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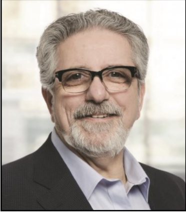
KPW LIFE PLAN—IMAGINE YOUR FUTURE

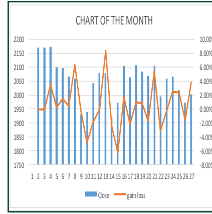
VOL. 8, ISSUE 5 MAY 2019

“CASH COMBINED WITH COURAGE IN A TIME OF CRISIS IS PRICELESS” - Anonymous



Sergio Simone
EDITORIAL COMMENT

Sergio Simone
YIELD CURVE INVERSION—SHOULD WE BE WORRIED



FORGET “SELL IN MAY AND GO AWAY.”

Ryan Simone
RISK & RETURN

Editorial Comment

Sergio Simone

Late cycle investing can cause a lot of angst with investors. On one hand you are convinced a recession is coming any day now while on the other hand you don’t want to pull your money out of the market because you are afraid of missing out on a potentially huge rally. The question for both advisors and investors is “how do we build a portfolio that can maximize return potential without taking on too much risk?”

Continue Reading

U.S.—China Trade War—How Concerned Should I Be?

Sergio Simone

Going into May I was optimistic that U.S. President Donald Trump and China’s Xi Jinping would reach a conclusion in their trade disputes. I’m sorry to say that things are not progressing the way I had hoped. My optimistic expectations for a quick resolution to the U.S. – China trade war are fading rapidly as it seems inevitable that President Trump will levy a 25% tariff on about $300 billion of additional Chinese goods.

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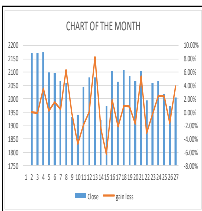
Forget ‘Sell In May And Go Away.’



With the S&P 500 up 17 percent just four months into the year, investors could be forgiven for thinking about taking profits ahead of the usual summer doldrums. Not so fast, says Societe Generale.

“In our view, 2019 will be different,” Societe Generale strategists including Sophie Huynh and Alain Bokobza, the firm’s head of global asset allocation, wrote in a note Tuesday titled

Continue Reading

Risk & Return

Ryan Simone

Most investors I speak with are happy with a 6% to 8% compound return in their portfolio. The good news is that this is an achievable goal. The difficult news is that it requires taking on more risk than we previously needed.

Continue Reading

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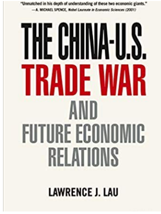
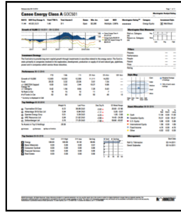
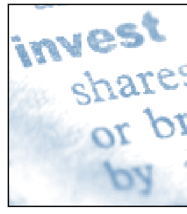






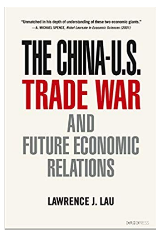
BOOK OF THE MONTH

FUND OF THE MONTH RBC QUBE LOW VOL CDN EQUITY FUND

INVESTMENT TERMINOLOGY

BLOG OF THE MONTH RICH DAD

BOOK OF THE MONTH

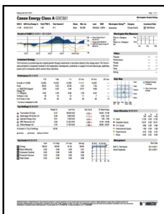


The China-U.S. Trade War

—By Lawrence J. Lau

Lau examines various economic statistics of the past few decades to show that while the real effects of the China-U.S. trade war are not negligible, they are relatively manageable for both nations. There is no need to panic, despite psychological effects on the Chinese stock markets and on the renminbi exchange rate. Behind the trade war is the potential economic and technological competition between the two countries which is likely to become the 'new normal'.

FUND OF THE MONTH



RBC Qube Low Volatility Canadian Equity Fund

The fund seeks to provide long-term capital growth by investing primarily in equity securities of Canadian companies using a quantitative investment approach. The fund seeks to achieve a reduced level of volatility of returns as compared to the broader Canadian equity market.

INVESTMENT TERMINOLOGY

IMPACT INVESTING

According to the Global Impact Investing Network, impact investments are: "Investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return."

Examples include: A private equity investment in an early-stage company focused on early childhood education, or a community bond investment in a solar-power co-operation.

BLOG OF THE MONTH

OTHER PEOPLE'S MONEY (OPM)

There are two ways to get rich. One way is to use your own money. The other way is to use other people's money, or as we call it at Rich Dad, OPM. One (using your own money) provides small-to-modest returns, takes a long time to pan out, and requires some financial intelligence. The other (OPM) provides large-to-infinite returns, creates incredible velocity of money, and requires a high financial intelligence.

Other people's money (OPM) is a fundamental concept of Rich Dad and a sign of high financial intelligence. By using both good debt and OPM, you can dramatically increase your Return on Investment (ROI) - and you can even achieve infinite returns.

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

Forbes

ULTRA-HIGH NEW WORTH NEED ADVISORS WHO KNOW HOW INVESTMENTS AND TAXES INTERACT

Tax laws are inherently complex, and the 2017 Tax Cut and Jobs Act hasn't made finding ways to reduce tax drag easier for tax lawyers, especially those serving and catering to ultra-high-net-worth (UHNW) individuals and families.

While fiduciary duties should make objectives clear for investors and alternative investment vehicles such as hedge funds and venture capital, the need to achieve compelling risk-adjusted returns is not a passive exercise, but an unending

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WOMEN AND WEALTH

By 2026, women in Canada will control close to half of all accumulated financial wealth, a significant increase compared to a decade earlier when the share was closer to one third. This increase will be partially driven by a significant flow of inheritances to women of all ages in Canada, roughly estimated by Strategic Insight to represent up to $900 billion in financial and real assets over the next decade.

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MARKET MOMENTUM: IMPACT INVESTING & HIGH NET WORTH CANADIANS

In 2017, SVX began a research and engagement initiative to develop a greater understanding of high net worth individuals' interest in and experience with impact investing. To date, Canadian studies and research on impact investing has focused on investments made by large institutional investors and funds. As such, there is a lack of in-depth insights into individuals investors' views on impact investing. The aim of this report is to provide a comprehensive perspective of high net worth individuals (HNWs) in Canada and their investment preferences, interests, barriers and levers.

Continue Reading

LIFE INSURANCE AND HIGH NET WORTH CANADIANS: AN EYE-OPENING OPPORTUNITY

The unique needs and expectations that high net worth (HNW) Canadians have of the financial services industry are well understood, and extend across both the wealth and protection product categories. But while wealth managers have fine-tuned their efforts to meet affluent clients' requirements, three in ten wealth Canadians own no life insurance (a result consistent with national ownership rates). Given the alignment between life insurance product attributes and the unique financial planning needs of HNW Canadians, one would expect life insurance ownership to be higher among the affluent.

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FUND MANAGER COMMENTARY

ADAM KRAMER
FIDELITY INVESTMENTS

ERIC LASCELLES
RBC GLOBAL ASSET MANAGEMENT

DAVID ZAHN
FRANKLIN TEMPLETON

MICHAEL HUGHES
GUARDCAP ASSET MANAGEMENT

Adam Kramer, Portfolio Manager

Fidelity Investments

Investors had plenty to worry about late last year. They fretted about the Federal Reserve taking a hardline approach to tightening monetary policy, and about increasingly tense international trade negotiations. They worried China's economy was teetering on the edge of recession, and about a strong US dollar and a weakening US economy. Continue Reading

Eric Lascelles, Chief Economist

RBC Global Asset Management

Green Shoots Emerge

Report Card: Positive Developments:

Economic green shoots—China rebounding—Risk assets rise—Easier financial conditions—yield curve uninverts—Fiscal stimulus coming—U.S.-China trade negotiations continue.
Continue Reading

David Zahn, Head of European Fixed Income and Senior V.P.

Franklin Templeton

European Debt Disputes Make An Unhappy Union

Once upon a time, bonds backed by a government's full faith and credit pledge were generally considered less risky than corporate bonds. Times have changed. In today's political climate, not all governments inspire us with the same confidence.

Continue Reading

Michael Huges, Senior V.P. & Client Portfolio Manager

GuardCap Asset Management Limited

Conviction + Patience: One PM's Approach to Enhanced Growth

While index funds carry a mandate to add sector or geographic exposures even if those areas lack interesting opportunities, BMO Concentrated Global Equity Fund takes a different approach by limiting the strategy to a maximum of 25 names, in the belief that thoughtful equity selection merged with an elongated time horizon can yield double-digit compound returns over a sustained period of time.

At the same time, our investment approach is not "anti-indexing." We recognize and appreciate the enduring role of passive investors, particularly when they outperform active managers who may fall short of the benchmark; however, common sense suggests that markets misprice securities in the short-term, leaving room for some portfolio managers to achieve above market returns over the long run.

Continue Reading

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LINKS

Bank of Canada Holds Interest Rates: Here Are 2 Ways To Capitalize

Since the Bank of Canada is holding in abeyance any interest

2019 CAP Member Survey: Helping Each Generation On Their Retirement Journey

Though more than half of

Economy Added 263,000 Jobs In April, Unemployment Falls To 3.6%, New 50-Year Low

Hiring was strong for the second

Guide To Estate Planning—Disabled Beneficiaries

When you have a child or family member who is disabled and/or

University Costs Delay Parents' Retirement

Eight-in-ten (82% parents with children under age 18 say they intend to assis their children

Bank Of Canada: Climate Change Among Top Vulnerabilities In Economy

For the first time, the Bank of Canada ranks climate change as

A Quick Guide To The US-China Trade War

US President Donald Trump has complained about China's trading practices since before he took office in 2016.

Changing The World's Most Important Number: Libor Transition

The London Interbank Offered Rate is the reference interest rate

2019 Global Market Outlook—Q2 Update

Markets are caught between incoming data that point to slower global growth and forward-looking

DO CANADIANS KNOW THEIR RETIREMENT SYSTEM?

The level of general financial literacy among Canadians is fairly low, although it is comparable to what is observed elsewhere.

MOODY'S ANALYTICS

CREDIT MAY AGAIN OUTSHINE EQUITIES AT DIVINING MARKETS' NEAR-TERM PATH

During a week of heightened equity market volatility, the corporate credit market was relatively calm. As of May 8's close, the credit market had yet to sense much collateral damage from an intensification of the trade conflict between China and the U.S.

As inferred from the statistical record, the jump by the VIX from a Friday, May 3 close of 12.9 points to a recent 19.4 points could have been joined by a 160 basis point surge by a composite high-yield bond spread from May 3's 391 bp.

VIDEO LINKS

Canada's Labour Market Posts Largest Monthly Jobs Gain Since 1976

Canada's labour market delivered a surprise Friday with its biggest

Alternative Investments: Separating Myth From Reality

While many investors equate alternative investments with

Markets Turn Volatile US-China Trade Tensions

Markets are facing volatility as the U.S. and China attempt to hammer out a trade deal.

Deloitte.

2019 Investment Management Outlook—A Mix Of Opportunity And Challenge

Investment management is in a period of rapid change, driven by shifting investor preferences, margin compression, regulatory developments, and advancing technologies. While the nine-year bull run has diminished the intensity of these industry challenges, experience tells us that markets work in cycles. Successful investment managers (which we define as managers of mutual funds, hedge funds, and private equity firms) in 2019 will likely be the ones that can continue to manage these challenges with plans designed to withstand changing market conditions.

EDITORIAL COMMENT-CONTINUED

Whenever you are going to reposition a portfolio the natural first step should be to try and figure out where in the business cycle we are. If you look back at historical returns during the various business cycles, you will see that money can be made in all stages of the cycle save one. It is very difficult to earn positive returns during a recession.

Successful investing during the current stage of the economic cycle requires more emotional and psychological fortitude than investing acumen. If you are a savvy investor, you know that it is best to stay in the market because trying to time an exit point and then a re-entry point is virtually impossible, after-all, as the saying goes, “investment success is not about timing the market it is about the time in the market”. If you believe, as successful investors do, that you are going to stay invested, then the logical progression is to prepare your portfolio for a recession without giving up too much in potential gains while smoothing out the volatility.

The consensus is that a wide range of economic indicators are suggesting that we are now in a “late-cycle” phase. I would not be too concerned at this point as we are still premature in the “end of cycle” stage. In fact, I believe we are primed for some good potential growth in the equity markets before we enter the recessive part of this cycle.

Some of the indicators associated with a late-cycle are moderating growth, rising inflation, tightening credit and earnings pressure. Central banks use restrictive policy to control inflation, wage and commodity price increases. This tightening exerts pressure on profit margins which negatively effects earnings.

Late-cycle investing makes us wary, but it does not make us pessimistic. It is the “wary” part that motivates us to take some risk off the table while still leaning towards decent returns. Now is the time to prepare your portfolio for a variety of scenarios. Now is the time to include high-quality fixed income, though at an underweighted level, and globally diversified equities. These allocations should be enhanced with non-correlated assets like alternatives and low-volatility strategies.

Now is the time to consider using fixed income allocations as an effective diversifier and tailoring equity allocations to capitalize on the late-cycle stage. Fixed income will provide some stability to a portfolio during a downturn. This is a very important component of a portfolio during a late-cycle. Before allocating to fixed income there are some important things to take into consideration, like Duration and Yield.

Duration is a measure of how sensitive a fixed income investment is to a change in interest rates. For example, as interest rates fall a longer duration bond will help increase returns but when the expansion eases and the central banks are implementing tightening or restrictive policies, the longer duration bonds can lose money. This may be counter-productive, and investors may want to be a little cautious, as this kind of shift can reduce the ability of fixed income to do what it does best: to offset the downside in the equity markets.

Yield refers to the income that is returned on an investment. In the case of bonds, it would be the interest received.

Recessions have a way of making most forms of investments correlated. When the markets collapse during a recession neither equities nor fixed income are immune. This is a time that preservation of capital is paramount. If we are prepared to wait out a recessive period, then it would be best to wait it out in an investment that does not bear the full impact of the market. The key is to find an experienced fixed income manager that can make tactical decisions around duration, yield and global diversification to help mitigate the negative impact of a recessive market.

The principal reason investors incorporate equities in their portfolios is because they are the main driver of returns. Let’s face it, if we could put our money in a Guaranteed Interest Certificate paying 10%, we would probably not invest in the stock market at all.

The role of equities in our portfolios need not change in the late cycle. In fact, history proves that equity returns have been very strong during the late cycle as evidenced in the S&P 500 which has averaged a 10.4% return in the late cycle.

EDITORIAL COMMENT-CONTINUED

This suggests to me that it might still be too early to underweight our exposure to equities at this time, though we should proceed with a little caution.

Today our equity mutual fund assets should be allocated to managers that focus on investing in companies with strong balance sheets and are profitable. The debt in these companies should be manageable and they should be growing their earnings faster than their cost of debt. In my opinion investors should consider using dividend paying mutual funds during this late-cycle stage. Dividend payors generally are higher quality companies and exhibit lower volatility. Over the last thirty years dividend payers have exhibited 2.5% less volatility than the S&P/TSX Composite Index. To put this in perspective, dividend cutters and non-payers have experienced 7.0% and 9.5% more volatility respectively.

Another successful strategy is to look at countries around the world that are at an earlier part of the cycle than Canada and the U.S. There are many countries that have not yet fully recovered from the 2008/9 crash and are trading at very favorable valuations.

Once the asset classes, countries and sectors have been determined it is time to consider the best mix between these asset classes to build a portfolio that can achieve the optimal return without taking on excessive risk. With an endless combination of assets available this can be a daunting task for any investor. It is difficult enough during great markets let alone during late cycles.

For me, the best place to begin is by focusing on the core of your portfolio. This is generally where there is a strong balance between the core equity funds and fixed income funds. This will provide a mix of stability during falling markets and exposure to rising equity markets.

This core should be complemented with a mix of lower-correlated assets like alternatives, specialty fixed income and other low volatility strategies. This strategy can increase your risk-adjusted returns and keep you positioned to take advantage of potential upside gains while at the same time reducing your exposure to downside risk.

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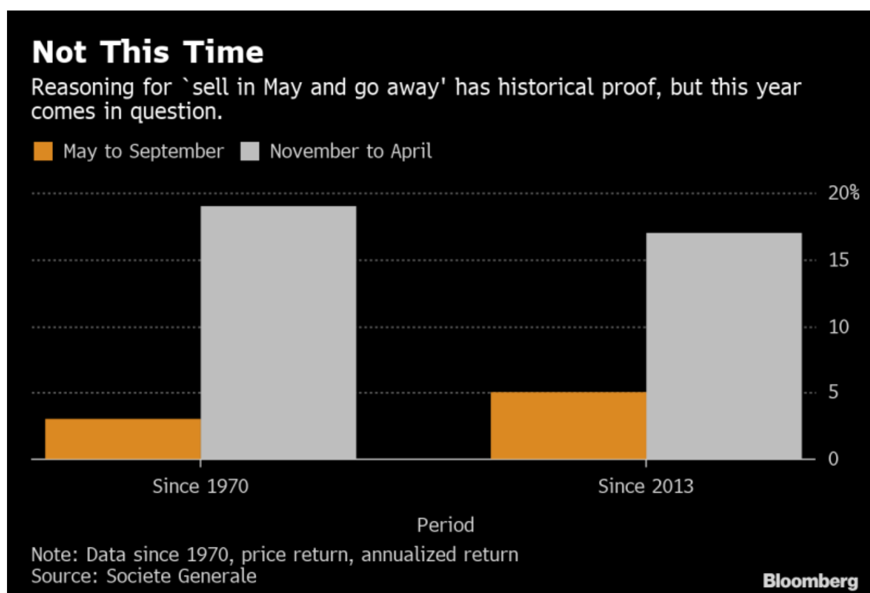
CHART OF THE MONTH-CONTINUED

"Why 'Sell in May and go away' won't work this year.

Their argument boils down to earnings downgrades. While it's true that market performance is typically worse between May and September than at the beginning and end of the year, the pattern generally coincides with profit forecast cuts. Earnings estimates are almost always too lofty at a year's start, and the downgrades typically cluster in June and October, according to the strategists.



But given that profit forecasts were furiously downgraded at the start of 2019, and now estimates are beginning to be revised higher as benchmarks reach records, further cuts in the warmer months are probably unlikely.

"2019 will be different as we started the year with already quite pessimistic expectations," the strategists wrote. "Going forward, we should see U.S. earnings growth bottoming out, as we think it is too early for an earnings recession cycle."

The firm sees room for the S&P 500 to rise to 3,000 in the near term -- a 2 percent gain from current levels.

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U.S.—China Trade War—How Concerned Should I Be?

CONTINUED

This will move this conflict into uncharted territory. These new actions will prevent negotiations with Beijing from moving forward. The big question on my mind and on the mind of many investors is: “How will this impact my investment portfolio?”

One of the biggest effects this dispute will have on our portfolios is an increase in the level of volatility. Expect to see major swings as news hits the airwaves. For example, US Treasury Secretary, Steven Mnuchin recently made a comment that he was hopeful that the two countries can reach an agreement to prevent a trade war. This simple statement resulted in the largest single day stock market gain since 2015. This single comment boldly underlines how easily any development in this story can seriously impact the movement of stock markets around the world.

An axiom in the investment business says that “bull markets rise on a wall of worry”. This has been particularly true of the last few years where we have seen a relentless bull market power ahead despite all the worrisome “bricks” like Brexit, US elections, European populism, North Korean tensions and on-going political pressures in the United States.

If this trade war persists, and it appears that it may, it will be critical for investors to rethink their portfolio allocations to help manage the wild and expected volatility. Diversification will be a key component in bulletproofing your portfolio. I continue to like equities but prefer exposure to a broadly diversified asset mix with over-weightings in defensive and more value oriented sectors as opposed to growth equities, Other asset classes to consider are alternative investments, absolute return funds and investments with lower correlations to the equity markets, will be essential to weather this storm.

At this point we seem to have more questions than answers, but one thing is clear to me: The situation is likely to get worse before it gets better. It is inevitable that at some point the fears will get fully reflected in the markets and the selling pressure will have run its course. The reality is that the direct economic effect, although negative, remains fairly small, as US/China trade is not a large component of either country’s GDP (less for the U.S., more for China, given the relative sizes of the two countries). What investors should also consider is that companies with tariff exposure are in the process of restructuring supply chains to avoid the tariffs, which will further mute the impact of those tariffs.

The big unknown will be in how President Trump behaves in the future. It is impossible to forecast what future measures he may impose. Aside from this, my belief is that the market will quickly price in the trade conflict and we can look forward with more optimism as the U.S. market fundamentals continue to point to long-term rising markets.

It is not all bad news out there. For example, volatility often breeds opportunity. As markets become more volatile and prices make large downward swings, investors will have the opportunity to add to their portfolios at discounted prices. Also, the trade conflict will likely restraint he Federal Reserve from future interest rate increases, which would support economic growth. We need look no further than the last few months to see that the rapid fall in bond yields have had a positive impact on the North American housing market as affordability has improved. I would venture to guess that the U.S. housing cycle is beginning to turn up again, which reduces the likelihood of a recession in the United States.

I tend to side with the thinking of Jamie Cox, managing partner for Harris Financial Group, who suggests that the best approach, for now, is to sit tight and see how things play out. He said, “Wild swings caused by criss-crossing headlines makes doing nothing the right choice for most investors.”

Risk & Return—Continued.

These days, an investor with a balanced risk tolerance (60% equity/ 40% bonds) should expect an annualized return of 5% before taxes. When a balanced investor is looking for a 6%-8% return, it presents challenges because it means the investor will have to take on additional risk. But it wasn't always like this.

Anyone who invested in the 1990s probably remembers double digit returns being the norm. In fact, a balanced investor's 5% return expectations today wouldn't even match a conservative return expectation in 1995.

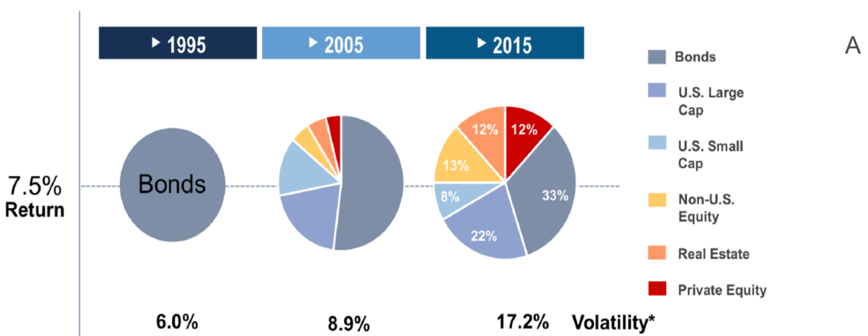
In 1995, a 7.5% return could be achieved by having a portfolio consisting entirely of bonds. Keep in mind this was the type of portfolio reserved mostly for investors in the latest stages of life and with low risk tolerances and subsequently a low standard deviation. We use standard deviation as a measure of risk in a portfolio. It is the probability of a portfolio's volatility moving around its mean return. For example, in 1995, a bond portfolio had a standard deviation of 6%, meaning the portfolio would fluctuate most of the time within a 6% range from it's 7.5% return (i.e. anywhere from 1.5% on the low end to 13.5% on the high end).

As time progressed, and the world changed, this same 7.5% return could still be achieved but investors would have to take on additional risk in their portfolios. For example, in 2005, a 7.5% return required the introduction of several new asset classes into the bond portfolio such as: U.S. large-cap equities, U.S. small-cap equities, non-U.S. equities, real estate and private equity. Bonds could still make up more than 50% of the portfolio; however, the addition of equities meant that the standard deviation also increased from 6% to 8.9%. That means the volatility of the portfolio would typically be in the range of -1.4% to 16.4%.

Unfortunately, things aren't any better closer to today. As of 2015, a return expectation of 7.5% required the investor to reduce his or her bond exposure to 33% of the portfolio. The other 67% would need to be invested in equities and real estate asset classes. This also means that the standard deviation increases to 17.2%. That's not a typo. A portfolio with a 7.5% return expectation will have a volatility that moves the portfolio within a range of between -9.7% and 24.7% most of the time.

To maintain the same expected 7.5% return today v. 20 years ago:

- More asset classes are needed to get same return
- Yet volatility has almost tripled since 1995!



7.5% return is achievable over the long term. It just means that investors have to ignore the bumpier ride we'll experience along the way. The truth is, investing like it's 1995 is no longer possible and there is no indication that we are headed that way again any time soon. Fortunately, fund companies understand this and as investors we're now offered a wide range of tools to help ease the burden. By including things like low volatility funds into a portfolio, we can mitigate some of that volatility. Also, as a replacement to bond exposure, infrastructure funds, which are a seperate asset class that were once only available to large pensions or instituional money, can now be used by the common investor. Even finding the best managers who know how to look for good companies to invest in can help reduce the downside of a portfolio.

It may not be as easy as it once was and constructing a good portfolio will require a little more hardened patience from the investor, but when all is said and done, the end goal can still be achieved.

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Labour Sponsored Investment Funds (“LSIF”) have tax credits that are subject to certain conditions and are generally subject to recapture, if shares are redeemed within eight years. Please note that Mutual Fund Representatives in Alberta are not permitted to sell LSIF.

An investor proposing to borrow for the purchase of securities should be aware that a purchase with borrowed monies involves greater risk than a purchase using cash resources only. The extent of that risk is a determination to be made by each purchaser and will vary depending on the circumstances of the purchaser and the securities purchased.

Discuss the risks associated with leveraged mutual fund purchased with an investment funds advisor before investing. Purchases are subject to suitability requirements. Using borrowed money to finance the purchase of securities involves greater risk than a purchase using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same if the value of the securities purchased declines.

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