The Sandler Quarterly

Wealth Management
Dominion Securities

Volume 21 | January 2021

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BUY NOW! No interest till 2023!

KEY INSIGHTS

- Ultra-low interest rates and fiscal stimulus send markets higher
- Economic recovery exceeds expectations
- Vaccine rollout provides light at the end of the tunnel
- Consumer price inflation gains traction but not to problematic levels
- Asset price inflation takes hold in stealth mode

The pandemic remains the key challenge for the economy as we begin the New Year, with case counts and fatalities reaching near record levels. Tighter restrictions to combat the virus will likely lead to some further slowing of the economy, but there are reasons to be optimistic. The economic recovery has been exceeding expectations and the vaccine rollout, while seemingly slow to start, is promising. Although there may be hurdles in the near term, RBC's growth forecasts for 2021 have featured more upgrades than downgrades and are now situated modestly above consensus.

In this edition of our newsletter we promise not to get bogged down in COVID predictions or US politics. You are likely inundated, as are we, with more than enough low-value opinion and dubious data on these subjects. Toronto radio station Boom 97.3 might have been on to something with their "COVID-free Fridays"!

Our last two newsletters discussed inflation, specifically asset price inflation. By this we mean increasing values of businesses (the stock market), real estate (just try to find a Muskoka cottage for sale), gold (up 25% in 2020), bitcoin (up 300%!! in 2020) and other investable assets and stores of value. This trend, from a financial perspective, should be a positive driving force as we move ahead.

Let's assume, hypothetically speaking, that global central bankers got together and announced that they would create

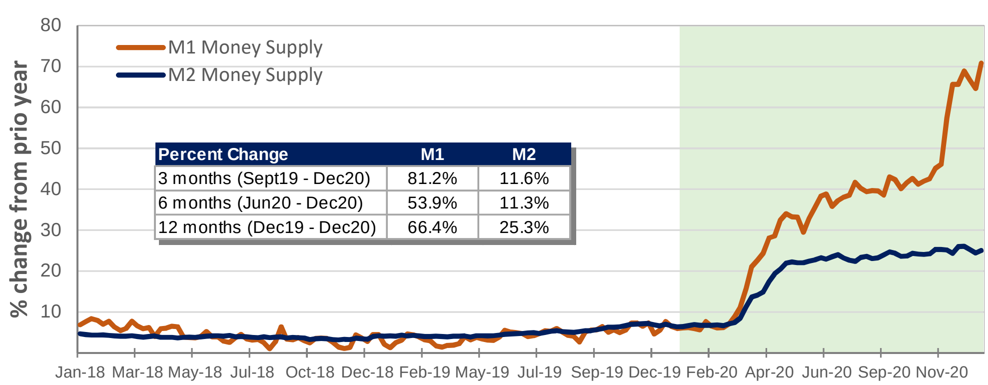

Figure 1: M1 & M2 money supply, January 2018 – January 2021 *(Source: St. Louis Fed)*

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one new dollar for every dollar currently in circulation. Logically, you would quickly infer that the price of things would increase rapidly as money flooded the system. Economists describe inflation simply as “too much money chasing too few goods” (or assets in our case). This is what is happening right now and we believe will continue to play out for the foreseeable future. While central bankers have not doubled the money supply as our example above supposes, they have increased it dramatically and in a significant way.

At time of writing, the [US Federal Reserve website] shows the change in money supply for the 12 months ending December 2020 as an increase of 25%! (see *Figure 1*). This measure, known as M2, includes all cash, bank deposits and money market funds. Canada’s trajectory is not dissimilar.

This surge in money supply is presumably not held onto by those less well-off in society. While lower income individuals may benefit from CERB and other support programs, they are not in a position to save or stockpile their $500 weekly allowance. Spending on essential goods and services quickly transfers newly minted currency to wealthy businesses and the individuals that own them. Understanding this can help explain why large companies and the stock market can continue to prosper while smaller businesses and some segments of the economy may be suffering. As the saying goes, Wall St. is not Main St. (see *Figure 2*).

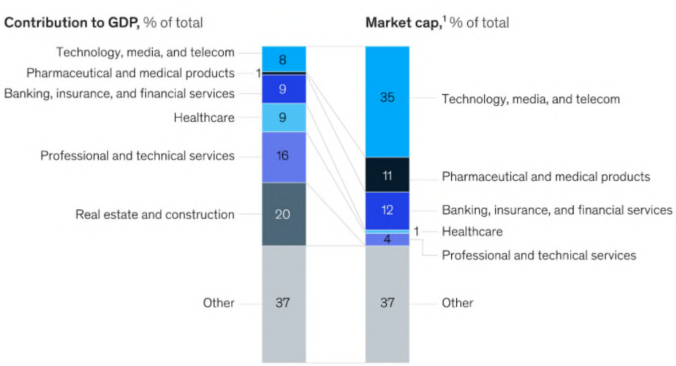

Figure 2: GDP vs. stock market capitalization *(Source: McKinsey)*

Consider now that as central banks rapidly expand the money supply, they concurrently broadcast that they have no intention of increasing interest rates until at least 2023. What is a person to do with all of this cash earning next to nothing (or less than nothing after inflation)? Particularly in light of the fact that more money will be created tomorrow, thus devaluing each outstanding dollar held. As we speak,

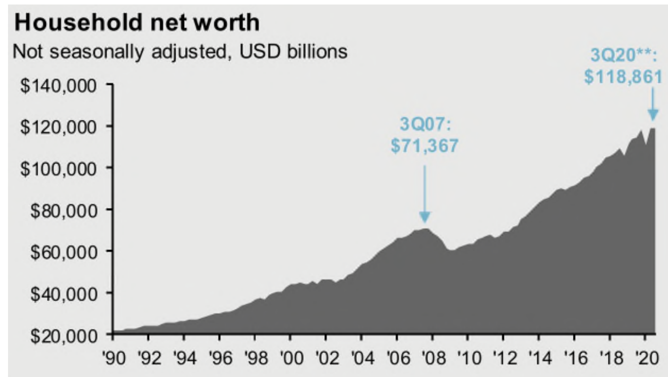

Figure 3: Household net worth *(Source: JPMorgan)*

Joe Biden is readying to fire another 2 trillion dollars from the money cannon. The answer, whether rightly or wrongly, has been to put money to use in a working asset (the stock market), a store of value (gold) or a combination of the two (real estate) among other asset classes.

What we have described above is not theoretical. We are seeing this every day within our own business. Clients continually call to discuss the fact that they are sitting on money in the bank and feel the need to put it to work rather than leave it idle. Household net worth is at an all-time high (see *Figure 3*). Outside of our business, and on a much larger scale, this is happening around the globe as investors strive to keep pace with inflation (see *Figure 4*). One example close to home is RBC Global Asset Management (GAM). They once again increased their target allocation to equities in December by 2.5% while reducing their allocation to fixed income by the same amount. As a frame of reference, RBC GAM manages over half a trillion dollars globally. The following paragraph is taken from their recent 2021 outlook:

> *“With the economy entering a period of normalization supported by low interest rates and ample fiscal stimulus, stocks continue to offer superior return potential versus fixed income. Our forecasts look for mid-single to potentially low-double digit returns from stocks over the year ahead versus low single-digit or potentially negative returns from sovereign bonds. Moreover, extremely low bond yields mean that fixed income markets may not provide as much protection against stock declines as they have in recent decades. In our opinion, traditional views on optimal asset mix should be reconsidered to reflect the impact of structural change in the global economy on returns, correlations and risk mitigation within the universe of investment options. For many, one option may be to invest over longer time horizons and add more equities to portfolios.”*

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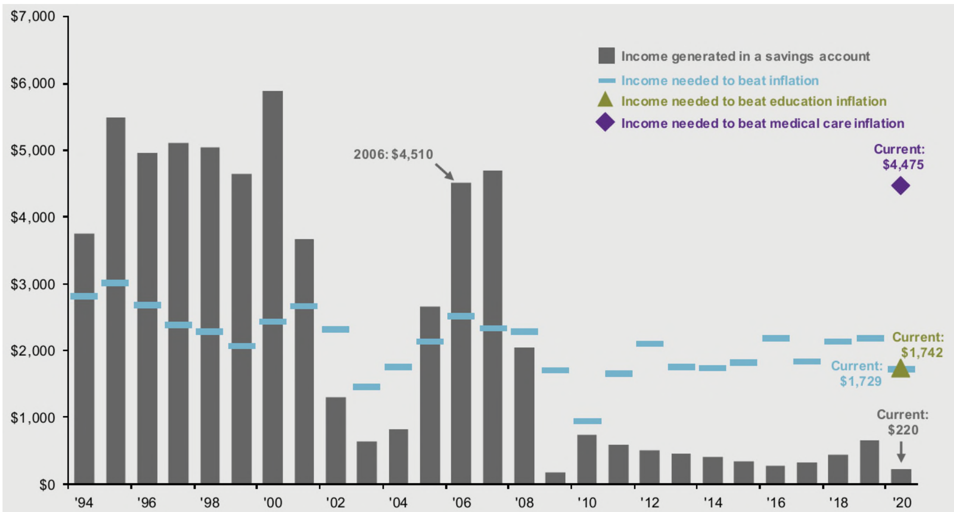

Figure 4: Income earned on $100,000 in a savings account *(Source: JPMorgan)*

Despite ultra-low interest rates, investment grade bonds remain an important part of a well-diversified portfolio. They continue to lower volatility, reduce risk and provide liquidity and attack capital in bad markets. That said, return expectations on the traditional 60:40 equity / fixed income portfolio should be lowered relative to the past, when bonds provided much higher yields (see *Figure 5*). Investors unwilling or unable to accept reduced returns on the bond component of their portfolio will need to reconsider their asset allocation targets. We regularly discuss asset allocation with all of our clients to ensure it is appropriate to meet both investment return objectives and tolerance for risk and volatility. Please speak with us directly to discuss your personal asset allocation targets.

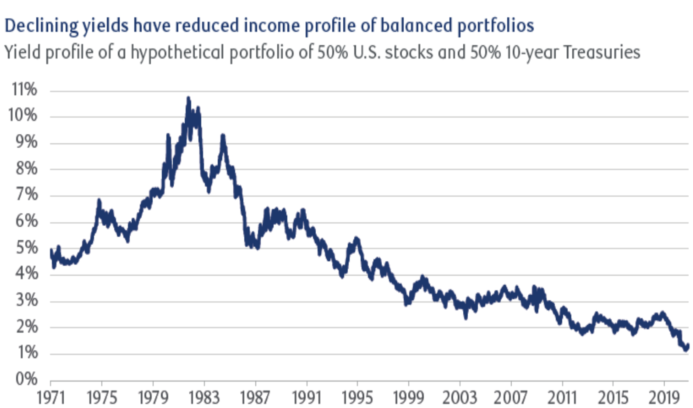

Figure 5: *Hypothetical yield of a 50% U.S. stocks and 50% 10-year treasury portfolio (Source: RBC GAM)*

Wealth Planning

One of the great advantages of being part of RBC Dominion Securities is that we are able to offer our clients access to the best wealth planning services in the country. Too often this newsletter focuses exclusively on investment management; the markets, the economy and even individual companies. Increasingly, this is not an accurate reflection of our business and the service we offer to clients. Going forward we intend to place greater emphasis on the broader wealth planning arena in these pages. Financial planning, tax planning and estate planning are as important to your financial well-being as choosing the right asset allocation.

Our extended wealth management team consists of some of the best accountants, lawyers and estate planners in Canada. These individuals are readily available to consult with us in crafting a comprehensive plan for our clients. In recent months we have helped clients with the following wealth planning strategies:

- *Financial Planning and spousal/prescribed rate loans*
- *Estate planning*
- *Trust and executor services*
- *Life insurance strategies for both risk management and tax efficient succession planning*
- *Valuation and sale of a private business*
- *Tax efficient charitable giving*

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In the spirit of placing a greater emphasis on wealth planning, this guide to estate planning serves as a wonderful resource as well as a kick in the pants for anyone who has been procrastinating about updating their will. Time and time again we discover client wills that are desperately in need of attention.

If we have not embarked on this process with you please ask us to explain how these services can be of value to you.

Sincerely,

Scott Sandler
VP & Portfolio Manager

Ronan Clohissey, CIM
VP & Portfolio Manager

A Market Update with Jim Allworth

Please join us on Thursday, January 28th at 4.00pm EST for a conference call with our Chief Investment Strategist, Jim Allworth.

Jim's experience and wisdom are second to none – it will be 30 minutes well spent!

Call in number: 833-808-5098 (no need to pre-register or download anything, just dial the number)

	Q4 2020	2020
Indices		
S&P/TSX	8.14%	2.17%
Dow Jones	10.17%	7.25%
S&P 500	11.69%	16.26%
Nasdaq	15.41%	43.64%
Euro Stoxx	11.24%	-5.14%
Japan Nikkei	18.37%	16.01%
India Sensex	25.44%	15.75%
VIX (Volatility)	-13.73%	65.09%
Commodities		
Gold	0.66%	25.12%
Silver	13.63%	47.89%
Copper	16.21%	26.02%
Oil	20.64%	-20.54%
Natural Gas	47.89%	14.71%
Currency		
CAD	4.61%	2.01%
EUR	4.22%	8.94%
JPY	2.07%	5.15%
AUD	7.43%	9.59%
GBP	5.80%	3.12%

*As of December 31st, 2020

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