Manulife Securities

ROYDS REPORT

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Resumption of Planning Meetings

This spring we spoke to many of you to invest new money, while the market was down, or to reposition your portfolios out of funds which were not capturing the upswing of the market. Unless someone had a new issue to discuss, we didn't do as much financial planning and updating as normal. Now it is time to focus on updating and reviewing people's financial plans. We know that many of you are eager to hear about the impact of COVID-19 on your retirement income stream or planned retirement date.

For July and August we will be holding review and planning meetings by conference call, Facetiming, Skype, Zoomc etc, but provided the current downward trends in COVID cases continues **in Sept we plan to resume face to face meetings**. We will need to wear masks. We will leave time between client appointments to sanitize the boardroom. We will continue to have hand sanitizer on hand. There are already signs up about social distancing when using the elevator.

So, if you are keen to have a planning and review meeting, you can call the office to book a summer phone or video review or to book a fall in person meeting. Otherwise, Sarah and Amber will reach out to people whom we feel are due for a review to set up a meeting time.

Positive Soundbytes from RBC's Chief Economist

Eric Lascelles of RBC highlighted on June 22/20 the following pieces of mostly positive economic news:

- Hotel occupancies in the US have already risen from 22% at the bottom of the market to 42%. Hotels need higher occupancy to be profitable, but occupancies are trending higher quickly.
- In May there was an 18% gain in US retail sales, whereas only an 8% gain was expected.

- Economic growth is greater when there is less inequality. So, we could have potential economic gains, if real change is made to reduce racism and discrimination.
- China's industrial production is back to normal, however consumer spending is not as high as before. The reverse is true in the U.S. Consumers are resuming their spending, even though U.S. industrial production has been slow to restart.

Tax Rates

There was an interesting article in the May 4, 2020 Bloomberg Businessweek about whether the impact on the share of wealth held by the top .1% of the population versus the bottom 90% would more resemble the Great Depression and aftermath of WWII (1929-1950), or the Great Recession (2007-2016). After the Great Recession, the U.S. rich got richer and the U.S. poor got poorer. The wealthiest .1% went from owning 17% of the country's wealth to owning 19% between 2007 and 2016. However, after the Great Depression and WWII, the opposite was true. The wealthiest .1% went from 24% of the wealth to 10% between 1929-1950. Part of this shift in wealth was because from 1929-1950 the top tax rate went from 24% to 84%, touching 94% during WWII. The article hypothesizes that "If higher taxes don't dent inequality, something less predictable might." It points out that **in the last 12 pandemics where more than 100,000 people died, the economic impact of the pandemic could still be seen 40 years after the last death from the pandemic**! All the social changes we have seen during COVID-19 may just be the first domino in a long-lasting chain of social change that we will see. And in the future, we may look back longingly on the days when the top tax rate was only 53.5% (like it is today). Many people who don't normally fall into this tax bracket will leave estates which will have to pay some taxes at this rate. So, it isn't just a rate the ultra rich have to worry about.

Investing for Retirement Readiness

The human resources consulting firm, Mercer, created a Retirement Readiness Barometer. They analysed 1000 workplace retirement programs to see how employees handled their investments and used this as a proxy for the general Canadian population. From this Mercer determined that "Canadians are too conservative in their investing and need to take more risk if they want to retire close to the age of 65." The TSX Composite Index (including dividends) had a return of 7.7% for the 10 yrs ending Jan 3, 2020. "Bonds averaged a solid 4.4 per cent annually over the past decade, but that's a result of a persistent falling interest rate trend that could be mostly played out (falling rates send bond prices higher). Treasury bills, which we'll use as a proxy for cash, averaged 0.9 per cent. … we found that the saving rates people have … did not make as much of a difference as the asset mix and the overall way people are investing. The story is really that we need to start taking more risk." Apparently Millennials were particularly conservative in their investments, switching out of their employers default investments into more bonds and money market funds. Source: The Globe & Mail Feb 26, 2020

So **the study showed you could save a whole lot more money to get ready for retirement, OR you could invest less in fixed income and more in the stock market**. That may always have been true, but it's more obvious these days, and now there's studies to support the idea.

Our strategy has always been to invest as little as possible in bonds or money markets while people are still accumulating their retirement savings. That's more important than ever with interest rates as low as they are.

As a side note, Fidelity Investments found that **between Feb 20 (basically the top of the market) and May 15, 2020, between a quarter and a third of all investors over age 60 dumped all of their stock market investments**. It would be a good bet that most of the dumping did not happen at the top of the market, but rather closer to a month later when the market was at the bottom. Those poor people may never recover the money they lost when the sold. They crystallized losses instead of riding out the market, as you have all done. It they invest in GICs, it could take 20 or 30 years to get back to what they had in Dec 2019, and due to inflation, they wouldn't have the same buying power back.

Many Canadians Started the Pandemic in a Precarious Situation

Much has come to light about small businesses which had little in the way of an economic reserve and shut down within the first month of the economic shutdown, because they had already run through their cash and savings. And we have heard of large companies, like Hertz and JC Penney, which couldn't meet their debt obligations and announced they'd have to close. And the news reports from the U.S. show huge line ups at food banks. In Canada a huge number of Canadians with mortgages applied to have their payments deferred by several months. But there was trouble with Canadians before COVID hit. According to an article in the June 15, 2020 Globe and mail:

- **Over half of all Canadians were already living paycheque to paycheque**
- One third of households were asset poor (meaning they spent so much of their paycheque on their mortgage or car payments, that they didn't have enough left over to pay their living expenses without going further into debt)
- Ten million workers had no pension or other workplace retirement plan
- Near retirement households with no pension only had retirement savings of $3,000 on average
- 40% of Canadians had zero retirement savings
- Household debt was at record high levels

30 -40 years ago, this was not the case in Canada. People regularly set aside 20% of their income for retirement, an emergency reserve, education and future big expenditures like roofs, cars, weddings etc. It was considered normal and essential to have a nest egg set aside. So what has changed? First, there is the fact that more than a third of workers today are on contract, work part-time, are self employed or are temporary workers. Their employment is precarious. We suspect that an increase in consumerism has also been a major factor. People are more concerned about social status, having the latest phones, a stunningly remodelled kitchen or a flashier car

The big question is how do we get society back to building nest eggs? Will the experience of this pandemic make people realize they need to have savings to fall back on? Will the time of self isolation and closed stores make people realize they don't need so many possessions to be happy? Will the newly announced grade 5 school curriculum which will teach about things like debt help the next generation? Can we as parents and grandparents, siblings and friends help others see the value of savings by example or direct teaching? **We hear that the most powerful influence on a person's financial future is usually what they learn from their family about money growing up. It isn't usually through direct teaching but through observation. Are we happy with the example we're setting?**

Searching for Excess Returns

Wouldn't we all love to know how to make more money that average market returns? Let's look at what worked according to figures from the May 2018 Investment Executive newspaper.

The **small company stock MSCI world index beat the large company world index by 4.1% annually** since 2001. Small companies in Canada did not exhibit such outperformance, only 1.5%. In contrast the **Canadian Quality Index outperformed by 2.5% since 1998**, but the world quality index since 1975 only outperformed by 1.3%. The value index internationally and in Canada both outperformed in the range of 1 – 1.1% annually. **Dividend paying stocks also outperformed the average globally** and in Canada by 1.7% and 3% respectively. The minimum volatility indices both globally and in Canada outperformed the general stock index from 1988 and 2001 by 1% and 2.3% respectively. **Price momentum stocks seemed to have outperformed the most since 1973** and 1998 globally and in Canada, by 2.7% and 4.9% annually. The problem with this last index is that as soon as a company stops moving ahead, it is dropped from the index. The result is that the index only counts its winners. The rest of us don't get to do that. Also, It's hard emotionally (and tax-wise) for an investor to get out of a stock he or she has ridden up or to recognize that the ride up is over. Ask the investors of Nortel, Research in Motion, Bre-X etc. So **momentum investing is much riskier than the it's index would indicate**. That's why so many day traders who are trying to play momentum, rather than really investing, go broke.

During COVID-19, dividend focused stocks and minimum volatility stocks did quite poorly. (According to our RBC service manager 51 dividends were cut or suspended in 08/09, and 60 dividend paying stocks stopped or lowered their dividends since COVID-19 started.) And **during any sizeable downturn, small companies fall harder, although they usually recover strongest**. **What has done well through this pandemic? Quality companies (that have competitive advantages and strong balance sheets with little debt) at value prices that are growing their profits have done very well. Those companies are often called Growth At a Reasonable Price (GARP) or QARP (Quality At a Reasonable Price)**. Strong companies and weak companies with improving situations have also done outstandingly. It takes courage to invest in weak companies when you see them down a ton. You can't wait until you see them not doing as badly as expected, because the market will already have reflected that. How do you figure out when they are going to turn the corner and start doing "less bad", and the big question is how does one identify which strong companies are going to do even better than expected? Those who bet on Shopify did great. Those who bet on Nike did – only for a while till the company's earnings disappointed. Nimble investors (or fund managers) also often did well. People who could act quickly and take advantage of the extreme non-sensical volatility we had (are having) could earn excess returns too. **With volatility, you may find people willing to sell things at ridiculously low prices or willing to buy at inflation prices, and if you are knowledgeable enough to know a company's true value, you might be able to capitalize on the volatility to make excess returns**. Luckily our fund managers and their analysts are in a position to take advantage of extreme volatility.

Based on history, the example of Warren Buffett, how this market acted with the unprecedented shutdown of the economy, how markets have behaved in other recessions and what has worked in between downturns, **GARP and QARP investing with skilled, experienced fund managers, backed up by strong research teams, still seems like the surest route to excess returns above the market over the long-term. The bonus to these styles is that they are generally way less bumpy or volatile** than the

general market. It's still not easy to ride through the downturns, but it's easier than it would have been in the market in general.

For those who are new to the style of investing we practice and who have been relieved to see your portfolios rebounding so quickly from the Mar 23 market bottom, we would just remind you that this was not a typical recession/recovery. Most downturns take much longer to unfold and recovery takes on average 18 months (half the time it takes longer!). So, people usually have to look at their depleted portfolios for much longer before the relief of recovery. And market drops can be even more severe than the -35% that this market drop brought us in only 30 days. You made it through the worst of this downturn without panicking, and this experience will make it easier for you to bear the next market downturn. When a worse market drop and a longer downturn happens, remind yourself that recovery will also come then. You need to focus on the quality of the businesses in your holdings and remember that there has never been a time when recovery hasn't eventually come. No market goes straight up. We have to endure these trying periods along our journey, and it's worth it, because if you sit in high interest savings or GICs and don't participate in the stock market, you're not likely to be ready for retirement as young, or to have your retirement savings last so long in retirement.

Desperate for Yield

A lot of the world holds bonds which are paying a negative yield. That means that on maturity people will be paid back less than the bond cost them. There were at least a few hours when North American Treasury Bills had negative yield. That was when people were totally panicked in 2008 and didn't want to put money in U.S. banks that they thought might fail. They invested in U.S. Treasury Bills, paying huge prices for the privilege and safety of holding government-backed debt instruments, even though the purchasers were guaranteed to get less money back from the T-Bill investment than they paid for it. Now negative yields are a reality for about ¼ of all bonds held in the world. So when Austria issued bonds in June 2020,which won't mature and pay back the principal loaned to Austria for 100 years, people snapped them up, even though the yield on them was 0.88%. That's less than inflation has been for the last decade. Imagine taking $100,000 of your savings and investing it so you would earn $880/yr from it for the next 100 yrs. How much capital would you have to invest to be able to earn enough to live on in retirement? It's hard to imagine a worse investment.

We keep hearing there is a record $5 Trillion sitting in cash in North American. It has to be put somewhere some time. If it goes to fixed income (bonds), prices will go up and yields down. If it goes to the stock market, prices will go up even more as demand exceeds supply. Time will tell.

What is the Market Up To?

By the time we write this, send it to Head Office for a Compliance check and send this out, the mood of the market could have changed, because we have what is being called "a headline market". Even more than normal, the market is reacting to the latest headlines. A couple of weeks ago there was a headline about increased tensions between China and the U.S. Markets fell about 7% that day! As the memory of that headline faded, markets gradually recovered. As we write this, the news about COVID case increases in Florida, Texas, California and Arizona, among other states, have the market worried about re-closing parts of the economy and the market has been slowly dropping for a few days. Who knows how many times our accounts are going to get back to Dec 31, 2019 levels before they will go significantly higher? Could we bounce around these levels for a year or even two? Who knows! Could

markets retreat more if there is a second wave, or if 3rd or 4th quarter profits are less than expected? Sure. Could markets lose a whole year of growth and then resume along their normal path? Yes, but markets could also continue to slowly inch up.

What we do know from history is this – markets eventually follow profits. So, when profits go up enough to warrant higher stock prices, the prices will follow. (And yes, there are companies out there now with record profits like Amazon, Loblaw, Paypal, Activision, Moody's, some healthcare companies etc.) As Buffett says, the market in the short-term is a popularity machine, but in the long-term is a weighing machine. So eventually the market will reflect true value, not emotion-driven values. And we also know that our managers are stock-pickers and valuers par excellence. They are selectively investing in businesses that are undervalued compared to their profits and prospects. Many of our managers are also investing in the areas benefitting from the pandemic (science, technology, healthcare, entertainment and communications). These managers have protected our investments from permanent loss in the past and have usually benefited us with extra gains, when they have had volatility to take advantage of. Their funds bounced back quickly, because they were in quality companies which were not as affected by COVID. These managers should protect us from permanent loss going forward too, although they aren't immune to the short-term ups and downs of markets affected by investor emotion.

COVID has taken growth out of economies and maybe taken a year's growth from our portfolios as a regular recession might have, but COVID has not destroyed our savings and hasn't changed the investment strategy we should follow. So don't lose sleep over your portfolio. You may hear your neighbours bemoaning how much they have lost (many were heavy into Canada, and into resource companies), but don't assume that your portfolio has suffered the same. Call us anytime you want to talk about your portfolio, or anything financial.

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