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Quarterly Report

Second Quarter Report 2020

The Money Game

Retail online trading is hardly new, of course, but what is new this time around is that many of the people now entering the market clearly have NO IDEA what they are doing.

It has been just over three months since the March market lows and many are worried about the dislocation between the real economy and the stock market. Not only is the S&P500 index up over 40% since late March, but the NASDAQ is sporting double-digit gains on the year, even while many anxiously wait for economic activity to return to some form of normal.

Politicians will credit the market upturn to the enormous stimulus packages and perceived success of social lockdown to get us to this point of reopening the economy. This may be true. I believe, however, that the incredible rise in online stock trading is a big factor contributing to this market disconnect.

It's a fascinating development to watch while being cringe-worthy at the same time. Retail online trading is hardly new, of course, but what is new this time around is that many of the people now entering the market clearly have NO IDEA what they are doing. Need some proof? Stocks that retail investors tend to favour have outperformed the S&P 500 by 30% since mid March[1].

Consider the following table highlighting the number of accounts opened at popular online trading platforms:

	New Accounts Q1 2020	New Acounts Q1 2019	Year-over-year increase
Charles Schwab	609,000	386,000	58%
TD Ameritrade	608,000	244,000	149%
Etrade	363,000	135,000	169%

SOURCE: FACTSET, CNBC

US unemployment rolls have spiked by about 15 million since February, and about a third of these newly unemployed have been in the food service industry where total employment has dropped from 12.3 million to 7.6 million currently.

While we don't yet have good data on what the demographics are of these new online investors, younger workers (who often work in food services) have been polled as being the most likely to push part of their stimulus cheques into the stock market.

		2020 Q1	12 Month Returns
S&P/TSX*	15515	16.0%	-5.3%
S&P 500	3100	20.0%	5.4%
Dow Jones	25813	17.8%	-3.0%
Nasdaq	10059	30.6%	25.6%
$CAD	$0.7366	3.6%	-3.5%
Crude Oil	$39.27	67.6%	-42.0%
Gold	$1,781.0	12.9%	26.3%

** The S&P/TSX, the S&P500, the Dow Jones and Nasdaq indices are not investable indices, and as such are not a direct comparison to any investment product available at Foster & Associates Financial Services Inc, and therefore should therefore be considered hypothetical in nature and for illustrative purposes only.*

Still, most of these new investors are likely not unemployed, merely office refugees. They are comfortable online, they still have jobs, but they are now freed from the internet-use restrictions and supervision they had at the office.

One additional feature of these new investors - making them distinct from the pre-2000 tech investors - is that a good portion of them seem to like to gamble on sports.

This is perhaps no surprise. Most people in the past would bet on special sporting events like the Super Bowl or US college basketball tournament "March Madness". That slowly moved into different sports like Golf and Tennis, then to daily-game wagering, to being able to bet the over/under time on the national anthem. With that gone, what do gamblers do?

DraftKings, a fantasy sports operator and online sport betting platform, offered Ping Pong to its customers for betting. While actually a bit of a hit, it wasn't nearly enough to fill the void. Stocks can be an easy transition for those wishing to continue "gambling".

1. BCA Research, Weekly Report – Our Bullish 12-Month Equity View: A Skeptical Q&A

Continued on next page

Continued from previous page

Consider these points:

Robinhood, whose easy-to-use app makes the transition between sports betting and trading seamless, boasts a similar customer base to most sportsbooks, notes Marc Rubinstein in his newsletter, Net Interest.

- "43% of North American men aged 25-34 who watch sports also bet on sports at least once per week, and that's the same group that has flocked to Robinhood," Rubinstein writes.
- "On the basis that their customers love sports betting, there's something meta about DraftKings itself having worked its way into more Robinhood portfolios than practically any other stock over the past month."

For longer-term investors, clearly the wrong thing to do now is to chase stocks that have benefited from this recent surge in trading activity, or to try to anticipate where this money will flow next. There is little doubt this will all end in tears, and perhaps sooner than later.

The first blow to this surge in online trading activity will be the return of professional sports. The restarting of sports will likely be halting, but even investment professionals have to admit that stocks lack the human drama of sport, and will likely win back the hearts of traders. If that doesn't work, a vaccine will do the trick, once and for all sending these COVID-era traders back to the office.

Philip Marion, Portfolio Manager

The 12-Month Market Outlook

Stocks (U.S.)	▲
Stocks (Canadian)	▲
Bonds (US)	▼
Bonds (Canadian)	▼
Canadian dollar	▲
Crude Oil	▲

This table represents the way the firm is leaning in particular market sectors over the next 12 months. It does not represent a trade recommendation, nor does it play a major role in our portfolio construction, which involves much more than having a view on a particular market index, currency or commodity.

What does insurance have to do with investing?

One single devastating health occurrence can bring financial ruin to a lifetime of work and a planned retirement. We are all familiar with how different financial instruments are used to diversity and protect your portfolio from market volatility. Insurance goes further, bringing protection to you and your family from the untimely death or illness of a family member.

Three general types of insurance - Life, Disability, and Critical Illness - are important considerations in any financial plan and can create financial certainty in an uncertain world.

Life Insurance

There are two types of Life Insurance: Term and Permanent. Term life insurance is well-suited to meet protection needs for the lowest initial cost. Most typically, this type of insurance is used to protect families against the loss of a key provider. Permanent insurance is more commonly used to protect the value of a family's estate over a lifetime. Many permanent insurance plans also generate a cash value which can be used at a future date to provide cash if needed.

Disability Insurance

In the event of an accident or illness, disability insurance could mean the difference between having an income and not having one. This form of insurance is particularly important if you are the sole or primary wage earner in the family, or if you are a key person in the operation of your business.

Critical Illness

Critical Illness Insurance is a form of protection that provides a sum of money if a family member suffers from a covered illness. This coverage can be just as important for children as it is for adults. Often, if a child becomes seriously ill, one parent may choose or be required to leave their employment to guide the care of the child. The physical and emotional strain of an illness can be severe enough, and when you combine that with a damaging financial impact, the result can be devastating. The lump-sum benefit can be used to pay for additional medications and treatments not covered by public healthcare, private nursing, out-of-country treatment, or medical equipment. One key feature is that it's up to you to choose how to allocate these funds, so you can focus all your energy where it should be.

Howard Schwartz, MBA, CPA, CMA,
Vice President, Wealth Management

Howard supports the Advisor Team at Foster & Associates to help customize insurance solutions for their clients.

The Taxreformists Cometh

Briar Foster
is a retired Portfolio Manager and remains an active investor.

One matter firmly established by the pandemic is that governments desperately need money. The pandemic has created a situation where federal and provincial governments take a more active role in the economy. This increased involvement is expensive. The need for money is big and is now.

Canada's federal debt has now reached one trillion dollars. The Parliamentary Budget Officer cautiously estimates the 2020-21 federal deficit could reach $252 billion. The 2021-22 deficit will likely add further to Canada's debt. It is clear current tax receipts have been insufficient to finance government spending over the past five years, let alone the additional $225 billion likely required by the shutdown.

Merely adding percentages to the various tax-gathering categories would create a nightmare of unfairness as well as make Canada's economy disastrously uncompetitive. An exception is the GST. A two-percentage point increase will raise something like $16 billion, two-thirds of the federal 2019-20 budget deficit. A GST increase after the next election is more than likely.

The top tax rate (53.5% in Ontario) is already too onerous to be increased. On the other hand, the capital gains tax (where 50% is included in income) is unlikely to remain the same. One impetus is that the 50% provision has been abused to the point where even high-frequency traders are able to take only 50% of their winnings into earnings.

As well, public corporations have shown a tendency to overuse stock options to replace salaries such that total executive compensation will be more lightly taxed. It has appeared to some CRA investigators that public corporations were buying back their stock in order to keep the share price above the executive option exercise price.

Many years ago, Justice Carter, recognizing how this lower capital gains treatment could be abused, declared, "A buck is a buck." But instead of adopting his contention that all earnings should be treated equally, a compromise was struck whereby 50% of capital gains were included into income.

A possible compromise this time around is to raise the 50% to 75%. However, it would not surprise me to see 100% of net capital gains income become regular income. In fact, if capital gains became 100% taxable income, the treasury would gain significant revenue, saving them from having to re-introduce estate taxes. As an aside, anyone in favor of the return of an estate tax should be required to read Dickens' Bleak House. An estate tax is to be feared. Some estates never settle.

To bring budgets into balance and begin to pay down debt, governments may also wish to tax new economic activity in an effective manner. The place to start is the digital economy because it generates an enormous amount of economic activity compared to the amount of tax revenue generated.

The main targets should be Facebook, Google, Netflix, Amazon and to a lesser extent Apple. Since their taxable income is already claimed by the United States, what is left is to tax is their Canadian revenue. Some European countries have already started to tax digital revenues.

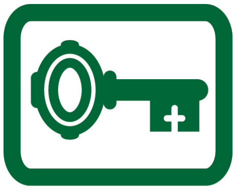
It has been suggested the digital revenue tax should be introduced as "a temporary measure," though industry is right to be skeptical of temporary measures, as income tax itself was introduced as a temporary measure a century ago! Officials estimate the annual digital tax revenue, including sales taxes, will be $6-$10 billion.

Mercifully, the pandemic has made tax reform a necessity on both sides of the border. So, if a Biden administration does move to raise taxes, it will provide the Federal Liberal Party the political cover it needs against the inevitable accusation that raising taxes will lead to a disastrous loss of competitiveness for Canada.

The views as articulated in this article are those of Briar Foster alone and do not necessarily reflect the opinion of Foster, and do not constitute a solicitation to engage in any specific investment or strategy.

Our core beliefs

What defines the culture of a firm is what stays consistent no matter what's going on in markets. Politics, market trends, and the business cycle will cause us to think different about the way we invest our clients' money. However, there are a few things you can count on from us, through good markets and bad, through recessions and buoyant recoveries:



Asset Allocation is Key.

While some individual securities will do well, and some less well, most of what will make or break your portfolio over time is asset allocation. Of course, we all remember our great buys, and mourn our missteps, but the key to how well you do in the markets will come from how much you owned of various asset classes, and when you owned them.

We Love Canada.

But it's not where we want to put all your money. The Canadian stock market is heavy on banks and resource companies, making true diversification hard to achieve. Venturing abroad can improve returns and lower volatility. You'll also find companies where Canada isn't as strong, such as in consumer staples and biotechnology.

Alternatives aren't that Scary.

Sure, some hedge funds can be dangerous, but there's more to the Alternatives space than hedge funds. There's private debt, real estate, infrastructure and market-neutral funds, all of which can provide a place of refuge during periods of excessive market volatility.

Costs matter a Great Deal.

Over time, even small increases in costs can significantly lower returns. If you pay us to manage your money, we will pinch your pennies for you.

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