ELAINE'S NEWS & VIEWS

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That was quite a ride we all just took in the stock market. Your portfolios all survived it. And nobody panicked and jumped ship before the recovery. You could consider it a life boat drill. It was a practice run for the volatility we will experience in the future.

It's not time for the end of quarter newsletter I always send, but with all the fear and uncertainty about the economy, trade wars and a recession, I wanted to give you an update before mid-April.

From Christmas Eve till now, US and global markets have virtually completely recovered from the almost 20% drops they experienced from Oct 4 to Dec 24, 2018. That doesn't mean we are through with scary markets. The market could continue up for quite a while, or the recovery we just had could be a "dead cat bounce" before the market goes down for a more sustained period.

In Jan when Jordan went to the Economics Club of Canada in Toronto to hear the chief economists of the 6 biggest Canadian banks, they were all in agreement about what they expect stock markets in 2019 and that is pretty much in agreement with most fund managers and other credible people we listen to. Most of these people expect 2019 to end positively and that there is about a 40-50% chance of a big market downturn in 2020 and about a 40% chance a downturn will be later than 2020. What this boils down to is that the stock market could take a nosedive anytime, tomorrow or not for years. As usual, no one knows. We do know that the market is getting more volatile and that is usually a sign that we are getting closer to the end of the bull or rising stock market. We also know that while profit reports have still been quite good from companies, a leading indicator of a stock crash, the Purchasing Manager's Index, is weakening. It is still in positive territory, so not predicting a recession right away, but it indicates we're moving closer to a recession and market downturn. A year ago only 2 countries in the world have PMI indices below 50. Today there are 11 countries in that position, including China. While 70% of companies reporting earnings so far this year reported earnings above expectations, a couple Canadian banks reported disappointing earnings, with substantial increases in their provisions for loan losses. The banks are expecting more loans to be defaulted on, which means more of their clients are headed for economic problems. There are cracks starting to appear in the global economy. And markets usually fall significantly in advance of a recession.

We also know that between 1945 and 2017 if we had gotten out of the market as much as 2 yrs before the market downturn happened, that we would have missed about 41% of gains, only to avoid being down on average-14% 1 yr after the correction (based on the U.S. market). Even getting out of the market 6 months in advance one would have missed out on about 15% gains, which is more than most of the downturns in that period. The Great Recession of 2007-2009 may have skewed people's perception of how quickly a market recovers. On average since 1945, the market has recovered all but

1% of any drop by the 24 month mark after the market started to fall from a peak. So if you can wait for 2 yrs, your portfolio is usually pretty much back at its all-time high. (Source J.P. Morgan Asset Management) Another reason not to try to time the market by jumping out in anticipation of a market fall and staying out till the danger is past, is how much you long-term returns can be reduced if you miss some of the big returns that happen when the market starts to recover. If you miss only 50 of the best days in the market over 30 yrs, you actually lose money! If you missed the 10 best days over the 30 years ending Dec 2015, your portfolio would have given up 60% of its returns. You need to be in the market all the time to be around for those super return days. (Source Morningstar courtesy of Sun Life Global investments)

So what are we to do when we see signs that the market is closer to a drop than a long upward climb? We need to make sure you are invested in quality and not holding over-priced securities. Our favourite strategy, Growth At A Reasonable Price (GARP), with managers who will hold cash rather than invest when prices are too high, is one of the best ways to protect yourself from any permanent losses. When the market starts a significant correction, historically everything, quality or not, will fall badly. Sometimes the quality companies even fall more at first, because the quality companies are liquid (easily sold) and are easy choices for investors to sell when they need to get cash out of the market. As the market correction continues, investors start to differentiate between quality companies at good prices and other companies. That's when quality companies start to hold their value while other companies keep dropping. So your portfolios might fall as hard as the market at the start of a big downturn, but then your funds should be more defensive. Not all quality companies will fall the same amount though. This may give our managers the chance to pick up stocks that have become especially cheap, so that they may get more gains in the recovery.

So right now we think it is important to:

a) If you are withdrawing regularly, make sure you have at least 5 yrs of low volatility holdings (usually balanced funds) to take income from at all times in case the market starts dropping
b) **If the downturn last quarter upset you terribly, reposition now to a more conservative portfolio before a bigger and longer market drop happens (which it will, we just don't know when)**
c) Have a portfolio review meeting, even if only by phone, to make sure that you don't have too much Canadian exposure or have any fund managers who have strayed from the style they professed to follow and didn't perform as expected in 4th quarter 2018
d) Calmly hold on to what you have till the bigger correction comes and then the inevitable recovery happens
e) Prepare emotionally to perhaps move out of, when the market is down a good 25%, some of the most conservative funds (particularly ones practicing a low volatility strategy) to go into more volatile ones that fell more and have greater rebound potential
f) **Call us if you have any concerns.**

It Takes More Tolerance to Volatility to Make The Same Money These Days

Back in 1998 one could invest in 100% US bonds with a measure of volatility of 6% Standard Deviation and earn a 7.5% return. By 2005, one needed to be 48% into stocks, and maybe a little real estate, with a total volatility measure of 8.9% to get the same 7.5% return. By 2015, one couldn't invest in more than 12% bonds to get 7.5% returns. One would have to endure 17.2% volatility with that portfolio. So where you could get 7.5% fairly comfortably without too many portfolio ups and downs about 20 yrs ago, now you need to accept way greater ups and downs (commonly called risk), to get the same return. Are you ready to handle greater ups and downs in your portfolio or to accept lower returns?

Investors Don't Do Well Following the Herd

Here is an interesting article written by some former Trimark fund managers about human tendencies and the danger this poses to investors. Click on the link and then click on the orange box, below the trees picture, that says "Visit the Academy" and once there, click on the first article, "A History of Herding". The older articles there are also very educational.

https://www.edgepointwealth.com/en/Insights

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