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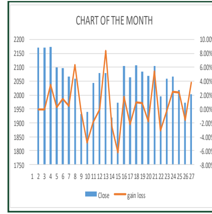
VOL. 7, ISSUE 12 DECEMBER 2018

"With diligent research our portfolios benefit from disruption and controversy. We're lucky to live in turbulent times." - Richard Fogler (Kingwest & Company)

Sergio Simone
EDITORIAL COMMENT

Sergio Simone
EMOTIONAL INVESTING



HISTORY OF U.S. BULL AND BEAR MARKETS

Ryan Simone
PRE-RETIREMENT ASSESSMENT SERIES (II)

Editorial Comment

Sergio Simone

On page 5 of this newsletter I posted a link to a Duke University/CFO Global Business Outlook report declaring that 86% of Canadian chief financial officers say the economy will enter a recession by the end of 2019. Although investors may beg to differ based on the vicious volatility experienced in 2018, the fact is that volatility alone is not a reliable predictor of a recession.

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Emotional Investing

Sergio Simone

When something more powerful is threatening us, thousands of years of experience tell us to get out as fast as possible. That's a useful reaction when dealing with fires, tsunamis and hurricanes, but not so helpful when it comes to investing.

When markets drop, our first instinct may be to sell immediately. But that's often the worst thing to do.

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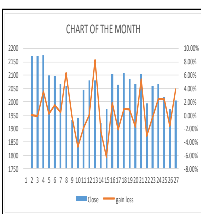
History of U.S. Bull And Bear Markets



Following the market collapse of 2008 there has not been a day that has gone by where I haven't read or heard a prediction of a pending Bear Market. The recently ominous market volatility gives us an opportunity to look back in history to see the impact of Bull and Bear Markets. I'm sure you do not need to be reminded that past performance is no guarantee of future results, yet the chart speaks volumes about market

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The Pre-Retirement Assessment Series: Theme Two: Large Latte Factor Theme

Ryan Simone

For pre-retirees, creating a Life Plan typically involves a pre-retirement assessment (PRA). This is where we gather information that is categorized as either a cash source or a cash use.

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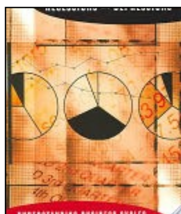
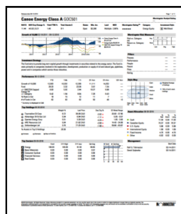



BOOK OF THE MONTH

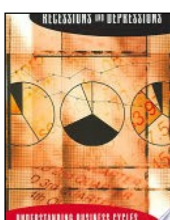
FUND OF THE MONTH Mackenzie Ivy Canadian

INVESTMENT TERMINOLOGY

BLOG OF THE MONTH THE BIG PICTURE

Book of the Month

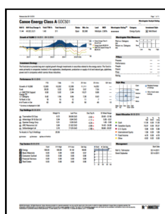
Recessions and Depressions: Understanding Business Cycles—by Todd A Knoop



The economy of any nation is an intricate web of relationships among the factors determining supply and demand—and everything that effects them, from inflation to taxes to the stock market. The study of business cycles attempts to explain why economies grow and contract, experiencing periods of prosperity and pain.

Click to read book online

Fund of the Month—Mackenzie Ivy Canadian



The Fund pursues long-term capital growth, while maintaining a commitment to protection of its capital. It invests mainly in equity securities of high-quality large-capitalization Canadian companies.

Investment Terminology

Reflation

Reflation is a monetary or fiscal policy by the government and central bank respectively to boost demand and thus increase the level of economic activity and combat deflation. Policies may include reducing interest rates, lowering taxes, investing in large infrastructure projects, and changing the money supply. Reflation may also refer to an economic phase after a period of recession—the initial stage of a nation's economic recovery.

Continue Reading

BLOG OF THE MONTH

24 COGNITIVE BIASES WARPING YOUR REALITY

Anchoring. The first thing you judge influences your judgement of all that follows. Human minds are associative in nature, so the order in which we receive information helps determine the course of our judgements and perceptions. Be especially mindful of this bias during financial negotiations such as houses, cars and salaries. The initial price offered is proven to have a significant effect.

Confirmation Bias. You look for ways to justify your existing beliefs. We are primed to see and agree with ideas that fit our perceptions, and to ignore and dismiss information that conflicts with them.

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PRIVATE WEALTH

INFORMATION AND SOLUTIONS FOR HIGH NET WORTH INVESTORS

A SUDDEN WINDFALL
A Blessing, Not A Burden

A windfall can be defined as the unexpected or unplanned acquisition of financial assets that alters the recipient's financial position. This can be a welcome surprise, but the pressure of managing and dealing with a significant amount of money can also be an unforeseen burden.

A California-based psychologist coined the term *sudden wealth syndrome* to describe the psychological issues associated with the unexpected acquisition of wealth. While coming into money should be a good thing, providing an opportunity to achieve happiness, many people who have suddenly become wealthy are

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6 TRENDS SHAPING THE 2019 UBER WEALTHY LUXURY INDUSTRY

According to the Luxury Institute, a number of trends will reshape the luxury industry in 2019. Companies will focus on intense, sustained growth, and legacy enterprises that hope to rest on their laurels will be disappointed to find that consumers are not as impressed with brand heritage as they used to be. How the latest and greatest gets communicated is evolving as well, with consumers more likely to be swayed by consumer-to-consumer channels than ever before.

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GIFTING FAMILY MEMBERS MONEY: DOS AND DON'TS

A loan or a gift of money to a family member can truly provide a helping hand. But caution is required if you want to avoid unpleasant surprises or misunderstandings. Here are a few valuable tips to simplify the transfer of money or assets to a loved one.

Many people would like to help their loved ones financially during their lifetime rather than wait until after they've passed. And wanting to help is a good thing, but you need the means to do so. This is where a retirement-income projection can

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THE MORE SOMEONE EARNS, THE MORE THEY ARE AT RISK

Whether you're a professional athlete, a musician touring to support your chart-topping album, an IT consultant who regularly travels to war-torn countries or a high-level executive, having disability insurance in place is a wise thing to do. For high income earners it's especially important since, in most cases, the long-term disability insurance they may have through their company group plan likely won't provide enough coverage. Here's why: Group long-term disability insurance policies limit how much they will pay out each month to an employee, usually capping the limit at $5,000 to $10,000 a month.

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FUND MANAGER COMMENTARY

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Clement Gignac, Chief Economist and Portfolio Manager

I. A. Clarington

A Look Back At 2018 And Ahead To 2019

According to Deutsche Bank, close to 90% of indices for bonds, equities and commodities have posted a negative YTD return—a first since 1901.

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Philip Petursson, Chief Investment Strategist

Manulife Investments

Philip Petursson says 2019 will be a rewarding year for Canadian Investors. His fearless forecast: the TSX will outperform the U.S. equity market and could produce double digit gains.

Continue to Video

Jan Faller, Portfolio Risk Manager, Alternative Investments and EM

Recognizing and Managing Loss-Aversion Bias

Behavioral finance, the idea that psychological biases make investors less than the perfectly rational beings assumed by modern economic theories, continues to gain currency. Behavioral economists, in fact, have won two of the Nobel Memorial Prizes in Economic Sciences awarded over the past six years.

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Kate Moore, Managing Director, Chief Equity Strategist

BlackRock Investment Institute

We identify three new market themes and update our asset views for 2019. We see growth in the global economy and corporate earnings slowing, and expect the Federal Reserve to become more data dependent in increasing rates. For investors, greater uncertainty calls for balancing risk and reward.

We expect global growth to slow next year, and see U.S. growth stabilizing at a much higher level than other regions, even as the effects of 2018's fiscal stimulus fade. Markets are vulnerable to fears that a downturn is near, even as we see the actual risk of a U.S. recession as low in 2019. Global earnings growth is also set to moderate in 2019, tracking the more subdued growth outlook.

This cycle has been a long and shallow one—and still has some room to run, in our view. Buy how far? Our analysis suggests the one-year forward probability of a U.S. recession is still relatively low, consistent with our base case for ongoing economic expansion in 2019.

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LINKS

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Is Herd Behaviour Influencing Strategic Asset Allocation?

When pension funds share key players, like asset managers,

Insured Retirement Program

The IRP program is now available to whole life insurance clients at all major providers!

Your Sneak Peak At Investing In 2019

As investors say goodbye to 2018, one thing they'll likely remember is saying hello again to market volatility.

Feds Consulting On Pension Deficits And Insolvency

Dividend payments, share redemptions and executive comp

'We're Kids In A Canady Store' - Money Managers Use The Wild Stock Market Swings To Find Value'

The Market is repricing risk.

Emerging Markets Are Better Than The U.S. If Dollar Cooperates

It's already happening. Don't let the recent sell-off scare you:

100 BlackRock Investing Pros Formulate A Game Plan For 2019

2018 started out innocently enough, with the positive effect

Overcome The Challenges Of Decumulation

Many retirees face a daunting challenge: converting lump sums of cash into a reliable, inflation

Inverted Yield Curve: How It Predicts Financial Disaster

The inverted yield curve is a graph that shows that younger

DUKE FUQUA

RECESSION CONSIDERED LIKELY BY YEAR-END 2019

Nearly half of U.S. CFOs believe the nation's economy will enter a recession by the end of 2019, according to the Duke University/CFO Global Business Outlook.

INVESTORS' FEARS AND THE FALL OF BOND YIELDS SEEM EXAGGERATED

Growing doubts about the health of the global economy have caused bond rates to fall sharply in recent weeks. Confidence indexes and leading indicators in the United States are completely at odds with the prospect of a sharp slowdown. We therefore expect the Federal Reserve (Fed) to order another rate hike on December 19, and to keep its tone positive, signaling that monetary tightening will continue. While the federal funds rate is starting to move closer to the neutral zone, the Fed could nonetheless confirm that future rate hikes will be less automatic and more reliant on the economic backdrop.

VIDEO LINKS

Animation: The Worlds 10 Largest Economies by GDP

While such a view provides useful context on the relative size of

What To Watch In 2019

After a year of trade wars, rate rises and more volatile markets, we see three big themes for equity markets over the next 12

Delaying Brexit Beyond March Is Easier Than You Might Think

Prime Minister Theresa May is struggling to save her Brexit

FORTUNE

WHY EMERGING MARKETS ARE A SCREAMING BUY

For a chorus of the leading voices in investing , it was the monster rally whose time had come. For about five years, a group of sages, including value-investing boldface names Jeremy Grantham, Mark Mobius, and Rob Arnott, kept pronouncing that shares of companies in emerging markets offered the world's rarest blend of attractions: deep-discount prices compared with U.S. equities, cheap currencies and the prospect of robust growth driven by a burgeoning population of youthful middle-class workers and consumers—all factors that long promised a powerful comeback in the beaten-down sector.

EDITORIAL COMMENT-CONTINUED

TD Chief Economist Beata Caranci says if this were the case, we would be on our third recession since 2009.

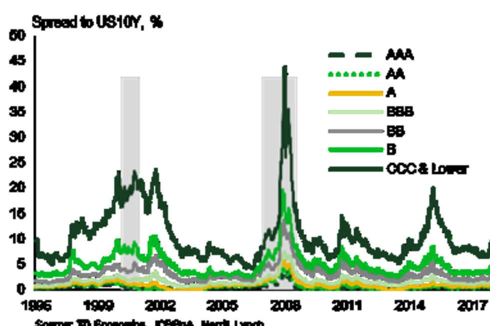
There are a few solid indicators of an impending recession and their numbers paint a different picture. The most reliable indictor of a recession is the U.S. yield curve or more precisely, an inverted yield curve. Many analysts consider this to be the bell-wether for an economic recession.

The inverted yield curve is a graph that shows that younger treasury bond yields are yielding more interest than older ones. This is a terrifying condition for financial pundits as it indicates the difference between a thriving bull market or the downswing of a bear market. A negative yield curve is known to throw entire economies into a state of chaotic doom and gloom. Although the yield curve looks somewhat uncomfortably narrow at 13-15 basis points, it has yet to invert and, historically, when it does it often takes one to two years for a recession to appear. This was experienced in 1990, 2001 and 2008.

Extreme volatility is considered another potential indicator of an upcoming recession. Lately, the indices have been riding a rollercoaster of volatility. I can't count the number of times that I have checked the markets in the morning and seen a complete reversal by closing. The number of 1% changes in the value of the S&P 500 index in a single day has broken just above the historical average but remains below other non-recessionary periods. Although these market swings can cause a severe bout of nausea, they are not the most reliable predictor of a recession. I can't help but recall Nobel winning Economist Paul Samuelson's famous quote that "stock markets have predicted nine of the past five recessions".

Another indicator that is not causing concern is the 'Corporate Bond Yields'. Although yields and spreads have edged up, they continue to maintain a healthy margin below what is considered dangerous. The chart shows that the current period is nowhere near as stressful as the period ahead of the 2001 recession or the European debt crisis in 2011, or the China growth concerns in 2015.

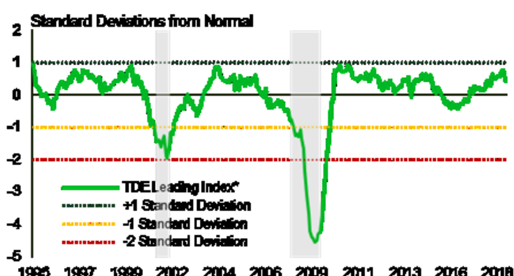
Chart 2: Corporate Bond Yields



Source: TD Economics, ICE BofA Merrill Lynch

Although the usual metric to measure spreads is the US Treasury 10-year vs 2-year spread, which is flat but positive, the UST 5-year vs 2-year spread has popped onto our radar when it inverted by 1-3 basis points. Although this is not the typical spread monitored as a recession signal, it warrants watching. This spread usually offers a recession lead time of approximately three years as it did leading to the 2001 recession. In my opinion, this spread would need to move deeper into negative territory before making a more compelling statement. In fact, many international agencies have dismissed this inversion as being caused by technical factors. They have blamed this inversion on distortions created by large central bank balance sheets. This being said, the situation requires close monitoring. Should the inversion broaden alongside other dovish signals then we will side with the bond market calling an upcoming recession. Fortunately, that day has not yet come.

Chart 4: TD Leading Economic Index



* Index is comprised of eight leading economic indicators. Readings of 0 are consistent with historical average (1995-present) points in the business cycle, while readings of -1 or +1 should be interpreted as one standard deviation below/above average, respectively.
Source: TD Economics

TD has constructed an economic risk-index to capture turning points in performance as evidenced by the following chart. This index is a "catch-all of economic indicators" which includes production, the labor market and consumer patterns. The Zero line points out the historical average. At a -1 Standard Deviation, the data corresponds to a recession. By the time that point has been reached, we are already in the midst of recession so, the point of concern would be at the point below the zero to about the .5-point mark.

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EDITORIAL COMMENT-CONTINUED

Today, the current indicator is still a fair way north of the Zero line. Concerns about the recent dip in the index can be attributed to deteriorating export orders that is being exaggerated by the U.S. trade war impact.

One of the foundations of any business cycle relates to the "confidence measure". What surprises me is that all the "recession" talks among the financial pundits would lead me to believe we are on the verge of disaster and yet the Business and Consumer Sentiment indicators are still very positive. I believe the pundits are looking for the negative in all signals. For example, the U.S. employment numbers released earlier this month highlighted 155,000 jobs had been created. Normally this would be a great growth signal, but the news headlines focused on the disappointment that this number was below market expectations. I'm sure a strong report would have been dismissed with a neutral reaction, but the weaker-than-expected report was met with doom and gloom.

When we look at the entire picture, we would see that the U.S. has posted job numbers in excess of 200,000 per month for most of the year creating the lowest unemployment rate in almost 50 years. A reasonable job gain number would be 150k rather than the 200k+. It seems that extraordinarily high expectations may be accounting for some of the problem rather than actual data trends. For example, the Duke report states that the CFOs believe the U.S. will expand by 2.7% in 2019 which is slightly lower than the current expansion, but well ahead of many professional estimations. The problem is that business investment intentions may become more cautious due to these beliefs thus leading to a self-fulfilling prophecy of recession.

The early part of 2019 carries a lot of event risks which can make or break the markets in 2019. We will be dealing with Brexit, the U.S. debt-ceiling and the U.S. – China trade tensions. Any one of these would be sufficient to undermine market confidence so having them all occur simultaneously could be what is leading investors to become more jittery and more cautious. These event risks can be solved with political solutions. If the problems are solved favorably, the market will likely react with significant upward movement and if not, I believe much of the negative has already been priced into the markets.

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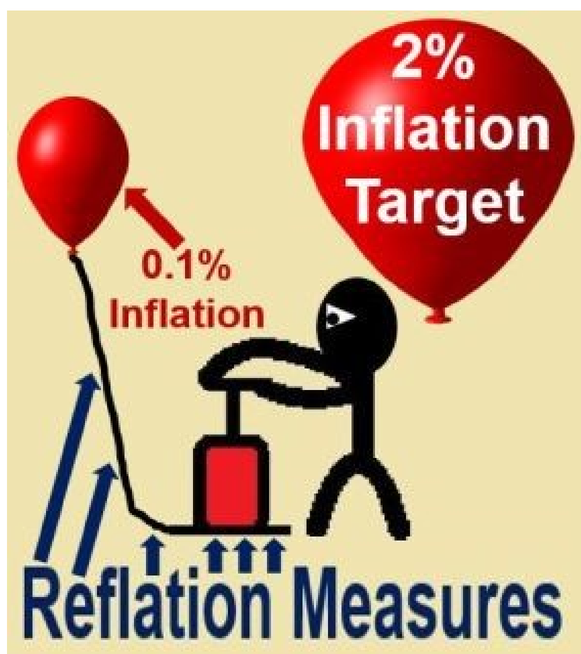
Monetary policy includes the things a country's central bank does, such as influencing the money supply and raising or lowering interest rates. Fiscal policy includes the things the government does, such as altering levels of government spending and tax rates to influence aggregate demand in a country's economy.

The aim in reflation is to alter a deflationary trend. Deflation occurs when the prices of products and services decline – when the inflation rate is below zero; it is in negative figures. Do not confuse deflation with disinflation, which means inflation rising more slowly (a slowing down in the inflation rate).



In this image, the man using the air pump could either be: **1.** The central bank, if he is lowering interest rates or injecting money into the economy. **2.** The government, if he has increased spending or lowered taxes.

The aim is to boost demand so that the economy expands again and inflation rises. The central banks of the US, Canada, EU, Japan and Australasia all have a 2% annual inflation rate target.

Nasdaq.com quotes Michael Gayed of Pension Partners, who said:

"Reflation is the process of restoring inflation to its long-run historical average, and can be considered a cure to potential deflation. reduce the natural economic contraction – or reignite the business expansionary cycle – which invariably follows a significant expansion."

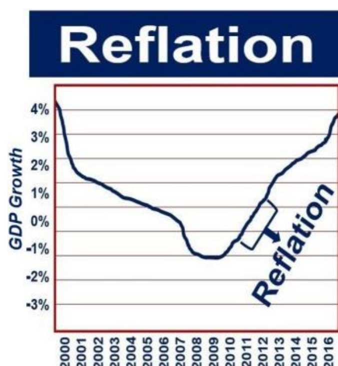
"This can be done through monetary policy – central banks may increase the money supply, lower interest rates, and/or ease bank reserve requirement – or federal fiscal policy changes that lower taxes or loosen business regulations. All of these efforts are taken to increase the amount of money flowing through the economy and instill confidence in consumers and market players."

Reflation – an example

Imagine a country's inflation rate in 2016 is trending at 2% annually, and in 2017 deflationary pressures pull down that rate to zero percent.

Then in 2018, the nation's central bank – such as the US Federal Reserve, the Bank of England, or the Bank of Japan – would introduce monetary policies to push the inflation rate back to its 2% long-term trend line.

As this 2% inflation target represents a return to the economy's long-term trend, it is seen as reflation. The initial phase of an economic recovery, following a period of recession – when GDP starts growing again – is called the reflation period.



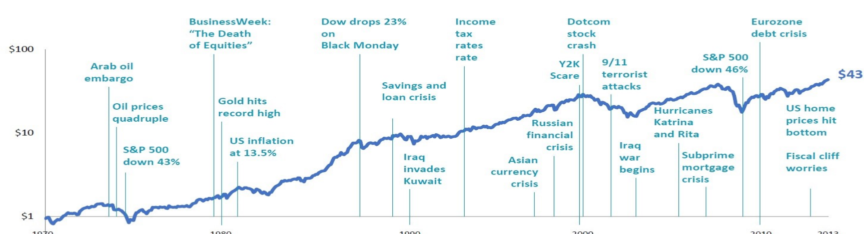
In other words, reflation is a recovery of inflation when it has fallen below the long-term trend line.

The term 'reflation', with the meaning of boosting economic growth and restoring the long-term inflation line, was coined by Irving Fisher (1867-1947), an American economist, inventor, statistician, and progressive social campaigner – one of the first American neoclassical economists. Fisher introduced the term after the 1929 Wall Street Crash.

EMOTIONAL INVESTING-CONTINUED

In fact, by the time we're feeling that urge to sell, it's probably already too late to limit the damage. And the period right after a market drop is often the most profitable. This is when portfolio managers typically buy more of the stocks they believe in, because those stocks are now bargains. And when the market recovers, it's often in vigorous fashion, as the chart below shows.

Markets Have Rewarded Discipline
Growth of a dollar—MSCI World Index, 1970–2013



By selling when your investments are dropping, you are locking in the declining prices and missing the inevitable run-up when the funds you sold return to the price before the drop.

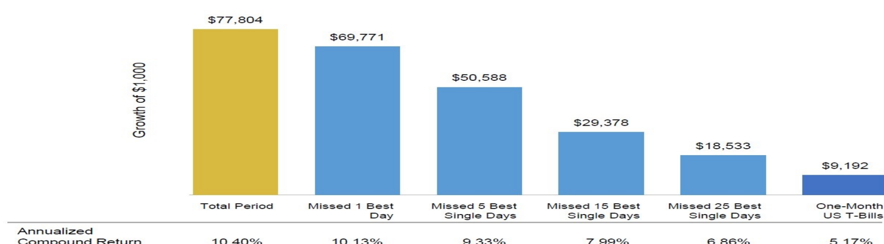
Unfortunately weathering the storm requires fortitude and disciplined investing. These are not easy tasks when you are watching your investment portfolio decline. Human nature equips investors with a variety of cognitive biases that may be aptly applied in everyday life, but ill –advised in the world of investing.

Some of the more common errors include: over-concentration, following the latest investment craze, allowing emotion to override common sense and reason, and taking too much or sometimes, not enough risk with your entire portfolio.

A Dalbar study confirmed that investors are their own worst enemy during volatile markets. The study found that while the S&P 500 generated annual returns of 9.1% between 1990 and 2010, the average equity investor only realized 3.8% annualized return during the same period. I know I have used this chart often over they years, but it is to the point during this time of market volatility where investors are prone to making emotional decisions.

In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Performance data for January 1970–August 2008 provided by CRSP; performance data for September 2008–December 2013 provided by Bloomberg. S&P

Reacting Can Hurt Performance
Performance of the S&P 500 Index, 1970-2013



data provided by Standard & Poor's Index Services Group. US bonds and bills data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).
Source: Dimensional Fund Advisors

While it is very difficult to change human nature, an awareness of the biases we face can help us avoid potential pitfalls. If you have made any of the following comments, you may want to take a step back and view the situation from a different perspective.

- **I have a proven system for picking winning managers**
- **My research confirms this is a great stock to own**
- **I knew this stock was going up**
- **It was a bad idea, but I don't want to sell at a loss**

EMOTIONAL INVESTING-CONTINUED

- **The trend looks good and should continue for a long time**
- **I work in that industry so I know where it's going**
- **I wasn't wrong about that stock, just unlucky**
- **The market tanked and I should have seen it coming**

Anchoring is a bias that causes investors to either hold onto an idea longer than they should, place a disproportionate amount of value on the piece of information they receive, or anchor their perception of value to a specific price point. The inability to fully incorporate new information causes investors to hold onto poor investments longer than they should.

Availability Bias is a mental shortcut in which investors use readily available information and media to make investment decisions, rather than a disciplined research process.

Familiarity Bias reflects an investor's tendency to invest in the known. Investors may perceive investments they are knowledgeable about as either less risky or more rewarding, and oftentimes both. Typically the tendency manifests itself in investors concentrating their holdings in their own country, company or industry.

Herd-Like Behavior reflects the tendency of investors to follow the crowd by chasing the latest investment fad. Driven by greed and fear of missing out, investor's project past returns into the future and pile in together. The behavior results in consistently buying into the most highly valued segments of the market, leading to sub-par results. Herding can also lead to selling at the most inopportune times.

Hindsight Bias occurs when events that have occurred in the past look predictable and obvious from the present. Hindsight bias leads investors to overestimate their ability to discern the likelihood of events occurring in the future, causing overconfidence.

The Inability to Control Emotions is common. Most individual investors are easily controlled by two emotions: Fear and Greed. While everyone would like to "buy low and sell high," very often investors, even very intelligent and well-educated investors, do the exact opposite. They, in effect, "buy high and sell low." It is unfortunate that investors tend to be fearful at the moment of greatest opportunity and greedy at the time of greatest risk.

Loss-Aversion is an investor's reluctance to realize a loss. Investors who exhibit loss aversion hold onto losing investments in the hope that they will recover. They may even engage in risk-seeking behavior by "doubling down" on a poor investment in hope of recovering losses faster.

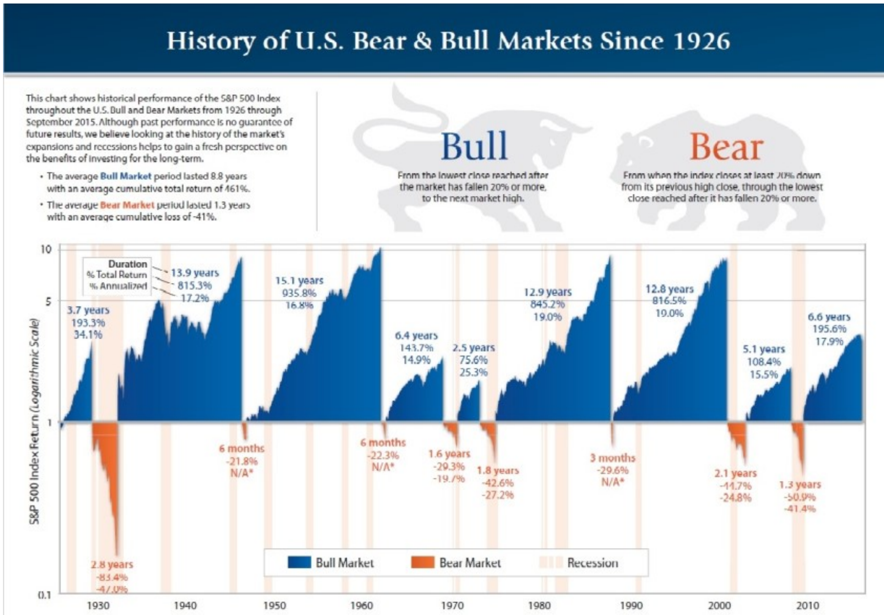
Overconfidence is a cognitive bias that causes investors to err in a number of ways, usually with financially damaging results. Overconfident investors are frequently overconcentrated in a specific asset class, sector, or stock. They often disregard the risk and seek out confirming evidence while ignoring any contradicting evidence. More times than not, this increased risk taking is punished with losses. Overconfidence can also lead to increased trading which may result in excessive taxes and fees.

Recency/Vividness Bias reflects a tendency to focus on events that are most recent or easiest to recall because they left a psychological impact. In investing, the event is typically a recent market correction or recent run-up. Since the events are recent or vivid, the tendency is for investors to overestimate the likelihood of the event occurring again and position the portfolio either too conservatively or too aggressively.

Market Volatility is Normal: Staying the Course is Critical - CONTINUED

recoveries.

The following chart illustrates the historical performance of the S&P 500 stock market index since 1926. It really is quite dramatic. As expected Bull and Bear markets always follow one another. It has always been this way and I expect with a high level of confidence that this will continue in the future.



A Bear Market is usually defined as a drop of at least 20% from the previous high, whereas a Bull Market is measured from the point where the market stops dropping until it reaches a new high.

Looking at the chart, the first thing that is obvious to me is that Bear Markets occupy relatively short periods of time compared to Bull Markets. In the grand scheme of things, Bear Markets are really insignificant. A large part of this can be explained by investor psychology. When markets begin their descent, most investors become concerned about the falling market values of their portfolios. As the market value continues to fall, they eventually reach a point where fear kicks in and the investor sells their underlying investments. This selling then contributes to further market declines. However, at some point all the frightened investors have left the market and the decline stops, setting the stage for the Smart Money to begin buying positions at extremely discounted values, thus setting the stage for the next Bull Market.

It is worth noting that the average Bull Market lasts for almost 9 years whereas the average Bear market lasts for slightly more than one year. There is also a significant disparity in relative gains and losses. The average Bull Market has earned a total return of 461% while the average Bear Market has a cumulative loss of 41%.

I am not advocating that all investors ride out all markets, only that if you have spent time developing a long-term investment strategy, that you give it an opportunity to do what it is expected to do over a business cycle.

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Pre-Retirement Assessment Series—Continued.

For example, employment income or rental income are cash sources; whereas, contributing to an RRSP, paying into CPP, or paying down debt are cash uses. From this information, one of five themes will inevitably take form.

Every plan, without fail, exhibits characteristics of one of these themes and identifying which theme applies to the plan is the best way to understand a person's core planning issue.

The five themes are: House Rich and Cash Poor, Large Latte Factor, Net Cash, OK to Spend More, and HNW (High Net Worth).

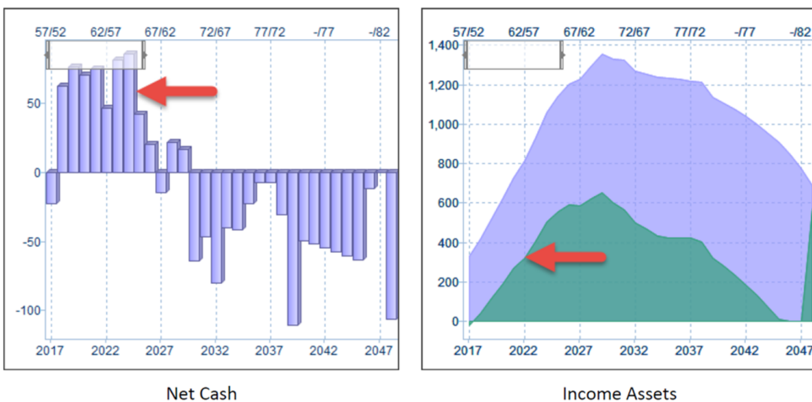
Last month I discussed the House Rich and Cash Poor theme (November 2018). This month I will be looking at the Large Latte Factor theme.

I drink coffee. Anywhere from one to seven times a week I'll head through the drive-thru to grab a cup for the road. Often, I'll use spare change I find in the cup holder or maybe a quick Visa tap. If you asked me how much I spend on my mortgage or what my car payment is I could tell you right there on the spot. But if you asked me what I spend on coffee in a month, I'd have to do some math and probably speak with a forensic accountant. In other words, I can't easily account for all my minor spending. In the world of Life Planning, this is known as the Latte Factor. Everyone has one and sometimes they are so large they can mean problems down the road.

In a Large Latte Factor theme, the Net Cash forecast displays a high and unrealistic non-registered portfolio savings rate that results in an over-stated Income Assets forecast. Income assets are liquid assets that can be used to fund a lifestyle expense. For example, a home (unless used as rental property) is not considered an income asset; whereas, investment accounts, bank accounts, or other cash sources are. Essentially, the Large Latte Factor is a term for unregulated spending.

People easily identify their sources of income; the biggest source prior to retirement is most often from career income. However, there is often an issue in the savings rate that is a result of under-estimating spending. Meaning, for most people it is not a problem of knowing where money is coming from but rather where it goes (ie: how is it spent). Basically, people spend money every day on "stuff", knowing neither where it goes nor how much, they spend. Often it is this spending that prevents people from having and doing what they most want.

When conducting a Life Plan analysis I can see how large a client's Latte Factor is by examining both their Net Cash and Income Assets forecasts. For example, if the Net Cash forecast displays a very high savings rate, but the client does not have a substantial amount in their non-registered portfolios, then they likely have a large latte factor.



Net Cash

Income Assets

In the above charts, Net Cash shows large amounts of money being retained 'somewhere' by this client. For example, under the Net Cash forecast on the left, this client has over $50,000 in 2018 of cash not sitting in a bank account or investment account (ie: non-registered account). Also, since it is showing in the net cash forecast, we know it has not been contributed to a registered account like an RRSP. (RRSPs and other registered accounts are not considered in Net Cash but are included in income assets and net worth).

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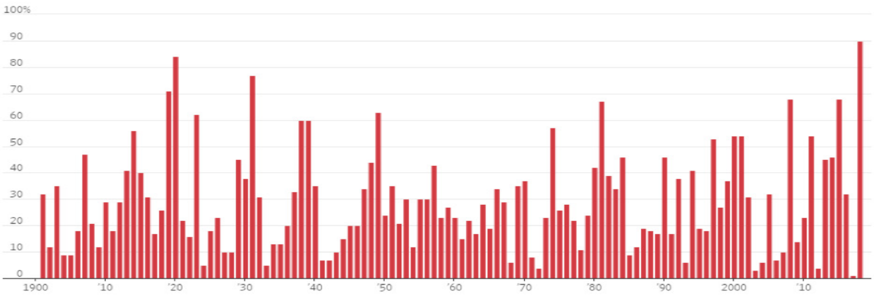
We do know the $50,000 exists because we know the client's exact career income amount as reported to the CRA. We also know to some degree of accuracy the larger regular expense commitments of the client (ie: cars, bills, mortgage, etc).

In other words, $50,000 is somewhere in the 'void'.

In the Large Latte Factor theme, I can surmise that the client is spending more than they realize and this may ultimately hurt them in retirement. Of course, we are in the business of helping clients realize their long-term goals, so there are strategies to help in this theme. For example, a new spending plan could be structured, or a PAC program could be set up (this is particularly useful for younger clients). However, we all have a Latte Factor so it's important that any plan leaves sufficient room for a little Latte Factor spending.

Clement Gignac, Commentary continued

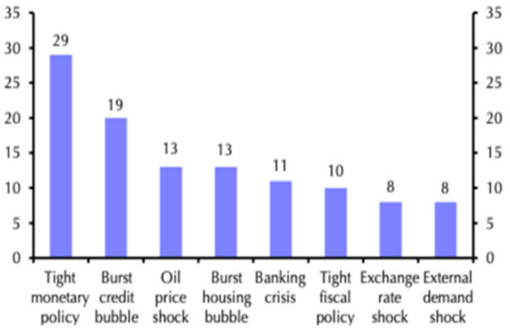


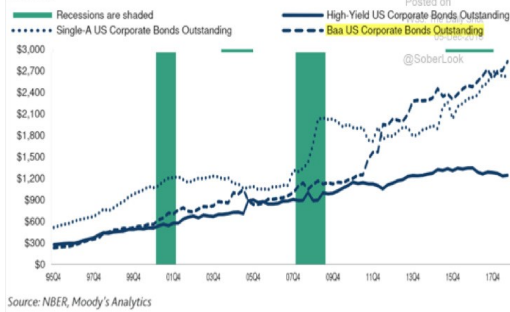
S&P 500 : Number of days with absolute returns of 1% and more

	Between 1% and 2%	Between 2% and 3%	3% +
2010	54	14	8
2011	61	23	12
2012	44	6	0
2013	34	4	0
2014	32	6	0
2015	62	7	3
2016	39	8	1
2017	8	0	0
2018	41	10	5

2018 has also seen a return to volatility. The S&P 500 Index has posted more than 15 trading sessions with volatility over 2% (not including intra-day volatility). Last year there wasn't a single session with this type of volatility.

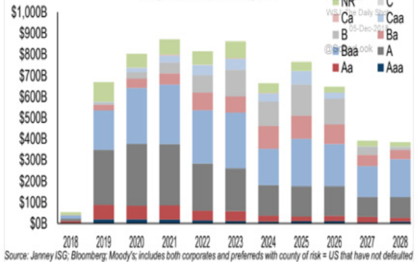
Our view is that it's a great opportunity to buy the dips, as long as there is no recession. The current business cycle is the longest on record, but business cycles never die of old age; the cause is usually policy mistakes or external shocks. Tight monetary policy has historically been a leading cause of recession, but even with the Fed's rate hikes, monetary policy in the U.S. is still very accommodative.





RISK FACTORS

One of the biggest risk factors we're watching is corporate America's debt level, an issue recently highlighted by former Fed Chair Janet Yellen. Next year we'll also be closely monitoring corporate spreads, which have widened significantly over the last four weeks.



We are also monitoring a number of other risk factors like: U.S.—China trade tensions; Wage acceleration in the U.S.; Real estate speculation in China and; Messy end to Brexit. In our view, the probability of a recession has gone from 15% to 25%, given yield curve flattening and widening credit spreads. However our base case is that the current cycle will continue because inflation is under control and we expect a solution to the U.S.—China trade disagreement. Traditional leading indicators suggest the expansion will continue.

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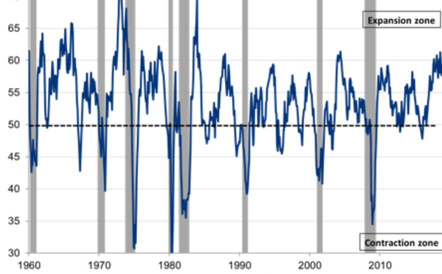
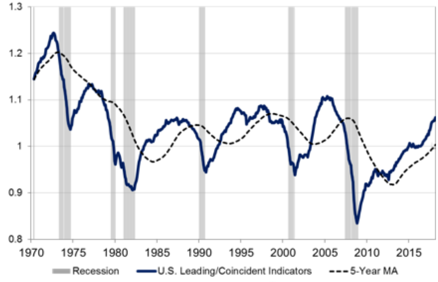
Clement Gignac, Commentary continued





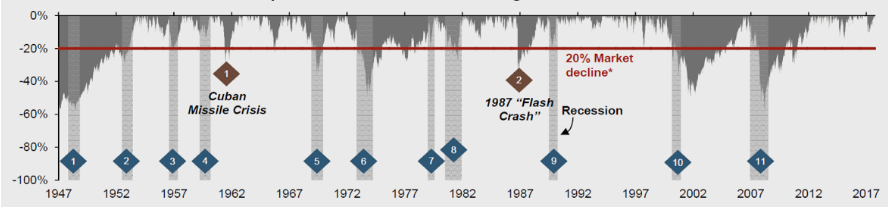
MONETARY POLICY

Fed Chair Jerome Powell recently said the U.S. is just below the neutral rate, so the Fed appears very close to moving to the sidelines. We expect one more rate hike this year and another in March or June of next year. The ECB is set to end its quantitative easing program and we expect very little movement from the Bank of Japan.

We are expecting the Bank of Canada to hold off on further rate hikes until March. It has another 75 bps to go before it reaches the neutral rate. The Canadian dollar should strengthen as rates rise further. As we speak, we are hedged 25%; depending on what the Fed does in the final meeting of the year, we could be at 50% or 75%.

EQUITIES

It's unlikely that we're heading into a bear market. You typically don't see a bear market without a recession, and our view is that a recession is not likely, so we see the dips as buying opportunities.

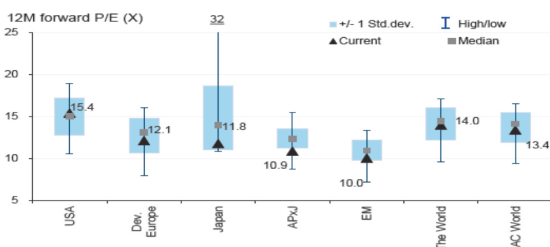


Characteristics of recessions and related stock market declines

	Recession			Related market sell-off			Macro Environment		
Recession	Peak Quarter	Trough Quarter	% Decline	Peak date	Trough date	% Decline	Commodity Spike	Aggressive Fed	Extreme valuations
1 Recession of 1949	4Q48	4Q49	-1.5%	6/15/1948	6/13/1949	-21%			◆
2 Recession of 1953	2Q53	2Q54	-2.4%	1/5/1953	9/14/1953	-15%			
3 Recession of 1958	3Q57	2Q58	-3.0%	8/2/1956	10/22/1957	-22%			◆
4 Recession of 1960-61	2Q60	1Q61	-0.1%	8/3/1959	10/25/1960	-14%			◆
5 Recession of 1969-70	4Q69	4Q70	-0.2%	11/29/1968	5/26/1970	-36%		◆	
6 Recession of 1973-75	4Q73	1Q75	-3.1%	1/11/1973	10/3/1974	-48%	◆		
7 Recession of 1980	1Q80	3Q80	-2.2%	2/13/1980	3/27/1980	-17%	◆	◆	
8 Recession of 1981-82	3Q81	4Q82	-2.5%	11/28/1980	8/12/1982	-27%		◆	
9 Early 1990s recession	3Q90	1Q91	-1.4%	7/16/1990	10/11/1990	-20%	◆	◆	
10 Early 2000s recession	1Q01	4Q01	-0.4%	3/24/2000	10/9/2002	-49%	◆		◆
11 Great Recession	4Q07	2Q09	-4.0%	10/9/2007	3/9/2009	-57%	◆	◆	
Non-recession Bear Markets									
1 1962 flash crash, Cuban Missile Crisis	-	-	-	12/12/1961	6/26/1962	-28%			◆
2 1987 flash crash, program trading, overheating markets	-	-	-	8/25/1987	12/4/1987	-34%			◆
Average	-	-	-1.9%	-	-	-30%			

Earnings growth is likely to disappoint next year, which has been driving P/E multiple contraction. The Canadian market continues to trade at a significant discount to the U.S. (13x forward earnings vs 15x). The Canadian financials sector is trading at 11.5x. The energy sector's prospects are also improving.

Exhibit 16: Valuation ranges (MSCI Regions) over a 10-year timeline
12-month forward price to earnings multiple



We are underweight the U.S., overweight EAFE and overweight emerging markets.

If we are right that the Fed will soon go on the sidelines, the U.S. dollar will be under pressure, which would be very good for emerging markets. We expect emerging markets to account for more than half of global growth over the next four to five years. At the portfolio level, we are neutral U.S. equities. We'd like to wait for relief on credit spreads before going back to an overweight. As noted, we are buying the dips on the assumption that a recession is not in the cards for 2019.

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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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