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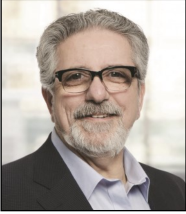
KPW LIFE PLAN—IMAGINE YOUR FUTURE

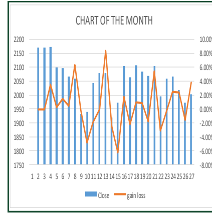
VOL. 8, ISSUE 6 JUN 2019

"OFFENSE SELLS TICKETS, BUT DEFENSE WINS CHAMPIONSHIPS." - Bear Bryant



Sergio Simone
EDITORIAL COMMENT

Kristina De Souza
INSURED RETIREMENT PLANS



WHY DOWNSIDE PROTECTION MATTERS

Ryan Simone, CLU, CHS
ESTATE PLANNING DISPOSITION OF ASSETS

Editorial Comment

Sergio Simone

Recently the markets have been quite volatile. This is the time that having a lower downside capture ratio is more important than having a higher upside capture ratio of the same magnitude. Mutual funds with lower downside capture ratios generally exhibit a lower overall risk than other mutual funds. The current late stage business cycle places a considerable amount of emphasis on these two ratios and what it means for an investment portfolio going forward.

Continue Reading

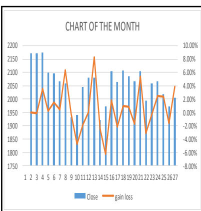
Insured Retirement Plans

Kristina De Souza

Despite the fact that these are not a new concept, Insured Retirement Plans (IRP) are making their way back to the headlines within our industry. This strategy initially surfaced in the 90's, under the premise of using a Universal Life (UL) insurance policy to supplement retirement income once other savings vehicles such as RRSPs (and more recently TFSAs) have been exhausted.

Continue Reading

Why Downside Protection Matters



As the average age of my clients increases, I have noticed that they have become less tolerant to market swings, let alone the prospect of losing money. Today, it is imperative that their investment strategies take their investments to the proverbial endzone.

Continue Reading

Estate Planning—Disposition of Assets

Ryan Simone, CLU, CHS

About a quarter of Canada's population is made up of Baby Boomers. The next largest cohorts are the children of baby boomers followed by Generation Z (the latest generation born after 1993).

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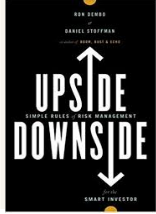
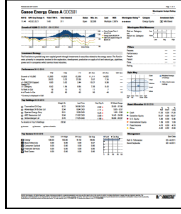


BOOK OF THE MONTH

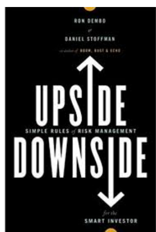


FUND OF THE MONTH TD CANADIAN LOW VOLATIITY CLASS

INVESTMENT TERMINOLOGY

BLOG OF THE MONTH BOOMER & ECHO

BOOK OF THE MONTH

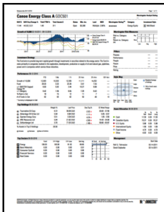


Upside Downside

—By Ron Dembo & Daniel Stoffman

Upside, Downside is a guide to the biggest danger facing investors in an increasingly uncertain world: financial risk. As a generation of investors knows, financial markets are vulnerable events—from terrorist attacks to epidemics—that are guaranteed to occur, yet impossible to predict. As markets become more complex and intertwined, investors feel increasingly unsure: how can you safeguard your financial prospects when you can't know what the future will look like?

FUND OF THE MONTH



TD Canadian Low Volatility Class

The Fund's objective is to achieve long-term capital appreciation by investing primarily in, or gaining exposure to, Canadian equity securities, while seeking to reduce volatility. TDAM uses proprietary risk models to review and identify Canadian stocks which have demonstrated lower long-term volatility. The model is then extended to assess correlations between stocks and sector concentrations with the aim of achieving an optimized portfolio.

INVESTMENT TERMINOLOGY

UPSIDE/DOWNSIDE CAPTURE RATIOS

The term "upside/downside capture ratio" might sound wonky, but the concept is pretty straightforward. In short, the statistics show you whether a given fund has outperformed—gained more or lost less than—a broad market benchmark during periods of market strength and weakness, and if so, by how much.

Continue Reading

BLOG OF THE MONTH

3 REASONS TO TAKE CPP AT AGE 60

It's generally not wise to voluntarily take up to a 36 percent reduction in income, especially if that income is paid for life. But that's exactly what happens to retirees who elect to take CPP at age 60.

I'm a big proponent of delaying CPP up to age 70 to help protect against longevity risk and enhance your monthly pension benefit in retirement. Only a small percentage of retirees do so, however, as many prefer to take CPP as soon as they're eligible.

Taking CPP early may not be the most optimal financial decision but there are a few cases where it can make sense. Here are three reasons to take CPP at age 60:

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

BARNES
INTERNATIONAL REALTY

ULTRA HIGH-NET-WORTH INDIVIDUALS: CONTINUED GROWTH

The global population of UHNWI (Ultra High-Net-Worth Individuals, those having more than 30 million dollars available for investment) is up 12.9% year-on-year, a marked acceleration after a 3.5% increase the year before.

Indeed, their number has increased from 226,450 to 255,810! During the same period, their combined wealth has increased from 27,000 to 31,500 billion US dollars, an impressive increase of 16.3%.

Continue Reading

THE SOCIAL NETWORK: WHERE THE WEALTHY ARE SPENDING THEIR TIME

A ground-breaking new study of social media activity for The Wealth Report reveals how our readers divide their time around the world.

We can track how wealth moves in many ways, but usually this will be at the level of capital transfers and investment flows, as well as more permanent population growth and migration trends.

Continue Reading

LIFE INSURANCE AND HIGH NET-WORTH CANADIANS

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 client's requirements, three in 10 wealthy 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.

Continue Reading

FOR THE FIRST TIME, WOMEN'S COLLECTIVE WEALTH WILL SOON ECLIPSE MEN'S

Next year will mark a full century since women in the United States were granted the constitutional right to vote. We've come so far in 100 years—and yet, when it comes to money, we still have a long way to go.

Financial inequity in our country has been culturally systemic for generations. And I'm not just talking about pay inequality. For a bit of perspective, it wasn't until 1975 that a woman could open a credit card without her husband or another male authority figure cosigning; and only in 1981 was a federal law passed that gave women the explicit right to be the sole executors of wills or estates.

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FUND MANAGER COMMENTARY

CLEMENT GIGNAC
IA CLARINGTON INVESTMENTS

DANIEL E CHORNOUS
RBC GLOBAL ASSET MANAGEMENT

ROBERT W. SHARPS
T. ROWE PRICE GROUP INC.

PHILIP PETURSSON
MANULIFE INVESTMENTS

Clement Gignac, Portfolio Manager, Chief Economist

IA Clarington Investments

Let's start with an update on the global economy and the ongoing U.S. and China trade tensions.

According to the most recent IMF forecasts, global GDP is expected to growth by 3.3% in 2019.

Continue Reading

Daniel E. Chornous, Chief Investment Officer

RBC Global Asset Management

The first quarter of the year, into late April, actually saw the stock markets in most places rise 20%, 25% from the Christmas lows. So it was a pretty spectacular beginning to 2019. Remember, as 2018 finished, you had a lot of pressure on markets: concern over ongoing rate hikes, protectionism. And all this with a backdrop of a historically aging economy in the U.S. and elsewhere

Continue Reading

Robert W. Sharps, Portfolio Manager, Head of Investments

T. Rowe Price Funds

Global Growth Should Improve If Trade Disputes Don't Worsen

Heading into the second half of 2019, senior T. Rowe Price investment leaders remain cautiously positive about global economies and financial markets, but they warn that political risks—in particular, escalating trade disputes—could

Continue Reading

Philip Petursson, Chief Investment Strategist

Manulife Investments

US & China Trade Tensions, So What?

What a difference a month makes in global markets, after a tremendous start to the year, global equity markets took a step backwards as U.S./China and U.S./Mexico trade tensions intensified. Investors' concerns resulted in the S&P/TSX, S&P 500, Stoxx Europe 600 and MSCE EAFE falling -3.3%, -6.6%, -5.7% and -5.4% respectively on the month. Despite the selloff in May, the majority of these equity markets are still up strongly for the year. Although investors are concerned, they have not reached the level of panic of the fourth quarter last year as measured by the CBOE Volatility Index (known by its ticker VIX). The VIX index sits nearly 16, nowhere near the levels of 25-30 that we saw between October and December of last year.

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What Investors Must Consider Amid U.S.-China Trade Tensions

As two opposed economic models emerge, companies must

Powell Signals Openness To Cut Rates If Needed On Trade Tension

Referring to "trade negotiations and other matters," Powell said

It's Not China Or The US: Here Are The Trade War's Winners—So Far

Vietnam has emerged as the largest beneficiary of a diversion

The Results Are In: A Look At The 2019 EU Election

While fringe parties to both the left and right did take several

ECB Raises Prospect of Rate Cut, Follows Fed Lead

Federal Reserve officials have indicated they could lower

Stressing Over The Mortgage Stress Test

When you look at the overall situation, clearly the housing market in Canada is slowing

Aging Parents & Financial Support

Some Canadians expect that supporting their parent(s) will postpone their retirement or delay paying off their debts

CRA Provides Clarity On The Tax On Split Income

New tax rules are often accompanied by uncertainty until they've been tested, and the expanded

Why Stocks Are Soaring While Bonds Tumble

Just as the S&P 500 was setting a record high on Thursday, bond yields were tumbling to their low

the balance

US ECONOMIC OUTLOOK FOR 2019 AND BEYOND

The U.S. economic outlook is healthy according to the key economic indicators. The most critical indicator is the gross domestic product, which measures the nation's production

2019 GLOBAL INVESTMENT CONFERENCE

One of the many excellent speakers, Brian Singer, spoke about "Preparing your portfolio for when the next bubble bursts". The monetary easing since the financial crisis has caused significant risks, but there are also opportunities which investors can take advantage of, said Brian Singer, head of the dynamic allocation strategies team and portfolio manager at William Blair. During the last four decades, there have been four "waves" of monetary policy easing, all of which ended with a reckoning where equity markets significantly dropped. "And now we are in the fourth wave," said Singer.

VIDEO LINKS

Paul Tudor Jones Says Fed Rate Cuts Are Coming And This Is What Investors Should Do

Investors should start adjusting

Positioning Your Portfolio For An Uncertain Business Cycle Turn

It's late in the business cycle. While no one knows exactly when

Inside The Markets: Expect A Recession In 2019

The Inside the Markets panel aren't fully in agreement, but a few think that a recession is a

Trade Uncertainty Dragging Down Global Growth

Global growth slowed sharply, and will remain weak. Trade growth has plunged and investment slowed. Job growth is supporting consumption, but living standards have not yet recovered from the crisis. Actually, there were two crisis—first the dot-com bubble, after which strong growth resumed; then the global financial crisis. Growth has since been stuck at relatively mediocre rates. The global economy peaked in 2017.

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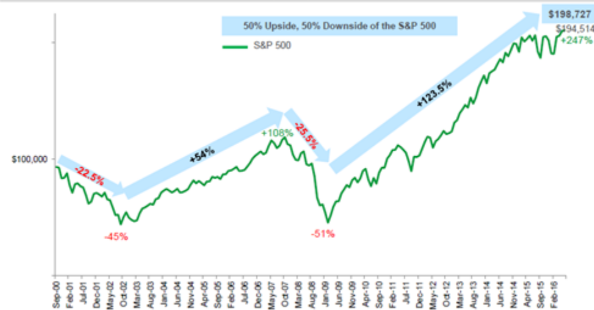
EDITORIAL COMMENT-CONTINUED

If we are to learn something from negative events, the biggest takeaway from the global financial crisis of 2008/9 was to understand how quickly and painfully investment losses can occur and how long it can take to recover from those losses. Conventional wisdom holds that the older an investor is the less ability and time there is to absorb adverse market events. In simple terms, “they likely won’t have a second kick at the can.” Although painful, this situation has much less impact on a younger investor but could be devastating for a pre-retirement or post-retirement investor. Investors were not the only ones to learn from this crisis. Many mutual fund managers made strong commitments to pay more attention to and mitigate downside risk by constructing portfolios with objectives that focused on losing less than the market during downturns.

Why Limiting Volatility (Downside Risk) is so Important
50% Upside/Downside Capture

S&P 500 versus 50% Upside/50% Downside Capture (8/31/00- 9/30/16)



Source: Crestmont and Morningstar as of 9/30/16. Past performance does not guarantee or indicate future results.

When we do our due diligence on a fund manager, a primary concern is trying to understand the fund managers “view of the world”, and make no mistake about it, most managers have an opinion of how the markets work and what the impact will be on their portfolios. For example, some managers believe in a laissez-faire or passive approach to investing using indexes. This approach has gained many proponents for the simple reason that this extended bull market is now in the late stages which makes it more difficult for a manager to outperform the index they are being compared to. Other mangers use a GARP (Growth at a Reasonable Price) approach while others focus on trying to find undervalued positions.

Although any of these managers can produce excellent results, my opinion is that it is best to understand the current risk/reward environment and to focus on losing the least amount possible during the next severe downturn that will eventually occur.

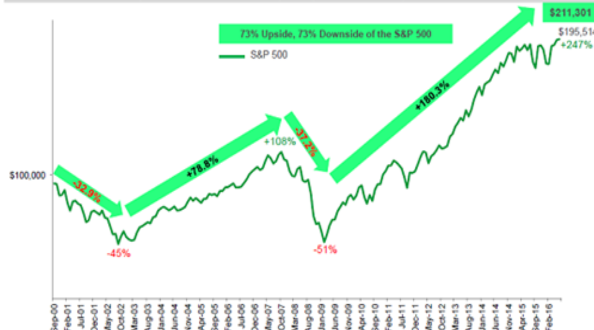
This really does make good sense as it is obvious that protecting from losses during a falling market leaves more capital to grow when the markets turn bullish which they inevitably will. This will lead to quicker recoveries and studies have proven that downside protection can be highly correlated to long-term market outperformance. I do understand that it makes sense to focus on gains in the middle of a bull market, but downside protection can be a powerful contributor to market outperformance and long-term wealth generation.

The following chart the real return of the S&P 500 (green line) and a hypothetical return of a portfolio that captured 50% of the upside during rising markets and 50% of the downside during falling markets since 2000. While it seems to go against common sense, capturing half the upside and half the downside actually produced a better return than the index.

Mark Peterson, the Director Investment Strategy and Education at BlackRock. Wanted to determine what the optimal Upside/Downside Capture percentage was. His research led to the conclusion illustrated on the following chart.

Why Limiting Volatility (Downside Risk) is so Important
Optimal Upside/Downside Capture 73%

S&P 500 versus 73% Upside/ 73% Downside Capture (8/31/00- 9/30/16)



Source: Crestmont and Morningstar as of 9/30/16. Past performance does not guarantee or indicate future results.

During this seventeen year period of time, capturing 73% of both the upside and the downside would have produced the most superior results.

The science behind this phenomenon concludes that, due to the asymmetry of gains and losses, protecting capital during falling markets can have a large impact on the total return of an investment, especially over the long term.

EDITORIAL COMMENT-CONTINUED

For example, your portfolio would have to gain 11.1% to offset a loss of only 10%. The rate and magnitude of this asymmetry increases as the rate of the decline increases. So, a loss of 50% would require a subsequent gain of 100% to break even. This suggests that limiting losses would have a more powerful effect on long-term growth potential than achieving an equivalent nominal positive return.

Eleven years ago, the S&P/TSX Composite Index hit a peak of 15,154.7. A mere five months later the index had fallen to 7,647.11, a drop just shy of 50%. It wasn't until five and a half years later that the index recovered these losses.

If an investor had participated in 100% of the downside and 100% of the upside, their portfolio would have been underwater for almost six years. To illustrate the value of NOT participating in the entire downside, if an investor had only realized half the loss of the index (around 24%), and only participated in half of the positive return during the recovery, it would have taken only two years to recoup the portfolio losses, not five and a half years.

The research irrefutably suggests that favorable downside capture correlates with better excess returns, lower volatility and higher risk-adjusted returns. During this late stage of the market cycle where volatility dominates, investors would be wise to position their portfolios to minimize the downside capture of the markets as mutual funds with lower downside capture ratios tend to exhibit lower overall risk.

CHART OF THE MONTH-CONTINUED

There is a lot of geopolitical noise out there and it is making investors very nervous. When you add to this the fact that we are in the late stages of a bull market, it is easy to conclude that we may be looking at a low rate, low growth investment environment going forward.

The challenge for us is to generate attractive returns while preserving capital during the inevitable market downturns. To this end, our focus begins to shift to capital preservation from capital growth. Downside protection becomes the number one priority. This matters more than most investors realize because losing less during a correction or recession means that less gains are required to bounce back. In fact, this is the stage in the business cycle when avoiding losses becomes more important than achieving gains. The following chart shows the percentage gain required to recover from a drawdown.

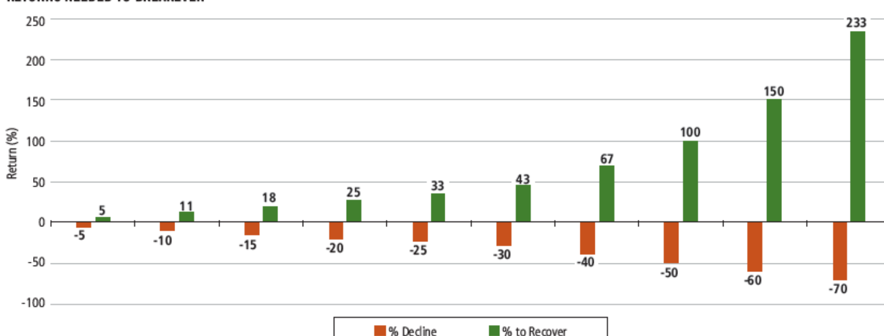
As you can see in the chart, the returns required increases exponentially as losses deepen. A drawdown of 10% would require a gain of approximately 11% to recover the loss whereas, a drawdown of 50% would require a doubling of your return to recover the losses. Before you question the likelihood of this happening, we only need to go back to 2008/9 to have experienced this kind of portfolio drop. The last bars on the chart show that a gain of 233% would be needed to recover from a portfolio drop of 70%.

This chart demonstrates that a dollar of excess return in a down market is worth much more than a dollar of excess return in an up market. I would argue that it is more important to protect the downside than it is to focus on the upside.

WHY DOWNSIDE PROTECTION MATTERS

Suppose you had a portfolio of $100,000 which suffered a loss of 20%. This would make the new base $80,000. A return of 20% would only bring the portfolio up to $96,000. ((20% * $80K) +80K) = $96K. In actuality, a return of 25% is needed. The chart below shows the returns needed just to break even.

RETURNS NEEDED TO BREAKEVEN



Source: Manulife Investments. For illustration purposes only.

There are very few investment strategies that can weather a recession or depression. The way to outperform benchmarks during these down periods is to maintain a well diversified portfolio that will only capture a smaller portion of the downturn. This same portfolio should be designed to capture a higher percentage of the upside when the market recovers. Many “Alternative Asset” investments will fall into this category. These types of investments often fall between the typical equity or bond allocations. They encompass investments like “bank loans, high yield debt, emerging-market local and hard currency, mortgage-backed securities, and other alternative strategies.” Many of these strategies have a low correlation to traditional types of investments.

I truly understand that chasing growth is sexy and exciting, but savvy investors will understand that protecting against downside risk may give you more bang for your buck in the long run.

Insured Retirement Plans—Continued

During one's earning years, the deposits in the UL policy accrue on a tax-deferred basis, with the growth obviously depending on the investments within the policy. Until one retires, the key is to overfund the UL policy (up to the allowable limits of course) in order to maximize the growth of the cash value within the policy. Once the individual enters retirement, they take out a bank loan using the cash value of the UL policy as collateral, which is referred to as a "collateral loan". Ultimately, the loan interest may be capitalized, while the outstanding loan balance and interest can be repaid with the proceeds of the death benefit; which happens to be tax-free. In addition, any excess death benefit that remains after the loan is paid off is paid out to the beneficiaries free of tax.

Following is an example of how this arrangement works. An individual purchases a universal life insurance policy when they are 45 years old, and over the next 20 years they accumulate $1,000,000 of tax sheltered funds within the policy. Upon retirement, a bank loan is taken out, and the million dollars is used as collateral to withdraw $50,000 each year (tax-free because these withdrawals are a loan). The loan then continues to accumulate and accrue interest until the death of the policy owner, at which point the insurance policy is utilized to pay off the loan.

Like any great theory, insured retirement plans are not for everyone, and elicit both benefits and risks that are all worth discussing. One of the most significant factors to consider when it comes to IRPs is their suitability. The understanding is that these plans produce the most benefits once other savings vehicles have been maximized. Some argue that pensions, tax-free savings accounts, and RRSPs are better options, while IRPs only hold a secondary place when it comes to planning for retirement.

Also, like many other investment vehicles, there are fees and expenses associated with the IRPs; after all nothing (good) comes for free. Specifically, the investments used within the UL policy may have MER's (Management expense ratios) and/or DSC (Deferred sales charges) attached to them, which, when used inappropriately can lead to diminished returns and reduced flexibility. These fees need not be a deterrent, but rather, it is important that they be considered when it comes to assessing whether this plan is right for you.

Another risk factor to consider stems from the vary basis of this strategy- tax savings.

As it stands, RRSPs cannot be used as collateral for a loan, while IRPs rely on the tax free accumulation of funds in a sheltered investment and ultimately accessing them without triggering taxes. Like any other tax efficient strategy, there is always the risk that the CRA will change tax regulations preventing one from using the policy as collateral, but the likelihood of this happening remains up for debate. Generally speaking, CRA does not look kindly upon vehicles that take advantage of tax loopholes; but as it stands IRPs are fully acceptable to date. This risk can certainly be mitigated by ensuring there is an actual need for the life insurance. UL policies have a multitude of benefits including wealth enhancement, estate protection, increased investment options, and creditor protection. Although IRPs work using the UL policy, they certainly should not be the sole purpose for purchasing a policy.

Interest rate risk can also be of concern, specifically as it relates to the loan upon retirement. Bank loans are only allowed to reach a certain percentage of the collateral they are backed by. Should there be a high interest rate on a loan near retirement, the loan amount can surpass the value of the insurance policy, forcing the loan to be called. This would eliminate the valuable tax-free annual income and require a full loan repayment with potential taxes being owed as the result of the "sheltered" funds from a cancelled policy.

As most investors know, there is risk inherent in many of the very best strategies available today. The key is to be aware of the risks, fully understand a strategy, seek the advice of knowledgeable professionals, and use this knowledge to decide if something is right for you. IRPs have their place and are undoubtedly appropriate for certain investors. They are a great way to offer protection by meeting one's life insurance needs while simultaneously offering a method of supplementing future retirement income.

Estate Planning—Disposition of Assets—Continued.

Parents of the baby boomers are now entering their 80's and 90's and we're starting to see large transfers of wealth occurring across generations. It's a theme in financial planning that I suspect will come up with greater urgency over the coming years.

As Benjamin Franklin once said: "nothing is certain but death and taxes". So, what happens when a Canadian taxpayer dies? Quite simply, the person is deemed to have disposed of all his or her assets and this means taxation will apply on any capital gains triggered by their sale. These gains are then included in a final tax return filed in the year of death.

The primary strategy for deferring taxes at death is to transfer assets to a surviving spouse. However, this does little to help boomers who are in a position to inherit assets from a deceased parent. This means real estate, gains in investment portfolio's, and any other assets will be included in the final return. A large sum will put the deceased taxpayer in the highest tax bracket meaning a significant portion of the inheritance can go to the CRA.

This could also mean an estate executor may be forced to sell a property the estate heirs were hoping to keep. I've seen this happen with family cottages. In one example, a cottage being passed down had a capital gain of over $1.5 million.

The deceased had no estate plan in place, no insurance and little in the form of liquid assets like cash or investments. The tax bill on the terminal return was around $300,000; a sum that could only be paid through the sale of either the cottage property or the deceased's home. This is also an example of the importance of diversifying one's money and having an estate plan.

Real estate can be a great investment, but it can also put limitations on the effectiveness of an estate distribution if proper planning isn't done. Real estate is not very liquid and when cash is needed it may require disposing of the home or property in question.

These types of dilemma's are be avoided through several different strategies. For example, insurance is a popular strategy because the proceeds are paid tax free to the beneficiaries (as long as the beneficiary isn't the estate). This can then be applied to the terminal return leaving all assets available to the heirs. Trusts can also be used to distribute assets; however, taxation will still be an issue.

Where trusts excel is in their flexibility and their ability to ensure that assets are distributed exactly as the deceased wanted. Having a valid will is also important. Again, it won't help much with taxation, but it will reduce the cost of probate and ensure that the distribution of assets isn't determined by the province.

I suspect that as more and more baby boomers finalize their parents' estates, we will see a surge in discussions around estate planning. Boomers who have experienced any kind of trouble administering a parent's estate will want to make sure it doesn't happen with their own children.

I would caution that each case is unique, and it is best to seek professional guidance on these matters. Involving an estate planner, lawyer, and accountant can seem a daunting task but, in the end, a properly organized estate will be one of the best things you could ever leave an heir.

Philip Petursson—Continued.

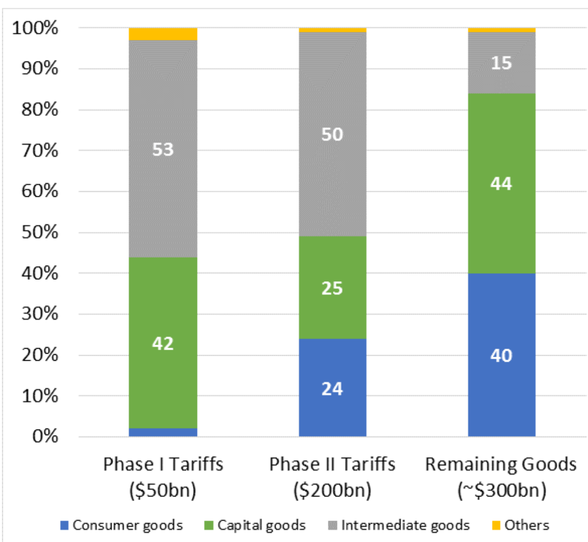
Prospects for a speedy conclusion to the U.S.-China trade tensions have dimmed but we continue to believe that it is unlikely to lead into a full blown trade war. A full blown trade war would include a further increase of tariffs , export bans of rare earth metals from China to United States (the U.S. imports 60% of these metals form China used in 'anything' technology related), and a dumping of U.S. Treasuries by China which would contribute to intensified recessionary risks, an undesired outcome for both countries.

Initially, President Trump saw his administration as negotiating from a position of strength over the past couple of months, founded on a rock-solid U.S. economy. Gross domestic product in the first quarter rebounded from the end of 2018. The April jobs report showed the U.S. economy added a robust 224,000 jobs and the unemployment rate fell to 3.6% (the lowest in nearly 50 years). But there are reasons to be cautious on the underlying strength of the U.S. economy as manufacturing, housing and car sales continue to trend downwards, likely resulting in weaker U.S. economic growth going forward. Also, last Friday, the May labour report showed that the U.S. economy added only 75,000 jobs. Is this the first sign of employment weakening in the U.S.?

China's economic position is no different. It appears that the massive amounts of stimulus implemented by the Chinese government in the second half of last year was having some impact on stabilizing their economy in the early part of 2019. However, that has suddenly reversed course as China's manufacturing PMI fell back into contraction territory in May with concerns over the Chinese economy having resurfaced.

From a political perspective, an escalation in U.S./China trade tension could not have come at a worst time with a U.S. election in the near future. The threatened 25% tariff on the remaining ~$300b worth of goods would have a more material impact on the US consumer than the first two rounds of tariffs, for two reasons: the value of affected goods is about 50% larger, and will target more consumer goods (clothing, shoes, electronics and toys to name a few). Whereas consumer goods made up only 1% of Phase I tariffs ($0.5b), and 24% of Phase II tariffs ($50b), they make up 40% of the remaining imports from China ($120b). The latest tariffs (Phase II) will add another $500 - $750 a year in costs for the average U.S. household according to many economists. If the U.S. were to go ahead with Phase III tariffs, the additional cost to the average U.S. household would likely be in the thousands. The result could see millions of Americans sticking with their old washing machines, televisions and computer monitors, and refrain from buying new clothes and furniture. But they may have a harder time avoiding the shops for their kids' birthdays and during the busy holiday season when children expect new electronics and toys. This is not an environment that would favor a re-election bid by President Trump who has campaigned on his acumen as a businessman. President Trump has proclaimed that the barometer of his success should be the economy and the stock market – a continued trade war will have chilling effects on both.

The Composition of U.S. Imports From China Subject To Section 301 Tariffs



Source: Manulife Asset Management

In last month's email we pondered whether these negotiation tactics could have an impact on global economic activity and earnings over the next couple of years. We may be seeing the early signs that an unstable business environment is negatively impacting growth. For example, CEO and business confidence has deteriorated over the past six months which will likely lead to weaker hiring (an area of strength in the United States) and investment. Recent Global Purchasing Manager Indices signaled that manufacturing downshifted into contraction during May. Business conditions deteriorated to the greatest extent in over six-and-a-half years, as production volumes stagnated and new orders declined at the fastest pace since October 2012. The trend in international trade continued to weigh on the global manufacturing sector, with new export business contracting for the ninth month running. Business optimism fell for the second month in a row and to its lowest level since future activity data were first collected in July 2012.

Philip Petursson—Continued.

Global Manufacturing PMI Heat Map

	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19
JPMorgan Global PMI	52.6	52.6	52.7	53.2	53.3	53.5	54.1	54.5	54.4	54.1	53.3	53.5	53.1	53.0	52.8	52.6	52.2	52.0	52.0	51.4	50.8	50.6	50.5	50.4	49.8
United States	52.7	52.0	53.3	52.8	53.1	54.6	53.9	55.1	55.5	55.3	55.6	56.5	56.4	55.4	55.3	54.7	55.6	55.7	55.3	53.8	54.9	53.0	52.4	52.6	50.5
Canada	55.1	54.7	55.5	54.6	55.0	54.3	54.4	54.7	55.9	55.6	55.7	55.5	56.2	57.1	56.9	56.8	54.8	53.9	54.9	53.6	53.0	52.6	50.5	49.7	49.1
Mexico	51.2	52.3	51.2	52.2	52.8	49.2	52.4	51.7	52.6	51.6	52.4	51.6	51.0	52.1	52.1	50.7	51.7	50.7	49.7	49.7	50.9	52.6	49.8	50.1	50.0
U.K.	56.7	54.3	55.3	56.7	55.9	56.6	58.2	56.3	55.3	55.0	54.9	53.9	54.3	54.3	53.8	53.0	53.6	51.1	53.6	54.2	52.6	52.1	55.1	53.1	49.4
Eurozone	57.0	57.4	56.6	57.4	58.1	58.5	60.1	60.6	59.6	58.6	56.6	56.2	55.5	54.9	55.1	54.6	53.2	52.0	51.8	51.4	50.5	49.3	47.5	47.9	47.7
Germany	59.5	59.6	58.1	59.3	60.6	60.6	62.5	63.3	61.1	60.6	58.2	58.1	56.9	55.9	56.9	55.9	53.7	52.2	51.8	51.5	49.7	47.6	44.1	44.4	44.3
Switzerland	55.6	60.1	60.9	61.2	61.7	62.0	65.1	65.6	65.3	65.5	60.3	63.6	62.4	61.6	61.9	64.8	59.7	57.4	57.7	57.5	54.3	55.4	50.3	48.5	48.6
Holland	57.6	58.6	58.9	59.7	60.0	60.4	62.4	62.2	62.5	63.4	61.5	60.7	60.3	60.1	58.0	59.1	59.8	57.1	56.1	57.2	55.1	52.7	52.5	52.0	52.2
France	53.8	54.8	54.9	55.8	56.1	56.1	57.7	58.8	58.4	55.9	53.7	53.8	54.4	52.5	53.3	53.5	52.5	51.2	50.8	49.7	51.2	51.5	49.7	50.0	50.6
Italy	55.1	55.2	55.1	56.3	56.3	57.8	58.3	57.4	59.0	56.8	55.1	53.5	52.7	53.3	51.5	50.1	50.0	49.2	48.6	49.2	47.8	47.7	47.4	49.1	49.7
Spain	55.4	54.7	54.0	52.4	54.3	55.8	56.1	55.8	55.2	56.0	54.8	54.4	53.4	53.4	52.9	53.0	51.4	51.8	52.6	51.1	52.4	49.9	50.9	51.8	50.1
Ireland	55.9	56.0	54.6	56.1	55.4	54.4	58.1	59.1	57.6	56.2	54.1	55.3	55.4	56.6	56.3	57.5	56.3	54.9	55.4	54.5	52.6	54.0	53.9	52.5	50.4
Czech Republic	56.4	56.4	55.3	54.9	56.6	58.5	58.7	59.8	59.8	58.8	57.3	57.2	56.5	56.8	55.4	54.9	53.4	52.5	51.8	49.7	49.0	48.6	47.3	46.6	46.6
Hungary	61.9	56.9	54.2	56.8	59.3	58.3	58.8	60.5	61.1	57.2	56.6	53.3	55.2	52.9	53.3	56.0	54.1	57.1	53.5	54.3	54.7	55.5	52.5	55.2	57.9
Poland	52.7	53.1	52.3	52.5	53.7	53.4	54.2	55.0	54.6	53.7	53.7	53.9	53.3	54.2	52.9	51.4	50.5	50.4	49.5	47.6	48.2	47.6	48.7	49.0	48.8
Greece	49.6	50.5	50.5	52.2	52.8	52.1	52.2	53.1	55.2	56.1	55.0	52.9	54.2	53.5	53.5	53.9	53.6	53.1	54.0	53.8	53.7	54.2	54.7	56.6	54.2
Australia	54.8	55.0	56.0	59.8	54.2	51.1	57.3	56.2	58.7	57.5	63.1	58.3	57.5	57.4	52.0	56.7	59.0	58.3	51.3	49.5	52.5	54.0	51.0	54.8	52.7
New Zealand	50.0	49.5	47.5	48.6	50.9	50.1	50.5	55.1	56.0	53.4	54.9	58.8	55.1	59.4	57.1	54.3	55.7	57.0	56.4	56.2	56.5	58.4	55.2	52.6	53.3
Japan	53.1	52.4	52.1	52.2	52.9	52.8	53.6	54.0	54.8	54.1	53.1	53.8	52.8	53.0	52.3	52.5	52.5	52.9	52.2	52.6	50.3	48.9	49.2	50.2	49.8
China (caixin)	49.6	50.4	51.1	51.6	51.0	51.0	50.8	51.5	51.5	51.6	51.0	51.1	51.1	51.0	50.8	50.6	50.0	50.1	50.2	49.7	48.3	49.9	50.8	50.2	50.2
South Korea	49.2	50.1	49.1	49.9	50.6	50.2	51.2	49.9	50.7	50.3	49.1	48.4	48.9	49.8	48.3	49.9	51.3	51.0	48.6	49.8	48.3	47.2	48.8	50.2	48.4
Taiwan	53.1	53.3	53.6	54.3	54.2	53.6	56.3	56.6	56.9	56.0	55.3	54.8	53.4	54.5	53.1	53.0	50.8	48.7	48.4	47.7	47.5	46.3	49.0	48.2	48.4
Vietnam	51.6	52.5	51.7	51.8	53.3	51.6	51.4	52.5	53.4	53.5	51.6	52.7	53.9	55.7	54.9	53.7	51.5	53.9	56.5	53.8	51.9	51.2	51.9	52.5	52.0
Indonesia	50.6	49.5	48.6	50.7	50.4	50.1	50.4	49.3	49.9	51.4	50.7	51.6	51.7	50.3	50.5	51.9	50.7	50.5	50.4	51.2	49.9	50.1	51.2	50.4	51.6
Malaysia	48.7	46.9	48.3	50.4	49.9	48.6	52.0	49.9	50.5	49.9	49.5	48.6	47.6	49.5	49.7	51.2	51.5	49.2	48.2	46.8	47.9	47.6	47.2	49.4	48.8
Singapore	51.4	50.7	51.3	53.2	53.7	54.2	54.4	52.1	53.6	55.3	53.7	55.6	56.8	56.0	53.0	51.1	49.6	52.6	53.8	52.7	50.1	49.8	51.8	53.3	52.1
India	51.6	50.9	47.9	51.2	51.2	50.3	52.6	54.7	52.4	52.1	51.0	51.6	51.2	53.1	52.3	51.7	52.2	53.1	54.0	53.2	53.9	54.3	52.6	51.8	52.7
Brazil	52.0	50.5	50.0	50.9	50.9	51.2	53.5	52.4	51.2	53.2	53.4	52.3	50.7	49.8	50.5	51.1	50.9	51.1	52.7	52.6	52.7	53.4	52.8	51.5	50.2
Turkey	53.5	54.7	53.6	55.3	53.5	52.8	52.9	54.9	55.7	55.6	51.8	48.9	46.4	46.8	49.0	46.4	42.7	44.3	44.7	44.2	44.2	46.4	47.2	46.8	45.3
South Africa	50.2	49.0	50.1	49.8	48.5	49.6	48.8	48.4	49.0	51.4	51.1	50.4	50.0	50.9	49.3	47.2	48.0	46.9	48.2	49.0	49.6	50.2	48.8	50.3	49.3
Saudi Arabia	55.3	54.3	55.7	55.8	55.5	55.6	57.5	57.3	53.0	53.2	52.8	51.4	53.2	55.0	54.9	55.1	53.4	53.8	55.2	54.5	56.2	56.6	56.8	56.8	57.3
Russia	52.4	50.3	52.7	51.6	51.9	51.1	51.5	52.0	52.1	50.2	50.6	51.3	49.8	49.5	48.1	48.9	50.0	51.3	52.6	51.7	50.9	50.1	52.8	51.8	49.8

With profit margins at a historically high level and a buildup of inventories over the past couple of quarters, it is likely that earnings growth has peaked for this cycle. It is becoming increasingly apparent that we are nearing the end of the current economic cycle measured by levels of employment, credit conditions and manufacturing. We continue to believe the odds of recession risk for the coming 12-months are low however, the risks are increasing as a result of a potential trade war. At this point in the cycle, we believe it's not prudent for investors to be picking up pennies (low returns) in front of a steam roller (potential recession). Therefore, as we outlined earlier in the year, we believe it will be prudent for investors to take advantage of equity market strength and reduce exposure as the opportunities to take profits presents itself. As of the end of March, we reduced our equity holding from 65% to 60%. At the end of June, we will likely continue reducing our equity position in our model portfolio in either a 5 or 10% increment dependent on market and economic performance. We advocate diversification, asset allocation, and discipline when it comes to investing. Shifting one's asset allocation is prudent at times, and it's even more crucial at this point in the cycle.

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