The Stan Clark Financial Team's

PERSPECTIVES

In this issue...

Volume 12 - Issue 7 October 2021

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Intuitively, the human mind seeks patterns from information. But when we make financial decisions based on intuitive insights, rather than careful, evidence-based thinking, the results can be costly. In this issue, discussing how to avoid such mistakes, I look back to the shrewd, wise Greek hero Ulysses. Meanwhile, in our Quarterly Economic Report, Michael Chu and I review 2021's mostly positive third quarter, as well as what may lie ahead. And Sylvia Ellis explains the four-step cycle our team uses in creating and maintaining your financial plan.

Stan

Behavioral finance

To improve investing, learn from Ulysses

By Stan Clark - Senior Investment Advisor

In my articles on behavioral finance, I often show how we are of two minds about – well, about almost everything.

Our *intuitive* mind skims information and seeks patterns. We then arrive at conclusions and make decisions, almost without thinking. Meanwhile, our reflective mind mulls over our intuitive actions. We often rationalize these intuitive actions according to our ingrained biases.

What can we do about this? In this article I will suggest that, to improve our investing, we can learn from the mythic Greek hero Ulysses.

I'll start by noting that, fortunately, our intuitions are often right. We are pretty good at judging other people's characters and sizing up complex social situations. But our intuitions can also lead us astray. They can be wrong in ways that cost us money – sometimes, big money.

Last month, I discussed how our emotions and biases affect our intuition, and how these biases won't disappear just because we know about them. Our intuitive biases are quite similar to optical illusions. Just because we know an optical illusion exists doesn't eliminate it.

The problem is, our emotional intuitive mind can have a tremendous influence on our judgement and decisions. It can twist our thinking, and cause us to buy and sell the wrong things at the wrong time. So, how to prevent our intuition from leading us astray?

Here's where Homer's story of Ulysses comes in. Do you recall this myth from your school days? The Greek warrior wanted to hear the songs of the Sirens, which no man had ever heard and survived. The Sirens' irresistible songs drove men mad, causing them to crash their ships on the rocks or jump into the sea and drown.

Cunning Ulysses entered into a contract with his crew. They would plug their ears with wax, tie him securely to the mast and then row past the Sirens. While within earshot of the Sirens, the crew, at Ulysses's behest, would ignore his pleas to be set free. This they did, and Ulysses became the first man ever to survive hearing the sweet-but-lethal Siren songs.

The essence of this story was that Ulysses recognized that he, like all other humans was susceptible to the Sirens songs. So he created a strategy so he could experience the songs while avoiding the tragedy.

When our team invests, we use a set of strategies that are, in a sense, a Ulysses contract. We set up your portfolio with a mix of equities and fixed-income assets tailored to your needs and your risk tolerance. Then we stick to the target, rebalancing when it gets too far out of line. This helps us avoid the lure of market timing, in our view a high-risk endeavour with low odds of success.

We select specific stocks according to objective data related to their intrinsic value and likelihood of appreciating. We don't buy according to hunches or transient news items that affect daily prices. This helps us avoid the temptation of speculating in fads and popular hot stocks that lack sound fundamentals. When investments no longer meet our criteria, our strategies move them out of your portfolio and into better ones, always following our rules and keeping your portfolio properly balanced. Since all the stocks we invest in meet certain standards, we increase the odds that your portfolio will rise in value – even higher than the very good long-term trend of the market.

Next time, I'll look at more tools for counteracting psychological biases. ■

Stan Clark is First Vice-President, Portfolio Manager and Senior Investment 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.

CIBC Wood Gundy

Team Talk:

Martha Rodriguez

Administrative Assistant

By the lake in Osoyoos

It's been a busy year! I've been doing yoga for a year now. I started because I felt I was not as flexible as before. It's helped me a lot to relax and stretch and I like it. I continue to SkyTrain to work twice a week and it's been fine. I just sit and read, doze off, check my messages, etc. and don't have to have the stress of driving and getting stuck in rush hour.

On the family front, we were in Osoyoos in July. It was first time for my husband and myself as our daughter, Mariana, had been there before with family friends. Loved the fruit and bought lots of cherries and jams. Mariana has started grade 12 so now she's focusing on studying and applying to post-secondary schools.

The highlight of the year will be our trip to Peru in December, we will have a warm Christmas and New Year in Lima as it's summer in the southern hemisphere. Mariana is very excited to see her four grandparents and cousins again.

Quarterly Economic Update:

Outlook stays mostly positive

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

Continued strength in the stock market

It's already been about a year and half since the pandemic began. A period of enthusiasm in markets followed the initial shock. Then concerns about slowing growth, supply-chain bottlenecks, rising inflation and central-bank tapering weighed on markets around the world. Despite these concerns, markets in the third quarter were mostly positive – bolstered by economic expansion, low interest rates and growing corporate earnings.

At home, the TSX was up 0.2% for the third quarter. The World Equity Index, a gauge of stocks around the world, was up 2.3% (in C$).

	3rd Quarter 2020	Year to date 2020	Trailing P/E	Trailing Earnings Yield	Dividend Yield
Canada	0.2%	17.5%	16.5	6.1%	2.7%
U.S.	2.9%	15.5%	25.9	3.9%	1.4%
Europe	0.6%	10.8%	18.5	5.4%	2.6%
Japan	5.2%	0.7%	17.7	5.6%	2.0%
EAFE (Europe, Australia, Far East)	1.8%	8.0%	18.5	5.4%	2.5%
Emerging Markets	-6.0%	-1.6%	15.1	6.6%	2.2%
World	2.3%	12.6%	22.9	4.4%	1.7%

Source: Bloomberg

Growing company earnings

During the previous earnings season, companies in the U.S. handily beat expectations for both sales and earnings. Third-quarter results, which are currently being reported, will likely not show growth at such a rapid pace. Year over year, third-quarter earnings are expected to rise 26%. Going forward, the corporate earnings guidance will likely be more conservative, given higher labour and materials costs and shortages in labour and parts.

Inflation higher and longer?

Inflation is turning out to be more persistent and less transitory than U.S. Federal Reserve officials had predicted. Recently Fed Chair Jerome Powell said, "It's also frustrating to see the bottlenecks and supply-chain problems not getting better – in fact at the margins apparently getting a little bit worse. We see that continuing into next year probably, and holding up inflation longer than we had thought." According to economist Ed Yardeni, Powell is no longer thinking about the temporary base effect, but about a more persistent problem with global supply chains. It doesn't help that ultra-easy monetary and fiscal policies have been boosting demand, thus contributing to supply bottlenecks and higher inflation.

Energy prices are also contributing to inflation. Energy demand has recovered, along with economic activity. Meanwhile, energy companies, under pressure from activists, have reduced drilling and spending on fossil fuels. Also, wind turbines have turned out to be not as reliable as expected, and droughts have caused issues for hydroelectricity. All these have combined to produce shortages and spikes in energy prices.

Overall, Yardeni sees elevated inflation for the rest of this year and the first half of 2022.

Wharton Professor Jeremy Siegel agrees, saying the enormous stimulus by the Fed and government policies will produce a strong economy but will come with higher inflation. Siegel notes that many consumers have continued to spend, despite higher prices, since the government put trillions of dollars in their hands. He predicts that the inflation we are seeing will probably be one of the major political issues in 2022. As well, he sees prices up 20% over the next three or four years – this works out to 5% to 6% per year. But Siegel feels this level of inflation is still considered moderate and should be good for stocks. He also thinks that bond tapering by the Fed will start in early 2022 and bond yields will rise to 2% by year end.

But maybe inflation won't be as high as Siegel predicts. According to the asset-manager firm GMO, inflation is complex and involves a feedback loop between prices and costs. Labour costs are important in the production process; sustained inflation requires wages to rise significantly faster than productivity. But for a long time GMO has been seeing the opposite, which it calls wage repression. GMO concludes that without a radical shift in labour's bargaining power (of which it sees no sign), inflation likely will not become systemic.

What's stagflation?

A growing concern lately is stagflation: an environment of low growth and high inflation. It's the worst of both worlds. Inflation erodes your purchasing power more quickly than usual while central banks cannot rejuvenate growth with low interest rates, as they are simultaneously trying to battle inflation.

People usually want high growth and low inflation – somewhat like what we're experiencing today. But a major debate is whether the current high inflation is temporary. With overall economic growth around 4%, the stagflation argument breaks down. From a theoretical perspective, stagflation usually results from a negative supply shock, like the 1970s oil embargo accompanied by structural inflexibility, such as excessive labour-union power. Suddenly a product disappears and prices go up, resulting in inflation, while costs can't adjust due to cost rigidity. The economy then grinds to a halt while prices stay high. Together, that's stagflation.

Today we see some prices rise because of supply shocks, as in the auto industry. But much of the rising prices are from positive-demand shocks, caused by people buying more things. So, economic growth is good and, from the demand side, inflation is higher.

Things could change. Rising prices could lead to reduced consumer demand, which could slow the economy. Worsening supply chain disruptions, due to anything from shipping to chips, could also weigh the economy down.

Growth may be slowing, but growth is still growth. A slowdown differs greatly from a recession. And, the persistence of inflation remains unknown. For all these reasons stagflation seems a low-probability outcome.

Kicking the can down the road… again

Because of funding issues, the U.S. federal government almost shut down at the end of September. The shutdown was averted, but only for two months. In December the funding issues will need to be addressed again. You might recall that the U.S. has gone through this several times over the years and the general result is that funding gets resolved, albeit sometimes at the last possible moment. A government default or shutdown is very unlikely. But the situation is messy. It could cause an intense and, to say the least, interesting time over the next few months as the politicians work things out.

Lowdown on Evergrande

China's housing market plays an outsized role in that country's economy and wealth. About one quarter of the Chinese economy is connected to housing. So, anything that affects housing is of great significance.

For some time, China has been trying to put the brakes on its ever-ascending property market. But new regulations and a cooling market have contributed to problems for developers. Take Evergrande, China's second-largest property developer, with over 1,300 developments. Evergrande has branched into unrelated businesses, such as electric cars and insurance. While it has a lot of assets, it also owes a lot of money. Believed to be over $300 billion in debt, Evergrande is now facing a liquidity crisis. It owes money to investors, banks, suppliers, individuals and even employees.

Some investors fear that an Evergrande meltdown would have systemic risks similar to those the Lehman Brothers' demise had on the U.S. economy in 2008. This, in turn, creates headaches for other property developers. It's unlikely that the Chinese government will fully bail out Evergrande. However, we have to think China learned from the mistakes the U.S. made in 2008, and will provide for creditors and customers to avoid a similar crisis.

Help wanted – apply within

It's strange that the U.S. economy can claim a record number of job openings, yet still have an elevated level of unemployment. There are more jobs available than there are people unemployed: 10.9 million vs. 8.4 million. This unusual gap has been widening even as jobless benefits have

In Canada, private-sector finances have excelled during the pandemic. Some of this might be due to the stock market and improved savings rates. Despite one of the deepest recessions in generations, private-sector bankruptcies and mortgage arrears have declined for the past two years.

expired, schools have reopened and the risk of infection has fallen. Granted, it takes time to match people with jobs, and maybe people are in the midst of changing jobs, or waiting until COVID-19 settles more before re-entering the workforce. There may also be geographic issues. But this is a growing cause of concern and a source of risk for future growth.

Time for renewal

The Bank of Canada is set to renew its mandate this month. This happens every five years where decisions are made on a range of options, such as inflation targets. It's likely that the 2% inflation target will remain unchanged, as the economy has performed well under the existing mandate. Observing what's happening with inflation in the U.S, the Bank of Canada may afford itself some flexibility in its inflation target.

Home sweet home

In Canada, private-sector finances have excelled during the pandemic. Some of this might be due to the stock market and improved savings rates. Despite one of the deepest recessions in generations, private-sector bankruptcies and mortgage arrears have declined for the past two years. As government support fades, some of this may unwind, but it seems businesses and households are in good shape despite the pandemic.

Business activity has been accelerating lately, making up for lost time during the lockdowns. Though things could slow while COVID's Delta variant works its way through the population.

The wall of worry

While the economic recovery since the start of the pandemic has been remarkable, the sharp rebound has also exposed several risks. China's economy, the second largest in the world, has been slowing – confronted with slowing retail sales, credit issues and power shortages. Supply-chain disruptions, including long queues of ships at shipping ports and shortages of truck drivers, are jeopardizing the ability to meet consumer demand. The disruptions are also causing inflation to be more persistent. Input cost increases continue to be a common concern with companies, although some of these have been offset by efficiency gains or price increases to the consumer. A shift towards local supply chains to make processes more robust could imply higher long-term costs for businesses.

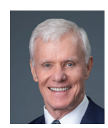
While most of these worries are legitimate, worrying actually helps to fix things! Most of the issues can be resolved. Plus, there's the added benefit of keeping the markets from getting ahead of themselves.

Looking ahead

As we took towards the end of the year, the base case is likely positive thanks to an accommodative monetary and fiscal environment. However, slower growth is expected and rising inflation is a concern.

The upward trend of stocks can continue in the long term, but anything can happen in the short term. We should expect lower rates of return going forward, and avoid excessive speculation and unnecessary risk. While optimism in the earlier part of the year has now given way to a more cautious view, stocks still look favourable compared to cash and bonds over the longer term.

Having the right balance is key. An equities target customized to your own personal and financial needs is important and will help us be resilient through these unusual times. Meanwhile, please stay healthy and safe! ■



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

Financial Planning: As easy as 1, 2, 3, 4

By Sylvia Ellis, Senior Estate Planning Advisor

Last month we briefly wrote about financial planning – and how it doesn't have to be complicated. Here, we expand on that further.

Planning is best thought of as a repeated cycle: a series of simple steps that you go through, preferably with your financial advisor. When you've completed all the steps, you go back to the first one and start over. You do this continually, each time focusing on what's most important to you then. That way you can consistently adjust your financial plan to changes in your life.

You can keep things simple with a four-step cycle:

1. Clarify your situation and goals
2. Create a Personal Financial Plan
3. Customize your investments to fit your plan
4. Complete your financial action plans.

Let's explore these steps in a bit more detail:

Step 1: Clarify your situation and goals

To make sure your financial plans are right for you, it's important for your financial advisor to know as much as possible about you and your family; your work; your needs; your life goals and dreams; and the opportunities and challenges you're facing. The more information you share, the better the job your advisor can do in providing advice.

One of the most challenging areas for many people is determining their goals and dreams and figuring out what is truly important. Keep in mind that money is not important in its own right – rather for what it allows you to do with your life, and for the people and causes you feel passionate about. Steven Covey, author of The 7 Habits of Highly Effective People, writes, "Some people spend their whole life climbing the ladder of success, only to find out the ladder was up against the wrong wall." Your financial plan should make sure your ladder is up against the right wall; that your money and other resources are being put to the best possible use to help you get the most out of your life.

Clarifying your situation and goals is the foundation of all future planning, so it is something you need to spend time on before you put the rest of your financial plan in operation. It's also something you need to revisit regularly.

Step 2: Create a Personal Financial Plan

Once we have a clear understanding of your situation, needs and goals, it's time for the next step: putting numbers to them. This step allows your advisor to create a plan to see if you can actually achieve what you want. It's a look at where you are today and what you will need in the future to achieve your goals. It also serves as a roadmap for you through the rest of your life, answering such basic questions as "When will I be able to retire?", "How much retirement income will I have?" and "How much should I be saving?"

This roadmap, your Personal Financial Plan (PFP), not only provides useful answers to those basic questions, but also valuable information needed to explore other areas of your financial planning. Your PFP isn't dissimilar to a regular medical checkup. It gives us a sense of your overall financial health and what work needs to be done.

For example, to do your wills and estate planning, it is useful to know such things as the size of the estate you will likely leave to your heirs, and how much tax your estate will owe on your death. To decide on your insurance needs, you need to know your tax liabilities and other needs covered by your income, and also how much you could afford to pay. Your PFP provides information to help make those decisions.

Once we update your plan, we review your "plan versus actual" so see how you are progressing relative to your last plan.

Step 3: Customize your investments to fit your plan

Besides the PFP, the Stan Clark Financial Team has developed a unique method of integrating your financial plan with your investing. To do this, we use our proprietary Equity Target Review, only available through our team's customized program. Together, we review your plan and come to an agreement on what this target should be for you, considering your unique time horizon and tolerance for risk. After the Equity Target is set, we then decide the other guidelines we will use to manage your portfolio, such as your geographic mix; which specific equity and fixed income strategies to use; and any personal preferences you would like considered.

This may sound simple, but without the right technology, achieving the guidelines can be a big stumbling block. However, the Stan Clark team has overcome that! We've designed our customized portfolio system so we can enter individualized guidelines for each client and continually monitor each portfolio to best meet your personal objectives.

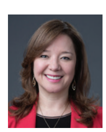
We also create an Investment Policy Statement (IPS) for our clients. The IPS is a written document, usually one page long, summarizing the key policies or guidelines we have agreed to. This helps ensure we're on the same page and that things are clear between us. Research from behavioral finance also shows that writing the plan down helps you stick to it. In the volatile, emotional world of investing, written guidelines help keep you focused on the right things, especially during times of heightened uncertainty.

Step 4 – Complete your financial action plans

After creating your PFP and customizing your investments, we address any action items that were identified in Step 2. For example, protection from risks to your financial plan, such as disability, critical illness, long term care and premature death. Or, controlling the distribution of your assets to family, friends and/or charities, according to your wishes.

We recommend updating your plan every year or two, or whenever there are significant changes in your circumstances or your goals.

Financial planning helps you make better decisions about your investing. The Stan Clark Financial Team wants you to be secure, save taxes and achieve your goals and dreams. We provide financial planning to our clients at no extra cost, as part of our commitment and services to you. ■



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.

CIBC PRIVATE WEALTH
WOOD GUNDY

The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

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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. Like the mythic hero Ulysses, who looked ahead and planned strategically, the Stan Clark Financial Team:

    a) Sets up your portfolio with a mix of equities and fixed-income assets tailored to your needs and risk tolerance.

    b) Selects the equities to invest in according to objective data related to their intrinsic value and likelihood of appreciating.

    c) Doesn't buy and sell willy-nilly, according to hunches or transient news items that affect daily prices.

    d) Does all of the above.

2. In the third quarter of 2021, markets were mostly positive – bolstered by:

    a) Relief that people are getting vaccinated.

    b) The increasing use of proof-of-vaccination cards.

    c) Economic expansion, low interest rates and growing corporate earnings.

    d) More people deciding to retire.

3. The term stagflation refers to an environment of low growth and high inflation.

    a) True

    b) False.

4. In creating a financial plan, keep in mind that money:

    a) Is what you should place most importance on.

    b) Is not important in its own right – rather for what it allows you to do with your life, and for the people and causes you feel passionate about.

    c) Isn't something you need to think about, as long as you're working.

    d) Is there to be spent.

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 October 29, 2021.

Trivia challenge runs October 1 - 28, 2021. 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.