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A New Age of Uncertainty

It has been said that there are known knowns—the things we understand; known unknowns—the uncertainties we are aware of; and unknown unknowns—the surprises we don't realize exist until they happen.[1]

The start of 2025 may well be defined by the "unknown unknowns" as the markets responded to two largely unforeseen events: the emergence of an allegedly cost-competitive Chinese AI model DeepSeek, and U.S. President Trump's decision to unleash a trade war with Canada and Mexico. Uncertainty often drives short-term market behaviour. Technology stocks took a hit, with Nvidia losing over $550 billion in market capitalization, while concerns over a 25 percent tariff were acknowledged by the financial markets as tariffs were deferred in February, implemented in March and then adjusted days later.

Times like these highlight the importance of diversification. Until now, Canada's heavy reliance on the U.S. as its primary export market has largely been overlooked: 77 percent of Canadian exports go to the U.S., while no other destination accounts for more than 5 percent. Just as diversification is important in portfolio management, it is equally critical in trade. Canada's reliance on a single trade partner makes it especially vulnerable to unexpected shifts in U.S. policy. The evolving trade war also serves as a wake-up call. In this new era of rising national protectionism, there is much work to be done to strengthen Canada's economic position.

In recent years, diversification may also have taken a back seat in investing focus due to strong market gains, largely driven by a handful of dominant U.S. tech giants. However, DeepSeek's emergence serves as a reminder that no sector remains unchallenged—disruption is inevitable in any innovation cycle and technology continues to evolve at an unprecedented rate. Could this mark the beginning of AI democratization? One of the best ways to navigate uncertainty is to prepare for multiple possible outcomes, and diversification is intended to position portfolios to withstand changing environments and varying market conditions.

Similarly, the rapidly shifting rhetoric on tariffs suggests we have entered a new age of uncertainty, influenced by the current U.S. administration. As advisors, we continue to assess the evolving developments and their potential impact on portfolios—while emphasizing the importance of discipline. Unknown unknowns can tempt investors to react hastily. However, even the "known unknowns"—such as fluctuating interest rates, high inflation, economic declines or stock market drops—remain beyond the investor's control. Yet, more often than not, an investor's reactions to these uncontrollable events can have the greatest impact on long-term outcomes.

If the first months of 2025 are any indication, the next four years will bring considerable speculation about Trump's next moves. The challenge will be to look beyond the headlines. A longer-term perspective reminds us that policy changes can take time to unfold, are often subject to revision and may not always have consistent or predictable effects. Markets and economies also don't always react as expected, as we saw in the aftermath of the pandemic. While the near term is likely to bring new unknown unknowns, the underlying forces that drive progress—resilience, adaptation and innovation—will endure over time.

1 Attributed to Former U.S. Defense Secretary Donald Rumsfeld in a speech given in 2002.

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Tax Time: The Taxation of Investments—A Refresher

With tax season back in full swing, here's a refresher on common types of investment income and how each is taxed. This overview focuses on investments held in non-registered accounts. Keep in mind that the type of account where investments are held can also impact tax obligations. While this article doesn't address investment location, we are here to provide perspectives.

Interest Income — Income earned from interest-producing bank accounts and fixed-income investments, such as GICs, government Treasury bills, bonds and fixed-income mutual funds/ETFs is taxed as ordinary income. It is fully taxable at your marginal rate, making it one of the least tax-efficient types of investment income. Generally, interest income is taxable in the year it is earned and must be reported on a tax return, regardless of whether it has been received.

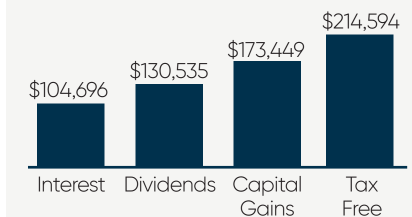
Dividends From Canadian Corporations — Canadian dividends are designated as either "eligible" or "non-eligible" and are included in income at a grossed-up rate. However, they qualify for the dividend tax credit, which reduces the taxes you pay. Eligible dividends—typically received from larger publicly-traded Canadian corporations—qualify for an enhanced tax credit. Non-eligible dividends are typically received from Canadian private corporations—small businesses that pay corporate tax at a lesser rate. In general, Canadian dividend income receives preferential tax treatment compared to interest income. That said, since the grossed-up amount is reported on your tax return, it can potentially impact income-tested government benefits, like Old Age Security.

Dividends From Foreign Corporations — Dividends from non-Canadian corporations are fully taxable at your marginal rate and do not qualify for a dividend tax credit. Additionally, they may be subject to foreign withholding taxes at source. A foreign tax credit may be available to reduce the taxes payable.

Capital Gains — When a capital asset, such as company shares, is sold for more than its adjusted cost base (ACB—generally its cost plus any expenses to acquire it), the profit is considered a capital gain when realized. Since 2000, one-half of a capital gain has been included in computing a taxpayer's income. The proposal to increase the inclusion rate has been deferred until January 1, 2026

Mutual Funds & ETFs — There are additional considerations for mutual funds and ETFs. In general, when held in a non-registered account, two situations require you to report information on an annual tax return: i) when a fund makes a distribution, and ii) when you dispose of some or all of your fund holdings.

After-Tax Value of Investing $50,000 Over 25 Years at 6% Annual Return



Tax rates are based on the average of 2024 combined federal, provincial/territorial marginal tax rates for $250,000 of ordinary income, eligible dividends or capital gains: 50.00%, 34.78% and 25.00%, respectively.

- **Distributions —** A distribution represents the earnings being passed to the investor/unitholder. Distributions are taxed based on type (i.e., dividends, interest, capital gains) and are taxable whether you receive the distribution in cash or reinvest it in additional units. The amount of the reinvested distribution is also added to the ACB of your investment.
- **Return of Capital (ROC) —** A return of capital may be reported as a distribution and represents a return of your original investment. This generally occurs when the amount distributed exceeds the fund's earnings (income, dividends and capital gains). A ROC is not considered income and is non-taxable, but generally reduces the ACB, as long as the ACB is positive.

It's important to keep records of changes to the fund's ACB as a result of reinvested distributions and ROC. When the fund is eventually sold, this must be reported on a tax return and any capital gain/loss resulting from the disposition will be based on the ACB.

Reminder: You should have received most investment-related tax slips by the end of February. However, T3 and T5013 slips do not have to be sent before the end of March. Please call if you have questions.

During Uncertain Times: The Value of Diversification

Volatility made a comeback to start 2025, fueled by the introduction of DeepSeek's AI platform and U.S. President Trump's imposition of tariffs, serving as a reminder of the value of diversification.

At the end of January, China's DeepSeek claimed to have developed top-tier AI for just $6 million—a fraction of other players' costs without relying on Nvidia's expensive chips. While this figure has since been disputed, it has shaken market assumptions about the dominance of certain U.S. AI players. In March, the U.S. launched a trade war by imposing tariffs on Canada. Both events serve as strong reminders of why diversification remains one of the investors' best allies.

Sector Dominance & Rotation — The AI boom has fuelled market optimism in recent years. The capitalization-weighted return of the top five U.S. technology companies relative to the S&P 500 in 2024 alone (chart below) highlights how a handful of names have come to represent a disproportionate share of the benchmark. DeepSeek's announcement may have unsettled markets, but consider that innovation inherently requires disruption—a concept often described in Schumpeter's Creative Destruction theory.[1] Indeed, the progress of humankind is a result of incessant product and process innovation.

2024 Capitalization-Weighted Return of Tech Stocks[2] vs. S&P 500

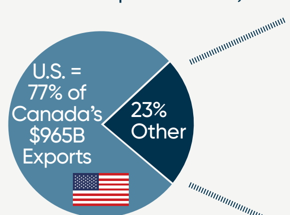
Top 5 Tech: Meta, Microsoft, Amazon, Nvidia, Alphabet.

This may encourage constructive sector rotation into non-tech areas, some of which have been overlooked amid the intense focus on technology, with a greater focus on earnings growth and strong fundamentals as the driver of stock prices. It may also be a reminder that companies, sectors, geographies and even asset classes can fall in and out of favour over time.

A Changing Geopolitical Landscape — Trump's tariff stance has underscored Canada's vulnerability to trade disruptions. Canada remains heavily reliant on the U.S. as its primary export market, with 77 percent of the C$965 billion in exports going to the U.S. (2023). No other country accounts for more than 5 percent of export values (chart below). Just as diversification is essential in portfolio management, it is equally critical in trade. Overreliance on a single partner carries significant risk should conditions change.

With the imposition of tariffs in March, we would be wise to remember that their magnitude and duration—as well as their potential economic impact—can evolve over time

Canada Export Markets, 2023



Non-U.S. Export Destinations[3]

The Continuing Importance of Diversification

A core principle in our approach as advisors has been the importance of diversification. This may be even more important in today's environment, which is heavily tilted toward uncertainty. While we can never predict the future with certainty, a well-diversified portfolio can help to dampen volatility and, perhaps most importantly, prepare us for multiple possible outcomes.

1 https://www.nytimes.com/2000/06/10/your-money/IHT-half-a-century-later-economists-creative-destruction-theory-is.html
2 Capitalization-weighted return of top tech stocks versus the S&P 500 adapted from BMO Portfolio Advisory Team
3 https://www.scotiabank.com/ca/en/about/economics/economics-publications/post.other-publications.canada-and-us-economics-.canada-and-us-decks.trade-stats--january-31--2025-.html

The Evolving Trade Tariff Situation: Is a Recession on the Horizon?

When the U.S. unleashed a trade war in January, many observers were quick to warn of the risk of recession. Given current sluggish economic growth—Canada's GDP growth is projected at just 1.8 percent for 2025—the Bank of Canada estimated that a 25 percent tariff would reduce GDP by 3 to 4 percentage points.

President Trump campaigned extensively on using tariffs as a tool to reduce the U.S. deficit and support tax cuts. During his first term in office in 2018, Trump imposed tariffs on Canadian steel and aluminum, which remained in effect throughout the renegotiation of the USMCA.[1] As such, the imposition of some form of tariffs in March may not have come as a surprise.

Given this backdrop, is a recession imminent? As a reminder, a recession is often defined as two successive quarters of declining GDP. For now, Canada has some economic buffers in its favour: low interest rates, low inflation and a weak Canadian dollar, which may support exports by making them more affordable to international buyers or help offset the impact of potential tariffs on U.S. buyers. The federal government is also aware of the ramifications and, as we saw during the pandemic, may provide fiscal and monetary support to mitigate a prolonged downturn. Additionally, the tariff situation continues to evolve and may be subject to change.

What Should Investors Do?

Without a doubt, a sweeping tariff would put downward pressure on the economy. Yet, even if tariffs slow economic growth, investors should maintain perspective. Why?

Markets and economies are not the same. Seasoned investors remember that markets don't always reflect the state of the economy. At times, economic downturns and stock market performance can diverge. Market composition plays a role. The S&P/TSX is heavily weighted in financials (33%), energy (17%) and metals and mining (12%).[2] While these sectors are integral to the economy, they have an outsized influence on the index. Notably, the financial services sector, as one example, is expected to see minimal direct impact from tariffs, though an economic slowdown will still affect areas like loan loss provisions. As advisors, we continue to assess the potential impact on investments.

Economic cycles are normal. While recessions have become less frequent in recent decades due to fiscal and monetary stimulus, economies, like financial markets, naturally expand and contract over time. It's unrealistic to expect perpetual economic expansion; contractions are a natural part of the cycle and are often necessary to correct inefficiencies and spur innovation and growth.

Recessions in Canada Over 50 Years

Date	Duration (Months)	Category 1 = Mild 5 = Severe
February 2020	3	5
October 2008	7	4
March 1990	25	4
June 1981	16	4
January 1980	9	1
December 1974	6	2

Source: CD Howe Institute "Business Cycles"

Equity markets trend upward over the longer term. Despite financial crises, a pandemic, supply chain disruptions, war—and even recessions—the longer-term market trend has been upward. Between 1970 and 2024, we've seen all of these adverse events; yet, the S&P 500 delivered positive returns in 80 percent of one-year periods and 90 percent of 10-year holding periods.[3] The S&P/TSX delivered positive returns in 75 percent of one-year periods and 100 percent of 10-year holding periods.[4]

Moreover, the economy may not always react as expected—especially in extreme scenarios. More recently, we saw this following the pandemic, which many anticipated would push us into a sustained recession. During periods of economic uncertainty, careful analysis and strategic investment selection become even more important. This is where our support as advisors shines through. For a deeper discussion, please call.

1 USMCA is the United States-Mexico-Canada (free trade) Agreement that took effect on July 1, 2020
2 At 01/31/25: https://www.spglobal.com/spdji/en/indices/equity/sp-tsx-composite-index/
3 BMO Private Wealth Insights January 31, 2025, https://privatewealth-insights.bmo.com/en/
4 S&P/TSX Composite Index total return 1970 to 2024.

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