Manulife Securities

ROYDS REPORT

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Bonds and Balanced Funds - The most successful investor in history, with over a 60 yearhistory of compound returns over 20%, Warren Buffett, wrote in his Feb 27, 2021 annual letter to Berkshire Hathaway investors, "Fixed-income [bond and GIC] investors worldwide – whether pension funds, insurance companies or retirees, face a bleak future." Interest rates today are less than the rate of inflation and as interest rates rise (because of inflation, because governments want them to rise and because they can hardly go lower), the value of existing bonds goes down. US Investment grade bonds in the 1 yearending May 31 dropped 12.7%, while Emerging Market and High Yield (riskier bonds) were positive. The universe of all Cdn bonds was also negative. (Source: RBC GAM) Fortunately our clients don't hold bonds directly, although bonds do form 30-40% of most balanced funds to provide price stability, rather than to add to return. Getting that price stability has a lot of opportunity cost. Over the last 120 years, a typical mixture of 60% equities and 40% bonds, would have produced 69 yearsof negative real returns (real returns are what you make after adjustments to remove inflation). That would be negative returns 58% of the time, in 7 – 19 yearlong stretches. In between there were stretches of up to 10-15 yearswith actual buying power gains. So, if you're holding balanced funds out of nervousness about market volatility, rather than because you have need of the funds in fewer than 5 yrs, you are really handicapping your long-term growth. (Source: Edgepoint & GMO Asset Allocation Insights)

If the Market Is at All Time Highs, Shouldn't My Portfolio Be Too? - No investment goes up all the time, or is the best performing of all investments all the time. Our style (predominantly GARP or Growth At a Reasonable Price) did great last spring, when it didn't fall as much as the market. Then in the summer, most of our funds rebounded quickly and by fall they were in very positive territory, well ahead of the market. Then from Nov 5th (the day the results of the first successful vaccine were announced) till early March, different ones of our investments (mostly, the ones with the more conservative old world companies that had been out of favour for a long time) soared and anything that smelled of technology languished. Many clients had some exposure to technology in their funds. So portfolios kept rising, just

on the basis of different funds' performance compared to the previous half year. That's one of the reason's we diversify. But we never diversify into unprofitable companies or commodities where your profitability depends on the price of your product, over which you have no influence. (For Example, an oil producer has no control over the market price for a barrel of oil, so it can't control its own profitability as well as other kinds of companies.) So from mid March to May, when unprofitable, highly indebted or cyclical resource companies started leading the market higher, we weren't participating. Goldman Sachs produced a chart for Sun Life Global Investments which shows that from Jan 2021 till the end of May, unprofitable technology companies gained in value over 10%. Meanwhile, profitable mega tech stocks (Facebook, Apple, Amazon, Microsoft and Google) fell about 31% between mid-March and the end of May. Other profitable smaller tech or tech related stocks fell too. Our portfolios don't have a lot of Facebook, Apple, Amazon, Microsoft and Google, but even a small exposure to things that fell over 30% has an impact. And not having exposure to oil and gas and other resource companies, which had done pretty poorly for the last 5 yrs, also meant we didn't participate in those stocks big gains. With those stocks, it's unclear how long before they fall dramatically and stay down for quite a while again. What all of this meant was that generally we were ahead of the market from Feb 2020 to Feb 2021 and then we went on pause while the market caught up. So the market is now hitting its highs, months after we started achieving new highs. So yes, it's possible for the market to hit new highs, without us also hitting new highs, like this spring because the market is catching up to the recovery and growth that we'd already had, and in this case also because the market was favouring junk stocks that we don't want to be in. Long-time clients will remember 1999-2001 when markets were soaring with this "new" category of stocks called technology, which didn't have any profits, or had very low profits. And the market was paying exorbitant prices for them. Our portfolios lagged until the tech crash of 2001, when many tech stocks fell 95% and our portfolios barely noticed the market crash. We won't chase short term market leaders, if there isn't real value there and growing profitability that will help us make long-term profits. We would rather lag the market for a while rather than risk permanent losses of your capital. This year, we didn't have to lag the market long, before some logic returned and our stocks started doing really well again. In June, more solid, low debt, profitable companies came back in favour and our portfolios had pretty strong gains. Most clients are at new all-time highs.

We stick with our proven GARP style, and with fund managers who have a repeatable process to invest in companies with rising profits. Stock prices will follow earnings up, even if it doesn't happen right away. After all, we aren't gambling; we're not playing at timing the market; we're investing.

Also, it's important to remember when you hear that a stock market index just hit a new all-time high, that it may only mean that 5 stocks gained in value. For the main US stock index, the S&P 500, the 5 largest companies carry 22% of the weight of the index. 495 companies could be flat or decline slightly in value, and the movement of the 5 largest companies could still take the index to a new high. Similarly in Canada, the banks, which had languished for a couple of years and did poorly in the COVID market drop, did well this year and so did commodities, which were a disaster for most of the previous decade. If someone owned them, they got a great rebound and for some of their commodity stocks, maybe they even recovered to the same price the stocks had been at a couple of years ago. Good for them. Over the long-term, resource stocks haven't provided superior returns and have taken their stockholders on a rollercoaster ride. These stocks are rising now, because of the re-opening rally. Now that COVID is subsiding, factories and production are getting back on-line to replenish worldwide inventory shortages, and raw materials are needed for that manufacturing. But how big will the demand for commodities be

in 6-12 months? One has to time selling commodities at just the right point to avoid big drops in cyclical companies, and then buy them in time for any rebound, and then time it right again to get out before the next big drop. We're not in the business of timing the market like that. Virtually no one is consistently successful at it. Generally stock prices follow profit changes. So we like to hold companies that are growing their profits pretty regularly at an above average rate and for which the market has not already priced in that profit growth. It's not an exciting strategy, but like we already said, we're not in the gambling business. We just want to make good money in as smooth and secure a fashion as we know how.

Inflation, The Elephant in the Room – It's not a bad thing when markets have uncertainty or when not everything politically or economically is going smoothly. There's an old saying that is so true: "Markets climb a wall of worry." That means that while many investors are fretting about all the short-term problems that could upset the market, the market quietly marches upward. And today, many investors are worried – about inflation. For most of the last decade, governments and the market have been worried about deflation (where the price of normal goods keeps dropping every year, so people put off buying anything, because it will be cheaper the longer they wait. If not one buy things, the economy does poorly). No one has figured out how to stop deflation. It made Japan's economy and stock markets stagnate for a couple of decades. So no other country wants to experience deflation. Now however, it's inflation governments are worried about.

With shortages in inventory around the world (due to lower production during COVID), prices have been rising. And in some cases, the costs of production are higher because of the cost of PPE, extra cleaning costs, extra space for distancing and higher raw material costs. Also, if interest rates rise like the central banks (for example the Bank of Canada and the US Federal Reserve) of the world want, to stop their citizens from getting over-indebted and to stop the economy from over-heating, that causes inflation. The US would like to see 3% inflation, to bring the longer-term inflation average up to the 2% target they have been striving for. And despite the Federal Reserve promising not to raise interest rates before 2024, economists are predicting Canada and the US will raise interest rates several times before then, starting in about 1 yr. In anticipation of this, the market sent the price of companies with strongly growing earnings downward. Let's look at how rising interest rates affect strongly growing emerging companies more than established growing companies with this example of how you would value 2 companies. One company is expected to make $10 this year, $11 the next and then $12, $13, and $14 thereafter, for a total of $60 over 5 yrs, with earning forecast to be $80 over the next 5 yrs. The other company is expected to make $5 this year, $7 the next, then $12, $16 and $20, for a total of $60 over 5 yrs, with the next 5 years of earning forecast to be $150. Obviously the second company is growing much faster, but you have to wait longer to get those higher earnings. With the established, slower growing companies, you get more earnings in the early years. If interest rates are low, let's say 1%, you'd probably be prepared to wait for the second company to earn (and pay out) more in future years and you'd probably pay more for company 2 than company 1. But, if you have a chance to make 50%/yearon the earnings you receive from the company you invest in, you'd value the company, that paid out bigger profits sooner, higher than the other company. Similarly, the higher the interest rate (or potential to earn money on a reinvestment of profits), the more valuable current earnings are and the less valuable future earnings are. So, growth companies with the promise of high future earnings, have been devalued recently because of expected higher interest rates. If markets decide that we won't see

interest rates get quite high quickly, then those high growth companies could go back up in value sharply.

Every economist and fund company we have listened to in the last month has been debating whether the inflation we are seeing is temporary or systemic. If it were systemic, ingrained like it was in the late 1970s, prices would rise, then wages would rise, then prices would have to rise again, and wages would have to rise yet again in an endless cylce. In the 70s and early 80s, inflation got up to about 14% and interest rates went into the high teens or even 22% for short term mortgages. This runaway inflation was stopped back then by freezing wages till the cycle was broken. If what we are seeing now is temporary inflation, then wages probably won't rise more than usual and eventually prices will settle down. There is some support for the idea that inflation is temporary. For example, in the last weeks, the price of lumber dropped 50% from its high in early May (after rising during COVID by several hundred per cent). Copper, corn and gold prices also dropped significantly in June. And Economist Trevor Tombe of the University of Calgary calculates that the current level of inflation has only taken prices up to the level they would have been at by now following the pre-pandemic trend of inflation, so there should be nothing alarming about current prices. (Source – Globe and Mail June 21, 2021) And used cars are up 30% in price, but only because there is a shortage of new cars to buy (due to a world-wide parts shortage). When new cars become available, it's likely that used car prices will settle right down. There are even reasons why disinflation is possible, like because of new technology, continued globalization and competition, high private debt and the ever-increasing aging of the population (Source: Ned Davis Research). Most, but not all, economists we have listened to think inflation above recent levels of 2% or so is only temporary.

The market is not too worried about temporary inflation, but it is worried about systemic inflation and hyper inflation. It's not that stocks don't make money in periods of inflation, because indeed they tend to make good profits when there is high inflation. The problem is Central Banks, like the Bank of Canada and the US Federal Reserve. When they get worried about high inflation and an overheating economy, they raise interest rates to make borrowing less affordable and curtail spending. However, most recessions in recent history have been caused by Central Banks raising interest rates too fast or too much. 1994 is a good example. Canadian interest rates went for 7% to 12% in 6 months, because of Bank of Canada actions, and the country went into a recession.

We certainly don't know whether this inflation is short-term or not, but there are some reasons why we are not too worried about the impact on our investments, even if inflation is not short-term.

- Our managers are investing in companies with low debt levels, because those are high quality, lower risk companies. It will be the highly indebted companies that suffer most if interest rates shoot up.
- Our managers are now concentrating on investing in companies that are probably able to pass on higher raw material or labour costs to the consumer. So the companies' profits won't be affected too much.
- Our managers don't usually like cyclical stocks that only do well in boom economies, but rather like companies like Microsoft or a diabetes supply company that do well all the time.
- BMO Global Asset Management found that companies with low debt and high free cash flow which are very profitable, without the constant need to reinvest in capital upgrades (like

telephone companies have to), make more money the higher interest rates go. And our managers love high free cash flow and low capital intensive companies

- Lastly, the GARP style does even better in volatile times and usually falls less than the market and makes more than the market during recovery. So we wouldn't expect permanent losses, but perhaps even above average long-term gains.

And let us not forget, that optimists make more money that pessimists. So it's better not to worry about everything that could upset the market and just get in and stay in the market. Sitting on the sidelines is a sure way to fall behind over the long-term.

Insights into Retirement, Happiness, Health and Financial Freedom – Apparently people who lived 50,000 to 100,000 years ago had a life expectancy of about 16 on average. People born in the year 1000, had a life expectancy of 25 yrs. By 1400, it was up to 35, by 1800, 38 and in 1900, 47. Today life expectancy in Canada is 82, although on average people only have 71 healthy years and life 11 years in poor health. [CPP says for men, life expectancy is 80 and women 84.] We listened to a prominent psychologist talk about this increasing longevity and how like people's lives are now broken into 3 stages. The first stage is called Education and is from age 0-30 when we have our biological development, are learning and forming our identity. The second state is called Work and Family and is from 30-60, when we are focusing on family formation, parenting, career development and productive work. The 3rd age at 60+, a longevity bonus, is called Leisure, when people focus on new freedoms, emotional resilience and giving back to society. It's about building memorable experiences (not doing nothing) and adding value to your family, friends and society. Sometimes that includes retirement, but sometimes not. A study in the US showed people consider the new ideal is a flexible work/life balanced. For 24% of those financially able to retire, it means cycling between work and leisure. For 29% it's never working for pay again (active volunteers, babysitting grandparents etc). For 39% it's working part-time, and for 8% it's working full time. Some of you may have trouble imagining this. Let's look at how some famous people who could afford never to work again are spending their retirement, starting with the Rolling Stones. What they do now is go on tour for a bit, and then take time off and then go back on tour. They didn't retire. They cycle between work and leisure and just work on their own terms, because they enjoy their work. Helen Mirren, Sir Anthony Hopkins, Dolly Parton may be doing the same, or they just work part time, or may even be working full-time, like another famous senior, Joe Biden. In the "old days", say the last half of the 20th century, it was considered a mark of success, if you could retire by age 50. Now it's a mark of success if you are doing what you enjoy, whether it's working in a job or working like many of the 29% who are busy volunteers who don't work for pay, but certainly do lots of work.

As stated above, while the average Canadian may live to age 82, the average Canadian also suffers from poorer health for an average of 11 years. However, while physical health declines with age, older people rate their mental health as far better than younger people. Only 26-38% of people in the groups called Gen Z, Gen X and Millennials rate their mental health as very good to excellent. However 48-67% of those born before 1965 rate their mental health as very good to excellent.

Research has shown that the most important keys to Happy Longevity are, in order of importance:

- Good Health
- Financial Security
- Having the Love of Family and Friends

- Having a Purpose in Life
- Continually Trying New Things

Hopefully we will all have these factors in our life as we get older. To clarify financial security, here are things Canadians felt were the factors it was comprised of:

- Having no debt
- Knowing they and their partner would have enough money to last their whole life
- Being able to afford unexpected expenses
- Not being a burden financially to family and friends
- Being able to afford to do what they want, when they want to
- Have a certain amount of savings/investments

Before people retire, the things most they worry about losing on retirement are their:

- Reliable income
- Social connections
- Losing their work health insurance program
- Having less mental stimulation.

But once people actually retire, the things they actually miss most are prioritized differently:

- Social Connections
- Reliable Income
- Mental Stimulation
- Loss of their Work Medical Insurance

Something that might surprise you about retirees, which we see fairly often, is that 63% of retirees are willing to put their own financial future at risk by financially supporting their family (helping with their home purchases, helping them pay their debt, co-signing loans or just providing supplemental monthly income because their kids don't earn enough to support the lifestyle they want to live).

One last tidbit about retirement is what people felt was their legacy. The most important thing, that people surveyed felt they could leave behind, is their values and the learnings of their life. Personal possessions with emotional value also had a high legacy value. Financial assets or real estate were only valued as an important legacy about half as strongly as the values and life lessons were.

(Source: Dr. Ken Dycktwald, author of "Longevity Revolution & The 3rd Age)

Beware of the Grandparent Scam – If you got an email from "your grandchild" saying they were in trouble somewhere (stuck in France with their wallet and airline ticket stolen, or in jail in Oregon for speeding and unable to leave till they paid a big fine), would you hesitate to send them the money they need to get out of trouble? YES. Please hesitate. There is an extremely strong likelihood that that email is not from your grandchild and the account to which they are asking you to send money probably belongs to a thief. If you get such a message, call your grandchild or verify with their parents or siblings if they are even out of town. Chances are that you will find your grandchild is just fine and not in need of a financial bailout. Many people are currently being tricked with this scam.

The "Perfect" Responses to Covid Led to Unintended Consequences - Did countries that effectively responded to Covid right out of the gate get complacent and drop the ball? Countries that had quick and severe lockdowns and border shutdowns, like New Zealand and Japan, saved a lot of lives, but are in a pickle now. They didn't have to depend on vaccinations to stop the pandemic and consequently now have low vaccination rates and haven't been able to reopen borders without spikes in Covid and re-

closures. So those countries' full reopening could be long delayed, while they catch up on vaccinations. In contrast, we're headed to more normal operations sooner than later, and the US which, after doing just about everything poorly at the start of Covid, has had a strong vaccination program, is pretty far along the road to re-opening and recovery (even with triple the deathrate per capita that Canada now has). China is fully re-opened, thanks to its 2 home grown vaccines and vaccination program.

Strong Economic Outlook – Here are some reasons why RBC's analysts are expecting not just recovery, but accelerated growth coming out of COVID shutdowns:

- Developed countries are now exceeding the low productivity growth rates of the last decade that were holdovers from the financial crisis of 2008/2009
- There has been a leap forward in productivity due to remote working, online commerce, digital payments, automation, online education, online healthcare, online commerce and online government services
- There has been more spending on computers, software and Research and Development and there is a backlog of capital and research and development spending that is about to be unleashed
- There have been many exciting scientific advances, particularly in the areas of medicine, artificial intelligence, the environment and semi-conductor chip technology
- China is now as technologically advanced as the developed world, which means there are about twice as many people advancing the technology frontier forward than there have been in the past.

Source: RBC Global Asset Management May 25, 2021

"Mom and Dad's Guy" or "Retiring 30% Richer"? - The ubiquitous Questrade ads continue on radio and TV, suggesting young people are crazy to work with their parents' old fashioned financial advisors and invest in funds where the Management Expense Ratios include a slice to pay the advisor for their advice. Instead you can use Questrade funds with their lower fees, and "retire 30% richer" by that cost savings. These ads ignore the studies that show people who work with advisors end up with more wealth than peers who have the same income level but do don't work with an advisor. And the 30% richer really ignores the fact that Questrade's own funds, with their lower costs, don't have competitive returns compared to our favourite actively managed funds available from other fund manufacturers. Here's a look at $100,000 invested in Questrade Portfolio funds from inception Nov 2014 to Jan 2021 versus Fidelity Portfolio funds (which are funds made up of slices of other funds to be a diversified offering in the category, and which don't have nearly as good returns as Fidelity's actively managed pure funds that we use) in the same categories. Questrade's offerings just don't measure up.

Balanced Funds	
Questwealth Balanced Portfolio	$139,652
Fidelity Balanced Portfolio	$156,805
Fidelity Global Balanced Portfolio	$163,029
Growth Funds	
Questwealth Growth Portfolio	$146,812
Fidelity Growth Portfolio	$174,085
Fidelity Global Growth Portfolio	$182,579
Income Funds	

Questwealth Income Portfolio	$132,322
Fidelity Income Portfolio	$143,125
Fidelity Global Income Portfolio	$147,336

We should add that we do not use any of these Fidelity funds, because their returns are inferior to our chosen funds. Still the point is that even these mediocre Fidelity funds outperform the Questrade in-house funds.

Bitcoin - We're still getting questions about whether Bitcoin would be a good investment. Its future is still cloudy and unknown. Some governments, like China's, have declared that they won't allow payments in their country to be made with non-government sponsored digital currency like Bitcoin. It's possible that more governments will follow suit. Governments are concerned about how digital currencies facilitate money laundering and criminal activity, like ransomware demands, and also about how governments can't control money supply which is a key component of monetary policy. Environmentalists are concerned about how much electricity each bitcoin transaction uses, with an estimated 50% of it coming from electricity fuelled by coal (since most Bitcoin "mining" is done in China). The University of Cambridge Centre for Alternative Finance estimates that this year Bitcoin production will use about the same amount of electricity as the province of Ontario (or Argentina or the Netherlands)!! That's why Elon Musk has declared that Tesla won't accept Bitcoin until or unless it finds a less energy-heavy way to operate. Bitcoin may become a "stranded asset". That is an asset that society can no longer afford to operate, like coal mines. (Source – Corporate Knights Magazine Summer 2021)

Mark Carney, a previous governor of the Bank of Canada and also of the Bank of England, has warned that if digital currencies become the foundation for digital payments, commercial banks (like TD and RBC) could be completely disrupted. The Bahamas has already introduced a central bank digital currency. China is running a pilot project for one and Canada has accelerated its research into the issuance of a public digital currency. (Source – Globe and Mail Jun 29, 2021)

By August, our staff will have had the chance to get both vaccine doses and pass the two weeks it takes for immunity build-up. So we will be opening up to in person meetings. We know some of you have been passing on phone reviews or Zoom meetings, waiting for face to face discussions. So please call the office to schedule a meeting in our office. We will probably be retaining the Plexiglas dividers for a while, but we can still sit down at the same table to chat.

Have a safe and happy summer.

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