Michie Wealth Management's Quarterly Investment Update

Wealth Management
Dominion Securities

Summer 2018

The Michie Wealth Management Group of RBC Dominion Securities Inc.

Geoffrey Michie
CFP, FCSI, CSWP, CIM
Vice President & Associate
Portfolio Manager
Investment Advisor & Financial Planner
geoffrey.michie@rbc.com
905-434-5036

Nick Michie
CFP, FMA, CIM
Associate Portfolio Manager
Investment Advisor & Financial Planner
nick.michie@rbc.com
905-434-6065

Jason Michie
B.Comm, CFP, CIM, FCSI
Investment Advisor & Financial Planner
jason.michie@rbc.com
905-434-1214

17 King Street East, 3rd Floor
Oshawa, Ontario
L1H 7M9
www.michiewealth.com

"We build our business on integrity and service. The highest compliment we can receive is the referral of friends, family and business associates. Thank you for your Trust."

Dealing With Feeling: Understanding Investor Bias

No matter how rational or detached we'd like to think we are, the reality is that emotions often get the better of us. And when it comes to how we invest our money we have to be particularly attuned to our feelings in order to sidestep emotional traps.

When it comes to making complex investment decisions, many people follow a series of simple rules of thumb that in many cases are based on deeply ingrained biases that lead to irrational decisions. While these biases might be useful in helping individuals cope with day-to-day choices, they can be unhelpful for achieving success in long-term activities such as investing. By gaining insight into investor behaviour, investors can be coached to understand their own biases and make better investment decisions.

This article explores a behavioural finance topic that discusses one of the most common investment decision-making mistakes, loss aversion, and provides practical tips for avoiding them.

Loss aversion

Fear of losing is a much stronger driver of behaviour than the potential for gains. Loss aversion is a central concept in behavioural finance. It is captured in the phrase "losses loom larger than gains" that was coined in the groundbreaking 1979 paper, *Prospect Theory: An Analysis of Decisions under Risk*, by Nobel laureate Daniel Kahneman and the late Amos Tversky. Experiments by the authors revealed that the pain of losing is psychologically about twice as strong as the pleasure from gains. It is this aversion to loss that can drive investors to make emotional, rather than rational decisions.

The decision not to invest is an active decision made every day. The fears if having missed the boat with an investment opportunity or that markets are too stretched are common and understandable objections that investors make. When this happens, investors often decide to wait on the sidelines for the next opportunity rather than put their money to work in the market. So how can investors learn to look past their emotions?

Try the overnight test

Consider the following situation. As an investor you are holding a stock that is nursing a heavy loss but you just can't bring yourself to sell. How would you react if the stock was sold overnight and you woke up to cash in your bank account? Would you buy the stock back again? This "overnight test" is effective in determining an investor's true attachment to an investment.

Focus on the fundamentals

Media speculation focuses on the noise, while fundamentals – quantitative and qualitative data about companies or markets – act as signposts for the direction of stocks and economies. Buying a share of a business that has a proven track record of growing sales, earnings, and dividends tells you much of what you need to know. News noise and the prospect for short-term fluctuations, too often the tail that wags the dog, fade into irrelevance by comparison.

Is The "Robocalypse" Near?

Please see some highlights from a special report by the RBC Portfolio Advisory Group – US Equities.

Humans have been worried about being replaced by technology since the invention of the shovel and wheel. Automation unleashing mass unemployment is an old argument that can be traced back to the First Industrial Revolution. However, we believe that technology can invigorate GDP growth, spurring more jobs that evolve in tandem with the advances in automation, as seen in past revolutions. The growing integration of the broad range of robotics in the future is nothing to fear, in our view, and should be embraced as yet another technological leap that can save companies money, improved workplace safety, and enhance people's lives.

Why are robots suddenly upon us?

The emergence of robotics as a mainstream technological advancement stems from the culmination of several different technologies colliding at the same period of time, transforming the once-futuristic vision of robotics into reality. Physical capabilities, sensory perception, machine learning, natural language processing, and cloud robotics are all more advance and cheaper than they ever have been, making robotics more affordable for mass production and usage.

When will robots arrive en masse?

The robotics industry is now worth $24.5B, according to VC firm Loup Ventures and trade group International Federation of Robotics, and projected to double in 5 years. Until now, the majority of robot usage has occurred within factories to automate menial processes, replace manual labour, or mitigate safety risks. Health care and professional service robots are also likely to be integrated more into our daily lives. The International Federation of Robotics projects global sales of service robots for professional use to grow by 20% to 25% from 2018 to 2020.

In what form will AI arrive?

Personal preferences – Hardly any occurrences in out digital lives happen by chance nowadays. The shows we watch on Netflix, the recommendations on Amazon, and the top items on Google search results are all strategically placed there through intelligence gathered about each individual and the processed by AI and big data.

Transportation transformation – Autonomous driving is fast becoming a reality. There is increasing investment from a wide array of companies and self-driving cares are being tested on public roads. These powerful machines combine optical sensors and computerized communication to analyze and react to road and traffic conditions, optimize driving directions, and hopefully, over time, provide a safe journey.

Productivity boost – In offices and factories, AI has made significant contributions to enhance efficiency and reduce costs. Manufacturers are seeing a significant productivity boost from process optimization powered by AI. Applications include supply chain and demand management, output optimization, and predictive maintenance. Enterprise data solutions provided by tech giants help companies streamline their processes and improve cost efficiency.

Connectivity is the future – In the foreseeable future, more and more "things" that we use in our daily lives, physical or virtual, will connect to the internet. These will join the network of objects, devices, and software platforms that forms the Internet of Things (IoT), which enables connected objects to exchange data. The IoT is likely to not only support smart homes, but smart companies and smart cities as well.

Ready or not, change is coming

Predictions can be wildly inaccurate at these early stages of change, so robotics' ultimate penetration into our lives and the changes it may bring are still far from known. Looking back at how past industrial revolutions played out, we are optimistic that new jobs will be created in tandem with productivity growth as a result of advances in robotics. The Wall Street Journal projects AI to displace 1.8 million jobs while generating 2.3 million new jobs by 2020.

UPCOMING EVENTS

Enjoy the warm summer weather! Client seminars to resume September, 2018

The Year of the Tariff

Please see some highlights from a focus article included in the Global Insight May Edition. If you would like to read the full article, please feel free to contact us for a copy or access it through our team website (www.michiewealth.com) under the "Client Resources" section.

Financial markets are in a state of high alert, responding spasmodically to an onslaught of macro and company level shocks. Among them, protectionism has been a particularly central and recurring villain. Just how bad might the "year of the tariff" turn out to be? RBC Global Asset Management's chief economist tallies up the good, the bad, and the ugly.

The good

NAFTA negotiations, so far a long, grim affair, have suddenly bounded forward after the U.S. surprisingly eased its demands on the minimum domestic share of auto production. Granted, there is more NAFTA work to be done. Key sticking points include a proposed sunset clause, the nature of the pact's dispute resolution system, and government procurement rules. But suffice to say that whereas we rated the risk of NAFTA's destruction as high as 40% at one point, in our assessment it has fallen to just 15%. That doesn't guarantee the final deal is economically positive or even benign, but it does limit the potential for damage.

Lastly, it is some relief to learn that recently proposed trade barriers are set to inflict surprisingly little economic damage, according to most estimates. For instance, based on actions taken so far, the trade spat between the US and China will cost each economy less than a quarter of one percent of their economic output. The effective US tariff rate on imports will rise from just 1.6% to 2.1% - a far cry from the average tariff rate above 20% for much of the 1920s and 1930s.The world is still a much friendlier place to trade now than almost any other point in time.

The bad

Whenever protectionism is in play, there is also going to be a considerable amount of "bad" news.

First, protectionism has long since morphed from words into action, with US tariffs now in place on softwood lumber, washing machines, solar panels, steel, and aluminum. As much as President Trump promised and then delivered tax cuts, he is now clearly acting upon his protectionist mandate. The odds of further action are hardly trivial given the extent to which his more moderate advisors have fallen by the wayside.

Second, the latest Chinese tariffs are much more significant than anything that has come before, in part because of the size of the tariffs – a 25% tax on $50B of imports – and in part because China is proving to be an equally pugilistic adversary. Based on the orientation of the tariffs to date, on US agricultural products versus Chinese technological products, the US may take a disproportionate share of the economic hit this round because agricultural products can be more easily replaced than specialty manufactured goods. But Chinese vulnerability is ultimately significant given that the country exports three times as much to the US as the other way around.

The ugly

Our best guess is that protectionism will merely act as a pesky drag on global growth, avoiding an outright economic carnage.

But alternate scenarios abound, and one must acknowledge something like a 20% chance of a rather uglier outcome – a full blown trade war. This might not be outright recessionary, but it could certainly suck all the juice out of recent US tax cuts.

The scenario goes as follows: It is far from clear that the US is done conjuring up Chinese tariffs. To the contrary, the tariffs thus far merely respond to China's steel glut and the country's questionable intellectual property practices. China can also be accused of subsidizing and shielding a slew of other sectors.

From a broader perspective, China is responsible for much of the gaping US trade deficit that the White House finds so objectionable. President Trump is already threatening another round of Chinese tariffs that would be twice as big as the prior round. And while it takes two to wage a trade war, China has proven its willingness to punch back.

Bottom line

To reiterate, a trade disaster should not be anyone's base case. Given a number of positive tailwinds still blowing from other points on the compass, the global growth story looks capable of surviving a modest trade drag. US dalliances with protectionism in the 1970s and 1980s ultimately did little damage, and there is still the chance that US pressure manages to dismantle some foreign barriers.

But one cannot speak with precision about these things, and the potentially deleterious effects of second-order considerations such as uncertainty and skittish financial markets are hard to model. We are inclined instead to acknowledge this threat by flagging protectionism, alongside an aging business cycle (for what it's worth), as the key macro risks for the coming year at least.

In The Community

Every child needs a superhero! On Sunday September 30th Jason will be leading a team of 4 RBC employees to show off their speed by participating in a 4 X 5KM relay challenge. All proceeds raised from the challenge will support the Durham Children's Aid Foundation. The foundation was established in 2004 and is a registered charity that helps support local children/youth in need to break the cycle of abuse and neglect and to foster the healthy development of children into responsible adults. Geoff joined the board of directors for the Durham Children's Aid Foundation in 2016 and continues to be a strong supporter of their causes.

There is a family fun walk following the team challenge. If you are interested in participating please feel free to ask for details!

Team Announcements

We are pleased to introduce Teri Osmond who has joined our team at The Michie Wealth Management Group, acting as our new team assistant. She brings over 18 years of experience coming from a very successful advisory group in Toronto. Terri is a local to Oshawa with 3 children and enjoys spending time with her 2 dogs when she is away from the office.

We would like to wish Lynsey the best of luck while pursuing her new career. Lynsey has chosen not to return to Dominion Securities as she has been given the opportunity to pursue her life dream of being the Head Coach for a competitive swim club. We would like to thank Lynsey for the support she has provided our team over the years!

Thank you to Paula Austin who provided coverage for our team during Lynsey's maternity leave. Paula will be assisting another advisory group within the office to continue her extensive career with RBC.

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