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CIBC PRIVATE WEALTH

THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

Volume 14 – Issue 8 December 2023

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The stock market is subject to the workings of luck. When luck is good, investors may mistake that for skill by a company, CEO or fund manager. In this issue's behavioral finance article, I explore the risks in the *illusion of stock-picking skill*. Michael Chu looks at what we can learn from several centuries' worth of interest-rate trends. Sylvia Ellis shares how CIBC's annual Miracle Day, this year on December 6, supports children's charities. And Tom Cowans explains why and how you can save for retirement, even if it's a long way off.

Stan

Stan Clark is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

Behavioral Finance

LUCK AND THE ILLUSION OF STOCK-PICKING SKILL

By Stan Clark, Senior Wealth Advisor

Let's face it: Our world is complicated and messy. Much of what happens is either strongly affected by, or entirely due to, luck.

With that in mind, I'd like to discuss luck and the illusion of stock-picking skill.

In his book *Thinking Fast and Slow*, Nobel Prize winner Dr. Daniel Kahneman points out that three powerful political leaders rose to power at almost the same time. Mao, Stalin and Hitler profoundly affected the world's political landscape for more than half the 20th century.

At this point you're thinking, "What has luck to do with that?"

Well, consider that, at the time each leader was conceived, there was a 50-50 chance the fertilized egg would be a girl rather than a boy. You can be sure the world would be very different today if even one or two of those births had been girls.

The stock market, similarly, is complicated, messy and subject to the workings of luck. According to Kahneman, luck may be the dominant influence that decides how well a company, or a CEO or fund manager, performs year to year. But people don't want to believe luck is so pervasive. That gives rise to what Kahneman calls the "illusion of stock-picking skill."

Of investing, Kahneman says, "...a major industry appears to be built largely on an illusion of skill." Buyers and sellers trade billions of shares daily. They have roughly the same information about the stock they are trading, but opposite opinions about what that information means for tomorrow's valuation of those stocks.

Kahneman cites an analysis of over 160,000 trades in 10,000 investor accounts. The stocks sold actually performed significantly better over the short term than the stocks bought to replace them. The sold stocks, thought to be a poor bet for the future, outperformed the overall market by an average of 3.2%. In other words, sellers, often selling to lock in gains, ended up worse than the people who bought those shares. And those who frequently traded fared worse than those who only sold occasionally, even after trading costs were factored out.

Whether it's individuals trading on their own accounts, or professional fund managers priding themselves on their training, experience and research, nearly all fail to win consistently. About two-thirds of mutual funds underperform the overall market in any given year, and typically more than 80% of them over 10-year periods.

Still, people cling to the illusion of skill, largely due to our two systems of thinking. System 1 finds cause and effect in the world. It builds stories to confirm that view: "Company A did well this year. Must be because it is led by a skilled CEO. Mutual Fund B outperformed the market; its manager must be a skilled stock-picker."

System 2 could analyze information deeply, but is innately lazy. System 2 would rather not work. It accepts System 1's illusions and any rationalizations needed to keep those illusions alive.

The illusion of skill is a deeply rooted, persistent cognitive illusion. In stock trading, it's hard to set this illusion aside because those who view themselves as skilled have a lot invested in it. They review economic data, economic forecasts and balance sheets. They interview CEOs and try to evaluate how well companies are managed. They're not about to put their success down to luck.

Kahneman advises that, when evaluating a stock, your big question should be: "Is all the relevant information about a company already incorporated in its price?" He says most traders not only lack the skill to answer the big question; they are cognitively blind to that lack.

The illusion of skill is a trap, even for seasoned, professional investors. It leads them to have more confidence in their stock selections than they should have, considering how often their selections underperform the market. The only answer is to be aware of the role of luck, forget about relying on stock-picking skill and develop an objective, unbiased approach to selecting stocks. Then, stick with that approach – no matter what others or your own intuitions tell you.

TEAM TALK

Jocelyn Johansson
Wealth Advisor

Jocelyn, Curtis, Callan, Mattias and Bruce in our yard in Whistler

What have you been up to this year?

This year has been about local trips to Whistler and staying in and around Vancouver. I had one quick trip to Los Angeles in June to visit my dear friend and her newborn twins. My baby gift to her was to fly down to LA and then escort them all back to Vancouver for an extended visit. I was not previously aware, but you are not allowed to fly with more than one child under the age of 2! Makes it difficult to come home to see your family when you have twins and a partner who works full time. We had a summer trip booked to go to Scotch Creek in Shuswap, but it was hit by raging wild fires the day before we were to leave. Miraculously the cabins we rent survived, along with the grocery store and gas station, but fires have been devastating parts of BC all summer. We managed to pivot from Shuswap and bring all 16 of our friends to our cabin in Whistler for a week of fun. We packed twenty people into our cabin and managed to have a blast while crammed together!

Asset Allocation

THE 'SUPRASECULAR' DECLINE IN INTEREST RATES

By Michael Chu, Senior Wealth Advisor

It's rarely we come across an eight-century trend. But when looking at long-term real interest rates, we see a bumpy but steady decline in rates since the 14th century. This provides lessons that can help us understand today's volatile markets.

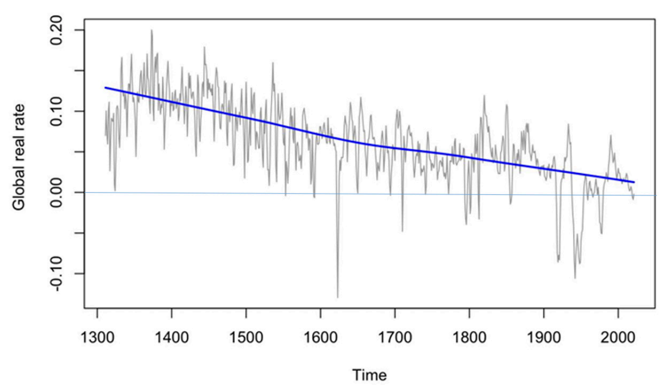
But first, some definitions. *Inflation* is the general upward movement in the prices of goods and services. Inflation weakens the purchasing power of your money because you can't buy as much as you did before.

Real and *nominal interest rates* are used to distinguish rates that do and don't consider inflation. A nominal interest rate is what you'll most commonly hear quoted. For example, the interest you receive on your bank account, term deposits or bonds do not consider inflation. But a real interest rate has been adjusted for inflation. In many countries you can buy "real return" bonds, which pay you an interest rate linked to inflation. The nominal rate is the real interest rate plus expected inflation. And the real interest rate is the nominal rate minus inflation.

Understanding real rates is especially important when inflation rates are high or changing rapidly. For example, in the 1970s a 10%+ nominal interest on deposits at the bank might have sounded attractive. But during the '70s, inflation was also high – even higher than 10% – so real interest rates were often negative. Investors might have thought they were getting a good deal. But they were actually losing purchasing power, even after receiving 10% interest.

In contrast, in the 1990s nominal rates were relatively low, but inflation was even lower. So, real interest rates were positive – meaning investors in deposits or bonds were gaining purchasing power.

Paul Schmelzing, a postdoctoral researcher at Yale and visiting researcher at the Bank of England, wrote a paper in 2020 on this *suprasecular* (beyond long-term) trend on real interest rates. Schmelzing updated his paper in 2022, along with Kenneth Rogoff and Barbara Rossi. They noted that real rates can change dramatically in the short term, but there has been a noticeable decline in rates over time. Schmelzing, Rogoff and Rossi calculated this decline to be 0.013% per year for the last seven centuries.



Source: Long-Run Trends in Long-Maturity Real Rates 1311-2021, Kenneth S. Rogoff, Barbara Rossi, Paul Schmelzing, Working Paper 30475.

Many theories try to explain the downward trend in rates. Some, usually focusing only on the decline in the past 10-20 years, revolve around declining productivity and its dampening effect on economic growth. The theory here is that slow growth goes hand in hand with low real rates. Another theory, favoured by Antti Ilmanen in his excellent book *Investing Amid Low Expected Returns*, focuses on the imbalance between savings supply and investment demand. The "savings glut" hypothesis points to the savings accumulations in China and other emerging economies this century, combined with those related to aging demographics and the growing need for pension savings. This theory seems more consistent with the longer-term evidence, as rates have fallen while global growth has increased sharply since the Industrial Revolution.

Also, improvements in the overall standard of living increase the proportion of people with the ability to save. When the general standard of living is low, it's hard for people to save. Those relatively few savers can command a higher interest rate than when many people save.

This research provides some important perspective on the oft-heard debate about when rates will return to "normal," as we were all hearing until last year. One issue is, what do you mean by normal? If you grew up in the 1960s and '70s during the oil shocks, you may recall how rates kept surprising people by going up more than expected. But since the '80s, and especially from 2008 until recently, rates were surprising us in the opposite direction. The consensus might be that these two trends cancel each other out, so we get something like 2-4% real rates. But based on the long-term evidence, real rates show a strong tendency to fall over time.

What does this mean for investors? Extrapolating trends can be dangerous, even 800-year-old ones. But if we do extrapolate, in a few decades we might see not only zero interest rates, but even negative interest rates in advanced economies like the U.S. This doesn't mean real rates will eventually become extremely negative with no bottom. There might be a natural lower limit to how low real rates can go. After all, who wants to lend money only to be paid back less? Maybe just don't lend it in the first place – essentially keeping rates only slightly negative.

After dipping below zero for a couple of years after Covid, real rates are now back up to their long-term trend line of just over 2%. This increase has pressured borrowers, but has been very welcomed by savers. While the long-term trend is down, we've also seen that real rates are volatile and in the short term could easily go up or down. In these circumstances, diversifying your fixed income across maturities – holding short, intermediate and longer-term fixed incomes – is more important than ever. So is matching those maturities to your needs as determined by your personal financial plan.

It's always tempting to make predictions and bets based on our own beliefs and experiences. But as always, we feel the safest and most profitable approach is to focus on your goals – and on organizing, protecting and growing your wealth through proper planning and a disciplined rules-based approach to investing.

Michael Chu is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Michael is a specialist in investment research and information technology.

Financial & Estate Planning

RRSPS: YOU CAN'T START SAVING FOR RETIREMENT TOO EARLY!

By Tom Cowans, Wealth Advisor

When you're young and in a career, retirement seems far away. But it *will* come eventually – faster than you think. So, you're best to start saving early for your retirement.

A Registered Retirement Savings Plan (RRSP) helps you do that. The two big advantages of an RRSP are:

1. tax-deductible contributions that lower your taxable income, resulting in less tax to pay; and
2. tax-deferred growth, meaning you don't pay tax on any of your gains until you ultimately withdraw them.

These two advantages are a huge help in saving for retirement. The larger the (positive) difference in income tax bracket when you contribute to your RRSP compared to when you eventually withdraw the funds in retirement, the greater the tax deferral benefit.

Contributions can either come from yourself or your spouse. There are limits on how much you can contribute each year. These limits will be the lower of:

- 18% of your earned income in the previous year, or
- the maximum contribution amount for the current tax year, which for 2023 is $30,780.

You can find your contribution limits on your Notice of Assessment, which the CRA provides each year after you submit your tax returns. By following the guidelines in our previous articles, you will have hopefully learned the tools to budget and save for personal investing. You should therefore have the funds to contribute! However, if you don't have the funds this year, it's still okay. You have the option to carry forward your RRSP contribution room and use it in the future.

As noted, you must close your RRSP the year you turn 71. At that time, you will have the option to withdraw from your RRSP, convert it to a Registered Retirement Income Fund (RRIF) or buy an annuity. Regardless which option you choose, you'll need to pay income tax when you withdraw from the plan.

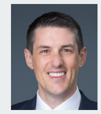
If you have a spouse who earns a lower income, and/or who is younger than you, you could benefit from a spousal RRSP. With this type of RRSP, the contributor can deduct the contributions, while the money grows tax-free under the spouse's name. By building up the spousal RRSP rather than your own, you can delay the withdrawal of your assets until your younger spouse turns 71. If you withdraw from a spousal RRSP, it will be taxed as income to your spouse, who is presumably in a lower tax bracket, and not to you as the original contributor. However, a withdrawal cannot be made within three years of the spousal contribution; otherwise the income will be attributed back to the contributor.

Designating your spouse as a beneficiary for your RRSP is an important part of estate planning. It allows your RRSP to flow to your spouse tax-free and, by ensuring your registered account will not be included in your estate, avoids probate fees.

You'll find plenty of RRSP calculators online that help you get an idea of how much to save to fund your retirement. Just make sure the assumptions are realistic. And remember to factor in inflation! Retirement may be a long way off, but remember that when it does come, it can last a long time, most likely decades. You'll need a healthy amount of savings to fund your retirement.

As we mentioned about TFSAs, you can arrange for funds to automatically be deposited (and invested) into your RRSP every pay period. This is an effective technique and simple to follow.

What if you don't have enough savings for both TFSAs and RRSPs? Which should you do first? The answer is, they are both great options. RRSPs are a bit more attractive if your tax bracket is higher, because the contributions are tax-deductible. TFSAs could be better if you might need to withdraw some of the funds in the next year or two. Withdrawals from TFSAs are tax-free, whereas you need to pay tax on RRSP withdrawals. If you want to increase the benefit from the RRSP contribution further still, then reinvest any tax refund the contribution may provide you with. The key lesson is: Just contribute as much as you can to one or both. Once again, your future self – your retired future self – will thank you for it.



Tom Cowans is a Portfolio Manager and Wealth Advisor for the Stan Clark Financial Team at CIBC Wood Gundy.

CIBC Miracle Day:

MAKING A DIFFERENCE FOR KIDS IN NEED

By Sylvia Ellis, Senior Estate Planning Advisor

CIBC Miracle Day, held annually on the first Wednesday of December, supports the invaluable work done by children's charities around the world. Since starting this giving tradition in 1984, CIBC has raised more than $272 million globally, helping to transform the lives of children and communities worldwide.

This year, CIBC will hold its annual Miracle Day on December 6. On that special day, we at the Stan Clark Financial Team will donate all fees and commissions to the CIBC Children's Foundation.

The Foundation has three areas of focus:

- help for high-needs children
- healthy, active living
- well-being and enrichment.

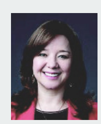
With its goal of improving the quality of life for children in need, the CIBC Children's Foundation is dedicated to helping them prepare for future successes. By focusing on health, education and well-being, the Foundation provides these children with the opportunity to participate in programs that might not otherwise be accessible to them. Such enrichment opportunities are vital in supporting young people in the formative years, encouraging personal and professional growth.

The Stan Clark Financial Team is proud to be a part of CIBC Miracle Day. As we do every year, we invite you to suggest causes that are close to your heart. Last year at your suggestion, we directed funds to several charities, including:

- **Athletics for Kids** – A4K is homegrown and focused on local impact. It was founded 20 years ago when two friends from North Vancouver felt compelled to open up sports opportunities in their community to kids from low-income families. Today, Athletics for Kids has evolved into a grassroots organization with significant reach, as their team of two staff and a small army of volunteers ensure that kids across BC have the chance to play.
- **C.H.I.L.D. Foundation** – CH.I.L.D. stands for Children with Intestinal and Liver Disorders, and they're who the Foundation fights for! More than 25 years since it began in 1995, CH.I.L.D. continues to be a labour of love for many people. It has been successful in achieving a public awareness that hadn't existed before. No longer do children, families and adults with such disorders as Inflammatory Bowel Disease shy away from talking about them. CH.I.L.D. has also succeeded in raising $27 million for research and the building of a research lab, the first of its kind in BC. And, CH.I.L.D. has established two Endowed Chairs for Research at the University of British Columbia and Children's Hospital
- **Zajac Ranch for Children** - For 19 years, the Zajac Ranch for Children has remained wholeheartedly committed to its promise of making a positive impact on children. The Ranch team continues to develop and operate an innovative medical camp, where everything is accessible and inclusive, and everyBODY can participate. Since 2004, Zajac has provided a place of INSPIRATION, HOPE and AccessABILITY so kids can concentrate on the main purpose of camp: having fun and making friends.
- **Cassie + Friends** – The only charity in Canada dedicated 100% to the pediatric rheumatic disease community, Cassie + Friends has raised over $3 million since 2007. These funds help transform the lives of kids and families affected by juvenile arthritis and other rheumatic diseases. Working with patients, caregivers, healthcare professionals, researchers and other friends, the charity provides life-changing support, education, community connections and research to help kids and families face the ups and downs of life with a chronic condition.
- **HEROS** – The Hockey Education Reaching Out Society is a volunteer-driven charity that uses the game of hockey to teach life skills to, and empower, Canada's marginalized youth. By providing a safe and stable environment for young people to succeed, connect and learn, HEROS guides its participants to become constructive citizens within their communities.

While it only takes one person to make a difference, great things happen when the Stan Clark team, together with our clients and charitable partners, rally around the cause of helping children in need – which is the spirit of CIBC Miracle Day.

We thank you in advance for your interest and support! ***And, as noted above, we warmly encourage you to let us know about any Canadian children's charities you would like us to consider.***



Sylvia Ellis is the Senior Estate Planning Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Sylvia provides support to the team in projecting and planning client financial affairs.

SCFT Trivia

Play our trivia – support the cure!

For every correct entry we receive in our trivia contest, the Stan Clark Financial Team will contribute $1 to CIBC's "Run for the Cure" to raise money for breast cancer research. Each correct entry will also be entered into the draw for this month's prize. Email or phone in your entry today.

Answer all four questions to be entered into the draw for this month's prize. *Hint: You can find the answers inside this newsletter.*

1. Investors who sell stocks to lock in gains often:
   a) See those who bought the stocks suffer losses.
   b) Are onto a sure thing. So, sell frequently!
   c) End up worse than the investors who bought those shares. Sold stocks, thought to be a poor bet for the future, have been found to outperform the overall market by an average of 3.2%.
   d) Become experts at predicting the stock market.

2. *Real* and *nominal* interest rates are used to distinguish rates that do and don't consider inflation. To explain further:
   a) The real interest rate is the nominal rate minus inflation. The nominal rate is the real interest rate plus expected inflation.
   b) The real interest rate is the one that affects you. The nominal one is too obscure to matter.
   c) Over many centuries neither type has changed much.
   d) Don't borrow or save, and you won't have to worry about either of them.

3. CIBC Miracle Day, held annually on the first Wednesday of December, supports the invaluable work done by children's charities around the world. Since starting this giving tradition in 1984, CIBC has raised more than $272 million globally, helping to transform the lives of children and communities worldwide:
   a) True b) False

4. If your spouse is younger than you, setting up a spousal Registered Retirement Savings Plan (RRSP) is beneficial because:
   a) As contributor, you can deduct your contributions while the money grows tax-free under your spouse's name.
   b) You can delay the withdrawal of your assets until your younger spouse turns 71.
   c) If you withdraw from a spousal RRSP, the money from it can be taxed as income to your spouse, who is presumably in a lower tax bracket, and not to you as the original contributor.
   d) All of the above.

Email answers to: **stanclarkfinancialteam@cibc.ca** or call (604) 641-4361

One prize winner will be chosen by a draw from all those who submit correct answers. The draw will take place on December 29, 2023.

Trivia challenge runs December 1 - 28, 2023. No purchase necessary. There is one prize to be won. Simply complete the trivia questions correctly to be entered in the draw. Limit 1 entry per person.

Chances of winning depend on number of eligible entries and whether you correctly answer the trivia questions. Open to adult Canadian residents (excluding Quebec). For full challenge rules, write to: The Stan Clark Financial Team, CIBC Wood Gundy 400-1285 West Pender St, Vancouver, BC V6E 4B1. © Stan Clark 2023

CIBC WOOD GUNDY | The Stan Clark Financial Team
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