Manulife Securities

ROYDS REPORT

June 2022

This whole newsletter will have three topics. First, some information about markets these days. We found it extremely exciting and comforting, and hopefully it will help you relax over what's happening in the markets. When you get your next quarterly statements in about 3 weeks, they'll look bad, but we don't believe there is anything to worry about. And this letter will share the reasons why we are so confident. The second subject is about how we lose our rationality at times like this, because we're overwhelmed and influenced by noise that really has no bearing on long-term investing. Lastly, we share an idea on how you may be able to profit by all the doom and gloom in the world, whether you have more money to invest, are simply holding registered investments, or are in the de-accumulation phase of your life (retirement). Now on to the exciting news from various sources.

First, here are some quotations from Noah Blackstein, a fund manager for over 20 yrs with Dynamic Funds. Noah is a growth manager, rather than a growth at a reasonable price (GARP) manager, which is our favourite style. Growth managers, especially Noah, can have very volatile funds. He's earned strong long-term returns, even though his funds fall amongst the hardest in down markets. Between his 20 year plus experience as a fund manager and his returns, Noah has a lot of credibility. We love listening to or reading his insights and wanted to share these words of his from June 17 2020.

"While May was a strong month for the fundamentals of the companies we own, it was an awful month for the price performance of their respective stocks. The ongoing battle between interest rates, inflation, and the economy are top of mind. These days, growth stocks are viewed as cyclical and inflation as secular. [Secular means long-term in finance-speak. So Noah is saying the market has a reverse view of what is temporary and what is long-term.] *Over the past 7 months, the underperformance of growth stocks as a group relative to the market, has now exceeded every period going back to 1952. On a price to sales basis* ***one has to go all the way back to 1960 to find growth stocks this cheap relative to the market****. The most frustrating part of this market has been a disconnect between the collapsing market and the continually rising outlooks for the companies in the Portfolio. We are seeing portfolio companies deliver sales and earnings growth rates that are higher than many of these companies had pre-pandemic, and in so many cases, are accelerating over 2021. I understand people are questioning the growth and the estimates given recession fears.* ***The stock market falling while earnings estimates continued to climb has happened only twice*** [before] ***in the past 40yrs: 2002 and 2011. In both cases while earnings estimates eventually fell somewhat, the market recognized it as fleeting and in both cases it was a significant*** [buying] ***opportunity****."*

Next, let's look at what RBC Global Asset Management using Scotia GBM research as of May 24, 2022, showed about the Canadian market. The S&P/TSX's long term price for stocks is 14.6 times earnings. It currently sits at 12.6 times earnings, so the Canadian companies in the index are substantially cheaper than normal. Staples, Communications, Industrials and Utilities are trading above long-term average prices (compared to earnings). Utilities are trading at over twice the average of the rest of the market. (This is understandable since people often flee to utility companies when they're afraid, because people pay their hydro and gas bills through thick and thin. At twice the price of the rest of the market, with no

special growth prospects, this could make those stocks risky to hold – in our opinion.) Technology, health care and energy are trading well below long-term prices. In fact, 75% of the stocks on the market trade near or below long-term prices (financials are the ones trading near long-term levels). So, there is real opportunity for some stocks to go up when prices normalize.

It's actually good news that consumer sentiment in June 2022 was the lowest (least optimistic) seen in over 50 years, even lower than during the 2007-2009 great financial crisis. This is because market recoveries after really bad consumer sentiment are usually so good. On average, in the 12 months after the last 8 low points of consumer sentiment, the S&P 500 index has risen almost 25%. In contrast, after the last 8 peak consumer sentiment times since 1971, the US stock market typically gained just over 4%. Maybe that's why Warren Buffett recommends people to, "be fearful when others are greedy and greedy when others are fearful". And people are more fearful now than they've been in 50 years!

Why do we feel so bad about this market downturn, even if we are long-term investors who don't need any money from our investment for years? We found this interesting explanation by Joe Wiggins at https://behaviouralinvestment.com/2022/06/16/what-can-sherlock-holmes-teach-investors/ , based on Sherlock Holmes' logic. Here's a shortened, sometimes paraphrased and sometimes quoted version.

> Dr Watson learned that Sherlock Holmes did not know that the earth revolved around the sun. Watson asked how can that be? Holmes answered that he made it a point to never remember anything that would not be useful in his profession as a detective. In the first Sherlock Holmes book (A Study in Scarlet by A.C. Doyle, published in 1904 by Harber & Brothers) Holmes says, *"A fool takes in all the lumber of every sort that he comes across, so that the knowledge which might be useful to him gets crowded out".* Wiggins extrapolates that wisdom to investing by saying, *"The concern Holmes expresses on noise is around it's propensity to obscure or overwhelm the insightful knowledge he holds or the mental models he wishes to use. Likewise, an investor might be applying a simple and effective set of models to meet their long-term needs – diversification, rebalancing, regular saving, and compound interest – yet this sensible framework can be torn asunder by the magnitude and force of market noise… In treacherous market conditions …salient negativity will be inescapable, and it will seem negligent to ignore it. This not only risks us forgetting our best laid plans but questioning whether they are even still relevant…As investors we … must be constantly on guard against the often irresistible spectre of noise".* The writer warns us to watch out for conscious noise, *"information that we think is meaningful but is entirely redundant. Worse than that, the fact that we interpret it as some form of signal transforms it from being innocuous to damaging because it leads to poor behaviours. Take, for example, a long-term investor consistently checking the latest stock market movements or worrying about how some macro-economic event will impact their portfolio. There is no signal in this, nothing that can be used to better fulfil their aspirations, quite the contrary. Unconscious noise arises in situations where our decisions are influenced by extraneous factors, but we have no awareness or acceptance that they have affected our judgement. The best examples of this are related to emotions; how we feel – pressurised, stressed, excited or fearful – can lead to wildly inconsistent choices through time."*

Let's add Buffett's two cents' worth about not worrying about negative news. *"Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a fly epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497." Source:* https://www.suredividend.com/warren-buffett-quotes/

You have heard this before, but it bears repeating. Watching the markets too closely is dangerous to your financial health! People who look at their portfolios every day, earned on average .2% less returns each year than average investors. Those who check their portfolios twice-a-day make twice as much less as people who don't watch their portfolios too closely. As Som Seif, the CEO of Purpose Investments sums it up nicely, "You go into sell mode, that's the thing that truly destroys wealth, more than the markets going down." Tim Shufelt, an investment reporter for the Globe and Mail, reminds us that, "the market is a proven compounding machine. Given enough time, it always bounces back. But not for those let their emotions get the best of them when the chips are down."
Source: Globe & Mail June 11 22

How can you benefit from a market downturn? There is the obvious way of course, to put more money into the market while things are on sale. There are more subtle ways too. Maybe you are forced to take money out of a registered account, like a RRIF or LIF, every year that you don't need or you voluntarily withdraw from your RRIF or RRSP gradually to stay in a low tax bracket while ridding your estate of a future tax liability, but you don't need that money so you just reinvest that money, perhaps in a TFSA. Let's say you are taking out $4,000 and that that is 4% of your $100,000 account. If the market is down 20% and your account has fallen to $80,000, that $4,000 now 5% of your account. When you remove the $4,000, you pay the same amount of tax whether the market is up or down. But if the market is down, you have gotten a higher percentage of your account for the same tax penalty. And then when the market rebounds, the gain on the money you moved to an unregistered account or TFSA will either never be taxed or will be taxed at only half the rate that it would have been taxed at, if the gain were made and withdrawn later from the registered account. So, if you are going to withdraw from a registered account and keep the money invested why not remove the money now, rather than later.

Along the same line of thinking, if you are adding money to your RRSP to get a tax deduction this year, why not put it in your TFSA first, if you have contribution room, and let the money rebound there. Then you'll have more to contribute to your RRSP for a bigger tax deduction. (Caution: There is no guarantee that the market will rebound by Feb 2023, the last time to make a 2022 RRSP contribution.) Even if you don't plan to contribute money from your TFSA to an RRSP, now, while markets are down, is still a great time to make your TFSA contribution to end up with more money tax sheltered in your TFSA.

Another opportunity could be to trigger (or harvest) a capital loss to offset a capital gain you had last year, if last year was a particularly high income year, because tax losses can be carried back 3 years.

If you want to take advantage of this market downturn in any of the above ways or others you can think of, give us a call and let's do it.

Hope you are keeping well. Don't hesitate to call us for a phone, Zoom or in-person appointment.

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