GROW TOGETHER

CWB Wealth Management Newsletter | **April 2019**

Message from David Schaffner, President and CEO

Our primitive battle

FOMO: a fear of regret, which may lead to a compulsive concern that one might miss an opportunity for social interaction, a novel experience, a profitable investment or other satisfying events.

FEAR: a feeling induced by perceived danger or threat that occurs in certain types of organisms, which causes a change in metabolic and organ functions and ultimately a change in behaviour.

We know through decades of data and experience that markets are rational over the long run. That same data and experience also shows us how the market, and in particular sectors and companies within the market, can diverge wildly from time-tested valuation methods in the short run. ***The problem lies within us***. It is incredible what we have learned, even within the last decade, about how the more primitive part of our brain still has such a powerful effect on our behaviour, and how that affects our decision making. While we can't (and shouldn't!) eliminate the signals we have used to survive as a species, as professional investors we have developed tools, techniques and discipline to help keep these signals in check.

The battle between the primitive and rational part of our brains applies to all investors in the stock market, which is how opportunities are created. Our ability to overcome our primitive instincts and execute on logic, especially in times of turbulence, is how we avoid landmines and gain from overreactions. As you read on, our FOMO article on cannabis stocks points out how individual and institutional investors can frequently propel valuations far ahead of reasonable estimates, even when a sector or stock has great long-term potential. On the other hand, our article on Brexit shows how fear can cause potential undervaluation given an overestimation of the market consequences of a risky event. It is far too easy to let our natural instincts (knee-jerk reactions in FOMO and in fear) take over, and much more difficult to remove our emotion and focus on rationalizing before action.

CWB Wealth Management believes in providing you peace of mind, for all of life. We help you win this primitive battle with an integrated plan and appropriate, customized solutions that fit your unique situation. We have in-house Wealth Advisory Services that develops integrated plans for our clients; from individual needs to the complex needs of business owners. Part of the solutions they can now provide are insurance strategies for life, health, business planning, and estate planning.

If you have questions on how our Wealth Advisory Services can be made available to you, please contact your Client Portfolio Manager or CWB Account Manager.

Sincerely,

David Schaffner
President & CEO

CWB WEALTH MANAGEMENT

Fear of missing out (FOMO)

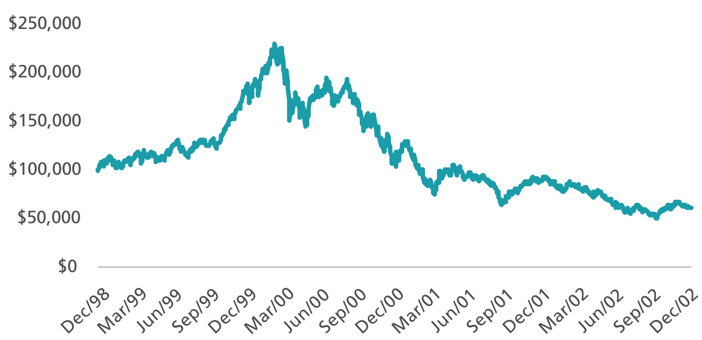
by CWB Wealth Management Research

The stock market is a great mechanism to grow and preserve wealth. Although year-to-year the market can be volatile, over time it has rewarded those that stayed invested with good steady returns. Every so often a new concept or regulatory change happens to drive the public's imagination. Often what happens is early investors make a fortune, the general public then catches on (experiencing FOMO) and starts to invest with dreams of getting rich quick, only to be disappointed. We believe we are in a FOMO moment for cannabis stocks.

We've seen FOMO play out many times in the history of our markets. We draw a parallel to another great FOMO moment; the dotcom bubble. In its early days, the internet seemed to have almost limitless possibilities and investors wanted to be a part of it - at ***any cost***. Stocks with minimal or no earnings (sometimes no revenues) were worth billions of dollars. The market rallied hard toward the end of the 1990's. Many investors that had previously focussed on buying good quality businesses trading at reasonable prices became frustrated at "missing out" on the great returns dotcom stocks were generating and switched strategies.

Of course, the dotcom bubble created many spectacular failures, as new enterprises with poor business plans either went bankrupt (Pets.com), were before their time (Webvan) or pursued poor acquisition strategies and could not keep up with the pace of change (Nortel). In 1999, the NASDAQ (U.S. exchange where a lot of tech names are listed) rose over 80%. The next three years saw significant declines of 20-40% in the NASDAQ per year. A dollar invested in the NASDAQ at the end of 1998 was worth roughly $1.86 a year later. By the end of 2002 it was worth less than $0.65 (Figure 1 shows this loss with a $100,000 investment). Investors that were able to stay the course by buying quality and value avoided dotcoms and were well rewarded in the end.

Figure 1: Value of $100,000 invested in the NASDAQ



Source: Bloomberg

So what are the similarities between the dotcom era of the late '90's and the cannabis legalization craze of today? We see at least three:

1. Tremendous future growth opportunities.
The potential of the internet was obvious twenty years ago and it has fulfilled its potential and more. The global legal cannabis industry won't be as transformative, but it is also going to be huge compared to where it is today. We have seen estimates that it could be a $130B U.S. industry by 2029 if cannabis was fully legalized in North America, Europe and Latin America (it's currently legal in 22 countries for recreational and/or medical purposes). Currently, the global legal industry is about $12B U.S. A lot of these sales are already happening today in the illegal market so growth is virtually certain, it's just the magnitude.

2. A lot of good news is already priced into the stocks.
Valuations are hard to justify. In 1999, Amazon's market cap was 69x its revenue (the company did not have any earnings). Today, Canopy Growth, which is one of the largest cannabis companies in the world, trades at 67x its projected yearly revenue to the end of March 2019. Amazon is thriving as a business today but the valuation got so ahead of itself in 1999 that the stock fell around 90% from December 1999 to September 2001.

3. All the stocks are priced like winners.
Just like in the dotcom bubble, anything internet-related seemed to move higher each day with the market not caring about management, business models or fundamentals. It's very similar today in cannabis. The six cannabis stocks in the S&P/TSX Composite are worth a combined $47B. In the last twelve months, they've generated $400M in revenue. Overall, the whole cannabis group trades at over 100x sales. For context, Molson Coors Brewing Company trades at just over 1x sales. Not all cannabis companies will be successful.

In conclusion, we believe that the legal cannabis industry is here to stay and it will become large, but we do not own any of these companies in our clients' portfolios. The valuations are too high, the industry is too speculative and in our opinion, at current prices, the risk of losing money investing in cannabis stocks far outweighs the potential reward of making money. We prefer to stick to our discipline by focussing on great businesses trading at reasonable prices and preserving our clients capital.

Where art thou BREXIT?! by CWB McLean & Partners Research

As we write, 1020 days have passed since the Brexit vote whereby the UK voted in favoring of splitting with the EU. As it turned out, the vote was the easy part, while the actual details have been elusive, to say the least. Once the initial shock of the vote was absorbed, we (as investors) have all been very much in a "wait-and-see" mode. We have often wrote about investing when there are significant unknowns and unknowables - where risks are nearly impossible to quantify. This is definitely the case with regards to Brexit. Therefore when it comes to Brexit, instead of FOMO, investors are exhibiting FOBI or ***"Fear of Buying In!"***

The traditional investment approach of most money managers has been to wait on the sidelines for clarity. Indeed, the latest BoA Merrill Lynch's Fund Manager Survey shows the lowest allocation to European stocks in two and a half years. In addition, investors are pessimistic and are long defensive stocks and shorts cyclicals. Most telling is that being short European equities is the most crowded trade. What this tells us is that the road to Brexit is too complicated, too volatile and has investors fearful. Our playbook for investing through the Brexit saga has been one of assessing probabilities and managing risk. While there have been endless headlines of the battles between UK Prime Minister May, the UK House of Commons, pro-Brexiters/pro-EU and, of course, the EU itself, our focus was on the probability of the worst case outcome - a hard Brexit or the UK leaving the EU without any trade deal. This for us would by far the most disruptive to the markets.

Given the economic weakness in the UK and the EU, a hard Brexit would cause undue pain to the UK and Europe. With both regions already dealing with an economic soft patch due to global macro factors like the US-China trade war, we assign a low probability of this worst case scenario occurring. In fact, last week, while the House of Commons could not agree on anything else, they passed a motion that the UK should not leave the UK without a deal. While a motion is not a law, we are confident enough to make a hard Brexit unlikely. For us, this analysis of an unknown and an unknowable is enough.

Simply put, all other scenarios involve some type of deal - and a deal is all that we are looking for. We have no way of assessing whether the UK or the EU will get a better deal and, frankly, to us it doesn't matter. Investors are fearful of a 'no deal' and, therefore, if there is a deal we see upside to stocks because, as we mentioned earlier, many investors are in a "wait-and-see" mode. We have been proactively taking advantage of the volatility and embracing the complexity to find value where others may not. As such, we've found opportunities in names such as Tesco and Vodafone in the UK. Also, adding to stocks such as Aercap and Infineon in Europe, while taking profits in the Emerging Markets by trimming CCR in Brazil.

Our process and philosophy leads us to be individualists. Being different than the crowd, instead of following it, is what it takes to outperform and provide value to our clients as active managers.

Federal Budget 2019 by Wealth Advisory Services

On March 19th, the Liberal government presented their 2019 Federal Budget with the theme "Investing in the Middle Class". No changes were made to personal or corporate tax rates, but there were a number of measures aimed at helping both personal and business taxpayers, as well as initiatives to reduce or eliminate certain perceived 'unfair' tax advantages.

Depending on your individual situation, these new budget initiatives may have a varying impact. Some highlights include:

Personal Income Tax	Business and Business Owner

• Enhancements to the first-time home buyers' plan
• Introduction of the $250 per year refundable Canada Training Credit
• Interest relief on student loans
• Tighter restrictions on:
  ▪ Investment activity inside a tax-free savings account (TFSA): Account holders will be liable for any tax owing on income earned in a TFSA if the Canada Revenue Agency (CRA) determines that the holder has engaged in disallowed investment activities, such as day trading
  ▪ Employee Stock Options: A $200,000 annual cap on employee stock option grants taxed effectively at the capital gains rate
	• Incentives for investing in zero-emission vehicles
	• Improved ability to claim refundable credits for Scientific Research & Experimental Development
	• Protection for farmers and fishers for the Small Business Deduction
	• Additional measures to enhance anti-avoidance provisions and tax compliance

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Of particular interest to businesses and their owners is the government's commitment to farmers, fishers and other business owners. Where previous years' budgets introduced what many perceived to be unfair measures on small businesses and their owners, budget 2019 did not introduce any new measures for small businesses that were found to be as punitive.

What rhymes from the past

2016 and 2017 saw some controversial initiatives introduced by the Liberal government that were aimed at businesses perceived to benefit from unfair tax advantages. Given the feedback from the business and tax-advisor community, certain items that were originally proposed were scaled back, or eliminated altogether. Although some initiatives remain, such as the rules surrounding tax on split income ("TOSI"), budget 2019 appears to offer some reprieve for business owners in some cases.

For instance, the 2016 Liberal government budget enacted rules that disqualified, with some exemptions, some income for Canadian Controlled Private Corporations (CCPCs) from eligibility for the small business deduction. Budget 2019 expands the exemptions such that sales by a CCPC's farm or fishing business to any arm's length corporation are excluded from 'specified' corporate income. The measure is retroactive to March 21, 2016.

Another measure previously raised in the 2017 budget proposal involved restrictions on the disposition of the shares of a corporation. Under certain circumstances, individual taxpayers would be prevented from using non-arm's length transactions that 'stepped up' the cost base of a corporation's shares in order to avoid additional taxation. As presented, the rules would have severely impacted the ability of business owners and farmers to transfer family-owned businesses to subsequent generations. Budget 2019 now promises to develop new proposals to better accommodate intergenerational transfers of businesses while protecting the integrity and fairness of the tax system. Budget 2019 appears to indicate that the government has acknowledged the importance and contribution of business owners, and their desire to be able to maintain within the family.

If you are a business owner, it's important to consider how these and other tax rules and initiatives impact you from both a personal and business perspective. With good planning that considers each facet of your wealth, you can take advantage of several solutions that help minimize the taxes you pay both personally and corporately.

Our Wealth Advisory Services team can help you walk through these planning techniques and work in-step with your Portfolio Manager. Considering all the factors is important and reviewing your tax situation goes hand-in hand with your overall wealth management strategy. Learn more at cwbwealth.com.

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