Manulife Securities

ROYDS REPORT

Dec 2021

Tax Distributions and Tax Slips –

- Next month you will start getting yearend statements from fund companies. Sometimes the fund companies send their tax slips in the same envelopes. Please keep you eyes out for them.

- If you have qualified for reduced Management Expense Ratios (MERs), you may get a refund of some of the regular MER (that's how Fidelity does it, for example). (Reduced MERs may apply to those holding $100,000 or more in funds with a single fund company.) The refund however is considered to be taxable income. So watch out for tax slips like that, if applicable. Many people ask if they should be looking for a tax receipt for regular MERs. Nope! You need to have a fee-based account where you get discounted MERs, but then pay Manulife for service and advice separately. The separate fees are tax deductible. This applies only on unregistered fee for service accounts. With regular MERs, there is no capital gains, and therefore no tax on them, on the gains that were used to fund the MERs. Since there is a hefty annual fee minimum on fee for service accounts, only certain large accounts can save money with one. Most people have regular MERs.

- We have been notified that a few fund companies (Manulife Investments for example, RBC (but not for funds we hold) and Invesco) had large taxable distributions this year. When a fund has made too much money (at some point in the year, even if the fund doesn't end the year up very much) to write off against expenses, the fund companies distributes out the excess income to unitholders for them to report as taxable income. Fund companies do this, rather than pay the tax from the funds, because many or even most unitholders won't actually have to pay tax on the distributions, because they hold them in RRSPs, RRIFs, TFSAs or other registered accounts. Only investors holding the fund in unregistered accounts end up paying any tax on the distributions. It's not fun to get tax slips showing lots of income, even on funds you haven't taken a penny from, but it happens. If you make money, you pay tax on it, and it can't always be deferred. Any taxable distributions you receive now reduce future capital gains. Of course making money, that you have to pay tax on, beats not making money!

Sharing Online Access – There's a new way for you to share account information with trusted family members through Manulife online access. It enables you to share views of each other's account details, including the value of current holdings and activities. Family access connections can only be made between Manulife Securities clients with active accounts. You will only be able to share individually owned accounts. Joint accounts and entity (corporate) accounts cannot be shared. Getting started is simple. When you invite a family member, they will receive an email with a personal invitation link. Following the instruction, they will accept the connection and have the option to share view-only access to their own accounts if they choose. Here are some resources to help you get familiar with this new feature:

- Family access overview (video)
- Send an invite on Family access (PDF)
- Accept an invite on Family access (PDF)

Estate Implications for Registered Education Savings Plans – When a person who holds an RESP passes on, what happens to any RESP they have? If there is nothing stipulated in the person's will, the executor may still be able to take over administration, but, unless there is a special stipulation in the will, the executor could then collapse the RESP and take the money for themself! And if there is nothing in a will about the RESP, the RESP could also be collapsed with the grant money going back to the government. Taxes (possibly regular taxes plus 20% extra) would be owing on monies that end up being counted as income to the estate, and then the proceeds could be distributed the way the will says to distribute other assets. The intended beneficiaries of the RESP might never get a dime from the RESP. So, if you have an RESP, be sure to check with your lawyer how you can make it benefit the children you set it up for in the event you pass on before the RESP is used to fund education. (Source: Advisor's Edge)

Markets - After a strong July and August, September took back most of those market gains. October and the first 3 weeks of November took all North American markets to all time highs. Then came fears over Omicron. The last week of Nov and the early part of Dec has been marked with high volatility, 1-3% swings in a single day, but the market kept going back to its recent all-time highs. We don't know for sure how Omicron will affect the world. There's the positive news from Pfizer that people with 3 (or is it now 4?) vaccinations are as safe from Omicron as they had been from older COVID strains with 2 vaccinations. However, much of the world hasn't even gotten the first 2 vaccinations. Here's something we know concretely. According to the US Bureau of Economic Analysis, the last 2 quarters has seen non-financial companies enjoy the widest profit margins since 1950. (Information courtesy of Sun Life Financial) Profits are expected to continue to be good through early 2021. And since stock prices ultimately follow profits, this bodes well for future stock prices.

Inflation is stronger than before, but has totally abated in some areas, like lumber, and may fall significantly in other areas when supply rises to match demand, or when pent up demand is satisfied. On average we are back to 2003 inflation levels. If memory serves, the world didn't come to an end in 2003 with that inflation. So the world will probably survive inflation this time too. It may (should?) prompt central banks (like the Bank of Canada and the US Federal Reserve) to increase interest rates sooner than later. Source: https://www.rateinflation.com/inflation-rate/canada-historical-inflation-rate/

We still hear lots about markets being expensive. For sure, some stocks are expensive. In general though, the market isn't as expensive now, even at or near record high levels, as it was in Aug last year or Feb this year. Back then, the S&P 500 Index's stocks were collectively trading at over 23 times earnings. Recently they've been in the 20-22 times range. How can that be, that while stock prices are up, the stocks are cheaper than they were? It's all relative to earnings. How much are investors paying compared to a dollar of current year earnings. As companies are recovering from Covid, their profits are growing even faster than their stock prices. It always seems that prices are high during and right after a recession, because the market is anticipating the recovery of profits, before they happen. (Source: Fidelity Investments)

The market will continue going up and down, as it always does. We can reasonably expect a short-term 10-15% pullback sometime in the year, since that happens almost every year. Over the long term, markets should rise, as they have for hundreds of years. Omicron, housing bubbles, wars, assassinations, good US Presidents, bad US Presidents, inflation, record bad weather etc have never made markets drop and stay down. In fact, if you look back in history, there have been almost no years when there wasn't a crisis that scared some people from investing, but the markets continued up anyway. The moral of the story is to invest in quality without overpaying for it and leave the investments alone. Let us watch them for you, and we'll contact you if there's a change, or if we think you should move some investment. Just give the market time to work (see the Buffett quote in red below for more on that).

The Other Side of Mania - Charlie Bilello of compoundadvisors.com provided some great examples of stock manias of the last year. For example, a year ago Litecoin Investment Trust was trading at $500 per share, while its underlying assets were worth less than $9/share. Its assets are now worth closer to $19 and it's trading around $19. Some people lost 96% of their investment by getting carried away by the company's potential. Beyond Meat and Tilray (a cannabis stock) fell 70% and 86% from their highs earlier this year. The grand-daddy of all follies this year may have been with Squid Game crypto coin (not associated with the Netflix show of the same name). In a matter of 4 ¼ hours in the middle of the night, each coin went from $38.19 to $2,856.65 to $0.0008. Based on how many coins there were, their total value hit just over $2 Trillion at 5:35 a.m., but a few minutes later they were down to less than $1 Million. A couple of weeks ago on 680 News, I heard that a digital house in some video game, so not a real tangible house, sold for $240,000 of real dollars. I wonder if the purchaser regrets that purchase yet. Some people profited on all these trades, but some people lost tremendous sums of money. This is gambling, not investing and you probably get better odds at the casino.

Once again I'll quote Warren Buffett about how emotions affect the market. "As Ben Graham [his teacher at Wharton Business School and the father of Value Investing] said: 'In the short-run, the market is a voting machine – reflecting a voter-registration test that requires only money, not intelligence or emotional stability – but in the long-run, the market is a weighing machine.'" – Warren Buffett (1993 Berkshire Hathaway Letter) And let's throw in a quote from another smart person, Bill Gates. "Headlines, in a way, are what mislead you, because bad news is a headline, and gradual improvement is not." Source: www.greeatest-quotations.com That's why it's wise not to place too much emphasis on short term news you hear in the media.

Insightful Quotes – The author of "Thinking, Fast and Slow", Daniel Kahnemann, said a couple of things that investors would do well to remember. He said, "Confidence is not a very good indicator of accuracy." And he said, "People, it turns out, are not that averse to risk…but they are opposed to losing". That sounds odd, but we see it all too often. Some people, in their pursuit of higher returns, are eager to invest in what may be "risky or volatile" investments or market sectors, but then they're surprised and unhappy if the risk materializes and they have a loss. The higher the risk, the greater the chance of a permanent loss, and only sometimes does taking the greater risk result in greater gains. So it shouldn't be a surprise when some risky investments lose money. If you can't afford the loss, or it will upset you, don't take the chance. Past success however can encourage people to take risks. Ben Graham, quoted above by Buffett, said, "The chief hazard of a careful common stock program is not that it may bring unexpected losses, but that its profits will turn the investor into a speculator greedy for quicker and bigger gains – and therefore headed for ultimate disaster." We've had some pretty spectacular returns over the last year by investing carefully, and through the brilliance of our funds' managers, and also thanks to the opportunities provided by the market as it recovered from the Covid shock. Let's not expect such returns to continue and let's not take outsized risks in pursuit of such strong returns. Greed is a dangerous trait for an investor. Source: https://novelinvestor.com/wise-words-on-investor-behavior/

The Globe and Mail's Dec 2021 Report on Business quoted Daniel Elkind et al's MIT Working Paper on who the most panicky investors are. Take a guess before you read on as to who you suspect it will be. "Investors who are male, or above the age of 45, or married, or have more dependents, or who self-identify as having excellent investment experience of knowledge, tend to freak out with greater frequency." There is a survey that shows how likely a couple of age group are to self-identify as having excellent experience or investment knowledge. Millennials and Baby Boomers were surveyed about their investing expertise. 23% of Baby Boomers assessed themselves as having expert or advanced investment knowledge versus 42% of Millennials. Source: https://www.visualcapitalist.com/wp-content/uploads/2019/07/investing-by-age-generations.html

As long as we're not the ones who ever panic! Because anyone who sells out of fear, just because the market has crashed, may prevent their assets from ever recovering. And anyone who stays out of the market out of fear, may have their buying power eroded by inflation and end up short of funds to support their lifestyle in later years. Investing requires patience and time.

Investing is a Long-Term Venture - Patience is a huge asset to build investment wealth. To realize a company's value, it's important to hold on until the company's value is realized and it's important to let a growing company keep compounding its growth. "Most self-made fortunes are largely the result of owning and growing a business over years, possibly decades, but surely not mere months. Stocks represent ownership in in a business, not just pieces of paper to speculate on the marketplace. … Imagine trying to replicate in the real world what transpires in the stock market. Let's say you buy a car wash business in September and sell it in February to buy a restaurant. Then you switch to the hotel business in July but change your mind and end up buying a bookstore in December. There are many disadvantages of doing this, from extra costs to a greater chance of making a mistake, given that the seller usually knows more about their business than you do. Another problem is you would not own any of these businesses long enough to grow them. Remember that fortunes are typically made over many years and not months. Imagine doing the above repeatedly over the average person's investing lifetime of 40 or 50 years. Yes, it sounds silly, but this happens in the stock market every day."" If you make a lot of quick decisions to change your investments, how much research can you have put into those decisions? Unfortunately, since 1960 the average holding period for stock investments has shrunk 95%. Even professional fund managers are impatient these days, changing on average about 89% of their investments each year, adding costs and not always return. One of the causes of this behaviour and short-term focus is the pressure on a fund manager to perform. and in some companies the system of rewarding short-term performance, rather than long-term performance. Also, about half of all fund managers don't invest in their own funds! [We're pleased to say that most, if not all, of our favourite fund managers have almost all their liquid assets invested in their own funds. And most of the fund companies we invest with base their fund managers' compensation on long-term performance. And our funds typically have annual investment turnover rates of only 3-15%. We don't invest in average funds, because we're not after average returns.]

Patience means not only sticking with great investments for the long-term and not trying to time the market, but also giving your funds a chance, even if they are underperforming in the short-term, as long as they're still following their long-term strategy and hold great stocks. For example, we have a fund right now that's full of stocks of companies with 18% compound earnings growth, low debt, and moats around their businesses to ward off competition. That fund had strong returns last year and has been a good performer with this same manager and same GARP strategy since 2005, but it's performance has lagged other top funds in 2021. We wouldn't think of bailing on this fund now. We have to wait until the market appreciates the high quality companies owned by the fund. On the other hand, there was a fund, Standard Life Canadian Equity, that we parted ways with in 2000. We'd had great returns from this fund for years. It was a GARP fund that ended up with 35% investment in BCE and Nortel. Nortel was hardly a reasonably priced investment. And BCE wasn't the type of investment Buffett would ever have, because Buffett doesn't like capital intensive companies that need to reinvest most of their profits to remain competitive. And what kind of mutual fund has a third of its money in only 2 stocks? Not a fund that claimed to be diversified and was walking its talk and following its professed strategy. We got out in time, before that fund crashed and burned in the tech crash, which it would not have done had it stuck to its professed strategy. What happened? One guess would be that the fund manager didn't want to risk being left behind the index, or behind other funds that were mirroring the index (without admitting it), by not holding the heavyweight, star performer in the index, Nortel.

If you'd been lucky enough in the 1960s or early 1970s to have discovered Buffett or his partner Charlie Munger or the legendary Sir John Templeton or other legendary investors who were Buffett's and Munger's classmates in Benjamin Graham's class at Wharton School of Business, you would have enjoyed epic returns, but not every year. In the 153 years of fund management of John Templeton, Bill Ruane, Tweedy Browne, Charlie Munger, Walter Schloss and Warren Buffett, their annualized (average annual) outperformance over the S&P 500 Index ranged from 6-15%. No wonder these men are investing legends. But, they sure didn't beat the market all the time.   These 6 legends underperformed the market anywhere from 28% to 40% of the time. The only way an investor could have enjoyed the spectacular returns of these legends' funds was to hold on through thick and thin and let their proven strategies work again and again, just not every year. (Source: EdgePoint's 3rd quarter 2021 Commentary)

We've had above average returns over the last 12 months. So why are we encouraging everyone to have patience now? After all, it's unlikely you'd be tempted to abandon your investments when they've just performed for you. The time to decide on how you'll handle bad markets is before those bad markets happen, especially since it's easier to make rational plans when you're not worried. Also, there's never a bad time for reminders about how to be better investors.

If we don't talk to you before the holidays, we wish you all the best. We will be in the office whenever markets are open. The last day for trades to count for the 2021 tax year is Dec 29, but try not to leave anything (like RESP contributions) that late. And the first week of January may be chaotic, with the change in regulations for the investment industry taking effect Jan 1, and we will also be analyzing your yearend Portfolio Reviews and getting them mailed out to you, as quickly as we can. So, if you can call the second week of January, rather than the first week, we'd appreciate it.

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