Monthly Newsletter
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Snow
Wealth Management Group

Canadian Equities

Indices	Q1/19 Return	YTD Return
S&P/TSX Composite Index	13.29%	13.29%

U.S. Equities

Indices	Q1/19 Return	Q1/19 Return (C$)	YTD Return	YTD Return (C$)
Dow Jones Industrial Average Index	11.81%	9.70%	11.81%	9.70%
S&P 500 Index	13.65%	11.50%	13.65%	11.50%
S&P 400 Index	14.49%	12.33%	14.49%	12.33%
NASDAQ Composite Index	16.81%	14.60%	16.81%	14.60%

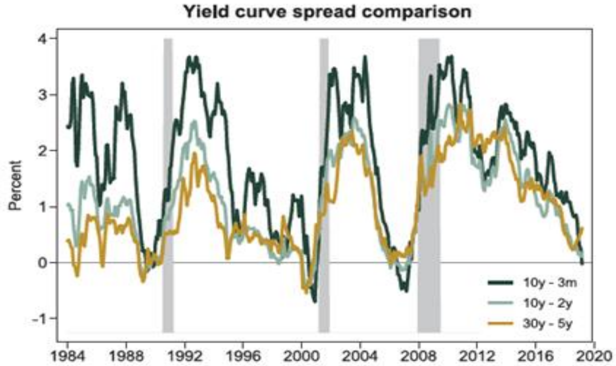
Source: Bloomberg Finance L.P. as at March 31, 2019. Total index values and returns. Index returns calculated in local currency and C$.

Wise Investor – April 2019

As quickly as the markets fell through the end of 2018, they have recovered through the 1st quarter of 2019. The question left in investors minds is was this the start of something more or are we back on track for more positive years of performance? I think it would be reasonable to assume that we are closer to the end than we are to the beginning. I would also reiterate that attempting to time the market and get out of equity completely isn't typically recommended nor a rewarding experience for most investors. In this article I will share a few paragraphs reviewing the underlying economy, discuss some of the implications of a recession, then equate that to what we're doing within our investment strategy. Regardless of which camp you are in, now is a great time to sit down and revaluate your level of comfort with equities because the future likely holds more volatility and if 2018 was painful for you, I believe in taking action as now is a great time to shift more defensive with the recent market strength.

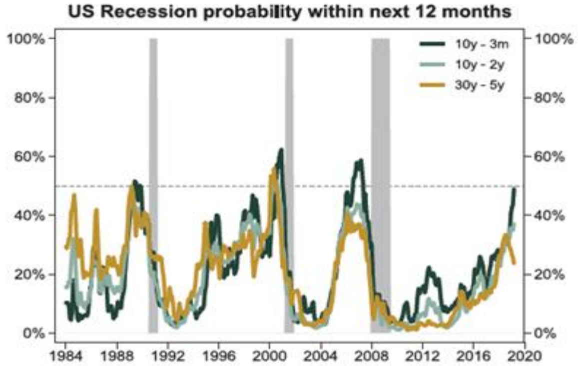
The most circulated bit of economic information through the end of March has been the dreaded yield curve inversion. This may sound like an acrobatic dance manoeuvre, but the term actually refers to the relationship of interest rates when short-term bonds pay a higher rate than long-term bonds. This has been associated with an economic slowdown and has preceded every post world war recession. A recession is defined as a significant decline in economic activity spread across the economy, lasting more than a few months (technically defined as 6 months or more). The reason we want to know when a recession is coming is because recessions are associated with long, negative stock returns and sometimes significant market sell-offs. Attempting to time a recession based solely on a yield curve inversion would not be prudent as a U.S. recession has followed an inverted yield curve on average one year. The problem is that the one year average comes from a range that has been as short as 2 months to as long as 2 years. Secondly, there have been several occasions that the yield curve inverted but a recession did not follow. We look for confirmation from a number of other economic indicators before acting too drastically. Also important to note that at time of writing, the 10 year and 3 month yield curve, as is frequently quoted, is no longer inverted and the 30 and 1-year rate never inverted which could be considered a more telling sign.

Yield curve spread comparison



Shaded regions represent NBER recession dates. Last observation on 22 Mar 2019.
Source: Federal Reserve Board, NBER, TD Securities

US Recession probability within next 12 months



Note: Probit estimate based on listed yield curve spread. Last obs on 22 Mar 2019.
Source: NBER, Federal Reserve, TD Securities

Past recessions have occurred for a variety of reasons. The 1981 and 1990 recessions were caused by overheating, as evidence by rising wage and inflation pressures, followed by significant interest rate increases. Today, neither are a concern but with record low unemployment, we would anticipate that more pressure on wages should eventually follow which is usually trailed by inflation concerns. The 2001 and 2008 recessions were driven by financial imbalances as evidenced by a huge run up in the markets and real estate values that needed to be corrected. In the great recession these imbalances were greatly exacerbated by financial products and extreme leverage and as the real estate market crumbled so did the financial world. I would argue that the general public and governments are sitting with high levels of debt but the Central Banks in North America have taken an about face suggesting interest rates will stay lower for longer making the debt manageable, for now. At the height of a bull market before a collapse, investors are euphoric often borrowing money to invest but today investors remain skeptical, sitting on a mountain of cash and all I seem to hear are stories of fear and extreme pessimism. Recessions rarely come when everyone expects them and markets rarely act the way investors anticipate. Financial markets can often provide signs within them as the utility, REIT and consumer discretionary sectors typically peak long before the more notable stock market indexes but these sectors are still leading the charge. Due to all these contradicting signs we closely monitor our recessionary dashboard on monthly to analyse the most recent underlying economic data possible and plan our attack appropriately.[1]

Figure 1: Recessionary Dashboard

Start of Recession	Yield Curve	Inflation Trends	Labour Market	Credit Perform.	ISM Mfg.	Earnings Quality	Housing Market
Nov. 1973	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	--	Recessionary
Jan. 1980	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	--	Recessionary
July 1981	Recessionary	Expansionary	Expansionary	Recessionary	Recessionary	--	Recessionary
July 1990	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary
Mar. 2001	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	Recessionary	Neutral
Dec. 2007	Recessionary	Recessionary	Neutral	Recessionary	Recessionary	Recessionary	Recessionary
Present	Neutral	Neutral	Expansionary	Expansionary	Expansionary	Expansionary	Neutral

Recessionary Expansionary Neutral

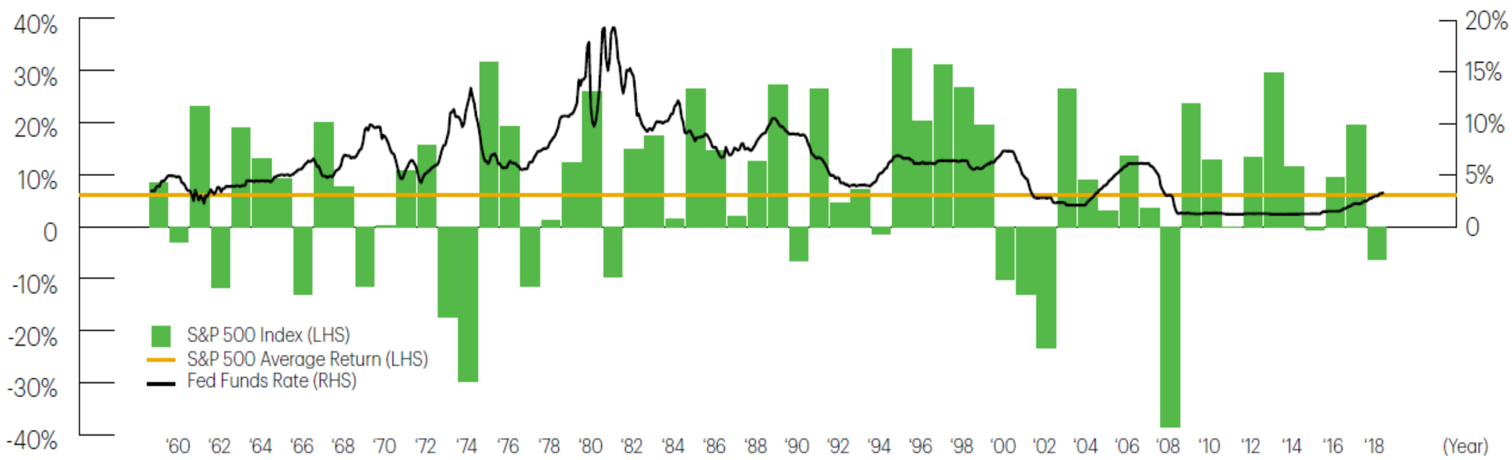
Although the economy is showing signs of a slowdown and risks have risen I would suggest that there is a less than 50% probability of a recession in the next 12 months. Outside of the recessionary dashboard that I have created (left), the Conference Board Leading Economic Index (LEI) is readily available to all investors. This index reflects 10 economic factors and rates the probability of a recession. A decline of at least 1% from the previous year has preceded the start of a recession by an average of four months. At this time, the LEI has no indication of a recession on the horizon which aids my confidence.

Look Back At It

As we periodically take the temperature of the economy, one or two neutral to negative ratings can be meaningless but several indicators turning red for a sustained period would prompt us to shift more defensive. Although we are currently positive, it's never too early to think about how a recession could impact your portfolio. Because a technical recession isn't identified until long after the economy has slowed, remember a technical recession is 6 months of negative GDP growth, equities may have peaked long before it is identified. While it may be possible that a trade deal or some robust corporate earnings could keep this rally moving we'd like to see stock prices supported by strong economic data into the 2nd quarter. Ultimately, I believe we may be in a lower return period for the foreseeable future, particularly after the solid start to 2019[2]

We've done some research at TD to look back at the past 60 years of returns which we believe is a much more representative period. This is because it takes us through a 30-year period of rising interest rates and a 30-year period of falling interest rates which is important as a lot of investors, myself included, have only experienced the latter.

Figure 2: Annualized Historical Returns I S&P 500 Index vs. Fed Funds Rate

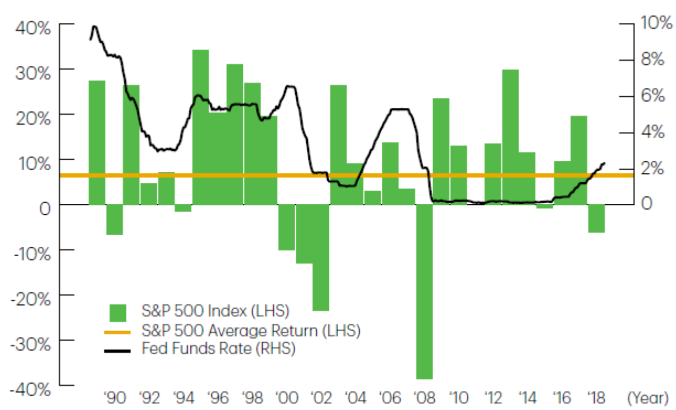


Source: Bloomberg Finance L.P.; Price return, Fed Funds Effective Rate

For the entire 60-year period, annual returns of the U.S. S&P 500 Index were somewhere between 6% and 7%. A balanced portfolio of stocks and bonds could still produce a good return as bonds would yield somewhere in the same range over that period. In reality, that's about half of what we've come to expect in recent years. This is due to highly accommodative government intervention by way of what's called monetary policy (emergency measures). This has kept interest rates low, allowing investors to buy more goods on credit helping the economy. The stock market is as simple as supply and demand and as the economy grows and investors have more money, more money flows into investments driving stock prices up. If we combine the need to own more stocks in a portfolio to produce decent returns because bonds only pay 2% to 3% you get outsized stock market returns. As a result, over the past 10 years we've seen that same S&P 500 return around 10%. It could be argued that to produce the higher than average stock returns we have had to borrow from the future as record debt levels, both personal and government, will have to be paid back at some point. It makes sense that we are appearing to be entering a period of economic slowdown. When things slow too far, less money will flow into the market likely lowering overall returns. if stocks don't have much room to run yet bond rates remain so low what is an investor to do? I hope to answer this question over my next two sections[2].

Graph 1: Falling Rate Environment: 1989 to 2018

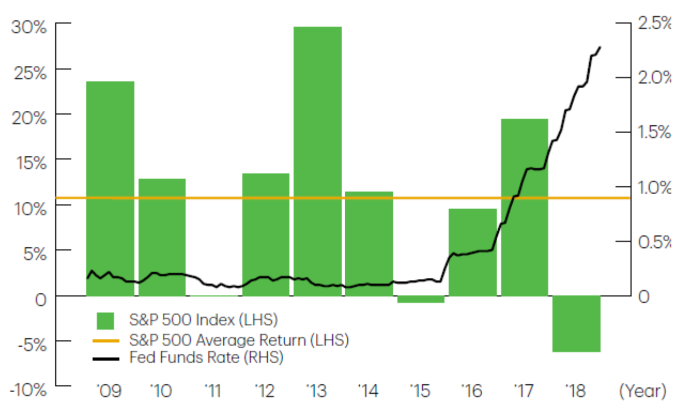
S&P 500 Index vs. Fed Funds Rate



Source: Bloomberg Finance L.P.; Price return, Fed Funds Effective Rate

Graph 2: Emergency Measures: 2009 to 2018

S&P 500 Index vs. Fed Funds Rate



Source: Bloomberg Finance L.P.; Price return, Fed Funds Effective Rate

My Investment strategy

Given that my analysis is showing signs of an economic slowdown, I will likely be looking to shift my investment strategies to a more defensive stance over the coming quarters. Late in the cycle moving out of equities can be risky as this is where some of the best returns can be had. It's also important to note that not all stocks respond the same during periods of economic stress. Through the last eight major declines, a number of sectors within the underlying market held up consistently better than the rest. Those sectors would include utilities and REITs which benefit from falling interest rates and consumer staples and healthcare as these two sectors include products and services that investors require in both good and bad times. During the late stages of economic expansion, equity markets tend to rotate toward these sectors with the highest quality, dividend paying stocks remaining the most profitable. Growth orientated stocks still have a place in portfolios, but you may want to consider locking in profits on anything lower in quality and only holding companies with the strongest balance sheets and consistent cash flows.

A prudent investor also aught to have some fixed income in their strategy despite the low returns. Bonds can offer protection and are essential to stability and capital preservation, most specifically when stock markets get volatile. Out of the last 6 market corrections, US bond markets remained positive in 5 of them while the stock market was down double digits in each. The only negative period for bonds was the beginning of 2018 where inflation was the scare and interest rate increase expectations rose rapidly. Even then, bonds were only down -1% when equities were down -10.1% (1/26/18 – 2/8/18)[3]

In a perfect world, when entering a period of economic contraction and muted returns an investor would be underweight equities with the largest exposure to more defensive sectors and overweight bonds diversified over a number of maturity years both long and short. Investment strategies can now include a third investment asset class to help mitigate volatility and increase returns which I have dedicated my following section to, Alternative Strategies.

Philosophy

Portfolio management begins and ends with a well-defined investment philosophy, a determined portfolio construction process and a robust commitment to risk management.

Asset Allocation

Global pensions and endowments have been rapidly shifting their investment strategy away from a traditional 60/40 approach to broad asset allocation and/or risk-based allocation.

Risk Factors

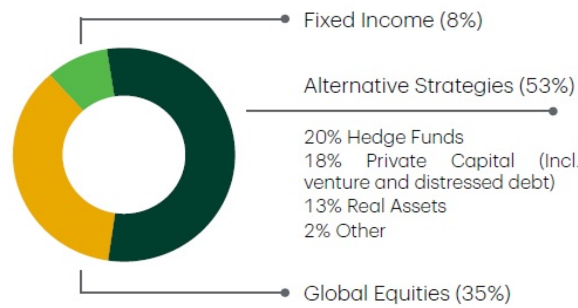
Risk-factor management is critical: minimize unintended and unrewarded exposure, while building portfolios based on outcomes, not benchmarks.

Source: Risk Priority Portfolios July 12th 2018

Alternative Strategies

Over the past few years I have been running a seminar caller What the Wealthy Do Differently. I spent considerable time understanding who the most successful investors in the world were and to my surprise it was not the Warren Buffets or Ray Dahlios that did the best, although they have done fantastically, but Pension Plans and University Endowments took the trophy. 2019 marks the first time that Canadian investors can now get very close to having the same investment options as these institutional investors. What I am referring to is the ability to invest in alternative assets to compliment traditional stock and bond portfolios. Alternative assets could include things like private real estate or infrastructure or commercial mortgages.

Figure 3: Allocation on U.S. University Endowments

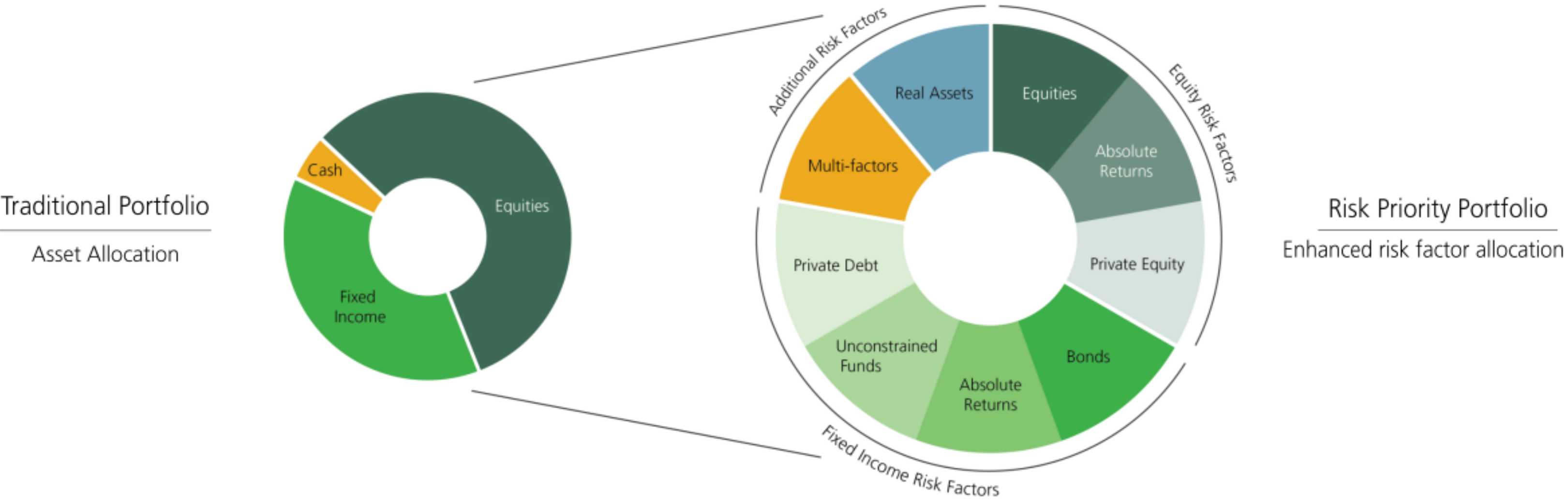


Source: National Association of College and University Business officers. As at January 31, 2017. 4% held in cash.

Large pension plans can go out and buy a commercial building or an airport but until now, your traditional investor obviously could not, unless very wealthy. Alternative strategies could include absolute return or long-short, where an investor can put their trust in an investment team with sophisticated strategies designed to profit from stocks going up as well as stocks going down giving the ability to make money even in a falling stock market. The traditional name for this type of strategy has been a hedge fund, previously only available to accredited investors after completion of a mountain of paperwork. These types of investment can provide a reliable income stream, low correlation to stock markets, outsized returns and an alternative way to pursue capital preservation[2]. Institutional investors have been doing this for decades and as outlined above, alternative strategies make up a significant portion of their overall assets invested.

Every investor can now access these types of strategies through a new mutual-fund-like framework. This new asset class was introduced for the first time in Canada this January and is called liquid alternatives. I would caveat this by saying that one of the biggest risks within this new asset class would be investment manager execution as some of their strategies can be very sophisticated and unique. Therefore extensive due diligence should be done by you or your investment professional to be sure you completely understand what your are investing in even if it is as easy as buying a mutual fund now. For full transparency, I have a number of these new strategies on our watch list but have only committed assets to a very small portion that had investment managers with proven track records. I'm always happy to discuss who and why if you have questions or are interested in more information.

On the surface



Source: Portfolio Advice & Investment Research. For illustration purposes only.

Taking a pension plan approach to your investments without getting too technical could be compared to relying on a custom wealth plan. Pension plans understand how much they need to fund current and future liabilities. Then they look at what percentage of their assets need to be protected and what portion won't be touched for a number of years. From their they can determine the amount of return they will need to achieve all goals. Then, rather than rely on an index to track returns or monitor how a portfolio performs on a day to day basis, they fund their long-term requirements with different asset classes and adjust that strategy over time accordingly. This often means they only need mid single digit returns from their stocks, bonds can cover their short-term needs while providing stability and the addition of alternative assets focussed longer-term can help to mitigate volatility when markets take a turn while adding to consistent income along the way.

Individual investors can now come pretty close to replicating the strategies that have had pension plans and endowments outperforming for decades. I encourage my clients to go through our wealth planning process to help determine exactly what they need to do to achieve their specific goals. It makes it easier at times of volatility like 2018 to sit back and enjoy some dividend income with a little less concern on what market averages are doing or the next financial pundit predicting the end of the world. It also allows us to determine the appropriate asset allocation for their investment strategy. Without knowing what you are trying to achieve it is hard to build a plan to get from here to there.

Our wealth planning process involves the four pillars of wealth management (next page). Its starts with building your net worth which comprises of taking calculated risks within your level of comfort based on your long-term financial goals to grow your assets. The second step is protecting those assets when it gets closer to a time of transitioning into retirement while understanding your priorities. Third, we want to do this in the most tax efficient manner possible by structuring your investments correctly. Lastly, as some of my clients will have more money than they need, we look at ways to leave behind a legacy. These inputs build the fundamentals of your plan that by collaborating with out team of specialists at TD, can then be used to build an appropriate investment strategy with the added resources of alternative strategies where applicable.

TD Wealth

Helping you achieve your vision of success

Building net worth

We know how important it is to build your wealth so you can enjoy life's priorities and achieve your vision for the future. Working together we can develop innovative strategies to help grow your net worth by identifying which credit strategies and investment solutions match your current lifestyle and needs. Our team of professionals can work with you to develop an effective plan to help you make your vision a reality.

Implementing tax-efficient strategies

You've worked hard to accumulate your wealth and we want to help you to make the most of it. Working closely with you and your tax advisors , we'll create an integrated wealth strategy that will structure your investment portfolio to help reduce tax exposure and keep income available as and when you need it.

Protecting what matters

Life is filled with uncertainty and that's why we're committed to delivering advice and solutions to help protect the things you value at every life stage. Whether through comprehensive risk strategies or connecting you with a specialist in trusts, estates and other risk mitigation products, we've got the expertise to create a comprehensive plan that's right for you.

Leaving a legacy

You are the architect of your legacy and we can help you with the blueprint. We'll collaborate with you to identify your top priorities, from estate planning and trusts to gifting and philanthropy. Our goal? To help you optimize the transfer of your wealth.

Provided by TD Specialists

In conclusion I remain cautiously optimistic and maintain the belief that equities are an essential portfolio component for long-term investors. Short-term market volatility can be mitigated with high quality bonds and long-term performance can be improved with complimenting alternative investment strategies. As we work through the barrage of recent research on alternative strategies I hope to have some recommendations and further opinions in coming publications but I encourage any questions or the sharing of any information you come across.

Before I sign off, I just wanted to reiterate that helping people reach their financial goals is the most professionally satisfying thing I do. So if you come across anyone who might want some help with their goals, retirement plan or investment strategy, let me know. I'd love to see if we can help!

Best Regards! *Marley*

1 Source: www.thebalance.com/the-history-of-recessions-in-the-united-staes-3306011
2 Source: TD Monthly Perspectives March 2019
3 Source: Thomson One