Wealth Management
Dominion Securities

Wealth Management Review

www.rbcwealthmanagement.com | January 2020

Weighing the evidence

By Jim Allworth

2019 was a good year for equity investors. The S&P 500 was up by almost 30%, while the TSX was no slouch either, delivering close to a 20% advance. While these gains were partly attributable to making back the ground lost in 2018's August-to-Christmas eve stock market swoon, both indexes set new all-time highs in the process.

For the coming year, comparisons will be more difficult for the opposite reason – 2019 has finished on a very strong note with both indexes at or near their highest levels of the year. Nonetheless, we have a constructive outlook for stocks for 2020. The economic expansion in both the U.S. and Canada should have further to run, underpinned by accommodative credit conditions everywhere, the robust good health of the American consumer, easing U.S.-China trade tensions, and the likelihood both countries (along with most developed economies) will deliver some fiscal stimulus. Corporate earnings will likely increase, as should dividends and stock buybacks, pushing share prices higher.

Some of these good things have already arrived in the closing weeks of the year just ended, transforming the gloom of 2019 around trade and recession talk into a somewhat sunnier outlook for most economies.

We have bullish expectations for stock prices but at the same time we are approaching the equity market with more caution than at any time in the past decade.

Curveballs

Our caution stems from several factors all relating to the U.S. economy, keeping in mind that U.S. recessions have historically been associated with equity bear markets in all the developed economies. The first development that demands an elevated level of investor vigilance is the inversion of the yield curve that occurred back in August when short-term interest rates finished the month higher than long-term rates. Normally the opposite would be true. The previous time such an inversion occurred was January 2006, 23 months before the start of the recession in December 2007. Since World War II, the U.S. yield curve

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In brief

RBC Tech for Nature

RBC Tech for Nature is RBC's new commitment to investing in solutions to the environmental challenges such as food security, air quality, energy needs and access to clean water. With a focus on innovation, data and technology, RBC Tech for Nature will build partnerships between charitable organizations, technology experts, and the private and public sectors. To learn more, please visit: www.rbc.com/community-social-impact/environment.

Tax-Free Savings Accounts

With the new year, you now have another $6,000 in available TFSA contribution room. Your TFSA contributions grow tax-free, and you can make tax-free withdrawals any time, for any reason. To make your 2020 TFSA contribution, please contact your Investment Advisor.

Weighing the evidence ...

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has inverted 10 times (not counting the latest instance). In nine of those instances, a recession followed on average 14 months later.

The yield curve is only one of the six indicators that we use to gauge the probability of a U.S. recession arriving. Four of the six are still giving the economy a "green light." That said, they are all much closer to flashing red than they were a year ago. However, it's not a foregone conclusion they will turn negative; instances of close calls followed by a rebound are common enough.

Another challenge will be the headwind of slow growth. Our estimate for U.S. GDP growth next year is 1.75% (ditto for Canada), much closer to zero than the 2.5% to 3.5% run-rate of prior cycles. Occasional negative quarters inducing more frequent bouts of market volatility can't be ruled out.

Staying loose

The most important positive factor underpinning our bullish outlook for the economy and stock markets is the fact that credit conditions remain unusually "easy." The arrival of "tight money" (i.e., prohibitively high interest rates simultaneous with a sharply reduced willingness of banks to lend) has preceded every U.S. recession but one since the 1930s.

Money is not "tight." Borrowing rates are very low and could go lower. The Fed has cut three times. The European Central Bank has cut its base rate to minus-0.70% and reinstated quantitative easing. The Bank of Canada has struck a dovish tone, indicating it might cut.

Confident consumers

The other tailwind for the U.S. economy (and the global economy) is the robust good health of the American consumer who shows no signs of running out of steam. The unemployment rate is sitting at a half-century low. The U.S. Labor Department reports seven million jobs are currently unfilled (versus six million unemployed). Labour tightness has pushed average hourly earnings gains up to 3.5% from just 2% two years ago. All this has produced a confident consumer who can go on spending at a moderate rate, which should be sufficient to offset any weakness from other sectors.

On top of this, the U.S. election season is likely to produce promises of more tax cuts and increased spending. In Canada, consumers are likely to be buoyed by an expected tax cut for the middle class in the coming budget.

Reasonable valuations

Finally, we are encouraged by the fact that the U.S. and Canadian equity markets don't look precarious to us. Consensus earnings estimates for the coming year in both countries look reasonable and makeable. Valuations in North America are not outlandish. Stocks are downright cheap in Europe and Japan.

Broad market advance

Importantly, the breadth readings of the market are confirming what the indexes have been doing. In other words, as the broad averages have been moving to new highs, so too have the majority of stocks. For a number of months prior to most bull-market peaks that relationship breaks down: the index gets carried higher by a dwindling number of high-performing, large-cap favorites while a growing majority of issues are either treading water or moving into outright downtrends. No such divergence has appeared, lending confidence to the idea that this market advance has further to go.

And the verdict is ...

For the past decade we have been well served by the idea that portfolios should maintain at least a full, target-weight exposure to equities as long as there was no U.S. recession in sight. We continue to be of that view.

If and when the weight of the evidence eventually moves the probabilities of a U.S. recession/bear market to unacceptably high levels, it will be tempting to rationalize away the bad news. When that time arrives, that temptation should be resisted.

For a more detailed update on our outlook for fixed income and equity markets, ask for our *Global Insight Year-Ahead Outlook for 2020.*

Jim Allworth is co-chair of the RBC Global Portfolio Advisory Committee.

What if ...

Planning for the what-ifs in life wasn't always about planning for the bad things?

Sure, it's important to make certain you're covered "in case something happens." You want to ensure you have the insurance you need (better get on it if you're one of us who tend to procrastinate about such things). An emergency reserve fund might also come in handy (you never know). And of course you'll want to make all the proper "arrangements" so when the time comes, things are a little easier on your family.

But what if something happens that isn't bad, but instead is good? Well, it can still make sense to plan for it.

What if ... you live to 100?

That's definitely not a bad thing, right? Especially if you're one of the fortunate ones to stay bright-eyed and bushy-tailed right to the end. It's not out of the question. According to Statistics Canada, if you're 65 today, you can expect to live another 20 years on average. There are more and more people living well into their 90s, and even becoming centenarians.

And that means more than just getting a 100th birthday greeting from Her Majesty The Queen (but for more on that, please visit the Governor General of Canada's website: www.gg.ca/en/contact-us/birthday-anniversary-greetings). It also means you may need to make your retirement "nest egg" hatch a few more golden eggs – enough to last until you're 85, 90 or even 100 depending on your individual situation. So, it may be time to dust off the old financial plan, and update those retirement income calculations with new life expectancy figures to ensure you will have enough to last as long as you need to live your life the way you want.

We can help – ask your advisor about updating your financial plan, especially if it's been a few years.

What if ... you can retire early?

For some people, work is life, and the thought of retiring early to sail around the world or watch exotic birds isn't exactly inspiring. But that's just for some people. For others, bring on the bird-watching! And what better time to pursue such pastimes than the decade before the traditional retirement age of 65?

But it does raise a slightly more serious point. Retiring early just because you can afford to, or just because you can afford to and you hate your current job, may not be the best reason. Before you release the "escape pod," consider how you're going to spend your days (nearly 13,000 of them if you retire at 55 and live until 90). People need meaning and purpose in their lives, and simply kicking back on the deck with the fanciest high-magnification bird-watching binoculars may not be enough.

Just a thought: You may also wish to run this idea by your partner (in advance). "Honey, I retired today ... so how are you going to entertain me?" may not go over as well as you'd hoped. Your early retirement affects your partner, and could turn their world upside-down. So it's a good idea to have a little chat, and to make sure you both have a shared vision for your early retirement.

Finally, consider whether you actually will have enough money (especially since you may be sailing – or cruising – the high seas into your 90s). Before you take that early retirement, crunch some numbers and make sure it all adds up, particularly if you're planning a very active early retirement filled with more expensive

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"bucket list" items like world travel. So talk to us first – we can help you crunch the numbers and run some scenarios.

What if ... you just have too much money?

To quote the late hip hop artist, the Notorious B.I.G., "Mo' money, mo' problems." But admittedly it can be a nice problem to have.

Whether you've built your wealth over time or come into it suddenly through an inheritance, you may wish to "do something" with it beyond simply having that much more extra financial security. Like investing according to your values. Helping your family get established in life. Creating a legacy that transcends generations. Giving back to your community in a meaningful way. You know: making a difference.

All good! But how? There are several strategies to pass your "excess" wealth (to the next generation in a well-coordinated, tax-efficient way, including family trusts and tax-exempt insurance. We can also help you consider your options when it comes to charitable giving, and assist you in setting up your own charitable gift fund as an enduring family legacy.

For more information on preparing for all the what-ifs in life (good and bad), please contact your advisor.

Interest rates applied to account balances as of December 22, 2019*

	Canadian dollar accounts	U.S. dollar accounts
All credit balances	0.05%	0.05%
Debit balances under $10,000	5.95%	7.00%
Debit balances $10,000 – $24,999	5.70%	6.75%
Debit balances $25,000 – $49,999	5.45%	6.50%
Debit balances $50,000 – $99,999	5.20%	6.25%
Debit balances $100,000 and over	4.95%	6.00%
All debit balances for registered accounts	5.95%	7.00%
All credit balances for registered accounts	0.05%	0.05%

The interest rates that will be in effect for debit balances in cash and margin accounts fluctuate with the Royal Bank prime rate as follows:

Debit balances	Canadian dollar rates†	U.S. dollar rates†
Under $10,000	CAD Prime + 2.00%	USD Prime + 2.25%
$10,000 – $24,999	CAD Prime + 1.75%	USD Prime + 2.00%
$25,000 – $49,999	CAD Prime + 1.50%	USD Prime + 1.75%
$50,000 – $99,999	CAD Prime + 1.25%	USD Prime + 1.50%
$100,000 and over	CAD Prime + 1.00%	USD Prime + 1.25%

† Based on Royal Bank prime rates as of December 22, 2019. CAD Prime = 3.95% and USD Prime = 4.75%. Rates are subject to change*.

* RBC retains the right to change interest rates on a discretionary basis. A committee comprised of individuals representing various authorities within RBC Dominion Securities administers these interest rates. These rates are adjusted from time to time based on various factors, including, but not limited to, competitive analysis, Bank of Canada and other bellwether rates and/or cash rates. Interest amounts less than $5 are neither charged nor paid on regular accounts, and interest amounts less than $1 are neither charged nor paid on special product accounts. Rate changes of less than 1% will be processed on the 22nd of the month. The average daily cash balance for the month determines the tier that will be used to establish the rate. For interest rates on balances other than CAD or USD, speak to your advisor, or go to www.rbcds.com/cash-margin-rates.html.

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