Manulife Securities

ELAINE'S NEWS & VIEWS

APRIL 2017

Vacation Alert

During my vacation **(Apr 27-May 19) the other advisor in my office, Jordan Royds, will be available** to meet with you, answer your questions or take any instructions for your accounts over the phone. If you have anything coming up that you particularly want to discuss with me, please call for an appointment right away.

Allergy to Dogs

Sometime this summer, we will be following the example of several of our clients by getting an "office dog" - a goldendoodle. **If you have an allergy to even non-shedding dogs**, please let us know so we can make arrangements to meet you outside of the office. Luckily we have a spare office for the dog to occupy during meetings, so she won't be a nuisance. She will be a better investment than a gym membership for me, since she will *guarantee* that I will be taking 2 walks a day, like when I had my last dog.

Starting Age for Collecting CPP

For years the biggest factor to consider when choosing at what age to start collecting CPP, has been longevity. If you expect not to live past your mid-70s, then you may as well collect the 36% reduced CPP amount starting at age 60. If you expect to live into your 80's, then you should wait till age 65 to start your CPP and collect the much higher amount even though it is for fewer years. There is **another critical factor to consider**. If you have a spouse and he or she is not eligible to collect a high CPP (perhaps your spouse did not work many years or did not have a high paying job), and if your spouse outlives you, your spouse is eligible to collect a survivor benefit from CPP. If you started your CPP early, your spouse's survivor benefits would be lower than if you had started your CPP at 65 or later. So now, both spouses' longevity needs to be considered when choosing what date to start collecting your CPP at. Globe & Mail Mar 6, 2017 article by Frederick Vettese of Morneau Shepel

Facing the Danger Ahead May Be the Safest Course of Action for Your Savings

After a decidedly lacklustre January, the Canadian and US stock markets rose to record highs. Several emerging markets had strong growth too (like Brazil). And, in the face of a U.S. interest rate rise, the Canadian dollar dropped a couple of cents, which made our foreign funds more valuable. So our portfolios had a good quarter. Indeed the bull market (rising stocks) that started in Mar 2009, is continuing today. It has been pretty constant although there was a small and short dip (7-10% drop over one year) in 2011 and a significant drop for Canadian markets, but not global ones, in 2015, followed by a Canadian recovery in 2016. Our portfolios barely showed the 2015 drop and recovery, because we had little invested in Canada. One rollercoaster ride averted.

So what is ahead? For sure **there will be a bear market (falling stock values) coming up**. The trillion dollar question is "when"? The longest bull markets in U.S. history lasted 10 yrs starting in Mar 1991 and 8 yrs 10 months starting in 1961. We are about 8 yrs into this current bull market, so it's **the 3rd longest stretch of rising stock markets since 1854**. The largest U.S. stock index, the S&P 500, which had dropped 56.8% from its top to its bottom, is up 249% from the bottom of Mar 2009. (By the way, value style investing (our style) outperformed growth style by about 50% since 2009, and the worst performing sector was the one we have been avoiding for 10 yrs - energy!) So, the bull market could end any time. That could happen if investors decide that prices got too high, or if a recession starts.

The fact that so much money is pouring into stock markets now should make us **ask if investor enthusiasm is pushing prices up beyond what is reasonable**. The last time I saw such a busy RRSP season as 2017 was in 2007, when the market was getting very over valued and shortly before the correction started. I hear that because bonds have been such a disappointment (some turning negative), bond holders started moving into equities (stocks). That is a bad sign. When new investors start pouring into stocks, it moves prices more than it should and is a sign a correction or crash will be coming. On the bright side, at least we didn't have bonds!

It doesn't appear that a recession is about to start, given that unemployment is at a 45 yr low in the U.S., corporate profits continue to grow (albeit slowly), and purchasing managers are projecting more spending for next year. (The purchasing manager index is one of the most reliable predictors of a recession.) So it is more likely that we could have a price correction and market pause, while profits catch up to stock prices. If that happens, remember not to panic. It shouldn't be too long or too severe a drop (maybe -10 to -20% for a year?). Luckily for us, our fund managers are stock pickers and practice defensive strategies. So, our portfolios should fall less than the markets, because our holdings typically are not overvalued and typically have less volatility. And our managers may be able to pick up some great bargains during any market dip, which will make us money later. Still it will be an emotionally painful and scary time, and it will be critical that we stay invested, with our eye on the long term. We have to wait it out. One should **never sell after a downturn**.

So what could trigger a recession and prolonged market downturn? History shows that **almost all big market downturns were caused by a shrinking of corporate profit margins** (the profit margin is how much profit a company has on every dollar of sales). This results in lower profits which makes investors less willing to pay as much for stocks. Profit margins have dropped in the past because of increases in interest rates (which the U.S. has already started and which increase company costs and discourage them from borrowing capital to keep growing), increases in labour costs (which has already started in the U.S. due to the low unemployment rate) or the lack of availability of capital for consumers or companies to borrow and spend (there is enough capital available, but Canadian consumers have borrowed so much already that they cannot afford to borrow much more). So there is reason to think that corporate profits could drop in the near future. And of course, the **rise in interest rates could lead to a stronger U.S. dollar and lower U.S. exports and reduced profits as a result**. Usually when the U.S. goes into recession, the rest of the world does too, because the world depends so much on exports to the U.S. And Canada could go into a recession if the oil glut gets worse of the U.S. raises trade barriers or for numerous other reasons.

Recessions have been averted in the past by governments dropping interest rates (which is the opposite of what the U.S. government is doing and rates cannot really go lower in most of the developed world) to encourage companies and consumers to borrow more capital to spend more and to lower corporate borrowing costs, or by governments cutting taxes so companies and consumers have more money to spend. **Hopefully profits grow faster than wage and interest expenses rise or the promised U.S. corporate tax cuts offsets increased costs enough to keep profit margins stable**. If not, profits could drop and so could the stock market.

Another factor that could end the long rise of the stock market is a contraction of the Price to Earnings multiple (P/E ratio) which some people refer to as an unwinding. As interest rates fell from 1982 to last year, the amount investors would pay for stocks as a multiple of earnings rose. Years ago when you could get 10% interest on bonds, and you could earn back the price of your bond purchase through the interest payments in 10 yrs, who would pay 10 times earnings for stocks (a 10 P/E ratio)? But now when interest rates are closer to 2% and it would take 50 years to earn back the price of a bond, investors are paying 22 times earnings for stocks, because it "only" takes 22 yrs to earn back the price of the stock. **Interest rates are starting to rise now in the U.S. and are expected to rise late next year in Canada. We can expect P/E ratios to lower as some people start preferring to earn interest on bonds or GICs instead.** Unless profits rise fast enough (which could happen), stock prices will fall in this unwinding. That alone could cause a bear market.

And of course, there is the **risk of Donald Trump** starting a global trade war or doing something else to upset the economy. Some economists think damage from Trump's policies could be evident by 2019 or 2020. In Feb 2017, TD Asset Management reprinted in their fund performance magazine an article from Epoch Investment Partners in which they estimated that "a full trade war would mean [more than a] 50% chance of a global recession by 2019".

So one way or another, the long upward march of the markets will retreat for a year or a few years before economies start to grow again and the market continues its long-term upward trend. So **what should we do in the short-term and the long-term** to handle this? We know from history that there are right things and wrong things to do. In the short-term, there are 4 options:

A. Some people will just go along with the herd. We know that's the wrong thing to do. We don't want to buy high and sell low like emotional investors who get are influenced by the media and friends to be too enthusiastic in up markets and too scared in down markets.
B. Some people will stick with GICs or "predictable" government bonds, even though the returns won't preserve the buying power of their investments against inflation. And we expect bonds to fall as interest rates rise. Anyone who doesn't hold their bonds to maturity could lose money.
C. We could try to time the market. If you have read my newsletters for the last 19 years or even the last year, you will know that no one has ever been able to do this successfully and repeatedly. If someone sells too early, they often miss out on more gains than they would have lost. And most people won't get back in the market in time to enjoy the gains when they start again.
D. **History has shown that the way to long-term gains and a sustained income through retirement is to keep fully invested in the markets, except for what you need as income for the few years. Stay on the rollercoaster**. This worked for us when the Tech Bubble burst, when the Great Recession (aka the Banking Crisis) hit, and it has worked through every other downturn in the history of markets.

So staying invested for the long-term is still the best course of action, but that is not to say that there is nothing we should be doing now to prepare for a downturn. First, we have to make sure that, **if you are retired or expect to withdrawn money in the next few years, you have enough low volatility holdings to supply your income till the market recovers**. Low volatility investments are needed for the income matching strategy that we use to make sure you don't have to sell any funds that have fallen greatly till the downturn is over.

Secondly, we need to stick with our strategy of staying away from anything that might have a permanent loss, like speculative new companies or companies which might not survive a recession. Our deep value, growth at a reasonable price (GARP), dividend focused and low volatility investing strategies tend to protect us from buying overpriced stocks. **Our funds tend to miss some of the over-exuberant rises in hot markets and also miss a portion of the gut-wrenching drops of down markets. Index investing and high risk investing might outperform our defensive style now, but in the long-run, value investing usually brings the best returns**.

In the past, we used to avoid investing in smaller companies or investing much in emerging markets, because their profits could be less predictable. Smaller companies and emerging market companies were riskier, so we avoided them. Times have changed. First, many emerging market companies are more established now, more like developed market companies, for example Hyundai, Samsung, Embraer (that keeps outdoing Bombardier). Secondly, **emerging markets are much cheaper than developed country markets in terms of P/E ratios (about ½ the price)**. Thirdly**, there may be more undervalued companies amongst smaller companies**, since not so many analysts research them compared to large companies. So now, **an argument can be made that emerging markets and smaller companies are not only not-more-risky than the highly priced big companies of developed markets, but may even be less risky**. Luckily some of our value oriented global fund managers are taking advantage of this by sprinkling some emerging market stocks in with their large company holdings. We should make sure that your long-term holdings are truly diversified, with some exposure to smaller companies and choice emerging market companies too.

So a last question people ask when we are closer to the top of a market than when we are nearer the bottom is **what you should do with new money?** Some people will save up their cash to buy into the market after a correction. **Buying into the market when it is down is a good strategy**. But saving money for possibly years waiting for a down market to buy into, can mean a lot of lost opportunity while markets are still rising. And most people aren't courageous enough to invest until long after markets have started to recover. So this strategy doesn't pay off for most people.

Studies shows that **investing on a regular basis (a pre-set amount each month) is very effective**. It takes emotion out of any decisions about when to invest and makes sure you invest in down markets as well as rising markets. So rather than waiting till you have a big lump sum to invest, investing monthly is usually better.

A 2016 study done in the U.S., Britain and Australia by the Vanguard Group found that if you already have a lump sum of cash, it's better to invest it all right away, than to put parts of into the market gradually. **2/3 of the time, one could make 1.45% to 2.39% more by investing the whole lump sum right away**.

Globe & Mail Feb 1, 2017 Article by Mary Gooderham

Housing Prices and Debt

Canadian debt levels are higher than American debt levels were before the banking crisis hit in 2007. "The amount Canadians owe compared with how much they earn hit another record high last year." Debt is at dangerous levels. Make sure you are part of the 46% of consumers who are decreasing their debt rather than the 37% who are borrowing even more. The Hamilton Spectator Mar 16, 2017

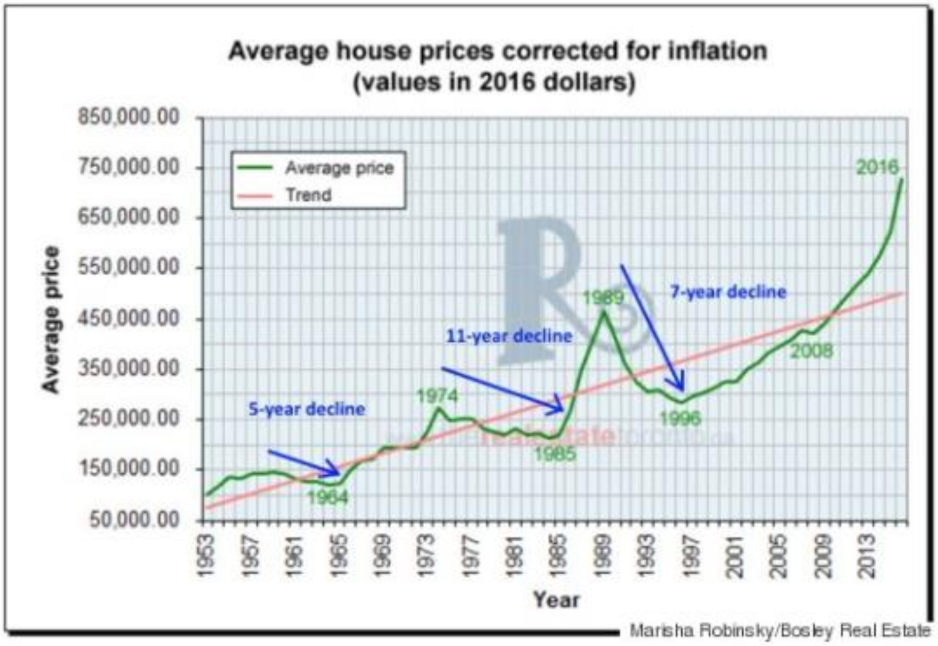
Housing prices in Southern Ontario continue to rise at a totally unsustainable rate. Every week there are new projections or quotes in the news about some economist or major organization **projecting a housing market correction in Canada as bad as, or even worse, than we happened in 1982, when housing prices corrected approximately 40%**. Recently Simon Fraser University Professor Josh Gordon (Globe and Mail Mar 14, 2017) wrote about "rampant price surges and a market bubble that will inevitably burst… Spurred by low interest rates, people are buying real estate for investment purposes… which is warping the demand side of markets… [there is] a "fear of missing out" that is leading to a disconnect between offering prices and local market fundamentals." Even politicians, who were previously against putting a special tariff on foreign buyers of houses in Toronto, are now considering it. So it really could happen that we experience a severe correction in the housing market. Make sure you are in a financial position to withstand a correction should the predictions come true, especially if your house value might fall below what you still owe on the mortgage.

And we aren't just talking about the GTA. CMHC reported that **Hamilton house prices go up 1.4 times as much as Toronto ones did the year before**. And CMHC warns that **when GTA housing prices drop, Hamilton prices could go down at a greater rate too**! Apparently Hamilton housing is up 88% in the last 10 yrs.

Posted on CBC.ca/news on Jan 24, 2017

For all the young people who have told me that you cannot lose investing in real estate, below is a chart posted on huffingtonpost.ca on Mar 13/17 from a Toronto Realtor, just for you. The rest of the article **predicted that a correction in the area of 40% would happen in about 2 yrs**. And if you think, "that's okay, because prices could go up 20% more in each of the next 2 yrs, so it's a wash", let's review math. A $1 Million house that increases 20%/yr would hit $1.44 Million in 2 yrs. If it then fell -40%, it would be worth $864,000. The article cites a pretty knowledgeable educated person who looks at these things, namely **BMO's chief economist, Douglas Porter, as saying "it's time to "stop the pretense" and admit Toronto is suffering from a housing**

bubble". Interest rates may not start rising till late 2018 in Canada, but something else could trigger a correction before that. It was also interesting that the video link to the realtor who supplied the chart said that **housing prices drop about 23 out of every 63 yrs**. We're overdue!



Consumer/Investor Beware

On Mar 10 and 11 2017 the internet and newspapers were full of news about CBC's Go Public report that **multiple TD Bank employees admitted breaking the law to meet aggressive sales targets**. They increased line of credit limits, credit card limits, secretly moved clients to higher fee accounts, upsold customers regardless of the affordability or suitability for the client. CBC's on-line report says hundreds of TD employees have reported the pressure to meet sales targets with "zero focus on ethics". Even some TD financial advisors admitted to selling clients unsuitable products to meet sales targets to keep their jobs.

Clients often tell me that they don't like going to tellers at other banks either anymore, because they are pressured to put their money into the bank's TFSAs, RRSPs, GICs or funds, or to take out a line of credit or credit card. Apparently the moment someone inserts their client card into the card reader, suggestions on what more the teller could sell the client pop up on the teller's screen. So it is no wonder that clients often tell me that they have an investment account at the bank that they didn't really want and they usually don't have any clue how it's invested. Some people are switching to Tangerine, President's Choice and Manulife Bank (on-line and telephone bank operations) to avoid such pressure.

There were 148 complaints going to the ADR Chambers Banking Ombudsman Office from TD clients about their practices last year. Royal Bank got about half as many complaints. The other banks use the Ombudsman for Banking Services, (OBSI), to resolve their complaints, and the number of complaints has risen over the last 2 yrs, but comparative complaint levels aren't available. There is enough concern though that Canada's **Financial Consumer Agency is reviewing bank business practices**. Globe & Mail Mar 15, 2017

Ask a lot of questions about anything being proposed to you and be prepared to <u>resist pressure from those whose only motivation is to meet a sales quota</u>. If you wonder how what a teller or bank advisor is recommending fits in with your Manulife holdings or strategies, give me a call to find out. <u>Consider the motives and knowledge level of the person making the recommendation to you</u>.

For your information, many or even most advisors who work outside of bank branches either have quotas to sell a certain amount of their employers' products or get extra rewards to promote in house products. At Manulife Securities Incorporated, we advisors do not have to promote any of Manulife Asset Management's funds, and we get paid exactly the same on their funds as for any other company's funds. Manulife Securities Incorporated is one of the last brokerages of any size around which have independent advisors.

Putting the Importance of GDP (Gross Domestic Product) Growth in Perspective

GDP is the measurement of goods and services produced in a country. Usually we focus on the growth rate of GDP as a measure of economic health. When an economy is booming, GDP is up. A recession is when the rate of growth of GDP drops two quarters consecutively. GDP growth rates show the relative productivity improvements and general economic strength of countries. So, you would think that GDP might be a good guide as to where to invest. Apparently that isn't so. Three finance professors from Cambridge and the London Business School studied 109 yrs of data from 10 countries and data from 83 developed and emerging market countries since 1970 and found **no correlation between economic growth and stock market returns**. When Chris Horwood wrote about this study in the Globe and Mail on Mar 15, 2017, he also gave specific examples of how when GDP was growing strongly, P/E multiples were high. So investors who bought when economies were strong had to pay a lot for stocks. It's hard to make a profit on something you may have overpaid for. Then in economically weak years, P/E multiples were low, presumably because of lack of investor enthusiasm about the countries' prospects. So stocks were cheap as investors focused on near-term poor economic prospects. This was when investors should have been interested in buying. The writer concluded that **investors should focus on the prices paid for individual stocks to make money over the long-term rather than getting caught up in the hype about the economy**. That's exactly what our value oriented fund managers do for us. The economic health of an economy or world economies may cause markets to go and down as investors get enthusiastic or fearful, but it doesn't really predict the long-term profitability of individual companies. Your gains on equity/stock purchases over the long term are only partly related to their long-term profitability. Much of your profit depends on whether you bought the shares at a good price to begin with.

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