Manulife Securities

ROYDS REPORT

Late June 2022

It's uncomfortable, fatiguing, and even a little overwhelming to see inflation soaring, the cost of debt rising, and personal net worth tumbling as house, stock and bond prices all plummet at the same time. And we're dealing with this while coping with the impact of Covid, and how it's all related or the horror of various political crises and natural disasters, like in the Ukraine, Syria, Afghanistan. How much worse and scarier it must be if one doesn't understand why we're experiencing the inflation, and what the government is thinking changing interest rates, or whether it's possible to lose all your savings. So, the theme of this newsletter is education. It won't change any of the negative things we're experiencing, but it may make a few more understandable and less scary. And most importantly, it may help with better decision making in the face of these challenges.

The topics in this newsletter are:

- **An invitation to another session of the Estate Planning Seminar that we've run 4 times in the last 3 years but that more people keep asking for**
- **A course on financial basics for students, new grads and even adults who may not understand how our tax system works or understand how to read tax slips and paystubs, tips on handling debt and savings**
- **The difference between fiscal and monetary policy, and how they each deeply affect our lives (this will help you understand the importance of many government announcements)**
- **What has been happening in markets, what's being done about it by governments and what we should do about it**

Estate Planning Seminar Invitation

Whether you're young or old, you should understand what happens to your assets on death and how much of that you can control by your actions now. If you have elderly family, you'll also want to know what should be done now, so that you don't face a nightmare (or unnecessary taxes) when a loved one passes on. We will hold 2 estate planning seminars in our office, in a big room that we annexed in January, where we should be able to stay distanced. We'll also have the hepafilter running. People are encouraged to wear masks. **If you can't attend in person, you could attend by Zoom. The seminar will be offered on:**

- **Tues Aug 30 from 10 a.m. – 12:30**
- **Thurs Sept 15 from 7-9:30 p.m.**

Please call Sarah, Paulene, Darek or Dharini at 905-393-0787 to book a seat or to be included by Zoom. If you are coming in from out of town, you might want to book an appointment that same day with us.

Something Truly Valuable, a Free Graduation Present or Something for Yourself?

What can you give a graduate to help them on their way? Sometimes it can be help getting a first car so your child can commute to their first full-time job. Here's an idea for a gift that no grad is asking for, but which will help most of them for a lifetime. It's **an understanding of taxes. People pay them for a lifetime, but so few people know how the system works, what their obligations are, what the boxes on their paystubs and T4s are all about, and how their own actions can impact the taxes they pay. It can be a big financial advantage to understand these things. In fact, the first time your child gets a part-time job, this would be valuable information for you to impart to them or for them to learn online. The government has a free 3 hour course on these subjects. Each of the 22 topics in the course takes 5-10 minutes to go through.** Someone could easily do one topic a day and even pick and choose which topics are of interest to them at this time. There's also side links to additional information specifically on students and their tax issues (definitely valuable information for parents too). You might even find a topic you'd like to understand better. We often hear about two great finance-related "gifts" parents can give their children: not being a financial burden on our children in a parent's later years, and helping a child start their first full-time job with no debt hanging over their heads. Based on feedback from our clients, we'd say the gift of some financial savviness is a third valuable thing parents can give their kids. Maybe you have thought to yourselves, why didn't my parents tell me about the stock market or the dangers of credit card debt or the importance of saving early etc. It can make such a big difference in someone's life to start in the working world with a clear understanding of how to make your money work for you to achieve your goals. Understanding taxation is an important element of that as is how to read your paystub. So many people have no idea if they have disability coverage etc even though the information may be on every paystub they get. So why not let your older children (even adult children) know about the link below to the free government mini-course. It might be $100 well spent, if you offered a reward to each child or grandchild who finishes the course this summer and can send you screen shots of their results from the comprehension quizzes at the end of each section. We'd love to hear any feedback from you or your family on the course. Here's the link (remember to hold down your Control button and click on the link to open it):

https://www.canada.ca/en/revenue-agency/services/tax/individuals/educational-programs.html

Further to the tax course, wouldn't it be **important to get your kids off on the right foot as far as budgeting, saving, managing debt etc? There is a financial basics workbook and several videos on those topics also available for free from the Government of Canada's website**. You can download the workbook from:

https://www.canada.ca/en/financial-consumer-agency/services/financial-basics/participants-handbook.html

You can find the videos at:

https://www.canada.ca/en/financial-consumer-agency/services/financial-basics/financial-basics-videos.html

A free, government, **financial literacy program aimed at more experienced adults is also available** at:

https://www.canada.ca/en/financial-consumer-agency/services/financial-toolkit.html

To start understanding the basics of finance on a more macro-economic basis, the following webpage from Investopedia.com has a ton of clear, **important information on fiscal and monetary policy, that every adult should know, because these policies affect our lives so much. How can one have an opinion on whether the Bank of Canada or the Finance Minister are doing the right things, without an understanding of the historical impact of such actions?** Here's the link to the article that's a 5-10 minutex read.

https://www.investopedia.com/articles/investing/050615/fiscal-vs-monetary-policy-pros-cons.asp

What is Going On in Markets Today?

One of our favourite balanced fund management teams, the one at Arrow Capital, wrote the following in a commentary on June 24, 2022, to summarize what has been happening economically and in the market over the last 6 months. It gives **a high-level summary of what has been going on in markets** to lead us to where we are today. Some of it may not make sense if you don't understand the objectives and tools of monetary and fiscal policy, for example as summarized by Investopedia.com, the link to which is the last line in the previous topic of this newsletter. We have inserted some additional context and explanation in square brackets.

> "In October 2021, The Fed announced Quantitative Easing [buying of bonds by Fed] would end in March 2022. Bitcoin, the Nasdaq and Russell 2000 peaked in November 2021. The S&P 500 peaked early January. The Fed [the U.S. Federal Reserve] raised [interest] rates 25 bps [¼ %] in March, 50 bps [½ %] in May and 75 bps [¾ %] in June. **The Fed is raising rates to fight inflation that has remained stubbornly above 8%. The Fed's plan to reduce inflation is to reduce demand by reducing liquidity** [reducing how much money is available in the economy to buy goods]. How? 1) **raise interest rates** (cost of money) [so fewer loans will be taken out for personal and corporate spending] 2) **strengthen the U.S. dollar** [so imports are more expensive and high prices reduce demand] 3) Quantitative tightening (allowing bonds on their balance sheet to mature and not re-buy) [so **the government will not be putting more cash into the economy by buying more corporate bonds, to help companies fund more expansion**] and 4) **reverse wealth effect** (equities down) [higher interest rates depress stock and home values and if people's investments and house values are down, they feel less rich and spend less]. The idea is to put the economy back in balance. The supply side has also been negatively hampered by supply chain issues (caused by pandemic) and the Russia/Ukraine war has accentuated supply issues with food and energy [which fuels inflation].
>
> The above is the backdrop and what we already know. How have markets responded:
> S&P 500: -21%
> Nasdaq: -29%
> TSX: -10%
> 10-yr U.S. Treasury: -13.7%
> U.S. Dollar: +2.3%
> Gold: +0.5%"

US 10 year Treasury Bills (similar to government bonds) fell almost 14%! Bonds in general were down sharply too, so it hasn't just been the stock market. And **Bitcoin from Nov 2021 to Jun 18 2022 fell over 74%.** (Source: CNBC.com)

On Jun 27, Arrow Capital sent out another good summary of what's happened in other stock markets, and expectations for interest rates with the following information. Here are some excerpts:

- "**Russia has raised rates by 1,050 bps [that's 10 ½ %] since Feb 22 – equities down -64% since**
- Sweden $EWD has raised rates by 25 bps since Feb 22 – down -30%
- New Zealand $ENZL has raised rates by 175 bps since Aug 21 – down -26%
- Australia $EWA has raised rates by 75 bps Apr 22 – down -22%
- Brazil $EWZ has raised rates by 1,125 bps since Feb 21 – down -15%"

"**The market is pricing in 7 more (25 bps) [¼ % interest rate] hikes for the U.S. by Dec 2022 [which may not come ¼ % at a time. This is just the total increase (1.75%) still expected], 5 hikes for Canada**, 15 hikes for the Eurozone, 7 hikes for Great Britain, 2 hikes for Sweden, 9 hikes for Australia, 8 hikes for New Zealand, and 2 hikes for India."

So Canada and the US are not alone in trying to fight inflation by raising interest rates, and stock markets around the world have suffered like the US market, and worse than Canada's, because oil is temporarily keeping Canada's stock market from falling more. As oil companies reopen wells and bring on more supply, oil prices may and have historically dropped, which may end the support for a good portion of the TSX though.

That same Arrow Capital Jun 27 commentary also contained encouraging news. "Composite PMI [Purchasing Manger Indices that measure how much buying companies plan to do] preliminary for June coming in below expectations and University of Michigan 5-10 Yr Inflation Expectations for June coming in at 3.1% vs 3.3% as reported in the preliminary. The **perception from those two data points is economy is slowing and inflation expectations have not become unhinged = the Fed tightening cycle may be less than thought**."

We've seen almost 8 months of falling portfolio values for those holding stocks or bonds. Some argue that stock values are historically cheap and shouldn't fall much more (for more on that, see our last newsletter). Others worry that rising interest rates will send the economy into a recession, that we're not near the bottom of the market yet, and it could be a fair bit of time till markets fully rebound. Others, like Arrow Capital, wonder (they aren't predicting it, just speculating that it could be) if the rally we had last week signalled the bottom of the market and that the turnaround has begun. Looking at a chart Arrow Capital sent out in that June 27 commentary of US market rallies in 2022, I can count at least 5 rallies that have been this significant and the first 4 did not signal the bottom of the market for sure. No one knows if this latest rally is the start of a recovery, or is just another temporary bounce up. It's probably because there are such divergent views on whether the worst is over that is causing such wild swings up and down in the market. **No one has a crystal ball to know who is right. That's why investing in pure equities is for long-term investors who can outwait a downturn in order to achieve the long-term returns the stock market has historically achieved**.

Occasionally a panicked investor will say something like, "I better sell now, before I lose everything", or they ask if their investments could go to $0. This is because of the human tendency to think the latest trend will continue forever. Housing markets have also fallen a lot since early March, but no one is asking if their house will soon be worth $0. People understand that a physical asset doesn't just disappear and become worthless. Fewer people understand that mutual funds hold part ownership in companies that also own physical assets (like office towers, factories, inventory and cash deposited in banks) and also own intellectual property, like patents or copyrights, and "goodwill" which could be the

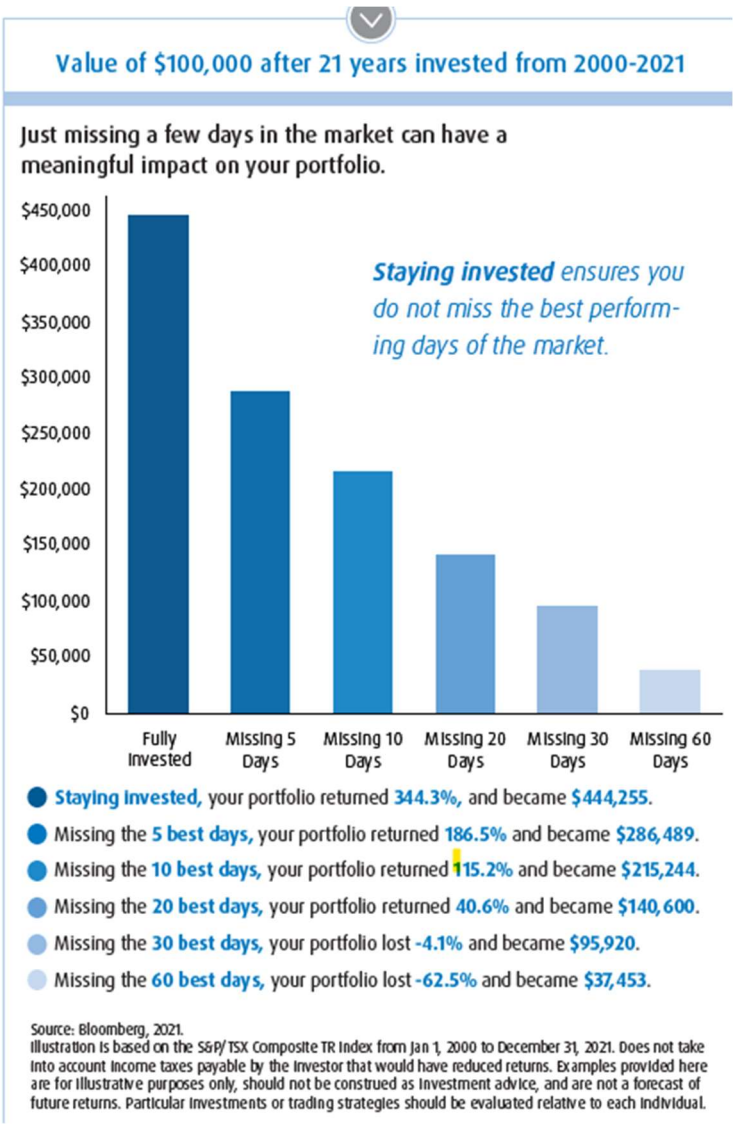
relationship they have with customers that leads to repeat business, like the trust you may have that Tide will get your clothes clean, CocaCola will taste the same and give you a caffeine jolt each time, or that Midas will have the muffler you need in stock when you need it. Those assets don't evaporate and become worthless, unless the company goes bankrupt. Companies that are at risk of going bankrupt are not the kind our mutual funds invest in. For example, no one with diabetes is going to stop buying their insulin. Farmers still need to get their grain from Saskatchewan to ships in B.C. so they'll still pay for shipment by train, and they won't stop buying fertilizer either. Is anyone going to stop paying their heating bills or buying pet food? Life goes on. Companies with essential services and many other companies will keep doing business and making profits. But the stock values could still drop more and stay down for quite a while. The stock market is greatly influenced by emotional and non-professional investors, but eventually the economic value is recognized. Of course, the higher interest rates go, the less people are willing to pay for stocks, so the market is fighting that, as well as fears brought on by inflation, Ukraine and the potential for a recession caused by interest rates rising too fast or too high. Historically though, the stock market has always risen over time more than it's fallen.

The other question people ask is whether they should get out of the stock market and just sit on the sidelines till the worries are over. That's not what we are doing with our own money for the following reasons. **We consider it a buying opportunity whenever markets are down more than 20%, even though we don't know whether markets will fall even more before recovering**. This worked well in March and April 2020 when people bought into the market after the COVID panic drop in the market. Even those who bought a week or two before the end of the four week drop, and who saw their new purchases go down in value before catching the big recovery, made extra money because they bought on a dip, even if they didn't buy at the bottom.

We look at what the smartest people we know of are doing. As mentioned in our last newsletter, Buffett bought $41B of stocks in the first quarter of 2022, which is more than he has bought in any quarter since 2008. He found prices compelling even before the stock price drops of the second quarter. It will be a while until we'll hear what Buffett may have bought in second quarter. (Source: https://finance.yahoo.com/news/buffett-ups-chevron-apple-holdings-223220603.html)

We don't know when the market will bottom and turn around. Near the end of March, it looked like the market was turning. If people had been out of the market, they might have wanted to get back in then, rather than miss the rebound. In hindsight we know the market hadn't bottomed then. Then 2 weeks ago, we had a nicely positive week after 7 bad weeks. Again, we didn't know if the market was turning and we were starting to miss the rebound. That wasn't the bottom either. And last Friday was one of the most positive days on the stock market in years. Maybe the day before was the bottom of the market or maybe it wasn't. If it was, we will be glad we didn't just get out of the market. If it wasn't, we just keep holding on. The point is that **if you don't know when the bottom of the market is, how will you know when to get back into the market. In fact, you have to get the timing right twice to successfully time the market. You have to know when to get out of the market when it's high and when to get back in the market when it's at its low point. And no one knows when those peaks and troughs are, except in hindsight.**

Since the first rebound days can be pretty strong, they aren't days we want clients to miss. Any mistake in timing when to get back into the market and we would miss those potentially great early recovery days. The following chart is the latest version of one that's been around for 20 plus years. The chart shows the value of $100,000 left invested all the time versus missing from 5 up to 60 of the best days over the last 21 years. There is risk in not getting back into the market fast enough.



In our experience, it is very, very hard to get someone to invest in the market after it's been down for an extended period. In the Great Recession of 2007-2009 the S&P TSX index dropped from 15,000 to 7,000. As it climbed to 11,000, one client kept saying they wanted to invest when the market recovered. How much more recovery did they want? They missed a huge opportunity, because they were too fearful to but into the market before it had recovered 100%. The market recovered another 2-3000 points before that client would risk getting back into the market.

The only thing useful thing we can know for certain is when a stock to help time the market is that, if a stock is down from its high by a significant amount, perhaps 20%, the stock is a better buy than it was before the 20% drop. That doesn't mean the stock is at a great price; it's just better priced than it was, and it's a relative buying opportunity, even if the stock continues dropping for while longer. Industry seems to be the only place where you can discount something by 25% (stocks) and have people no longer want to buy.

In the absence of a crystal ball, we have to rely on two strategies to make money from the volatile stock market. First, we can stay in for the long-term to get the market's long-term returns, even if some of the annual returns are terrible. Secondly we can invest through experienced fund managers and their teams of analysts who seek out companies that have honest, competent management, a competitive advantage, are operating in a growth industry, have strong balance sheets and growing profits, and whose stock price is far less than the present value of their conservatively estimated future earnings. Some of the fund managers tell us they make more money in volatile markets because they can find investors willing to sell good companies' stocks are bargain prices and sometimes find investors willing to pay unwarranted high prices for other stocks.

Because we can't time the markets any better than anyone else, and no one is known to have consistently done it well in all of history, instead **we try to make sure that people don't need to sell out of equities in a down market. The Income Matching Strategy we practice calls for us to put enough of a client's money into low or low-to-medium volatility investments, that shouldn't drop nearly as much as the market, to cover any withdrawals they might need during any years while markets are falling and then rebounding.** With this buffer of low or low-medium volatility balanced funds to take care of at least 5 years' worth of income, other savings can be invested for the long term even through the ups and downs of the market. The buffer of low or low-medium volatility funds will get depleted when markets are down, but it can be replenished later after a market rebound. This strategy has worked for our clients for the last 24 years and we trust it will continue to work. Of course, this strategy is dependent on clients having a good idea of when they will need to withdraw from their savings and communicating that to us in a timely manner to set up their accounts appropriately. **Sometimes clients surprise us with new plans to withdraw money way sooner than anticipated. If those surprises happen in a down market, it's costly. So if you see any changes to your plans of when you'll need money out of your portfolio, let us know as soon as you can. Give us a chance to protect the planned withdrawal amount from a full market downturn.**

Unless something really strange happens in the stock market, or we get really inspired by new research we come across, there may not be any more newsletters for 2 months. For a fair bit of July Jordan will be on vacation. In August, Elaine will get to travel for the first time since February 2020, going to Kenya, Rwanda and Tanzania for some safaris, to trek on a mountain to find and observe silverback gorillas up close in the wild and to watch the migrating herds from a hot air balloon. And she may have a few summer art classes here and there. There will be 4 days when we are both out of the office, but Jordan will still be reachable by Sarah for emergencies, and Sarah can always help you out, if you know specifically what change you want in your portfolio (like what you specifically want to sell). If you have questions or want to do some planning or a portfolio review this summer, call to make an appointment now. If we don't talk to you before September, have a great summer.

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