Portfolio Advisor

Wealth Management
Dominion Securities

Dustin Eckstrand
Investment Advisor
dustin.eckstrand@rbc.com
4033418866

4900 - 50th Street, Suite 300
Red Deer, AB
T4N 1X7
dustineckstrand.ca

Market commentary

We think the global equity market's steep decline in October is part of a temporary correction phase that should recede once it becomes clear that U.S. earnings growth is merely set to slow, not fully retreat, and that the global economy has the ability to work through its modest loss in momentum.

Trade and tariff uncertainties should linger, but markets have already begun to account for these risks.

The correction is not heralding some imminent economic downturn or U.S. recession, in our view, because reliable leading indicators are signaling growth in the next year, at least, and low recession risks. These factors should support corporate earnings growth, though at a slower pace. We continue to recommend that a global portfolio be moderately Overweight equities.

Fixed income

With year-end approaching, the Federal Reserve is poised for one more rate hike while other major central banks will likely remain on the sidelines. Plans vary for 2019, with central banks in North America signaling further rate increases albeit at a gradual pace, while banks in the U.K./Europe likely will be more patient. Concerns over trade, domestic economic data, and uncertainty with Brexit and Italy could continue to weigh on market sentiment which in turn could potentially affect future central bank policy decisions.

Credit continues to be our favorite sector within fixed income, and we maintain our selective focus on quality. Our Underweight to fixed income overall reflects the view that tight credit spreads amidst heightened volatility and higher rates limits opportunities, and we suggest shortening portfolio duration to be prudent.

To learn more, please ask us for the latest issue of Global Insight.

RBC Wealth Management
Global Portfolio Advisory Group

Stay calm and invest on

In stormy markets, keeping a sense of perspective can help you stay on track to reaching your long-term goals, like retirement or a legacy for your family's future.

When the markets are particularly volatile, there's a natural tendency for investors to move into safer investments, hoping to avoid further losses, and wait until the markets recover. But unfortunately it's nearly impossible to predict when the markets will recover. As a result, investors may miss out on the eventual recovery, which can negatively affect their long-term investment goals. As the chart at right shows, the investor who stays invested tends to do better than the investor who bails out and misses even some of the recovery.

Avoid market timing

Some investors try to improve their returns attempting to "time" the market – selling right before the markets go down, then buying right before they go up again. In theory, this sounds great. But in practice, it rarely works, simply because it's so difficult to predict when the markets will go up or down. Unfortunately, that doesn't stop investors from trying, which is why the "average investor" tends to underperform virtually every asset class.

Maintain your sense of perspective

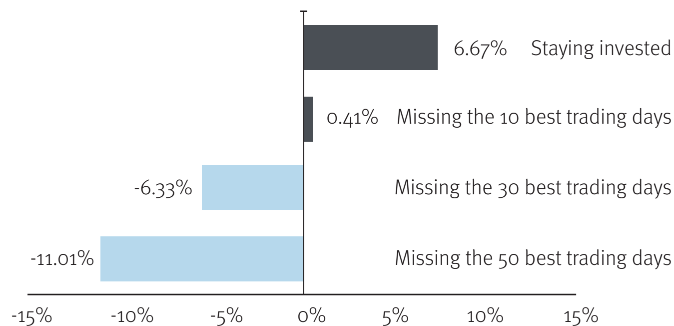
Unquestionably, stock market downturns can be painful, especially when you're in the middle of one. It's not always easy, but it's important to remember that downturns have happened before – and will happen again – and that historically the markets have always recovered and reached new highs, as the table below shows.

Reassess your comfort level with risk

It's one thing to say you are comfortable with a higher level of risk when the markets are only going up, and another thing when the markets are volatile. If you are finding it difficult to sleep at night because of market volatility, then it might be time to consider how much risk you are truly comfortable taking with your investments.

Why it's best to stay invested

Missing just the 10 best days in the market over the past 10 years would have reduced returns significantly.



Source: RBC Dominion Securities.
Based on annualized returns of the S&P/TSX Composite Index for 10 years ending July 2015.

Market recoveries following major downturns (S&P/TSX)

Year (event)	Return	Return in the following year	Average return over next 5 years
1974 (oil embargo)	-25.0%	+18.5%	+22.3%
1981 (double-digit inflation)	-10.2%	+5.5%	+13.7%
1990 (Gulf war)	-14.8%	+12.9%	+10.8%
2002 ("Tech wreck")	-12.4%	+26.7%	+18.3%
2008 ("Subprime crisis")	-35.03%	+30.7%	+8.7%

Source: Based on the returns of the S&P/TSX Composite Total Return Index.

Hindsight is 20-18

A butterfly flaps its wings and sets off an ice storm – or so The Butterfly Effect theory goes. Mathematician Edward Lorenz was studying weather patterns when his models revealed tiny changes to initial conditions dramatically altered the results. He used the flap of a butterfly's wings as a metaphor for the unpredictability of long-term weather events. But it's also the perfect metaphor for market downturns. Something seemingly benign and near impossible to predict was the beginning of the next decline.

2000 – Irrational exuberance

Popularized by Alan Greenspan, "Irrational exuberance" became the catchphrase explanation for the dot-com bust. It refers to late-'90s investors' confidence that dot-com stock prices would continue to rise despite non-supporting fundamentals. Hundreds of new internet companies reached valuations in the hundreds of millions, if not billions, having never made a profit only to soon crash into nothing.

The easiest explanation for the dot-com crash was excitable investors, propping profitless tech companies so high it eventually became their own undoing. But the fuse was likely set three years before. Between 1997 and 1999, interest rates were low and Asia was in the midst of a financial crisis; money was cheap and in search of a home. Then on August 5, 1997, The Taxpayer Relief Act was signed into law in the U.S., thereby lowering the capital gains tax rate from 28% to 20% for securities held longer than 18 months. Non-dividend payers, often growth companies, became incredibly attractive. Tech companies were considered new, exciting and the ultimate growth stock opportunity. Over the course of 2000-2002, the NASDAQ Composite fell 78%, and tech companies lost trillions in value. Looking back, the investing environment in 1997 was the beginning of a perfect storm.

2008 – Subprime mortgages

The 2008 financial crisis was the worst recession in 80 years. Many point to lenders who peddled subprime mortgages to borrowers with poor credit histories and little hope of repaying. Risky loans certainly played a part, but weren't the catalyst. After all, subprime lenders needed an incentive to write loans they knew they couldn't recover.

Arguably, it began in 1999 when U.S. banks were allowed to invest in derivatives using traditional deposits. This ability to speculate, coupled with leaps in financial engineering, led to toxic mortgages being pooled together, sliced and diced, and sold as investment-grade financial products. Subprime lenders didn't have to worry about keeping toxic loans on their books because they could sell them to be repackaged. In hindsight, the 1999 legislative change may have set off a chain reaction that brought the global economy to the brink of collapse nine years later.

20XX?

Not unlike the weather, markets are influenced by millions of tiny changes. Technological innovation, legal reform, market sentiment, Presidential tweets – all have the potential to alter the course of the markets. There are three things we can reasonably predict: 1) There will always be forecasts calling for the next market hiccup; 2) You never truly know the cause of a downturn until it's too late; 3) Historically, U.S. and Canadian markets have always recovered.

Like planning a barbeque for two months from now and worrying about rain, the best course of action for weathering market fluctuations is to develop a plan, diversify your investments, and stick to the plan. To learn more, please contact us today.

The magic numbers for retirement

Why they don't always add up

Humans went 200,000 years without numbers until the Sumerians inscribed clay tablets and baked them in the sun. Today, numbers power satellites, help us predict the future and serve as rules of thumb for retirement planning. And while numbers have generally proven useful, the same can't be said of the "magic numbers" on which we often base our retirement decisions.

The 4% rule

In 1994, U.S. financial planner William P. Bengen devised a "safe" retirement savings withdrawal strategy that would guide a generation of retirees – the 4% rule. Under this rule, you withdraw 4% of your total retirement assets in the first year of retirement. Then, in subsequent years, you increase the amount by the previous year's inflation. So, if your nest egg is $1 million and inflation is 2%, you would withdraw $40,000 in the first year and $40,800 ($40,000 plus 2%) in the next. Stay the course and, according to Bengen, you can expect your portfolio to last 30 years.

Bengen has since retired, and it may be time the 4% rule followed. The 4% figure is based on historical returns of the U.S. market, not today's markets. Moreover, the rule doesn't work if the markets do something unexpected. If returns are subpar, especially in the first few years, your savings may not last 30 years. But experience better-than-expected returns, and you could end up with considerable assets late in life that you could have enjoyed earlier.

100 minus age

Asset allocation and the discipline of adjusting it to your goals is complicated and time-consuming. So, along came the "100 minus your age" rule. How it works: subtract your current age from 100, and the remainder is your suggested equity allocation, with the difference being your fixed-asset allocation. For instance, if you are 55 years old, 45% of your portfolio should be in stocks.

Unfortunately, while convenient, this rule doesn't take into account rising life expectancies or falling interest rates. Also, not everyone retires at the same age, or shares the same tolerance for risk or investing goals. An age-dictated rule ignores many essential factors. Imagine you are risk-tolerant, 40 years old and have an investment horizon of 30 years: the rule would suggest a 60% equity allocation, which may be too conservative.

$X million net worth

Many of us measure our ability to fund retirement with a lump sum: $1 million, $5 million and so on. This suggests that a lump sum portfolio should cover all of your future expenses for the rest of your life. However, expenses are rarely fixed, and everyone has different goals for their retirement that require different sums. Rather than setting an arbitrary number, consider creating a personalized financial plan that takes into account your individual circumstances and specific needs.

Few retirement decisions can be made using universal "magic numbers" – your magic numbers are unique to you. To learn more, please contact us today.

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