Serber Speaking

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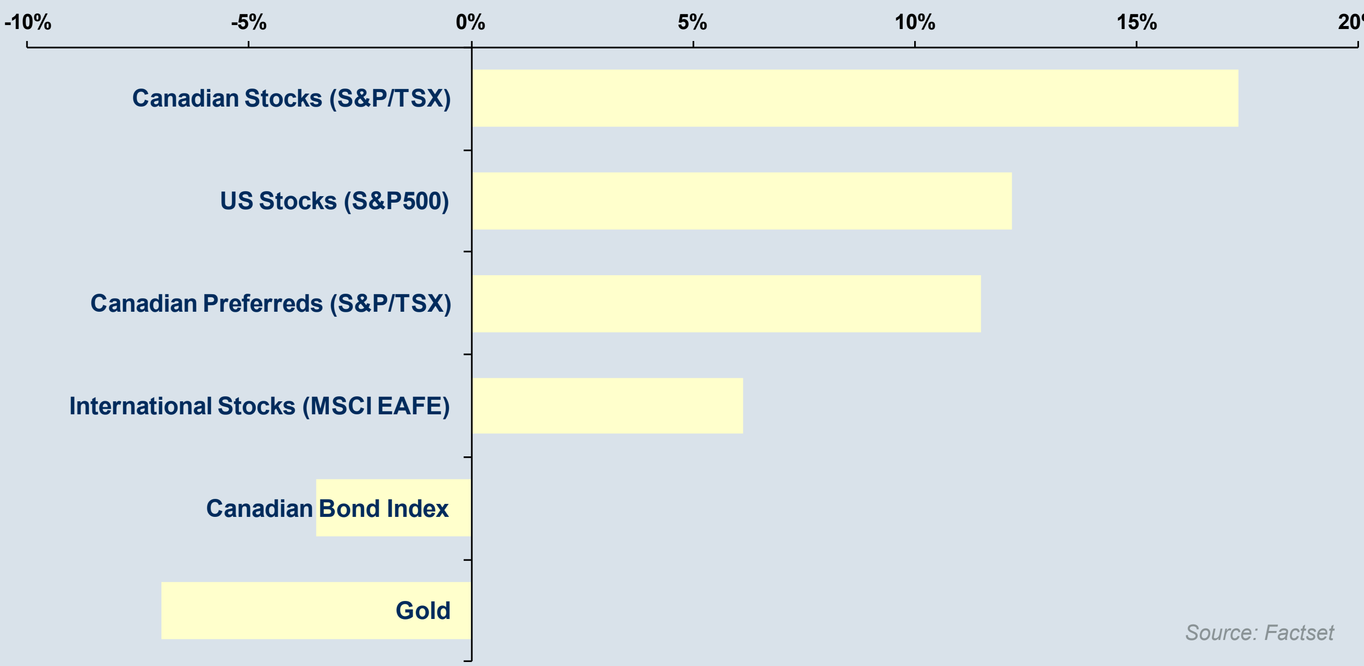
Commentary for the quarter ended June 30, 2021

That was Fun! Now What?

The second quarter of 2021 continued the positive momentum from the first quarter and delivered strong investment gains. The “safe haven” investments, gold and bonds, recovered somewhat from their Q1 drop, but are still in negative territory for the year, as seen on the chart below.

Performance by Asset Class: January 1 to June 30, 2021 (in Canadian $)



The good news about a period of strong performance is that portfolios have made good money - Yay! The bad news is that we have to deal with the question of “Now what?” From stocks to bonds to real estate to commodities to Bitcoin -- everything has gone up in price over the past two years -- since well before COVID. On further thought, maybe “now what?” isn’t the right question. Perhaps the right question is “what is my overall plan?”

Always have a plan that doesn’t change with the gyrations of financial markets and the economy.

I have advocated for years (decades?) that every investor needs to understand their “Investment Comfort Zone” as it relates to their portfolio. Specifically this means deciding what percentage of their portfolio will generally be invested in equities (owning businesses, aka stocks) versus the percentage that will be in safer fixed income investments such as bonds and GICS (lending out money temporarily). There are no cookie-cutter answers to this question. I have dealt with hundreds of investors over the years and every one is absolutely unique. Each person needs to clearly understand the essential character of lending versus owning (Fixed Income versus Equities) and decide for themselves what balance between the two is right for them.

A person's investment comfort zone may shift over time due to changes in life circumstances, investment experience and education. In my experience, more often than not for most people, it doesn't change that much over time.

Chris has thought carefully about his portfolio and over the years has settled on a plan that targets a 50/50 ratio between loaning and owning (fixed income and equities). He accepts that stock markets will occasionally have an unexpected drop of 10 or 20 percent and once every decade or two, will suffer a major bear market of perhaps 50 percent or more. He believes that, based on his perceptions about history, how the world works, and his own personal experience, that these drops will eventually be followed by recovery, and sometime after that, new "all time highs." That said, he knows himself well enough to understand that if his money was 100 percent in equities and there was a 50 percent drop, he would freak out. So for Chris, a 50/50 mix seems about right and over the last 20 years he has managed his portfolio accordingly. To be sure, there were periods when Chris had doubts: in the 2008-2009 financial crisis his equities were down more than 50 percent at one point and he was starting to feel panicky. In the end he stayed the course, and is happy with how things are going. Chris recently looked at the numbers, and sees that he would have made quite a bit more money over the last twenty years if he'd invested 100 percent in equities. "Too bad" says Chris, "I would not have been able to handle all the volatility." He intends to continue with his 50/50 portfolio for the foreseeable future. Chris's Investment Policy is to hold at a 50/50 mix, with periodic rebalancing to keep at or near that ratio.

What About Market Timing?

Mary has also thought carefully about her portfolio, and, like Chris, she feels comfortable with a 50/50 balance between equities and fixed income. However, Mary doesn't like the idea of "doing nothing" when the economy gyrates and markets seem to be getting "too high" or "too low." She thinks to herself "why would anyone not want to overweight stocks when prices go way down, and vice-versa?" For her this only seems logical. For Mary's Investment Policy we would set a minimum-maximum range for equities which could be, for example, 30 percent minimum to 70 percent maximum. The distance in percentage points between the minimum and maximum represents the degree to which Mary wants to time the market - increasing and decreasing her exposure based on economic and market conditions. We can debate, and many have, whether or not it is possible to successfully time the market. In the end, there is no right or wrong answer -- it boils down to what makes sense to each individual investor.

Creating the Game Plan

In my practice, the way we translate these ideas into an actionable investment plan is by helping each client decide on two critical numbers for their portfolio: the minimum equity percentage, and the maximum equity percentage. The mid-point between the minimum and maximum represents their long-term comfort zone for risk. The difference between the minimum and maximum indicates their appetite for market timing. Given these two numbers I can create and manage a portfolio that is personally customized to each client's exact comfort zone.

OK, but you didn't answer the question: "Now What?"

According to the analysts I follow who I consider to be most reliable, the outlook is that stocks should do better than cash or bonds over the next year or so. Interest rates are likely to remain low, consumers have cash in the bank, and unemployment is falling -- all of which means that spending should be strong over the coming year, which is good for the economy and good for business. The time to start worrying will be when central banks, most notably the US Federal Reserve, begin taking steps, such as raising interest rates, to cool down their economies. Stay tuned.

In the shorter term however, stocks have indeed had a very strong run - up double-digits year to-date in many cases. For a portfolio like Chris's, with a relatively fixed ratio of stocks versus fixed income, now could be a good time to lock in some recent gains if his equity percentage has risen above the target. For portfolios with a minimum-maximum range, like most of the portfolios I manage, I have adjusted the equity weighting to be a bit below neutral at the moment. If we see a decent pullback in the range of seven percent or more over the coming months, I will be increasing equity weighting back up towards neutral.

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From the Planning Notebook

Most people, to greater or lesser degree, worry about the future. This is only human. We want to know whether we are secure, what kinds of things could go wrong, and for those with families, whether they will be OK if something happens to us.

To help people visualize their financial future, RBC Wealth Management developed a software program called "myGPS." In my opinion, this is one of the most useful tools RBC has ever developed for clients. And my clients agree. They love the simplicity of the system and the value of the information it provides. Here is a sample of some of the questions that can be addressed:

What does my current financial situation look like?

Current Net Worth & Current Cash Flow – myGPS summarizes your incomes, savings, expenses, investments, real estate and debt – your critical financial information presented in one document.

If I live to be 95, will I have sufficient funds to maintain my lifestyle?

Projected Net Worth, Projected Income and Expenses – Based on the information provided, myGPS will project income, savings, taxes, expenses and the value of your assets into the future using a set of assumptions.

What will my government benefits be - should I start CPP early, or wait until I turn 70?

Many people are not clear about the amount of income they will receive from government programs such as Canada Pension Plan (CPP) and Old Age Security (OAS). myGPS helps make it clear.

If something happens to me, will my family be sufficiently provided for financially?

Estate Impact Analysis and Life Insurance Analysis – Anticipating your future financial needs is a difficult task. Anticipating your family's future financial needs should you or your spouse die unexpectedly, is even more difficult. myGPS can help identify potential financial shortfalls should an unexpected tragedy strike.

How does changing my financial assumptions impact my future financial situation?

Sensitivity Analysis – What if some of the assumptions prove to be wrong? What if you retire earlier than planned? What if inflation increases? What if the rate of return on your investments is lower, or higher, than forecast? myGPS allows us to change the assumptions to see how that change will affect your overall finances.

If you have not seen myGPS in action you can reach out to me at david.serber@rbc.com and I'd be happy to book a complimentary Webex meeting to show you a demo. If I have gone through myGPS with you in the past, please feel free to let us know if you'd like to run an update, or if you have any questions or comments.

Until next time, best regards,

David Serber

If you would like to discuss your personal situation please feel free to contact me. Also, feel free to forward this copy of ***Serber Speaking*** to anyone you think would find it of interest.