Manulife Securities

ROYDS REPORT

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Walking the Tightrope

No portfolio can always outperform the market. We strive to have our equity funds (not our balanced funds) outperform over the long run, like over a 5 year period. Some years they may rise the most. Some years they may outperform simply by not falling as much as the market. Some years they will simply underperform, while funds and indices with more exciting stocks in them soar. It's important to have patience and stick with funds that don't overpay for stocks and only buy high quality, growing companies with low debt, which are able to survive tough times. Those are the kind of holdings which don't lose value permanently and have strong futures. Many of those kinds of companies took quite a while to recovery after the Covid market dip, but now it appears that the market has recognized that those companies are relatively undervalued. Those companies are the current market favourites. It was worth holding onto them till the market was ready to value them more reasonably. If those companies ever become overvalued, the fund managers will sell them and find other great companies which aren't yet fully valued. This style of investing has worked for us for more than 2 decades, as it has worked for Warren Buffett for 60 yrs. We need to stay the course to realize the long-term returns we are after. Remember that timing the market only works when you can identify that the market has fallen greatly and equities are available to buy at bargain prices.

An extra reason to stick with equities, is that moving to bonds is not a reasonable option. In Europe, Italy and Greece are the last 2 countries which are still selling bonds with positive yields. Spain just issued 10 yr bonds, for which the buyers were paying the government to take their money: the bonds were purchased for more than the bonds would pay back to the purchaser after 10 yrs. And if interest rates go up sometime over the next 10 yrs, the market value of the bonds should go down. Since interest rates can hardly go down further, a rise in interest rates in less than 10 yrs is quite likely.

Bloomberg Daily E-mail Dec 11, 2020

Check out the two lists of stocks below. There are 3 stocks and the top and 32 below. Where do you think there is better safety? What about bigger value (remember that price is what you pay, value is what something is worth empirically)? If you could own one box of companies or the other, which would you choose?

Netflix	An American streaming service and production company
Nvidia	An American designer of graphics processing units and chip units for self-driving vehicles
Tesla	An American electric vehicle and clean energy company

Affiliated Managers	One of the top 10 publicly traded global asset management companies with over $600 Billion in Assets Under Administration
Amtek Inc	An American company manufacturing electromechanical devices and electronic instruments at over 220 sites worldwide
AON	An insurance and pension administration company operating in 120 companies
Bank of America	One of the big 4 banks in the US, B of A is the 8th largest bank in the world
Berry Global Group	A global manufacturer of plastic packaging products with 290 plants across the globe
Bharti Infratel	An Indian company that is one of the largest telecom tower and infrastructure company in the world
Crown Holdings	An American company operating at 149 plants in 41 countries making 1 out of every 5 beverage cans in the world and 1 out of every 3 food cans in N America and Europe
CSX Corp	An American railroad and real estate company
EchoStar Corp	A worldwide provider of satellite and internet services
Fairfax Financial	A major Canadian Reinsurance Company with a huge investment portfolio

Fidelity National	A leading American provider of title insurance and transaction support to the real estate industry
Flowserve Corp	One of the world's largest suppliers of industrial pumps, valve, seals and automation for the chemical, power, oil and gas industries operating in 55 countries
Fujitsu	The leading Japanese information and communication technology company
Grand City Properties	A leading real estate investment company in Germany
International Flavors & Fragrances	With operations in 44 countries, the companies produces flavours, fragrances and cosmetics
Kubota	A Japanese manufacturer of heavy equipment and agriculture and lawn equipment
Kuehne & Nagel International	With over 1400 locations in over 100 countries, K&N is one of the leading logistics (airfreight, seafreight etc) companies in the world
Manulife Financial	A multinational insurance and financial services company that is big in China and took over John Hancock years ago with almost $1 Trillion Assets Under Administration
Mattel	The second largest toy company in the world with brands like Fisher-Price, Hot Wheels etc
Mitsubisih Electric	A Japanese electronics and electrical equipment manufacturer known for elevators, escalators, home appliances, factory automation systems, train systems, satellites and semi-conductors
O'Reilly Automotive	An auto parts company with 5147 stores in 37 states
Prairie Sky Royalty	A Canadian company with the oil and gas rights on 6.3 million acres of land, which gets 6% of all sales of oil and gas drilled by other companies on their land
PriceSmart	A Western Canada grocery store chain
Restaurant Brands	The firth large fast food chain the world with Burger King, Popeyes and Tim Hortons
Richemont Financial	A Swiss luxury goods company
Shionogi	A Japanese pharmaceutical company

Shiseido	The fifth largest pharmaceutical company in the world, out of Japan
Subaru	The 22nd largest car manufacturer in the world
Swedish Orphan Biovitrium	A Swedish biopharmaceutical company
TE Connectivity	A technology company that produces connectivity and sensor products for industry, automotive, communications, aerospace, medical and energy industries
The Middleby Corp	Serves 97 of the top 100 food service chains in the US and internationally with commercial cooking and industrial processing equipment plus residential appliances
Univar Solutions	A global chemical and ingredients distributor

As of Oct 31, the 3 companies at the top had a little more market capitalization (were worth more on the stock market) than the stocks below. Does that make sense? Would this information change your mind about which group of companies you'd like to own: the 3 stocks at the top had one year income of $18 Billion USD, but the lower group of stocks had income of $83 Billion USD? Maybe someday the companies at the top will earn more than all the companies at the bottom (although so many of the companies at the bottom are also in growth industries and/or make products that are going to be essential for many decades to come), but how many years would you be willing to accept the lower income on the top companies for in anticipation that someday they might earn more than the other companies? The top box companies are selling for 66 times their last year's income. The bottom companies are trading for only 14.5 times their earnings. Most of our favourite funds have companies like the ones in the bottom box, although some of them do own some Nvidia. If you were betting your whole retirement on one box of stocks or the other, which group would you trust most? It's often a trade-off between safety & value and growth & cache/excitement. Over the long-term, dull, profitable, necessary companies often outperform, especially when you can buy them much more cheaply. We may miss out on the excitement of a Shopify or Tesla, just like we missed out on the rapid rise and faster decline of Nortel and Bre-X, but we'd rather have steady growth than own anything that "goes bust".

Source: Factset Research Systems

Where is Market Growth Coming From Next?

In December, US markets hit new all-time highs, mostly on the back of high tech stocks and the fact that older economy stocks have finally started to recover (although many are still considered to be undervalued). So where can our managers still find stocks with strong growth prospects that may not be fully or over-valued? Environmental impact stocks may be the answer.

China is trying to get carbon neutral by 2060 and Japan by 2050. Europe has voted for a 60% reduction of 1990 level emissions by 2030. Biden plans to get the US back into the Paris Climate Agreement, which will mean carbon emission reduction targets for them. This would mean that countries responsible for 60% of the world GDP would be committed to carbon reductions. This should translate into huge investments and demand for solar and wind power, electric or hydrogen vehicles. Power efficiency and electronic vehicles, as well as 5G communication advances and robotization, will all require semiconductors. There are less obvious beneficiaries of the digitization of everything and the environmental movement like companies that manufacture the hybrid metals that are essential for the production of wind turbine blades. One of our favourite managers has such a company in his fund.

Source: "Green Light to a Greener Economy: Three Investment Trends" by G. Sundstrom

So well beyond the FAANG+TM stocks, there are other high tech growth areas and other economic growth sectors emerging where new stock market growth can come from. Just because the market has hit new highs, it doesn't mean that the market has to fall or that it doesn't have lots of room left to climb.

Signing up for Manulife's Newest and Best On-Line Account Access

One of the many improvements with Manulife's new on-line account viewing system is that from it, you can print duplicate tax receipts. There is also technical support available Monday to Friday, from 8 a.m. to 6 p.m., for things like password resets at 1-833-363-0699.

To sign up, just go to https://portal.manulife.ca/manulifesecurities and click the yellow "Are you new to the site? Sign up" button. You'll be asked to answer a few personal questions to verify your identity, including a question that asks you for one of your Manulife account numbers. You can get that number from one of the paper statements that you've received in the mail, or you can ask Sarah at sarah.breimer@manulifesecurities.ca or 1-855-640-1857, and she'll help you.

Once you've answered all of the system's registration questions, you'll receive an email confirming your new on-line access account. That's it! You'll be able to log in to view your account balances and tax documents by going to the same https://portal.manulife.ca/manulifesecurities link that you used to register.

Other technical advances have been made this year. We can now send you electronic account update forms and transaction forms to do buys, sells and switches, that you just have to review and approve electronically. No more dependence on Canada Post! Well, at least not for most forms.

Most Productive Countries in the World Change

From 1960 to 1990 the top 10 most productive countries in the world stayed the same, although the order of the most to least productive changed. Then in the 1990s, Russia fell off the top 10 list and China cracked the top 10 and went to the 2nd spot in less than 20 years. Then Spain dropped off the bottom in the first decade of this millennium and India soared up to the middle of the pack. The list of the top 10 productive countries in 1960, now and projected for 2050 are below. (The chart doesn't show Canada's spot in 2050, but it looks like Canada just drops off the top 10 in the late 2040s. So hopefully we only drop to 11th by then.) Note that 3 of the top 5 countries in 2050 are predicted to be from Asia and are currently regarded as Emerging Markets.

1	1960	2020	2050
2	US	US	China
3	Germany	China	US
4	Japan	Japan	India
5	UK	Germany	Indonesia
6	France	France	Germany
7	Italy	India	Japan
8	Russia	UK	Brazil
9	Canada	Brazil	France
10	Brazil	Italy	UK
11	Spain	Canada	Turkey

Source: www.bloomberg.com/graphics/2020-global-economic-forecast-2050

These changes in productivity help explain why Mackenzie Financial's Multi-Asset Strategies Team published a forecast in Dec 2020 that predicts the following returns over the next 10 years:

Most Bond Categories	Less than 2%/yr
Emerging Market Bonds	4-5%
US and Japanese Equity	5.5-6%
Canadian and European Equity	6%
US, Canadian and Eurasian Small Caps	6-7%
Emerging Market and Chinese Equities	8-8.5%

Over the next decade, our portfolios will probably have much more Emerging Market Exposure. We just have to watch how much increased volatility EM this brings and whether you are comfortable with it.

Claiming Expenses for Working from Home

The CRA has now finally announced the new rules for employees to claim expenses for working from home. Employees who had to work more than 50% of the time from home for at least 4 consecutive weeks in 2020 can now fill out a shortened Form T2200 to claim a $400 expense. The regular way for employees to claim expenses is still available too, but that is a lot of paperwork and requires a signed form from the employer. And for people doing the regular way of claiming expenses, there is an expanded list of eligible expenses on CRA's website. It's worth checking into.

Annual Reminders

- Tax slips start arriving in January. The last slips may not arrive till early April. Always check the envelopes you get from Manulife and fund companies. Some fund companies attach tax slips and info to the semi-annual statements they send out, and you have to carefully search for them. CRA's "My Account" website will show you all the tax slips that CRA has received for you. It's a good place to check before filing your taxes to lower your chances of a missed slip and a re-assessment.
- RRSP contributions for 2020 can be made up to Mar 1, 2021.

What are ETFs All About?

A client recently asked for a refresher on Exchange Traded Funds to be included in a newsletter. Early ETFs started out as collections of every stock in the index, in the same proportions as the stocks' weighting in the relevant index. Since the composition of the index dictates what to buy and no research is required, the fees on ETFs are typically much lower than for actively managed mutual funds. They are bought and sold on the stock exchange. So, there are commissions to buy and sell the ETF units. And, if an ETF is cloning an index, it should perform similarly to the index, minus the operating costs, but it will have at least as much volatility as the market as well. And since there is no payment for planning advice built into the cost of the ETFS, like there is with funds, people started holding them in fee-based accounts where there were separate fees for advice. This cost is not reflected in the published performance for ETFs. And bond ETFs often perform much worse than bond indices, partly because of the illiquidity of the bond market and the fact that bond ETFs can never manage to duplicate the holdings of the index.

Since the majority of mutual funds don't beat the index (especially since so many funds mostly copy the index without admitting it), many people switched to the cheaper ETFs, particularly in the U.S. Then rules-based ETFs were invented. So an ETF might invest only in stocks that have a certain growth rate, or pay dividends, or are in the telecom sector etc. If you are lucky in guessing which factor is about to come into favour with the market, you might do really well with an ETF. Then fund companies starting offering their fund managers' picks in ETF form with lower fees, which people chose because they seemed to forget to look at net performance after transaction costs and the cost of advice. The ETFs were not actually identical to real actively managed funds. Let's look at Ivy Canadian Equity fund versus the ETF equivalent. The ETF fell much more than the fund when COVID hit. It turns out that any changes the fund manager made in the fund, perhaps at a very specific price which might only have been available for a few minutes or even seconds during the day, would get copied at the end of the day in the ETF, regardless of the stock price at that time. And, when the manager decided to hold cash when things looked expensive, the ETF wasn't allowed to hold cash. So when the market had a price correction, the ETF dropped in value much more than the fund. The actively managed fund might not always outperform the cheaper ETF, but so far the performance has been a bit better in the actively managed fund than the ETF, despite the higher fees on the fund.

ETFs might evolve and be the best solution some time in the future, but so far we haven't found a reason to own them.

New TFSA Contribution Room

The new contribution room for TFSAs in 2020 is $6,000 which makes the lifetime limit so far $75,500. As a reminder, any money you earn on an investment inside a TFSA is never taxed. Withdrawals from a TFSA are never taxed. There is no tax deduction for contributions to a TFSA. If you are in very low or very high tax brackets, or if you have used up all your RRSP contribution room, then a TFSA is probably the best place to invest. Don't let the name fool you. It isn't just a high interest savings account. In fact, using a TFSA as a savings account may get you the least tax savings benefit. Investments in a TFSA can be just about anything that you could hold in an RRSP. Lastly, you can have more than one TFSA. Just be sure to confirm your TFSA contribution limits with CRA's "My Account" online to be sure you don't over-contribute and get fined. "My Account" is often not updated by Revenue Canada until Feb and it only ever shows the contribution room used up to the end of the previous year. It will not update mid-year to show contributions year-to-date.

If you would like something explained in a future newsletter, let us know. If you want a review or planning meeting and we haven't called you yet, please call us to set it up. While Ontario is in lockdown, we won't be having in person meetings except in emergency situations, but we are glad to do conference or Zoom calls with you.

It will be a different holiday season this year. The important thing is for us all to stay safe. Let's all wish for a return to near normal as soon as is possible. Our best wishes go out to you and your families.

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