

Important Topic: Inflation

When evaluating any investment it is always critical to consider the after-tax and after-inflation return as the resulting figure is more accurate. Last month I addressed taxation so let's take a look at inflation.

Simply put, inflation is a measure of how quickly the value of our money is decreasing. If inflation is 3% then a \$100 item today will cost \$103 next year. Therefore, next year, \$100 will not be able to buy this item unless you get a return on investment that at least matches the rate of inflation. Consider a bond bought for \$100 that will pay annual interest and then return your \$100 in ten years' time. When the \$100 is returned in ten years it will only buy 66% of what it could have bought today. We describe this as \$100 in ten years' time will only be worth \$66 in today's dollars.

Therefore finding investments that will, at the very least, match inflation (after-tax) is critical. If not, the dollar value of the account may go up but the "value" (how much you can buy) will actually be going down.

Expectations:

Importantly, one's return expectations should rise and fall with inflation. With the inflation rate in Canada in 2020 at 0.61% (Source: Statista), significantly below the long term average, one should expect lower returns than average but understanding that one's net worth is still increasing at the same pace. In other words, a total return of 6% when inflation is 3% is the same as a total return of 4% when inflation is 1%. Our focus and expectations should be on the net return.

After Tax and Inflation:

Consider the early 1980s when one could get



18% interest at the bank (and I have heard people pine for those days). Now consider the after tax and after inflation return! For certain individuals, 18% interest was taxed at over 50% so they ended up with less than 9%. Rates were 18% only because inflation was at 12%. Getting an after tax return of 9% when inflation is 12% meant a REAL annual return of negative 3%. Today, assume that a person buys a 0.8% GIC with and pays a tax rate of 50% and inflation at .61% means that the REAL return is $0.8\% \times 50\% = 0.4\%$ - 0.61% = a negative annual 0.21%. Today's 0.8% GICs are better than the 18% return of the early 1980s.

Conclusion

Always remember to consider the effects of Inflation. It can have a significant effect on your net worth over time and therefore on your ability to meet your goals.



Market Update:

July 2020 - The Rally Continues .. what's next?

The market has continued its rally, now in its 19th week.

The underpinnings of the rally – government stimulus, low interest rates and better economic data than expected – remain.

As long as these remain in place, I expect that the rally will continue ... with its high volatility and with periods of sideways movements .. until the US elections and likely beyond.

At this time governments remain focused on providing assistance (the US Government is considering additional stimulus this weekend) and low interest rates are likely to be with of for some time.

The focus becomes economic data ... and the question becomes what's next?

Before I provide my opinion, and that is all it can be when speculating about the future, let me first reiterate two beliefs that underlie all that my team does:

1. No one knows the future and so no one can answer this question with certainty, and
2. Given this unknown, the best strategy remains

finding strong, financially sound, competitively advantaged, profitable companies that should survive and even thrive in whatever future lies ahead. Then hold until one of these characteristics are no longer true.

I believe what's next will depend on profitability. Profitability is key. When profitable, companies grow, provide for their stakeholders (employees, communities and shareholders) and increase in value.

Profitability in turn depends on a company being able to sell what it produces for more than it costs. And here is the rub. Sales and costs are undergoing great changes but which changes faster and which are temporary as opposed to permanent?

Are sales going to be able to increase if consumer spending falls given high unemployment, increasing bankruptcies and entire industries shut down?

At the same time will costs continue to fall ... with everything from energy to raw materials from technology and labour to overhead becoming cheaper?

This leaves us with a division:

A. Some companies are experiencing increased sales while costs continue to fall thereby driving increasing profitability.

B. Other companies are fighting to balance these two and while expecting a rough time over the coming year, see their way through.

C. Yet other companies are facing a collapse in sales and cannot cut costs fast enough. They will not make it or at least require many years to reposition and recover.

Therefore, the conclusion with respect to our investments, is, again, as always, dependent on the company. Continuously reevaluating investments and repositioning them as events dictate, is a key component to what active managers do. There remains many opportunities.

The conclusion with respect to the economy and the market indices differs. They will depend on how many companies fit into which of the three categories outlined above and how big they are.



The stock market indices are heavily weighted in a few top performers and their future will depend more and more on how these few names fare. But do not be surprised if the market appears disconnected from the economy.

The economy includes all companies (hundreds of thousands of small companies that are not on the stock exchange) and as such will have the hardest time rebounding.

Looking Forward

The markets are likely to remain quite volatile. There is still so much that we do not know and cannot predict. Moving higher on talk of a vaccine and moving lower on poor economic data will likely continue and likely be unsettling for some.

As for our investments, we like the positions we hold. We are continuing to buy, though very selectively.

While US Growth and Large Cap stocks continue to lead the way higher (NASDAQ setting a new all-time high), almost every other asset class (any non-US, or non-Growth, or non-large cap)

has not rebounded fully. Many stocks and bonds are still inexpensive, and we remain convinced that superior companies and investments will rebound in time, providing attractive long-term returns. We remain focused, selective and patient.

For the month, the bond market was up 1.5%, the Canadian market was up 4.4%, the US market was up 4.4%, International markets were up 1.9%, the Emerging markets were up 6.7%, the Real Estate market was up 2.9% and the preferred market was up 6.3. (Source: Reuters, as of 7/31/2020)

Year-to-date, the bond market was up 8.8%, the Canadian market was down 2.3%, the US market was up 1.1%, International markets were down 10.8%, the Emerging markets were up 1.5%, the Real Estate market was down 20.0% and the preferred market was down 6.2%. (Source: Reuters, as of 7/31/2020)

Have a great month and let us know if there is anything we can do for you,

- Meir

Meir J. Rotenberg, MBA, CFA®

Vice President & Investment Advisor
meir.rotenberg@td.com

Adam D. Shona, B.Comm

Associate Investment Advisor
T: 416 512 7645
adam.shona@td.com

Nelson Gordon

Client Service Associate
T: 416 512 6813
nelson.gordon@td.com

TD Wealth Private Investment Advice

5140 Yonge Street, Suite 1600

North York, Ontario M2N 6L7

Tel: 416 512 6689 | Fax: 416 512 6224

Cell: 416 602 1614 | Toll: 800 382 4964

TD Wealth



The information contained herein has been provided by Meir Rotenberg, Vice President, Investment Advisor, TD Wealth Private Investment Advice, and is for information purposes only. The information has been drawn from sources believed to be reliable. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

Certain statements in this document may contain forward-looking statements ("FLS") that are predictive in nature and may include words such as "expects", "anticipates", "intends", "believes", "estimates" and similar forward-looking expressions or negative versions thereof. FLS are based on current expectations and projections about future general economic, political and relevant market factors, such as interest and foreign exchange rates, equity and capital markets, the general business environment, assuming no changes to tax or other laws or government regulation or catastrophic events. Expectations and projections about future events are inherently subject to risks and uncertainties, which may be unforeseeable. Such expectations and projections may be incorrect in the future. FLS are not guarantees of future performance. Actual events could differ materially from those expressed or implied in any FLS. A number of important factors including those factors set out above can contribute to these digressions. You should avoid placing any reliance on FLS. Index returns are shown for comparative purposes only. Indexes are unmanaged and their returns do not include any sales charges or fees as such costs would lower performance. It is not possible to invest directly in an index.

Source: London Stock Exchange Group plc and its group undertakings (collectively, the "LSE Group"). © LSE Group [INSERT YEAR]. FTSE Russell is a trading name of certain of the LSE Group companies. "FTSE®", "Russell®", and "FTSE Russell®" are trade marks of the relevant LSE Group companies and are used by any other LSE Group company under license. "TMX®" is a trade mark of TSX, Inc. and used by the LSE Group under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company's express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

TD Wealth Private Investment Advice is a division of TD Waterhouse Canada Inc., a subsidiary of The Toronto-Dominion Bank. All trademarks are the property of their respective owners. *The TD logo and other trademarks are the property of The Toronto-Dominion Bank or its subsidiaries. BC21-109