Manulife Securities

ELAINE'S NEWS & VIEWS

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My Crystal Ball is Foggy

There is still no one who knows when the market is going to have a major downturn (30-40%, lasting 1-2 yrs usually). The likelihood of it happening sooner than later seems to be increasing because of the geopolitical situation. The US and China Economic War could lead to a global recession as early as 2020, or not for 4 years. Markets usually fall before recessions. And there could be one or several 20% drops and quick recoveries in the market before a major downturn.

There is the problem of lower interest rates for a long period of time, or even zero interest rates. Trump has said he would like to see zero interest rates in the US, even though zero interest rates in Japan over the last 30 years were a disaster. There are about $17 Trillion of bonds in the world currently with zero or even negative interest rates. In some cases central (government) banks are paying retail banks to accept money from the government in the hopes that those banks will loan out more money to consumers to stimulate the economy. In other cases, people want to put their money into the safest government bonds so badly that they are "investing" in them even though they know they won't get 100% of their purchase price back when the bonds mature. Besides low interest rates encouraging people to borrow too much money, low rates leave low volatility investors (like GIC investors) with a terrible challenge to save enough money to ever be able to retire on. As you will read below, we need to take on more risk than the previous generation had to endure to get decent returns to be able to live on our savings.

Without knowing the future of the markets or when the economy is going to hit a speedbump, I can only recommend following the strategy that history shows is the most successful through thick and thin – buy quality equities at relatively reasonable prices and hold on for the long term. Ride the market down and back up. And if you have short term needs, hold enough low volatility investments to provide your cash flow until the market can recover. In other words, carry on the way we have been.

Miscellaneous Wisdom and Facts

A study published by CI Investments showed that in the last 60 years there have been 15 crises, like the Korean War, the assassination of JFK, the oil embargo and energy crisis of the 70s, the Gulf War, Enron, the World Trade Centre, and the dot com bubble. After each crises global markets rebounded and continue on to produce good long-term gains. In 5 of the crises (1973, 1987, Sept 2001, Dec 2001 and 2008, the investor would have been better off leaving the market for 1 yr and then reinvesting. In the other 10 crises, the investor was better off staying invested rather than getting out and then back in. In fact, 2/3 of the time for the major crises of the last 60 years, the investor would have made 26.1% more over the 5 years after the crises by staying invested through the whole thing. Those returns don't even include extra dividends that could have been earned by not exiting the market.

Low interest rates have put Canadians at risk by encouraging them to take on too much debt and leaving them at terrible risk of defaulting on their mortgages or going bankrupt when interest rates normalize to a higher level than inflation. Low interest rates however help Emerging Markets, because low rates usually result in a strong US dollar which makes emerging markets' goods seems cheaper and helps emerging markets to export more of their goods.

In 1995 one could have earned 7% annual returns with only a 6% standard deviation (the measure of volatility) by investing in investment-grade bonds. By 2005, to get the same returns an investor could have held no more than 50% in such high quality bonds and would have had to invest the rest in equities with a resultant standard deviation of 9.5%. Today, to get a 7% return, an investor would have to accept a 19.2% standard deviation (2.9 times more than in 1995) and invest 90% in equities, including as much as 40% in emerging markets! What worked in the past isn't working with the low interest rates of today. If you want to stay ahead of inflation, you need to accept more ups and downs in your portfolio from month to month.

A report from 2018 from Russell Investments Canada Limited outlined how the Big Boys (Canada Pension Plan, Ontario Teachers Pension Plan, Alberta Heritage Fund, the Caisse in Quebec and the BC Investment Management Corp) were invested in 2016, 2017 or 2018. They ranged from 2-12% in Canadian equities, compared to the average Canadian who has 94% in Canada or average Canadian advisor who had 43%. The pension funds had about 23% in fixed income, much either very short term or high yield, not much in stable government or investment grade bonds. They had about 8% in private companies they bought and which aren't available to small investors like us and they average over a quarter in "real" assets, like the toll highway 407 that you and I can't invest in directly, or the largest airports in the world that charge fees for every landing and takeoff, or in pipelines, cell tower networks, farm lands, commercial real estate (especially in places like India), water desalination and water treatment plants, parking lots, railroads, satellites, power generation and transmission facilities etc. Those real assets are not too cyclical or very likely to go broke, especially since governments are expected to spend about $49 Trillion on infrastructure by 2030. In fact, assets like those, called infrastructure, normally only move in step with markets about 30% of the time and they give good solid returns. According to the CPP Investment Board report of Mar 31, 2019, since 2010 CPP has increased their infrastructure investments threefold since 2010. That's why you may be getting a call from Jordan or me before yearend to discuss whether your portfolio should have exposure to this asset class.

According to the Sept 7, 2019 Globe and Mail, "Canada's stock market has been one of the worst places to invest over the last five years". The main American stock market index, the S&P 500, returned 14.53% from Sept 5, 2014 to 2019. The Canadian S&P/TSX Composite index only averaged 4.17%. European and Asian stock markets did better than Canada but not even half as well as the US market.

One of the top US investment managers in the world, Peter Lynch, once said, "More money has been lost in preparation of a downmarket than is lost in a downmarket."

5-6 times in the last 10 years ETF (Exchange Traded Funds) quantitative models have caused huge turbulence in the market. In the most recent one, growth oriented stocks fell 7% in a single day, while value stocks rose 8% at the same time. The ETF models must have decided that growth stocks were overpriced or had lower prospects than previously thought while value stocks were good buys. Because computer model trading has massive volumes and has no human checking the logic of the trades in real time, the market is now subject to more volatility than ever and there might be no logic in the movement of market indices, and certainly no correlation to the price movements of Growth At A Reasonable Price (GARP) stocks in our mutual funds.

Quite of few of my clients are living common law, but are not declaring themselves to be married or Common Law Partners (CLPs) on their income taxes. They should consult with an accountant to see if the CRA could penalize them for making a false declaration. According to Tim Cestnick, an accountant who is frequently published in the Globe and Mail, there are some benefits to admitting your common law relationship on your taxes. For example, there are some tax credits which a lower income spouse can share with a higher income spouse or which you can claim under certain conditions because you have a spouse. There is the opportunity for pension splitting and CPP pension sharing. There may be tax planning opportunities related to spousal RRSPs and TFSAs possible when you have a spouse, and there are huge tax deferral possibilities on death.

On Sept 19, 2019 the Globe and Mail reported that research done by Citigroup found that stocks in the defensive sectors, like utilities, are extremely expensive relative to the market and relative to their prices of the last 7 years. So that is an area we continue to avoid or underweight at this time.

Yearend Reminders

The deadline for Registered Education Savings Plans is Dec 31.

If this is a low income year for you, or you are afraid of leaving too much in your RRIF when it passes to your estate, because it might be taxed at 53.3%, you might want to do an extra withdrawal from your RRIF before yearend. You can take advantage of your lower tax rate to pay less tax and then reinvest the money in a Tax Free Savings Account or unregistered account.

If you sold something with a lot of capital gains this year, check to see if you have something with a capital loss that you could sell before yearend to offset the gains and keep your tax rate down this year.

By the time you get my January newsletter, it may be too late to remind you to check your fund company yearend statements for any tax slips. Sometimes they are on the last page of the fund company statement.

Make sure you have registered for "My Account" with CRA before you get ready to do your 2019 taxes. You can see and download to your tax software all your tax slips from there, and by the end of January, you can probably find out your Tax Free Savings Account contribution room. This is super important, because the government can fine you for accidental over-contributions.

Moving on Up

Clients seem to like the free parking and elevator at our current office. We find our offices a little cramped, but we don't want to leave the building. So when a larger unit on the third floor becomes available sometime in Nov, we're moving. We will be in suite 301 in the same building as today at least by Dec 1. We'll send an email notification of the exact date, when it's known.

Finally, the following is a link to a fascinating and frightening look at an evolving system of citizen control in China, made possible by technology. It has nothing to do with finances, but I couldn't resist sharing it. Does Toronto's Smart City plan have some similar surveillance and behaviour modification characteristics?

https://www.visualcapitalist.com/the-game-of-life-visualizing-chinas-social-credit-system/

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