Portfolio Advisor

Wealth Management
Dominion Securities

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Market commentary

Following a strong rebound at the beginning of the year, equity markets have shifted attention to slowing growth in the big three economies of the U.S., Europe and China, and the related downdraft in interest rates that was accompanied by an inversion of the Treasury yield curve – a cautionary signal. Markets are also contending with earnings growth and trade/tariff uncertainties.

Global economic weakness is driving the move to "easy street."

These risks are balanced out by dovish central bank policies and signs U.S. economic growth should hold, while trends in Europe and China should stabilize/improve later this year. In our view, equity market valuations remain reasonable, with most trading near or slightly below their long-term averages. Consensus earnings estimates are also realistic. While we would maintain overall equity exposure at the "market weight" (benchmark) level in portfolios, vigilance is warranted.

Fixed income

The U.S. Federal Reserve's (the Fed's) significant policy shift in March to no fed fund rate hikes (from two) in 2019 set a new path for global central banks. Global economic weakness is driving the broad move to "easy street" and concerns are mounting as benchmark yield curves invert. The Fed projects one rate hike in 2020, but implied probabilities indicate an 80% likelihood of a rate cut by January, and market expectations predict one rate cut per year from 2019-2021.

There is the distinct possibility that rates could move lower, and we believe this makes "reinvestment risk" a potential issue for investors attracted by short-term rates equal to or exceeding long-term rates. As such, we maintain our "market weight" in fixed income, and recommend investors add duration with a focus on high-quality assets.

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

RBC Wealth Management
Global Portfolio Advisory Group

Recession-proof your portfolio with the three Rs

What do you do with your investment portfolio when you hear the infamous "R" word – recession? It's easy. Just follow the three Rs: review, rebalance and relax.

In recent months, economists have been cutting their growth forecasts for the Canadian and global economies. While evidence of a slowdown is mounting[1], it is notoriously difficult to predict – economists have failed to predict 148 of the last 150 recessions[2]. The dreaded "R-word", recession, is the economic term for two or more consecutive quarters of zero or negative economic growth (as measured by Gross Domestic Product). It is often trotted out when growth begins to moderate, but historically is rarely the outcome of such a slowdown, despite predictions to the contrary.

Recession: the nasty nine-letter word

Unfortunately, talking about a recession is one of the best ways to bring one about: hearing the "R" word, people begin to delay or abandon spending in anticipation of an economic slowdown[3]. This leads to a vicious circle: lower spending leads to lower business revenue, which leads to job losses, further worry, lower spending, more job losses and so on.

"R"-proofing your portfolio

Soaring or falling markets often generate strong emotional reactions, prompting investors to veer off course from their long-term plans. This can lead to common investment pitfalls like taking inappropriate risks, buying high and selling low, and moving to "the sidelines" (i.e. cash), thereby missing out when the markets recover.

Similarly, reacting to the "R" word by altering your investment plan is rarely the right move. Instead, investors would be well served to follow three other "R" words:

- **Review:** Wondering whether your goals are aligned with your investment portfolio's asset allocation and structure? Whether your risk tolerance is accurate?

  These are important questions and concerns to review with your advisor as your financial circumstances or goals change. But keep in mind that a recession is usually a short-term event, and that your investment portfolio usually reflects goals that stretch over a longer time horizon – so, changing it in response to short-term developments is rarely advisable.

- **Rebalance:** Your portfolio should be balanced in the right way to meet your goals and to reflect your appropriate risk tolerance. If your portfolio has drifted off-balance over time due to market movements or other factors, or your goals or circumstances have changed, speak to your advisor to review your portfolio to see if it needs to be rebalanced.

- **Relax:** Once you've reviewed your portfolio, and rebalanced as required, you can relax with confidence.

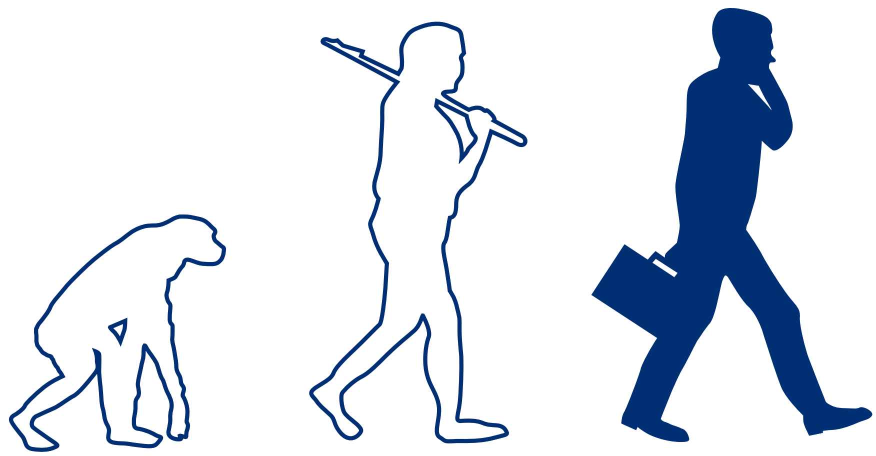
Remember, the average recession lasts six to nine months, and the impact is usually quick and transitory – making hasty, unwarranted changes to your portfolio is usually not.

To learn more, please contact us today.

[1] *Economic and Financial Market Outlook*, RBC Economics Research (March, 2019).
[2] *How Well Do Economists Forecast Recessions?*, International Monetary Fund, Zidong An; João Tovar Jalles; Prakash Loungani (March, 2018).
[3] *A reliable indicator of an imminent recession? Look to the pundits*, David Parkinson, The Globe & Mail (February, 2019).

The evolution of the investor

Developed over tens of thousands of years, the deeply ingrained instincts that kept us alive for so long now often work against us as investors. But there is hope for us yet.



Surviving in a woolly mammoth world

In one form or another, humanoids have roamed the Earth for over two million years, slowly developing into what we call Homo Sapiens over 300,000 years ago. It was a precarious existence for our ancestors, having to survive in a hostile world with multiple threats, including animals, disease, the elements and each other.

Learning to play well with others

To survive, we developed key instincts, such as the all-important fight-or-flight. Sizing up a one-on-one with an ornery woolly mammoth, your instinct would likely (and wisely) have tended towards a flight to safety. But backed by 50 of your spear-wielding mates? That same beast was a tempting dinner.

So, we began to realize that there was "strength in numbers," and that it was better to fit in with a tribe than to be on the outside looking in. We came to rely on the tribe for our survival.

Ancient instincts, common investment pitfalls

Gradually, mankind developed laws, policies and regulations – and the institutions to enforce them – to help eliminate many of the ancient threats to our survival.

But the same instincts we honed to survive can cost us when it comes to investing:

- **Fight-or-flight:** Research has consistently found that, due almost entirely to emotional reactions during periods of market stress that resulted in poor timing decisions, the annual return of an average investor over 20 years was significantly lower than that of the S&P 500 Index, and resulted in a difference of $120,000 on an initial investment of $100,000 (Dalbar, 2017).

- **Herd mentality:** Evidence shows that investors "follow the herd," consistently buying high and selling low, which can hurt portfolio performance over the long term. As equity markets were soaring in the lead-up to the financial crisis of 2008/09, so were equity fund sales. And following the crisis when equity markets tumbled, Canadians redeemed their equity funds (IFIC, Morningstar, 2018).

- **The tribal grapevine:** Listening to the (unqualified) press – who are often rewarded for generating alarmist content – and friends and family for your investment information is fraught with risk.

And, it is extremely difficult for even qualified forecasters to accurately predict where markets will go in the short term, and no forecaster has insight into your unique situation.

Homo Investorus: hope for the modern-day investor

Today's investors have the benefit of research, expertise and well-regulated markets. A well-structured and thought-out plan based on your goals and risk tolerance is the best way to control your ingrained survival instincts and keep on track. Strategies such as regular investing can help us avoid emotional decisions based on short-term market movements. The first step to being a modern day – and successful – investor is to quell the caveperson within us. And, to find safety and security in the fact that, those who stand their ground against the real investment woolly mammoths are most likely to achieve their goals.

To learn more, please contact us today.

Octo-investor

Managing multiple financial demands while trying to invest for future goals can leave you juggling competing priorities like an eight-armed mollusc. Fortunately, there are things you can do.

Canadians consistently state that they want to save to meet their long-term goals, especially their retirements. The problem? Too many competing demands on their limited resources require them to juggle multiple commitments today, forcing them to skimp on, delay or even skip altogether their long-term goals' savings plans.

How we spend: the eight-tentacled monster

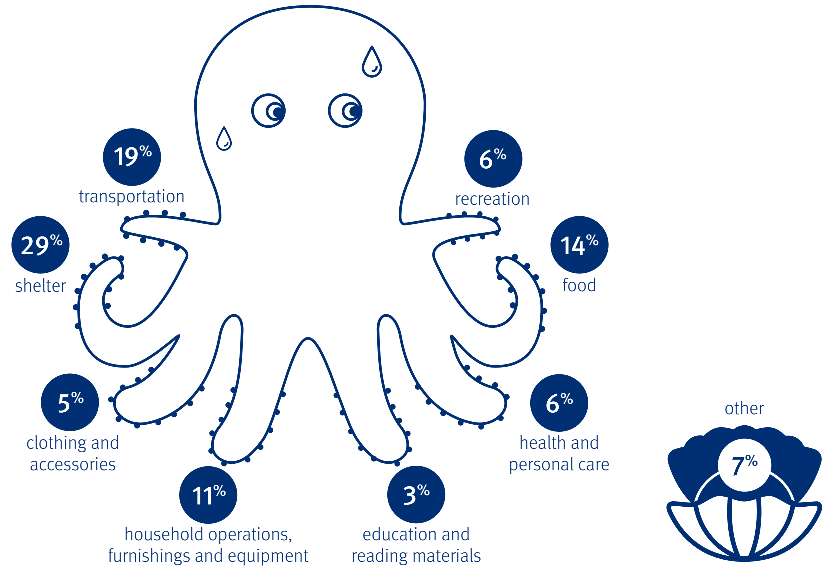
So, where does all the money go? More often than not, it's to meet life's necessities and immediate commitments. By percentage of income spent* these are the top eight areas:

1. Shelter – 29%
2. Transportation – 19%
3. Food – 14%
4. Household operations, furnishings and equipment – 11%
5. Recreation – 6%
6. Health and personal care – 6%
7. Clothing and accessories – 5%
8. Education and reading materials – 3%

Savings rates: the octopus in the room

Where do Canadians' savings land on the list? Though it varies from year-to-year, unfortunately, based on StatCan's most recent numbers, it's around 1.1%, and near an all-time low**. Yep, not great. But, despite multiple competing priorities, Canadians are still saving, even after direct contributions to government and company pension plans. That's commendable and, combined with the right strategies and tactics, can pay off over the long term.

Juggling commitments: Canadians' top eight spends* often leave little left over to invest



Even a little goes a long way

Fortunately, there are relatively simple steps to help save and build nest eggs to reach long-term goals:

1. **Review your budget:** Are you aware of everything you are spending money on? List your spending and see if there are ways to save money by eliminating items or choosing more sensible options. Even an extra $100 per month can make a huge difference over time (see Step 5 below).

2. **Enhance after-tax income:** Maximize your after-tax income by ensuring that you are using all of your allowable tax deductions and credits, and you are making proper use of government-sponsored tax-sheltered savings plans, such as RRSPs, RESPs and TFSAs.

3. **Establish a financial plan:** Start by setting out your short-, medium- and long-term goals. Setting out SMART goals – specific, measurable, attainable, relevant and time-bound – will allow you to determine what you need to save for, and to properly prioritize those goals.

4. **Start a regular investment plan:** Even a small amount invested early and regularly can, over time, grow into something significant. If it's automatically debited from your account? It's a simple "set it and forget it."

5. **Let the market help you:** Saving as little as an extra $100 a month over 30 years – or $36,000 – with an average annual compounded return of 6% can generate savings of nearly $100,000. $10 more a month? You can hit almost $108,000!

Today's octo-investor juggles multiple financial commitments. But by following these straightforward steps, you can get to where you need to go – without feeling lost at sea.

To learn more, please contact us today.

* *Survey of Household Spending*, Statistics Canada (2016).
** *Household savings rate*, Statistics Canada (Q4, 2018)
*** Octopus icon made by Freepik from www.flaticon.com

Teach your children well

Our children need more than an inheritance to thrive in the Digital Age

Despite the groans, sighs or – fingers crossed – silent disregard we might receive from our kids, we do our best to pass along the lessons we've learned, and help them achieve success in their lives. But today's youth face a new barrier: entering a workforce as it's being radically transformed by powerful technology.

This is the impetus behind RBC Future Launch – RBC's 10-year commitment to helping youth succeed in a changing workplace. But you have a role to play too!

New age, new skills: what is the data telling us?

Finding that first good job was never easy. But after concluding a year-long research project as part of RBC Future Launch[1], we found it's even harder today. It's not a job shortage – it's the new "Digital Age" skills we're short on.

The skills taught in school are quickly becoming obsolete. The top-10 in-demand jobs in 2010 did not exist in 2004,[2] and 50% of today's occupations will undergo a significant skills overhaul in the coming decade.[1] That doesn't just go for cashiers and factory workers; it applies to mining, farming, dentistry, graphic design and others fields, too.

The research uncovered a quiet crisis – where youth have trained for irrelevant jobs, and graduates are sweeping floors to pay off their student loans. You've worked hard to build a legacy for future generations, but will they have the means or financial experience to protect it?

Raising future-ready children – how you can help

1. Help them gain relevant experience

One day, all post-secondary programs will ideally incorporate work placements that build relevant skills. Until then, encourage your kids to target those that do, or summer jobs that will let them hone transferrable skills. They can find internships in our RBC Future Launch Youth Hub at **rbc.com/futurelaunch**.

2. Help them build in-demand skills

Skills like critical thinking, coordination, social perceptiveness and active listening become more vital when robots take care of the rest. **RBC Upskill** (found on the Youth Hub @ rbc.com/futurelaunch) offers a personalized report of what skills, experience and education correlate to the future job market and your child's interests.

3. Help them grow their network

Old-fashioned personal relationships still account for how 85% of all jobs are filled.[3] Introduce the young people in your life to friends and contacts who work in fields of interest.

4. Involve them in finances

RBC's recent *Wealth Transfer Report* found that a structured financial education doesn't start on average until age 27, yet starting earlier leads to higher confidence among beneficiaries.[4] Loop your kids into the conversation, or talk to your advisor about how you can improve their financial literacy.

As usual, times are changing. To succeed in a digital economy, our children need us to be smart about the life experience we foster for them. Well, that and an age-old ingredient: a willingness to work hard for their future.

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[1] *Humans Wanted*, RBC (2018).
[2] *Shift Happens*, Karl Fisch and Scott McLeod (2008, revised 2010).
[3] *The Essential Guide for Hiring & Getting Hired*, Lou Adler (2013).
[4] *Wealth Transfer Report*, RBC (2017).

To insure, or not to insure?

That's a complicated question

Every day we make thousands of choices – 226.7 decisions on food alone – by weighing potential risks against would-be rewards.* And while deciding whether "You'd like fries with that?" should be straightforward, some decisions, such as whether to insure or not, are anything but.

To consider insurance is to:

1. assess the probability of bad things happening to the people and things we love;
2. quantify the financial impact of bad things happening; and,
3. decide whether the likelihood and ramifications justify the premiums.

It's exactly this sort of decision – complex, emotional, future-oriented – that's most vulnerable to the psychological biases that drive the decisions we make.

We're wired to both under- and over-insure

Traditional economics assume we make rational choices with the aim of maximizing wealth after taking all information into account. That theory has been challenged by the recent field of behavioural economics or, as Nobel-winning economist Richard Thaler calls it, "economics done with strong injections of good psychology."

Behavioural economics studies the influence that social preferences, our emotions and our minds have on our decision-making. By recognizing these moments when logic is pushed aside, we can begin to make better decisions, including those that can protect us and our family.

Here are some examples of our all too-human inclinations:

- **Decisions are hard, so why make them?**
  When faced with an unfamiliar scenario, we tend to zero in on the familiar. Again, insurance forces us to consider the probability and timing of illness, accident, or death, acceptable deductibles, term lengths, what's covered, what's not covered, the financial health of the insurer, and much more. No wonder we get tunnel vision on the minor details, such as lowering the deductibles, or become paralyzed with choice.

- **Regrettably over-insured**
  If you've purchased a major appliance or consumer electronic, chances are the sales clerk strongly encouraged the extended warranty – a form of insurance with loss aversion at play. Loss aversion is our tendency to feel the pain of a loss more sharply than the pleasure of an equivocal gain. When we purchase the new Smart TV, we may opt for top-notch insurance, because the prospect of "losing" our purchase generally outweighs any "gains" from the dollars saved.

- **Live in the present moment – after reviewing your insurance quote**
  Our tendency to outweigh immediate rewards relative to future outcomes hampers our ability to make choices where the implications take place in the future over long periods of time. We like to be rewarded and rewarded now – and insurance doesn't scratch that itch. "Rewards" come later if at all, which adds one more reason to procrastinate or avoid purchasing insurance until it's too late.

What we can do about it

It's hard to completely remove emotion, and avoid mental shortcuts, when considering questions like, "would there be enough to take care of those I love?" But these are questions best answered today, not soon. Fortunately, awareness of your human inclinations can help you answer the hard questions with objectivity and a future focus.

* *Mindless Eating: The 200 Daily Food Decisions We Overlook*, Wansink and Sobal (2007).

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