Manulife Securities

ELAINE’S NEWS & VIEWS

APR 2018

As I write this, April is starting off with the biggest stock market in the world, (the US as represented by the S&P 500 Index) down over 10% from its high earlier this year. The DJIA and NASDAQ Indices also dropped significantly. The Canadian stock market isn’t down quite as much, but it’s still down very significantly, and the Canadian dollar is down - again. This may be partly in reaction to the tariff trade wars between the US and China, a weakening of oil prices, because of worries that some of the US market is still over-priced, as well as fears of growing inflation. On the other hand a 6-8% positive impact on US corporate profits is expected because of lower tax rates for them.

From the statements I have seen so far, once again our fund managers don’t seem to have been in the overvalued parts of the market that tumbled the most and our portfolios held up very well compared to the market. Remember though that the price of this relative stability, or not dropping as much as the market, is that when the market zooms up, we will go up much more slowly and lag. In the end however, our style (predominantly Growth At a Reasonable Price (GARP) and some Low Volatility or Dividend Focused, and maybe a smidge of Deep Value) tends to outperform over a full market cycle (maybe 7 yrs). The tortoise beats the hare in the markets too, in most cases.

I know at least one of the Growth At a Reasonable Price (GARP) managers whom I use a lot is still holding about 30% in cash, because even after the recent market drops he **still** doesn’t think there are any stocks available to buy at reasonable prices that meet his quality requirements. I would never get impatient with him to deploy the cash because he felt this way in 2007 and 2000 and held a lot of cash and no tech stocks right before the Tech Wreck and no resources or bank stocks right before the Great Recession. As a result, he lagged before the corrections, went down very little during the corrections and beat most others over the long-term. And another of my most trusted fund managers had record levels of cash in March and only slightly reduced that level by buying when stocks dipped lower. This would suggest that there should be more market drops because there may still be overvaluation in the stock market. On the other hand, some of my favourite and most successful managers don’t feel the market is too high and are fully invested. So there is no agreement even amongst top GARP fund managers.

What can we make of this? Well, maybe large cap US stocks need to drop more to be fairly priced, and then we could have another better buying opportunity soon, or maybe not till next year when the bank economists are predicting a recession. Or, maybe this is as good a buying opportunity now as we will see for a long time. My crystal ball is pretty hazy on this topic. So here’s my best advice, if you have money to invest this year, and expect to have more to invest in the future, then take advantage of this current drop and any other volatility that we get. **IF** the market really drops (over 20% from its peak), then add as much cash as you can, even if the market drops even more before it recovers. At least you will have bought way off the peak and that should help long-term profits. Or consider this strategy if an opportunity presents itself: after a sizeable fall (20%+) in the market, sell some of the relatively low volatility funds that didn’t go down much, and buy some of the more volatile value funds that went down tons more for a chance to get a faster rebound when it comes. Of course this only makes in tax sheltered or tax deferred accounts. Jordan and I have in mind a couple of funds that are normally too volatile for us but who have fabulous stock pickers as managers. I used this strategy a bit in 2009 and it worked well.

Lastly, think about doing an investor **Lifeboat Drill** right now. Think about how you felt when you heard markets were falling day after day and sometimes 2-3% in a day. How would you have felt if your portfolio had been down 10% by Mar 31. How will you fell the next time the market really drops and your portfolio could be down 20 or 30%? Will you be calm enough to hold on for the long-term, sticking to our investment plan, so you don't lock-in short term losses? Will you be able to sleep in the months (or years) it could take till the market recovers? If you can't handle the inevitable market drops, then time to get in the life boat now – bail out of long-term growth funds and de-rail your wealth accumulation plans. Feb and Mar were good reminders that markets do not go up in a straight line. If you couldn't stomach that volatility, then you better get out of the market because FOR SURE, MORE MARKET VOLATILITY IS COMING. WE JUST DON'T KNOW WHEN.

To put the past market volatility in perspective, let's look at the last 38 yrs, and let's also think about visiting Casino Niagara! If there were a roulette wheel at the casino at which you could win 29 out 38 times you played, would you play? Who wouldn't, after all lots of people play there even though the table pays out less than 50% of the time. At this roulette wheel, the odds of winning are 76%. Well despite the market correction of 1981, when interest rates rose drastically, the 1990 and 1994 negative markets, the 3 yrs of negative markets due to the tech wreck and the -38% market of the Great Recession in 2008, the flat market of 2011 plus the 2014 slight negative market, the stock market has still been positive 29 out of 38 yrs. However in every one of those positive years, there was an intra-year drop from peak to trough of anywhere from -3 to -49%, but most commonly in the -5 to -20% range. So to get the market gains in those years and over the long term, you had to stay invested through one or more intra-year lows.

So what we experienced in Feb and Mar is absolutely normal market volatility and doesn't change our expectation of a positive year in the market this year. If it worried you much and you don't think you can patiently stay invested through more severe negative market volatility, call us to get more conservative now. The last thing you want to do is bail out at the bottom of a market correction. You account value could take years or decades to recover.

One last thought: Are you getting a tax refund? If you are, make the most of it. You could pay down any high interest debt, or debt that you will have trouble paying off before retirement. You could add the money to your RRSP so that you get more tax deferral and another refund next year, or just so you could be better ready for retirement.

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