The Stan Clark Financial Team's

PERSPECTIVES

In this issue...

Volume 11 - Issue 7 October 2020

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Peer pressure may cause us to join in *herding*, or following and acting with a group instead of as individuals, without realizing it. In this issue's behavior finance article, I discuss the danger of herding tendencies to investments. In our *Quarterly Economic Update*, Michael Chu and I review how the pandemic has influenced the economy – and what we may experience ahead. And in the first part of a series on *Return Assumptions*, Sylvia Ellis shows why it's advisable to not only to take the long view in making financial plans, but to allow for the unexpected.

Stan

CIBC Wood Gundy

Behavioral finance

Don't let the investment herd trample you!

By Stan Clark - Senior Investment Advisor

Do you recall the riots in Vancouver after the final game of the 2011 Stanley Cup? Those riots were an example of a phenomenon called *herding*.

Herding causes us to follow and act with the group, instead of as individuals. Herding can result from panic after a major disaster or threat. Or, herding can be triggered – no one knows why – by the actions of just a few individuals, such as in a riot.

Herding is an odd phenomenon. Ask people if they would join a mob. Most would say, "No!" But, when the right circumstances arise, they might well join the mob. Peer pressure causes people to join herds without even knowing it – or thinking about what they are doing.

Herding, of course, also happens in the stock market. And when it does, watch out for your money! Herding is a major cause of stock market bubbles and subsequent crashes. It causes people to flock to overpriced stocks, to shy away from buying undervalued ones, and to engage in panic selling that locks in major losses.

Even canny money managers, who pride themselves on their contrarian approach to the market, can get caught up in herd behaviour. We saw this happen with the rise and then bursting of the tech bubble at the end of the 20th century – and more recently, with the one-month bear market in the first quarter of 2020.

In his 2007 book *Your Money & Your Brain*, Jason Zweig cites a study of thousands of buy-or-sell recommendations by analysts at hundreds of brokerages. The study found that "analysts tag along with the crowd… When the average recommendation is a 'strong buy,' for example, the next call from any given analyst is about 11% more likely to be a strong buy, too."

It can all begin with a few individual actions copied by a growing host of other investors. In such cases, the analysts and others have been caught up in an *information cascade*, which Zweig describes this way:

Even canny money managers, who pride themselves on their contrarian approach to the market, can get caught up in herd behaviour.

"When institutions own a hot stock in a trendy industry, they usually have heard of it by word of mouth rather than through original research – and they go on to talk it up with three times as many colleagues as the owners of less exciting stocks do. No wonder 'everybody' often seems to be talking about the same stock."

The only effective way to protect yourself from herd behaviour in the market is to adopt non-emotional, rational ways of making decisions. For example: Use disciplined rules to pick stocks. Or, set an equity target and stick to it, to avoid market-timing mistakes.

Herding often results from letting others do some of your thinking for you. Following the herd may sometimes get you out of trouble – when fleeing a disaster, for example – but it more often has the opposite effect. Just think of all those bones lying at the base of the cliff at Heads-Smashed-In Buffalo Jump in Alberta's Provincial Park.

In the next issue of *Perspectives*, we will revisit herding: its main causes – and how you can avoid it. ■

Team Talk:

This month, we've decided to do something a bit different with our Team Talk section. During the Covid-19 quarantine, many of us have been rediscovering our joy of cooking, and we'd like to take this opportunity to share some of our favourite recipes with you! Meghan, Mike & Heather's recipes can be found at the end of this issue of Perspectives. Here are some teaser photos...

Meghan's Graham Cracker Toffee Bark

Mike's Chicken in Oyster Sauce

Heather's Cinnamon Rolls

You'll find the complete ready-to-print recipes and the stories behind them at the end of this issue.

Quarterly Economic Update:

Outlook still positive, though with slower growth

By Stan Clark, Investment Advisor, and Michael Chu, Investment Advisor

The year so far

For 2020's third quarter, stock markets around the world posted positive results. At home, the TSX was up 4.7%. The World Equity Index, a gauge of stocks around the world, was up 5.9% (in C$).

	3rd Quarter 2020	Year to date 2020	Trailing P/E	Trailing Earnings Yield	Dividend Yield
Canada	4.7%	-3.1%	22.4	4.5%	3.3%
U.S.	6.9%	8.2%	28.4	3.5%	1.6%
Europe	0.1%	-8.3%	19.9	5.0%	2.7%
Japan	5.1%	5.3%	21.3	4.7%	2.3%
EAFE (Europe, Australia, Far East)	2.8%	-4.7%	20.2	5.0%	2.7%
Emerging Markets	7.5%	1.3%	18.6	5.4%	2.4%
World	5.9%	4.3%	25.1	4.0%	2.0%

Source: Bloomberg

Strong performance from the stock market in the second quarter carried over to the third quarter. However, the Q3 returns were much more muted after the remarkable recovery from the March lows. A massive amount of monetary and fiscal stimulus around the world continued to provide a positive foundation for stocks.

But heightened uncertainty around coronavirus infections, fresh restrictions and the damage already done continue to weigh on company-earnings prospects. While the world entered a deep recession, the impact wasn't fully felt because of substantial monetary and fiscal stimulus. Investors now weigh the impact of uncertainty regarding additional stimulus, a COVID-19 vaccine and intensified restrictions.

Help needed

One of the biggest financial stories of 2020 is the stock market rally that began in late March and quickly caused the indexes to regain ground. According to Howard Marks of Oaktree Capital, this isn't a typical cycle. In a typical cycle, the economy is growing well, but things eventually become euphoric, causing productive capacity to exceed what was needed. Then follows instability, leading to a downturn. Most of the time, economic weakness is fixed with economic tools. But today's downturn is different, as it was caused by an external, non-economic development: the pandemic. That means this downturn cannot be cured merely through economic stimulus. The root cause needs to be dealt with, i.e., bringing the virus under control. Meanwhile, however, government stimulus is still needed, as many of the initial programs are expiring. We hope the U.S. Congress can do something soon.

What happens if Washington fails to deliver? We might see widespread layoffs, businesses slowing, more defaults and bankruptcies, plus a softening in investor psychology and thus asset prices – creating opportunities for bargain-hunters.

A global depression seemed possible in mid-March. Fortunately, a swift and massive rescue effort from the Fed and Treasury succeeded. But there are possible ramifications from the rescue package. First, with rates so low, there's no more room to cut, as the Fed says it won't go to negative interest rates. Second, rescues have the potential to cause *moral hazard*. That is, if the government saves companies and investors from huge losses, it teaches them that it's okay to take massive risks. That's a bad lesson! Third, slow growth is a major concern. It might take a while to get the economy up to where we were supposed to be in 2020. Because this is the Fed's main concern, it's less worried about the risks from its rescue efforts. Therefore, the Fed will tolerate more inflation than normal. Not only did the Fed say it would be happy to accept 2% inflation, it added that monetary policy would remain loose until inflation *averages* 2% – meaning inflation can go above 2% as it works up to 2% average. The worst of all worlds would be *stagflation*, or slow growth plus inflation.

Nobody knows if we'll get inflation, stagflation, stagnation, disinflation or deflation. The thing is that given the pandemic and recession, there was no choice about the rescue package. So far, though, the policy response has been helpful.

The power of interest rates

One of the biggest reasons for the stock market rally that began in March is the low level of interest rates.

First, low interest rates are stimulative. For example, financing costs are lower, whether you are buying a property or building a factory. Also, the fear of missing out on low rates gives people a reason to act now, accelerating transactions that might have otherwise taken place in the future.

Second, lower rates increase the present value of future cash flows, which should increase the values of all income-generating assets. This implies a higher acceptable price-to-earnings (P/E) ratio for the stock market.

As interest rates go down, money moves from one asset class to another, in search of the best bargains until equilibrium is achieved. That's why, if interest rates are lowered, asset prices like stocks go up, thereby lowering future returns. According to Marks, most assets today are fairly priced relative to their risk, but future expected returns are about the lowest they've ever been.

A side effect of lower interest rates and lower prospective returns is that these encourage investors to seek more risk to maintain returns.

For example, investors might buy low-credit rating bonds for extra yield – while turning a blind eye to extra risk – the rates are higher for a reason! Bad things happen when the fear of missing out on returns takes over the fear of losing money.

Changes in the stock market

Howard Marks also discusses the bifurcation of the U.S. stock market. The leading tech companies have become different from other companies as the role and power of technology has expanded; and these tech companies have also grown and become more highly valued.

The gap in growth prospects for these tech companies and the rest is huge and expanding. Part of this is due to the pandemic pulling forward the adoption of technology, such as virtual meetings, e-commerce and cloud computing. These tech companies are investing aggressively on product development, addressing markets that are larger than ever. For example, during the tech bubble, there were 248 million Internet users in the world; now there are over 5 billion.

The tech companies are also disrupting non-tech companies. Perhaps some of this is hype, as in the dot-com boom of the late 1990s or the "Nifty Fifty" bubble of the late 1960s. On the other hand, today's big tech companies are stronger, faster growing, more dominant, scalable and perhaps even better valued.

It may be that a larger differential in valuations for big tech companies is warranted. But the reasons for higher valuations are also the same reasons that create their biggest vulnerability: exposure to anti-trust actions. We expect these to continue regardless of who wins the presidential election.

Another impact of big tech is on the stock indexes. If an index is 25% huge-growth companies, and 75% smaller-value companies, what relevance are the average growth, valuation and performance numbers in describing the stock market?

U.S. election uncertainty

One primary risk to the economy and stock market is a contested presidential election coming up in early November. The presidential election will likely be determined by key swing states. Hopefully any challenge or recount will just encompass a few states and not be too disruptive. The market usually cares more about certainty than about who is elected.

Don't mix politics with your portfolio

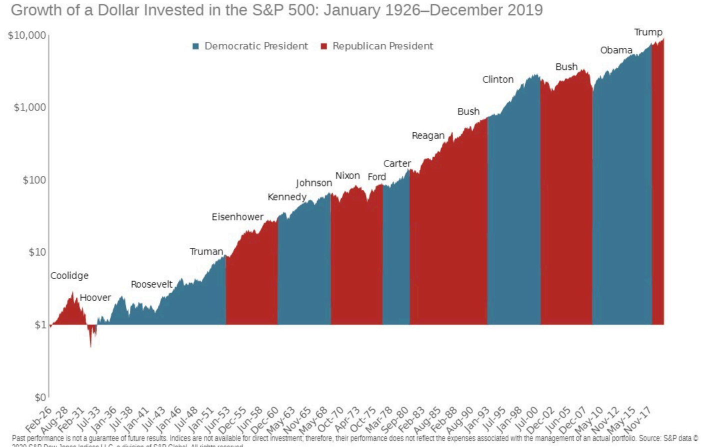
With the imminent presidential election, you've probably seen many predictions about the winner and what the impact will be on the stock market. All this may be entertaining, but the reality is we don't know about what comes next. This involves more than not knowing who the winner will be. We also don't know: what policies they will implement; how amenable the other party will be; what the impact on consumer sentiment will be; or even what the market's reaction will be or if it is already priced in.

According to Ben Carlson of Ritholtz Wealth Management, when Trump was elected, many experts predicted an enormous market crash. Instead, stocks rose steadily until the pandemic. There were over 130 new all-time highs for the S&P 500 during Trump's tenure. Similarly with Obama, there were dire predictions. But stocks set off on a huge bull run from 2009 that lasted the next decade. There were almost 130 new all-time highs under Obama.

We've had a lot of discussions about if Trump wins then X will happen, and if Biden wins then Y will happen. In fact, markets have rewarded long-term investors under a variety of presidents.

Markets Have Rewarded Long-Term Investors under a Variety of Presidents

Growth of a Dollar Invested in the S&P 500: January 1926–December 2019



Past performance is not a guarantee of future results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Source: S&P data © 2020 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

Note that every president going back to Herbert Hoover has also experienced down markets.

Yet another election uncertainty is which party will have a majority in Congress. The following chart shows historical returns under different combinations.

Average S&P 500 Annual Returns Based on Partisan Control

1933-2019

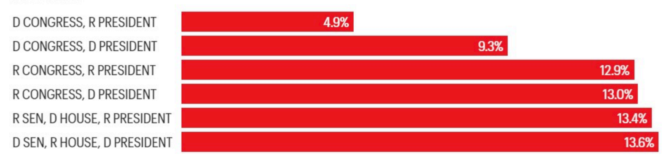


CHART: BEN CARLSON • SOURCE: STRATEGAS

FORTUNE

The reality is that politicians have far less control over the stock market than people believe. The effects of policy often lag and have unintended consequences. And as we've seen this year, the economy and stock market aren't always on the same page. Regardless of what happens in the upcoming election, it's important to keep politics out of your decision-making. Investing is already hard enough with emotions, biases and blind spots without adding politics.

Looking ahead

As we look towards the end of the year, the base case is likely positive, but with slower economic growth, thanks to an accommodative monetary and fiscal environment. However, we still have to be mindful of potential inflation and deflation.

We haven't had much inflation for a long time. But there are a few reasons this might change. COVID-19 has accelerated deglobalization forces, which makes it harder for companies to reduce costs. Add massive fiscal spending and you could get more inflation. Also, central banks around the world, including the Fed, have communicated that they will allow inflation to trend higher.

Deflation is possible, too, as without government support the recovery is somewhat fragile. Fortunately, stocks can provide a hedge despite lower yields.

The upward trend of stocks can continue. But we should cautiously move forward, expect lower rates of return and not take unnecessary risks. That's why having an asset allocation and equities target customized to your own personal and financial needs will help us be resilient though these unusual times. Meanwhile, please stay healthy and stay safe! ■

Financial planning

Return assumptions for financial plans – Part 1:Life is like a box of chocolates

By Sylvia Ellis, Senior Estate Planning Advisor

When we make a financial plan, we need to make assumptions about the future returns for the life of the plan. This isn't easy. As the eminent philosopher Forrest Gump would say, "My mama always said, life is like a box of chocolates. You never know what you're gonna get."

Future return assumptions, especially those used over a long period of time, have a huge impact on the results of a financial plan. They can mean the difference between projecting a significant estate – or having to reduce expenditures.

The first issue with future return assumptions is that, well, they're for the future! We know that future returns cannot be accurately forecasted. So, what we do is base them on long-term historical results. To be conservative, we reduce these by 2-3%. And by long term we don't mean just the past 10 or 20 years, as most plans would. We mean the past 100 years. This way we capture all the ups and downs, as well as the long-term trends. The average return for stocks over the past 100 years was 10.8%. For most of our plans we use 7-8% as an average, maybe 5% above inflation.

It sounds easy enough. Just plug in these forecasts, and see where we're at! Indeed, this is probably the most common approach to financial planning. Come up with a long-term return assumption – assuming it was reasonably determined – and then use that in the plan.

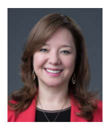
Let's say we're doing a plan for someone aged 60. We're projecting until they are 95, in other words, a 35-year plan. Over such a long period, minor differences in the return assumptions, even 1 or 2%, can have a significant impact on the final results. It's like we're boating and our navigation is off by two degrees. On a small lake, it won't make much difference where we end up. But if we're going a long distance, say, over an ocean, then that same two-degree difference could mean arriving in the wrong country! That's the first issue with return assumptions: small differences in returns can make huge differences in results – especially since they're being used over such a long time.

This raises another issue, one that most people don't consider. The past 100 years have been wildly volatile: inflation, deflation, a deep depression, explosive growth, two World Wars, embargoes, assassinations and pandemics. There were some very good 35-year periods, some very bad 35-year periods, and many in-between periods.

As we look to the future, the world remains uncertain. No one really knows what the next 35 years will bring. Maybe they will be average; maybe they will be really good. But what if it's one of the very bad 35-year periods?

History does tend to repeat itself. The problem is, you don't know what specific part of history is going to be repeated next! It makes a big difference when the up and down years occur, relative to when we are adding or withdrawing money.

In the next of this three-part series, we'll discuss how – even if the average returns are the same – the path or order of returns can make a big difference in financial projections. ■



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Meghan’s Graham Cracker Toffee Bark

Shared by Meghan Jones

I first came across this recipe in elementary school, if you can believe it! A few of the school moms at the time got together and created a cookbook as a way to raise funds, and they included this recipe. I have been making this bark for years and have passed it along to friends and family countless times. It truly is the simplest and most crowd-pleasing dessert – and it comes together in less than 30 minutes.

Around the holiday season, I like to add in crushed up candy cane or use gingerbread as the base. Or, I’ll switch up my crunch component to pecans or walnuts for something different. I hope you enjoy!

Photo: lovetobeinthekitchen.com

Ingredients:

- 1 box of graham crackers
- 1 bag of slivered almonds (any nut will do; you can also make nut-free!)
- 1 bag Skor bits
- 1 cup butter
- 1 cup brown sugar
- 1 bag of your favourite chocolate chips.

Preparation:

1. Preheat oven to 350°F.
2. Line cookie sheet with tin foil and cover with a layer of graham crackers.
3. Scatter slivered almonds on top of graham crackers. Do the same with a layer of Skor bits.
4. In a medium saucepan over medium heat, melt the butter. Add in brown sugar and whisk until mixture caramelizes (do this over high heat).
5. Pour caramel over layers on lined cookie sheet and spread evenly with the back of a spoon.
6. Put in the oven for 10 minutes or until caramel starts to bubble.
7. Remove from oven and add a layer of chocolate chips, using the same spoon to spread evenly over the top.
8. Put in freezer to set. Break into pieces and enjoy!

Mike’s One-Pan Roasted Oyster Sauce Chicken & Scallions

Shared by Michael Chu

A friend of mine recently recommended this recipe to me. I like making food – as long as it’s fast, simple and of course tastes good! This chicken dish takes just 10 minutes to prepare and has eight basic ingredients. As a bonus, it can all be done in one pot. However, I do use a tray when I move it to the oven.

The cooking website that this recipe is from is amazing. It’s run by a close-knit family of four sharing their home-cooked and restaurant-style recipes. The site, The Woks of Life, has been a huge resource for me, with its detailed recipes, how-to’s and interesting stories, as well!

Check it out: https://thewoksoflife.com/

Ingredients:

- 8 chicken thighs
- Salt and pepper
- 2 tbsp vegetable oil
- 5 slices ginger (¼-inch thick)
- 10 scallions (washed, trimmed, and cut into 2-3-inch lengths)
- ¼ cup Shaoxing wine (60 ml; you can substitute another rice wine, or dry sherry)
- 2 tbsp soy sauce
- 3 tbsp oyster sauce

Preparation:

1. Preheat your oven to 425 degrees F. Rinse the chicken thighs and pat thoroughly dry with paper towels. Season with salt and pepper.
2. Place a large roasting pan over medium high heat on your stove across two burners. Once the pan is hot, add the oil and ginger. Allow the ginger to fry in the oil for one minute, or until fragrant. Add the chicken to the pan, skin-side down, and sear until browned. Flip the chicken and sear on the other side.
3. Add the scallions to the pan. Thoroughly combine the wine, soy sauce, and oyster sauce in a bowl, and pour it over the chicken and the scallions. Transfer to the oven and roast for 25-30 minutes, or until the chicken is cooked through.

https://thewoksoflife.com/one-pan-roasted-chicken-oyster-sauce/

Heather’s Cinnamon Rolls

Shared by Heather Guzak

When I was growing up, my mom used to bake cinnamon rolls with me. The rolls were always something that we not only enjoyed eating, but also making together. Over the years Mom would add some ingredients and take others away, always seeing how she could perfect them. Here, below, is the final result!

Now that I have my own family, we’re continuing the tradition of making these delicious rolls. They’re one of our all-time favourite treats to bake in the fall, as we love spending a rainy Sunday together in the kitchen. After, we always fight over who gets to eat the centre! Needless to say, the rolls do not last long once they are out of the oven.

Ingredients - dough:

- ¼ cup warm water
- 1 tbsp active dry yeast
- ¾ cup buttermilk (room temperature)
- 2 large eggs (room temperature)
- ½ cup + ½ tsp granulated sugar, divided
- 1 tsp salt
- ½ tsp vanilla extract
- 6 tbsp unsalted butter, diced into 1-tbsp pieces and melted
- 3½ - 4 cups bread flour

Ingredients - cinnamon filling:

- 6 tbsp unsalted butter, softened
- 1 cup packed light brown sugar
- 2 tbsp cinnamon

Ingredients - cinnamon filling:

- ¼ cup unsalted butter, softened
- 3 oz. cream cheese, softened
- ½ tsp vanilla extract
- 1½ cups powdered sugar

Preparation:

1. Mix water, yeast and ½ tsp sugar into bowl and whisk well. Let rest 5-10 minutes to bubble up. Add in buttermilk, eggs and ½ cup granulated sugar, salt, vanilla and 6 tbsp melted butter. Add flour in increments. Knead until smooth for about 5-6 minutes. Transfer dough to an oiled bowl, cover with plastic wrap and let rise for about 1½ hours.
2. Put butter parchment paper on pan and set aside. Punch dough down, sprinkle with flour. Roll out into a 20-by-18-inch rectangle. Spread with butter and cinnamon sugar. Roll into a log, pinch the seam to seal. Slice and place on baking sheet. Cover with plastic wrap and let rise until doubled in volume for 1½ hours.
3. Preheat oven to 375 degrees. Bake for 18-22 minutes until centres are no longer doughy. Whip together butter and cream cheese until smooth and fluffy. Add in vanilla and powdered sugar and whip until light and fluffy.