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KPW LIFE PLAN—IMAGINE YOUR FUTURE

VOL. 7, ISSUE 10 OCTOBER 2018

"The key to making money in stocks is not to get scared out of them." ~ Peter Lynch

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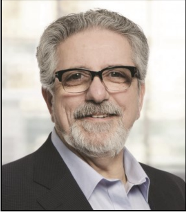
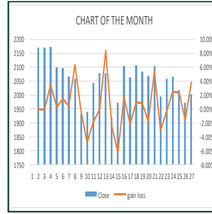


Sergio Simone
EDITORIAL COMMENT

Sergio Simone
IS THIS THE END OF THE BULL MARKET?



IGNORE THE MIDTERM ELECTION YEAR

Ryan Simone
ESTATE FREEZE—THE BASICS

Editorial Comment

Sergio Simone

Markets tend to experience high volatility during times it is trying to find a direction. These periods of high volatility are not unusual and in fact are inevitable. A few short weeks ago, we were all reveling in the new highs set by the S&P 500. Since then the index has retreated by 6.7% (USD). The typical reaction to a market correction has not changed since the stock indices were created.

Continue Reading

Is This The End Of The Bull Market?

Sergio Simone

The equity market sold off recently amidst what first appeared to be a perfect storm of rising interest rates and a downgrade for economic growth by the International Monetary Fund (IMF), all against a backdrop of a Fed focused on a tightening policy, a rising U.S. Dollar, uncertainty in the Eurozone and on-going trade disputes between the U.S. and China. Almost immediately a large part of the investment community responded with concerns that the current bull market had reached the pinnacle of its cycle and was heading south.

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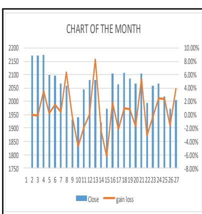
Ignore the "Midterm Election Year"



October 2017—September 2018 (i.e. this year) is the 2nd year of the "presidential cycle", also known as the midterm election year.

According to conventional seasonality, the midterm election years is "supposed to be weak (bearish)."

Continue Reading

Estate Freeze—The Basics

Ryan Simone

An estate freeze is an important estate planning strategy often utilized as part of an owner-manager's business succession planning. To effectively orchestrate a business succession strategy both the personal and business needs of the owner will be taken into consideration.

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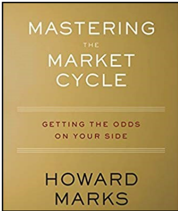
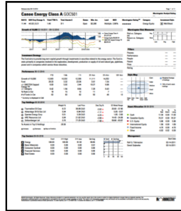
VOL. 7, ISSUE 9

SEPTEMBER 2018



BOOK OF THE MONTH



FUND OF THE MONTH
Ivy Foreign Equity Fund

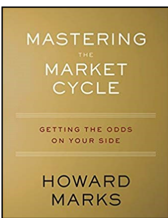
INVESTMENT TERMINOLOGY

BLOG OF THE MONTH
LESSONS OF THE FALL

Book of the Month

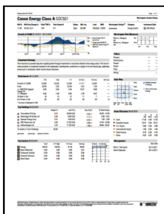
Mastering the Market Cycle

By Howard Marks



We all know markets rise and fall, but when should you pull out, and when should you stay in? The answer is never black or white, but is best reached through a keen understanding of the reasons behind the rhythm of cycles. Confidence about where we are in a cycle comes when you learn the patterns of ups and downs that influence not just economics, markets and companies, but also human psychology and the investing behaviors that result.

Fund of the Month—Mackenzie Ivy Foreign Equity Fund - A



A Low Volatility Foreign Equity Fund that pursues long-term capital growth consistent with protection of capital. The Fund invests in equity securities worldwide, emphasizing companies that operate globally. The Fund's investments are not limited geographically but generally do not include investments in emerging markets.

Investment Terminology

Volatility (From The Investor's Point of View)

Stock market volatility is arguably one of the most misunderstood concepts in investing. Simply put, volatility is the range of price change a security experiences over a given period of time. If the price stays relatively stable, the security has low volatility. A highly volatile security is one that hits new highs and lows, moves erratically, and experiences rapid increases and dramatic falls.

Because people tend to experience the pain of loss more acutely than the joy of gain, a volatile stock that moves up as often as it does down may still seem like an unnecessarily risky proposition.

Continue Reading

BLOG OF THE MONTH

Stock Market Outlook: Lessons of the Fall

Investors shouldn't obsess about past Octobers, but history can be one useful data point when making investing decisions.

The mere mention of October is enough to frighten some investors, while others wonder, "What's the big deal?" It all comes down to perspective. Sure, five of the stock market's worst 10 days happened in October—including 1987's more-than—20% plunge—but overall, it's a pretty average month for the market.

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

Business Immigration To Canada As A Quebec Investor Program Applicant in 2018

Canada is the World's Top destination for Business Immigration of High Net Worth Families due to its very Popular Government Managed Quebec Investor Program, its security, quality of life, Low Business Taxes, best access to Free Trade Agreements Worldwide, Welcoming of Immigrants from all nations, and Canada does not have Wealth or Inheritance taxation. Planning for Immigration to the best country on the planet is easier knowing that Business Immigration to Canada programs are Government regulated and supervised unlike in other countries.

Continue Reading

GETTING TO KNOW HIGH NET WORTH INVESTORS IN CANADA

The High Net Worth (HNW) population in Canada is a growth story that is becoming increasingly complex in terms of the wealth management needs and expectations of its members. This white paper addresses the opportunity for financial advisors represented by the 790,000 millionaire households in Canada and seeks to identify the key issues that need to be considered by advsiors as they seek to attract and retain HNW clients. We analyzed the demand side—HNW clients and their families—then the supply side, including financial advisors and other providers of advice and investment management services

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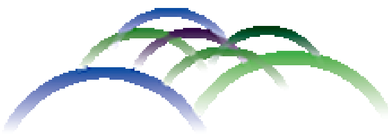

Lesniewski Moore
Consulting Group Inc.

INDIVIDUAL PENSION PLANS

An IPP is a corporate sponsored defined benefit pension plan created on behalf of one or two individuals. The object of the IPP is to fund the maximum lifetime pension benefit permitted under the Income Tax Act. Retirement may occur between the ages of 55 and 71. Contributions may reflect service with the same or a related employer prior to plan implementation—even where RRSP contributions have been maximized!

Continue to Video

TAX-EXEMPT LIFE INSURANCE FOR WEALTH CREATION AND ESTATE MAXIMIZATION

Life insurance has always provided a solid foundation in any financial plan. It provides protection for you and your family in the event of a disastrous situation, and has come to be regarded as a necessary expense in hedging the risk of future financial loss.

But have you also considered that life insurance can be another asset within your overall portfolio?

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FUND MANAGER COMMENTARY

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SEBASTIEN Mc MAHON
IA CLARINGTON

PHILIP PETURSSON
MANULIFE INVESTMENTS

JEAN-PHILIPPE BRY
CI INVESTMENTS

NICK PRICE
FIDELITY INVESTMENTS

Sebastien Mc Mahon, Senior Economist

I. A. Clarington

Fall Conference Call, October 2, 2018

Goodbye NAFTA, Welcome USMCA!

A difficult trade war was avoided in North America with an eleventh

Continue Reading

Philip Petursson, Chief Investment Strategist

Manulife Investments

Haven't we met before?

The US 10-year Treasury yield broke above its prior resistance level of 3.11% making time above 3.2% before settling back to 3.18% at time

Continue Reading

Jean-Philippe Bry, Vice-President, Portfolio Management

CI Investments

SIGNATURE'S POSITION ON THE EQUITY MARKET SELL-OFF

To quote the market's most stable genius in chief, Donald Trump, a stock market correction was overdue. A correction was something we have been anticipating, and highlighted as recently as early October at our conference in Scottsdale, Arizona.

Continue Reading

Nick Price, Portfolio Manager

Fidelity Investments

Emerging Markets: A Perfect Storm: Headwinds have been plentiful this year but I would cite tightening US monetary policy and associated dollar strength as the primary headwind for the asset class. The relationship of the US dollar to emerging market (EM) assets is well known, and so the extent to which markets have come under pressure is not a surprise to me. Clearly as the year progressed, the pace of US interest rate hikes under the watch of a new Governor has unsettled EM investors.

While I understand the reasons for dollar strength, I would reiterate a view that I have long maintained, that a lofty dollar places strain on the US economy—weighing on competitiveness, to the detriment of overseas trade. Certainly on a trade-weighted basis the dollar appears very extended. In stark contrast, EM currency weakness has been pronounced, but the pain is most evident amongst those countries that look particularly vulnerable to dollar

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LINKS

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CRA Targets RRSP, TFSA Abuses In Long-Awaited Tax Document

Hot on the heels of a much-anticipated tax document release,

IMF Cuts Forecast For Global Growth For First Time In Two Years As Trade War Takes Toll

Risks to the global outlook have

Why The USMCA May Lead To Higher Interest Rates

Canadian investors may have one less headwind to worry

This Economist Says That The Canadian Housing Market Could Return To Its 2017 "Ascent"

National home sales crept up 0.9

Market Outlook October 2018: Midterm October Launching Pad

Historically, the "Worst Six Months" (WSM) of the midterm

Canada Underwhelms On Global Competitiveness

Canada places 12th in the World Economic Forum's latest global competitiveness report—down

CPP Board Not Yet Interested In Cannabis Investments

A spokesman for the Canada Pension Plan Investment Board

Looking At Cannabis

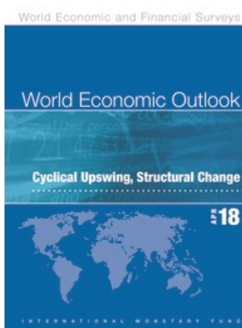
Established market makes cannabis less speculative than blockchain. With the legalization of cannabis set for Oct 17, financial

How The CRA Views Seg Funds In Registered Plans

On Oct. 1, the Canada Revenue Agency released its much

THE GLOBAL COMPETITIVENESS REPORT 2018

With the Fourth Industrial Revolution (4IR), humanity has entered a new phase. The 4Ir has become the lived reality for millions of people around the world, and it's creating new opportunities for business, government and individuals



International Monetary Fund

Challenges to Steady Growth, October 2018

A typical foreword to the *World Economic Outlook (WEO)* highlights how data since the previous projection alter our baseline growth assumptions. It pays detailed attention to the most recent developments and interprets the implications for policies going forward. This WEO foreword—my last—will instead situate the current

VIDEO LINKS

IMF Guts Growth Outlook On Trade War

The IMF says this trade spat between the Americans and the Chinese is now taking its toll on

How To Invest After The Fed Raised Rates

Rene Nourse of Urban Wealth Management, Allan Boomer of Momentum Advisors, Art Cashin

Hedge Fund Legend Ray Dalio On The Economy

Ray Dalio is the founder and c o -chief investment officer of Bridgewater Associates, the

HSBC Monthly View—October 2019—Willem Sels

We argue that we are in the midst of a selective re-pricing of assets around the world, triggered by the end of quantitative easing, higher interest rates in the US and a stronger US dollar.

And as we believe that the US cycle continues to be quite strong, US dollar strength should continue as well and therefore we may see some continued volatility in emerging markets. That's why we adopt a selective tone in EM and we focus on longer term and structural themes.

We also argue however in the Quarterly that we are not in the midst of an economic downturn

EDITORIAL COMMENT-CONTINUED

Many investors become worried that it is the beginning of the end of the world as we know it and they are convinced it is time to sell all their investments and stuff their money under their mattress, metaphorically speaking. What these investors are failing to do is to remember that volatility is a normal factor in long-term investing and generally, taking equity risks has been rewarded through these periods.

The most difficult reaction to have is one of calmness during these trying times. Don't panic, these things happen! I know I am repeating myself, but after a bull market cycle has run as long as this one has pay attention to the fundamentals. Unemployment is at the lowest levels, not seen in decades and GDP growth is very strong. It is only natural to expect interest rates to finally edge up, from their extreme lows, to keep inflation in check. There is nothing to see here. In fact, this situation is quite healthy for the stock markets. If you maintain your composure, stay the course and believe in long-term investing, you can actually benefit from this situation either directly or indirectly. When you look back five, 10, 15 or 20 years from now, you will be glad you stayed focused on your long-term goals, after all, the market clearly trends in one direction and that is upwards from left to right.

During periods of heightened volatility, portfolio managers are tasked with determining the best course of action to take advantage of the "dumb money" movement. For example, the "smart money" will take advantage of the sell-off by purchasing fundamentally attractive companies' stock at reduced prices. This is a fire sale for many experienced money managers.

Will Danoff is a vice-president and portfolio manager of Fidelity's Contrafund. Will has been managing this fund since 1990 and has seen it grow to US$129 billion, making Contrafund, the largest actively managed stock or bond mutual fund run by one person.

Will believes that going forward earnings growth in the U.S. continues to look attractive and he does not believe that the economic cycle will be coming to an end over the next few quarters. Regarding recent volatility, Will does not react to short term movements and sees these occurrences as buying opportunities to add to his favorite positions. For the time being, Will is looking past market volatility and is investing for the long-term. Will and his team have seen volatility in information technology stocks in the past and have always maintained their long-term outlook in the stocks they own.

History shows that when the markets have a sharp sell-off, more often than not, high quality and low-quality stocks get sold down in a fairly indiscriminate manner. This affords the managers a chance to put cash to work and buy the higher quality names at better prices.

After a long period in which global markets have been happy to look through negative events, they now appear to have become a great deal more nervous. During such periods, investors need to take risks that set them apart from the wider market if they are to have a chance of beating it. This favors an active approach where a manager picks stocks they think will outperform.

Driving the recent caution is the escalation in the trade threats being made by the US and China, as well as a revision of expectations on US interest rates. Additionally, the aggressive rhetoric from Saudi Arabia has influenced oil prices, and Brexit is in its crunch time.

While there is no shortage of issues to be worried about, what's interesting is the market's willingness to now pay attention to them when it has been happy to look straight past similar, or even worse, events up until now. It hasn't been that long ago that there was credible talk of a nuclear war between the U.S. and North Korea and the markets shrugged it off. Rising rates, Brexit and trade wars are nothing new, and previously, the market shrugged and remained generally unaffected. I believe investors are now waiting for a reason or excuse to take profits, and that the change of mood is being driven mostly by the higher returns from cash/bonds that is implied by the Fed raising rates more quickly.

David Kretzmann, an analyst with Motley Fool offers one of the best explanations of the recent pullback.

EDITORIAL COMMENT-CONTINUED

“This week is a helpful reminder that stocks do indeed sometimes go down. But at the same time, you do have to take a step back and keep this in perspective. The S&P 500 has just fallen back to where it was in July, a few months ago. Obviously, it hurts to see your money go down more than it feels good to see your money go up. We tend to react in a sharper way to pain rather than the joy of gain. Really, this comes down to the psychology of investing. When you can keep that long-term time horizon in mind, just remember that the longer you hold, the higher your odds of success over time. There's never been a 20-year stretch with the S&P 500 where you actually would have lost money. And that's going through the Great Depression, the Great Recession, multiple wars, and all sorts of other macro events and worries. The longer you can hold your stocks, and the wider your time horizon, the better off you'll be as an investor. It doesn't take away the pain that you see in a week like this, but with that kind of perspective, you treat a drop like we've seen this week as more of an opportunity rather than something to fear.”

Well said, David.

Is This The End Of The Bull Market?—CONTINUED

For us, nothing has changed. Our thoughts on the current selloff are similar to the ones we had following the correction we experienced earlier in the year.

The first takeaway is that corrections of 5% or more are not uncommon and in fact occur, on average, about three times per year. Since 2009 we have seen 19 selloffs similar to the one we are currently experiencing. With the exception of 2017 every year since 2009 has experienced at least one correction.

As the Federal Reserve continues its fight to hold inflation in check amidst a back-drop of a healthy economy coupled with rising inflationary pressures, we believe that the march higher in yields will continue to give equity investors a little indigestion.

Although the IMF issued a downgrade in growth, economic activity remains very positive. This downgrade is a result of the ongoing trade dispute between China and the United States. However, overall GDP growth remains robust while leading indicators for the economy have yet to provide any signs of a pending recession.

The bottom line is that we don't expect the recent turbulence to mark the start of a cyclical bear market. Absent an economic recession, history has shown that it would be a rare event if we were to enter one at this juncture.

S&P 500 CORRECTIONS GREATER THAN 5% SINCE MARCH 2009 MARKET LOW					
BEGINNING	ENDING	# OF DAYS	S&P HIGH	S&P LOW	% DECLINE
Sep 20, 2018	Oct 11, 2018	21	2,931	2,728	(6.9%)
Jan 26, 2018	Feb 8, 2018	13	2,873	2,581	(10.2%)
Jun 8, 2016	Jun 27, 2016	19	2,119	2,001	(5.6%)
Nov 3, 2015	Feb 11, 2016	100	2,110	1,829	(13.3%)
May 21, 2015	Aug 25, 2015	96	2,131	1,868	(12.4%)
Sep 18, 2014	Oct 15, 2014	27	2,011	1,862	(7.4%)
Jan 15, 2014	Feb 3, 2014	19	1,848	1,742	(5.8%)
May 21, 2013	Jun 24, 2013	34	1,669	1,573	(5.8%)
Sep 14, 2012	Nov 15, 2012	62	1,466	1,353	(7.7%)
Apr 2, 2012	Jun 1, 2012	60	1,419	1,278	(9.9%)
Oct 28, 2011	Nov 25, 2011	28	1,285	1,159	(9.8%)
Apr 29, 2011	Oct 3, 2011	157	1,364	1,099	(19.4%)
Feb 18, 2011	Mar 16, 2011	26	1,343	1,257	(6.4%)
Aug 9, 2010	Aug 26, 2010	17	1,128	1,047	(7.1%)
Apr 23, 2010	Jul 2, 2010	70	1,217	1,023	(16.0%)
Jan 19, 2010	Feb 8, 2010	20	1,150	1,057	(8.1%)
Oct 19, 2009	Oct 30, 2009	11	1,098	1,036	(5.6%)
Jun 12, 2009	Jul 10, 2009	28	946	879	(7.1%)
May 8, 2009	May 15, 2009	7	928	883	(5.0%)
Average		43			(8.9%)
Median		27			(7.4%)

Source: Dynamic Funds

Using data going back to the 1940s, we find that the typical gap between two 5% or greater drawdowns is 60 trading days, on a median basis, and 94 trading days, on an average basis. Based on this information, our current equity pullback was a bit over-due.

Since the current bull-market began, back in 2009, we have experienced 19 similar corrections which would average just over two per year. 2017 was the only year not to experience a decline of 5% or more while the two we've experienced this year is effectively in line with all the other years. It seems that we have returned to a more "normal" equity environment. Although, as of this writing, we may not have yet seen the low for the current correction, we do have a stronger conviction that the odds favor a return to the September high for the S&P 500 given decent economic growth and corporate earnings delivery.

Decent economic growth and inflationary pressures have pushed bond yields higher. The level of the 10-year Treasury yield breached 3.25%, the highest level since 2011, after rising 0.2 per cent over four trading days. This sharp move appeared to be the key catalyst for that week's selloff. We would not be surprised to see continued jitters in the equity markets as the Federal Reserve continues to steadfastly normalize their funds rate.

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Is This The End Of The Bull Market?—CONTINUED

As previously mentioned the second key catalyst being blamed for the selloff was the downgrade in growth by the IMF as a result of expectations for a resolution to the US – China trade dispute being pushed out. 0.2% was shaved off the 2019 GDP growth estimates for the U.S., China and the world. However, they are all still expected to perform quite well with growth rates of 2.5%, 6.2% and 3.7%, respectively.

In the case of the United States, the IMF's forecast for 2019 is now in line with consensus expectations. Meanwhile, leading indicators for the U.S. from the Conference Board have yet to provide any signs of a pending recession.

Historically we can see in periods where the Fed is on a tightening path, the yield curve tends to flatten – and ultimately possibly turning negative. Once negative, it takes another 12 months beyond that inversion point for the economy to enter into a recession. A key recession flag for us would be an inversion in the 10-year minus 3-month Treasury yield spread. Currently this spread stands at 0.9%. Currently, futures are pricing in a peak in the funds rate below 3% by the end of 2019 which could bring us close to an inversion as the Federal Reserve has 3.1% as a target for the end of 2019. If an inversion occurs at the end of 2019 we are likely to experience a recession by the end of 2020.

Meanwhile, if the forecasts of the IMF and consensus prove true, the probability of a positive return for equities in 2019 runs in the realm of 70 – 80% which is somewhat better than the 67% batting average for positive returns since 1928.

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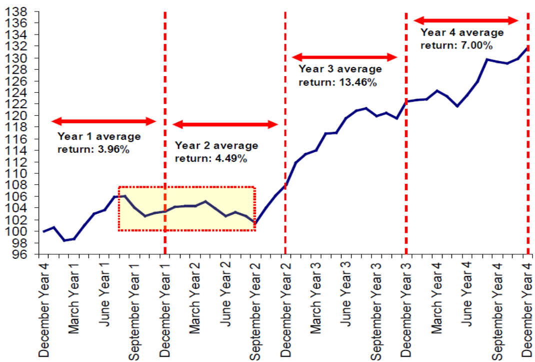
Ignore the “Midterm Election Year” - CONTINUED

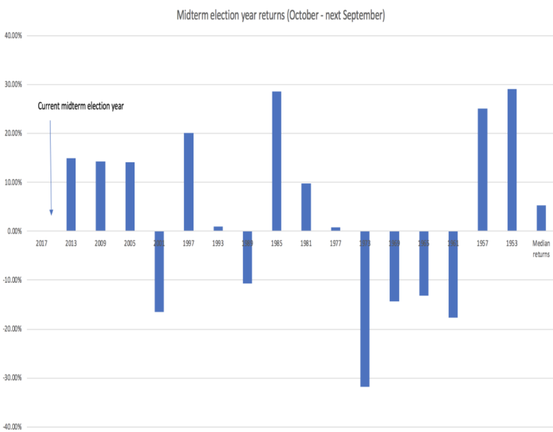
However, when we look at the data from 1950-present, the midterm election year isn’t as seasonally bearish as you think.



Midterm election year returns (October - next September)	
2017	
2013	14.89%
2009	14.19%
2005	14.16%
2001	-16.42%
1997	20.12%
1993	0.97%
1989	-10.68%
1985	28.53%
1981	9.71%
1977	0.88%
1973	-31.76%
1969	-14.28%
1965	-13.22%
1961	-17.63%
1957	25.01%
1953	29.10%
Median return	**5.34%**
Average return	**3.35%**

As you can see, the S&P 500’s median return during midterm election years (October to next September) is 5.34%. The average is 3.35%, which means that a few large bearish cases are weighing down on the average (e.g. 1973)

Remember that the S&P 500 goes up 7-8% on average per year. This means that although the stock market is “weaker” during midterm years, it still tends to go up.



I would not pay too much attention to the stock market’s relative weakness during the midterm election year. As you can see from the following chart, the stock market’s performance during midterm election years fluctuates wildly.

The midterm election year is now mostly over. We only have 3 months until the midterm elections: August, September, and October.

Here’s how S&P 500 performs from August—October before each midterm election. As you can see, the stock market’s forward returns from August-October during midterm election years tend to be mostly random. This suggests that the midterm elections don’t have a consistently bullish or bearish impact on the stock market.

S&P 500's returns during the last 3 months of midterm election years				
	August	September	October	August-October
2018				
2014	3.77%	-1.55%	2.32%	4.53%
2010	-4.74%	8.76%	3.69%	7.41%
2006	2.13%	2.46%	3.15%	7.93%
2002	0.49%	-11.00%	8.64%	-2.84%
1998	-14.58%	6.24%	8.03%	-1.96%
1994	3.76%	-2.69%	2.08%	3.07%
1990	-9.43%	-5.12%	-0.67%	-14.64%
1986	7.12%	-8.54%	5.47%	3.33%
1982	11.60%	0.76%	11.04%	24.87%
1978	2.59%	-0.73%	-9.16%	-7.48%
1974	-9.03%	-11.93%	16.30%	-6.82%
1970	4.45%	3.41%	-1.25%	6.66%
1966	-7.78%	-0.70%	4.75%	-4.07%
1962	1.53%	-4.82%	0.44%	-2.94%
1958	1.19%	4.84%	2.54%	8.77%
1954	-3.40%	8.31%	-1.95%	2.59%
Median Returns	**1.36%**	**-0.71%**	**2.84%**	**2.83%**
% of cases that are positive	**63%**	**50%**	**75%**	**56%**

Don’t put too much emphasis on the importance of presidential election cycles for the stock market. The stock market follows the economy in the medium-long term. Politics is mostly a sideshow. The economy is the signal, politics is the noise.

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Estate Freeze—The Basics—Continued.

Personal needs include such things as retirement planning needs, income needs, or leaving assets to children. From a business perspective it is crucial to consider the ongoing growth and ownership of the business, as well as tax liabilities while alive and at death.

The general purpose of an estate freeze is to 'freeze' the value of an individual's holdings and transfer future growth to other family members. A business owner can maintain control of the assets during his or her lifetime while other family members involved in the estate freeze keep future growth from those assets. An estate freeze is often used as an income splitting strategy between parents, who own/manage a business, and their children. A main benefit for the children is that they're able to take over the business without needing to gather the sufficient funds to purchase it. Moreover, the parents benefit by performing this transaction on a tax deferred basis. In this way, the business owners (i.e.: parents) will wait until they are closer to retirement and then freeze the significant growth in their company, ensuring less taxes are paid at death and that future taxes are paid by the children at their tax rates.

There are two common methods of accomplishing an estate freeze:

Section 85 Freeze

Section 86 Freeze

To illustrate the basics of the estate freeze, I'll use the example of Bob and Betty, a married couple in their sixties. Bob and Betty run a business together called B&B Co. They also have 2 adult children who are both interested in taking over the business and have the skill set to do so.

Under a section 85 estate freeze Bob and Betty would transfer their common shares in B&B Co. to a holding company created by the children. In exchange for the common shares, Bob & Betty will receive preferred shares of the holding company. The preferred shares would have a redemption value equal to the fair market value of the common shares transferred at the time of the freeze. For example, if the common shares were worth $4 million, the preferred shares would also have a value of $4 million. These shares will never grow in value, but they will carry with them voting rights in the event Bob & Betty want to maintain some control over the company. Moreover, these shares will pay Bob & Betty dividend income to fund their lifestyle needs. Any future growth in the common shares will now be in the hands of the children and as such the tax liability on that growth will also defer to the children.

In a section 86 estate freeze there is no holding company required as there was in the above example. Instead it is a reorganization within the operating company (ie. B&B Co.). Under this type of freeze, Bob & Betty would simply exchange their common shares for preferred shares. These preferred shares could also offer voting rights, dividends, and would be redeemable and retractable. From a tax strategy standpoint, the change from common shares to preferred shares for Bob & Betty would have no immediate tax implications since the shares would automatically rollover at their original adjusted cost base at the time of the freeze.

Although both methods are effective strategies the preferred method depends on whether a business qualifies for the Lifetime Capital Gains Exemption (LCGE). Qualifying for the LCGE would give preference to using a section 85 freeze. Doing so would allow each member of the freeze (i.e.: the parents and children) to utilize any unused LCGE and reduce the capital gains and subsequent tax liabilities. Alternatively, without an LCGE qualification, a section 86 freeze has the advantage of not needing an income tax election with the CRA since the tax rollover occurs automatically. Moreover, a section 86 does not require a holding company since it is a reorganization of preferred and common shares within the operating company.

The estate freeze is one of the most effective planning strategies available, but it must also be carefully planned to be successful. Questions need to be asked: are the children able to manage the company? Do they want to be involved in the company? Will it be a full freeze or will we freeze only a portion of the estate? However, when done properly, an estate freeze is a great way to defer tax, generate income, and pass on growth to the next generation.

of writing. There was a great line yesterday from an analyst who remarked “We shouldn’t be asking how did we get here when the right question is why did it take so long?”

We, alongside others in the market place have been calling for the 10-year yield to reach 3.25% since the first quarter. It took longer than we thought, but after a couple of pit stops and flat tires, we finally got there. The natural follow-through was a response by the equity markets…lower. Historically, as inflation and interest rates move higher, stock market valuations move lower. That’s what we saw today with the S&P 500 Index off -0.82%, the Dow Jones Industrial Average down -0.75% and the tech heavy NASDAQ down -1.81%. We would argue that the move in rates was very much justified in the higher inflationary and stronger growth environment that we have today when compared to a year ago. Comments yesterday by US Federal Reserve Chair Jerome Powell helped this along by saying that the US economy was going through “extraordinary times”.

Why This Matters

First, we would point out that investors should pay attention to how far rates can go relative to how far we have come. While we are not completely out of the woods with respect to the rising rate environment, we would argue that the worst of it is behind us. The commentary that came across the screen earlier in the day, “Is this the start of the bear market for bonds” is about a year and a half late. Rather, we should be asking, “Is this the end of the bear market for bonds?” Possibly.

What we tend to see towards the end of the economic and rate tightening cycle is a convergence of the 10-year yield, 2-year yield and the Federal Funds Rate. This scenario has played out pretty much to the historical norm as the 2-year yield has risen higher than the 10-year yield resulting in a gradual but substantive flattening of the yield curve. The laggard here would be the Fed. However, we expect the Fed to catch up in the next year with 4 more rate increases. We would expect to see less upward pressure on the 2-year yield and even less on the 10-year. So, unless investors believe that we would see another push higher of over 114 bps on the 10-year yield, (which would take us to 4.32%!!) then yes, dare I say we have seen the worst of the bond bear market.

Our Thoughts

The offset to a higher yield for bonds is a repricing of equity risk. And this is what we saw in the equity markets today. As we wrote earlier in the year, as the Fed embraces a tightening cycle and yields across the curve respond, the S&P 500 trailing 12M PE ratio tends to fall - an average of 4 multiple points (over the span of an average cycle of 2.5 years – since 1970). We have seen a multiple compression already this year by approximately 2 points. The consequence to a rise in yields over the last two weeks is ultimately a repricing of equities.

The US equity market has exceeded our expectations as far as returns year-to-date. While we don’t expect a negative return for the S&P 500 Index through the full calendar year, we may see a bit more of a give-back of return as equity investors price in the reality of a 3% 10-year yield that may range between 3.25-3.5% before we are done.

As per our Back to School outlook, we continue to suggest investors position themselves in favour of better value in the international equity markets and trim/take profits in their US equity position. Where we have been recommending an overweight to US equities since 2011 we are now suggesting a neutral weight while maintaining an overweight in international equities.

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