its books to regulators. It has more reserves it can readily tap — over 200 billion euros — whereas Lehman had trouble paying back customers who wanted their money back.

Also, the European Central Bank can make available big, ultra-cheap, short-term loans for banks if the system as a whole gets into trouble.

Then why are investors worried?

Burned by the experience of the financial crisis, it seems investors may be faster to respond to perceived dangers. "In banking, perception is everything, and in times of stress investors tend to shoot first and ask questions later," said Michael Hewson, chief market analyst at CMC Markets.

At the very least, it looks like Deutsche Bank will have to raise capital, and that tends to hurt the share price. The bank has tried to bring in money this week by selling a subsidiary for 1 billion euros. But analysts say that ultimately it will likely have to tap shareholders for cash. Others have suggested it merge with another weak German group, Commerzbank, which this week announced it was cutting thousands of jobs to save on costs.

More broadly, Deutsche Bank's problem highlights how weak many European financial groups still are. Unlike in the U.S., where banks were made to restructure aggressively in the wake of the financial crisis, European banks have been slow to clear out soured investments from their books and to readjust their business models.

3. Alberta to introduce tax credit for investments in small businesses

[September 30, 2016] The Alberta government plans to introduce a tax credit for investments in small businesses in the fall sitting of the legislature.

Economic Development Minister Deron Bilous says there will be a 30% tax credit for investments in Alberta small businesses made between April 14 of this year and Dec. 31, 2019.

The government says the tax credit would support up to 4,400 new jobs over three years and contribute up to $500 million to the province's GDP.

The tax credit is part of the government's jobs plan.

Bilous says the government is also restoring training programs for entrepreneurs, cutting the small business tax and protecting a multibillion-dollar tax advantage over other provinces.

Justin Smith with the Calgary Chamber of Commerce says the province has large pools of capital but until today, policy measures were sorely needed to encourage the flow of this capital into the province's small businesses.

“This tax credit puts the onus on investors to make the final decision on risk and efficiency, while keeping their money in Alberta and putting it toward growth-oriented firms,” Smith said in a news release Thursday.

The tax credit legislation, if passed, will have a budget of $90 million over three years and would be provided on a first-come, first-served basis.

The tax credit will be available for investments in companies that are substantially engaged in proprietary technology research, development or commercialization; interactive digital media development; video post-production; digital animation; or tourism.

The government says investment criteria were developed through extensive consultation with business and investment leaders across Alberta and are designed to encourage economic diversification.

4. Happy birthday, RRSP!

[September 30, 2016] The RRSP is fast approaching its 60th birthday. There have been many changes over that period and Canadians’ contributions have ebbed and flowed along with income growth, demographic changes and various tax changes.

A history of the RRSP

When the RRSP was created in 1957, contribution limits were 10% of the previous year’s income to a $2,500 maximum. If an individual did not contribute in any given year, that year’s contribution room was gone forever. Canadians were underwhelmed. In 1968, the first year contribution data was available, only 172,000 contributed.

By contrast, 1990 was a huge year for RRSPs. Contribution limits increased to 18% of the previous year’s income, the dollar limit was raised to $11,500 and the contribution carry-forward rule was introduced, allowing unused room to be carried forward seven years.

In 1996, the government starting indexing the dollar limit to annual wage growth. And the Pension Adjustment was introduced to level the playing field for contributors with employer pensions and/or deferred profit sharing plans (DPSPs). Finally, the seven-year carry-forward rule was replaced with an indefinite carry-forward.

The RRSP’s competition

Today, the RRSP is being challenged on two fronts. First, the TFSA, introduced in 2009, has given Canadians a flexible savings option that avoids tax on income and withdrawals, and that can be used for any savings purpose. Second, business owners must be paid a T4 income (i.e., salary) in order to be eligible to contribute to RRSPs, but the tax benefits of being paid dividends and investing within a corporation can be more attractive. As a result, many owners are forgoing salary and thus choosing not to contribute to RRSPs.

These headwinds mean that only about 6 million Canadians, or 23% of tax filers, use RRSPs. This proportion has remained fairly consistent since 2009.

Yet the RRSP is still here, 60 years later.

Why the RRSP is great

As of 2014, roughly 24 million Canadians have combined RRSP room of more than $951 billion. That's approximately $39,628 of unused room for every tax filer. Further, the median annual RRSP contribution is only $3,000. This presents a big tax savings opportunity that simply can't be ignored – but how big?

Let's do some simple math. The median marginal tax rate in Canada (combined federal and provincial) is currently 35.32%. If Canadians en masse maximized their RRSPs, this could generate a combined tax savings of $336 billion, or approximately $14,000 per Canadian.

Sure, not everyone is eligible to contribute or has the funds to do so. But no other tax-planning strategy combines simplicity with tax savings quite like the RRSP.

But wait, there's more.

Other benefits of an RRSP include:

1. Encourages long-term savings. The taxation of RRSP withdrawals can create a disincentive to use RRSPs for short-term needs and create a larger future nest egg when compared to a TFSA that can be tapped into at any time without tax costs.
2. Canadians retire with lower income. Most retirees are in a lower tax bracket during retirement than during their working years. As a result, the net tax savings (tax deduction at a higher tax rate than the tax rate applicable on withdrawals) can garner higher asset balances in an RRSP as opposed to a TFSA, all other things being equal.
3. Tax-deferred growth. The balance grows on a tax-deferred basis in an RRSP as opposed to being taxable annually when money is invested within one's corporation or taxable account.
4. Possible employer contributions. Employer RRSPs often mean matching contributions. I'm a big fan of free money, and every bit counts.
5. U.S. tax reporting exemptions. For U.S. persons living in Canada, RRSPs are exempt from Passive Foreign Investment Corporation reporting. They are further exempt from Form 3520-A (annual information return of foreign trust with a U.S. owner). Finally, under the Canada-U.S. Tax Treaty, they are recognized as tax-deferred

accounts for U.S. tax purposes. If your clients' U.S. tax reporting is up to date, this election is now automatic.

In recent years, the RRSP has lost some shine as new accounts and strategies have been introduced. But you have to admire the longevity of the RRSP. Sixty is a big milestone. And it has evolved in major ways since creation to remain a viable option for retirement savings.

Maybe it is the nostalgia talking, but we should make 2017 the year of the RRSP. Tell clients to let their RRSPs help them celebrate this momentous occasion with the best gift of all: cash. Then, suggest they pay down their mortgages, contribute to TFSAs or RESPs, or take vacations.

5. CPP fund to grow by $191B over next decade

[September 28, 2016] The existing Canada Pension Plan is on sustainable financial footing at its current contribution rate and its assets are projected to grow from $285 at the end of 2015 to $476 billion by 2025, according to the latest actuarial report on the CPP.

The report, which is prepared every three years, was tabled in Parliament on Tuesday by Minister of Finance Bill Morneau. It covers the three years ended Dec. 31, 2015 so doesn't reflect the proposed CPP enhancements agreed to by Canada's governments in June.

While the report projects that the current contribution rate of 9.9% is more than sufficient to cover expenditures over the period 2016 to 2020, it notes that a portion of investment income will be required to make up the difference between contributions and expenditures thereafter. In 2050, it's projected that 26% of investment income will be required to pay for expenditures.

The report also found:

- The average annual real rate of return on the plan's assets over the 75-year projection period, 2016 to 2090, is expected to be 3.9%.
- The number of contributors is expected to grow from 13.8 million in 2016 to 15 million by 2025.
- Under the legislated contribution rate of 9.9%, contributions are expected to increase from $47 billion in 2016 to $66 billion in 2025.
- The number of retirement beneficiaries is expected to increase from 5.1 million in 2016 to 10.2 million in 2050.

6. Ontario businesses expect less growth in 2017

[September 28, 2016] Small business owners in Ontario are headed into 2017 feeling less optimistic than last year, finds a poll by Meridian Credit Union.

The survey found 67% of small businesses expect growth this year, down 11% from 2015.

"I'm not surprised about these results, because when the economy becomes unpredictable, small businesses feel it first," says Geordan Robertson, director of small business for Meridian. "We've noticed that many small businesses are approaching us with cash flow concerns, especially those who were not conservative when they were running a surplus. These entrepreneurs are looking for solutions that they can't find with their current financial institutions."

The study revealed that 52% flagged cash flow as their top concern with economic uncertainty coming in second at 51%. Changes in fluctuating currency made 38% uneasy, and provincial legislation changes concerned 37%. Further, 23% are worried about finding good employees.

The surging real estate market also draws red flags with some small businesses. While 57% agree that the current market is unsustainable, only 12% say that the real estate market is negatively impacting their business expansion plans. Findings include:

- 24% indicate they will hold off on making a real estate purchase because of the uncertainty
- 35% feel a less expensive option would be to lease rather than purchase a business property
- 17% say the current market has provided positive opportunities for their business expansion plans
- 20% agree that the current real estate market generated positive effects for their business
- 20% have been prompted to adopt a virtual work environment

"The real estate market is definitely influencing the way small businesses operate," says Robertson. "We're seeing some of our members either race to purchase real estate, or liquidate some or all of their real estate holdings and turn to leasing instead. And as the results indicate, many are adopting virtual environments to cut down on capital costs."

Robertson has a few tips for small businesses, which you can pass on to business-owning clients:

Stay conservative if you're running a surplus: Keep your costs down, remain conservative and put the extra funds aside.

Capitalize on surplus funds: Ensure that you are earning interest on those surplus funds.

Separate personal and business credit cards/lines of credit: Business lines of credit should be separated from personal, otherwise you can run up personal expenses all too quickly and easily, compromising your business cash flow.

Understand the days' receivables and payables: Manage your cash flow better when you work around the payable and receivable days. It may take 60 days to get paid from a client, but you may also have 60 days to pay your supplier. If you work around these timelines, you can establish a rhythm where you're making your money go further in-between paying and receiving payments.

Keep up with the news: – Changes in currency, government legislation, taxes and the stock market can impact your business. If you're informed, you can make quick decisions that can save or make money.

7. OPEC agrees to cut production; oil prices surge

[September 28, 2016] It would be the first time in eight years that the oil cartel would lower output. The agreement was reached on Wednesday at a meeting in Algiers.

Oil prices surged more than 5% in reaction.

A global glut of oil supply caused oil prices to crash over the last two years. And OPEC nations, led by Saudi Arabia, have refused to lower production until now.

Under the agreement, OPEC oil production is expected to be reduced to a range of 32.5 to 33 million barrels of oil per day from 33.4 million. Saudi Arabia, the largest oil producer, is expected to give up 350,000 barrels a day, according to a senior OPEC source quoting the final proposal. Other OPEC nations are expected to lower production too, though more details were not immediately clear.

Three countries are exempted from the production cuts: Iran, Nigeria and Libya. Economic sanctions were lifted on Iran earlier this year, and Libya and Nigeria have had some of their oil facilities damaged by terrorist attacks in recent months.

Oil prices were as high as $100 a barrel in mid-2014. But the global oversupply caused prices to plunge to as low as $26 a barrel in February. The volatility in oil caused stock markets to dive at the beginning of 2016.

In recent months, oil prices have rebounded a bit and oil is currently hovering near $47 a barrel.

Have a nice and fruitful week!