RBC Dominion Securities Inc.

Wealth for Life

Wealth Management
Dominion Securities

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A polarized year by any measure

There is no question that 2020 will be a year we will never forget! The year started with promise and normalcy, but quickly became fraught with uncertainty. By fall, we were fully entrenched in COVID-19 protocols for the second time. The onset of fall and cooler temperatures brought with it a feared spike in new COVID-19 cases, which increased through the holiday season. Stricter economic business conditions were gradually employed and delivered the expected slowing of economic activity in Q4. While the COVID-19 economic freeze prevailed, equity markets and the economy continued their respective recovery processes.

In hindsight, 2020 was the ultimate illustration of the foresight of equity markets. No sooner had markets plummeted to a gut-wrenching low than the surprising "V"-shaped recovery began almost immediately. The equity market recovery continued throughout the year, following the cycle of new COVID-19 case formations and subsequent declines. By mid-September, U.S. equity markets set new highs, while in Canada, the TSX didn't hit a new high until early January 2021. Economic data supporting the equity market recovery proved powerful throughout the summer and fall, but waned in the last quarter as expected – still, equity markets continued to improve into year's end. What are financial markets telling us now?

Throughout the last quarter of 2020, economic data from China continued to confirm the country's economy had completely recovered from the COVID-19 slowdown. In North America, industrial and employment data confirmed a robust economic recovery. In fact, employment growth in Canada has recovered 80% of jobs lost to the COVID-19 recession. The U.S., by comparison, has recovered approximately 54% of jobs lost due to the COVID-19 crisis – like Canada, the travel, hospitality and leisure industries have been the hardest hit. Make no mistake, the loss of any job has been devastating to families everywhere.

The fourth quarter of 2020 also brought good news in the form of two highly effective vaccines that began rolling out in December. Although vaccinations in the U.S. and Canada have been slow to roll out, more recent efforts have shown signs of improved delivery. Additionally, Johnson & Johnson (JNJ) has announced a single-dose vaccine will be ready for February approval. Vaccine production estimates suggest the JNJ vaccine availability should result in an "over-supply" capacity of vaccines, so efficient delivery will be the remaining key to our COVID-19 "solution." At the time of this writing, new COVID-19 case formations in the U.S. had just turned down from surging levels – let's hope Canada falls in line as well and vaccines ramp up.

The prospects of warmer spring weather and vaccine applications will likely ease COVID-19's grip on our economic reopening, and usher in the anticipated reopening stages. IHS Markit estimates job growth in the U.S. could hit 6.7 million in 2021 (or 70% of those still unemployed), eclipsing the 4.6 million record job growth of 1946. Canada could also see robust

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A polarized year...

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job growth. Governments worldwide are still committed to stimulus to ensure economic reopening. President Biden just announced a much larger stimulus package in the U.S. Canada also announced a $100-billion stimulus package over 10 years to support businesses, families and citizens. Economic plans such as these are critical to support the economy, but time is of the essence to ensure vital parts of our economy are not imperiled in the long term.

The U.S. election brought a change in the White House with Biden's win and also a Democratic Senate, if the Vice President's tie-breaking vote is counted. The House remains Democratic, but with a smaller majority. Although some see this as a "blue wave," many expect the new, more "conservative" Democratic senators won't be so anxious to participate in grand tax agendas or over-the-top spending. Time will tell and the first $1.9 trillion COVID-19 package announced will challenge the new senators' resolve. Either way, we expect more spending and some tax increases, tempered by the looming 2022 U.S. election and the need to ignite the U.S. economy, not choke it. The overall economic impact of 2021 policy is almost certainly expected to be positive, and especially so since the Federal Reserve is committed to an inflation target greater than the previous 2%.

Financial markets began the fourth quarter on a weak note, but quickly reversed course after COVID-19 vaccine announcements from Pfizer and Moderna. As we know, the vaccines were a welcome development. Optimism regarding a COVID-19 solution spilled over into equity markets, driving Canadian equity returns to 9% for the quarter and 5.6% for the year. In the U.S., the S&P 500 powered to a 12.1% (7.2% in CAD$) Q4 return and 18.4% (16.1% in CAD$) for the year.

The narrowness of Canadian equity markets was again on display in 2020, with three sectors registering negative returns for the year. Shopify and the materials (metal, mining gold, paper and forest) sector accounted for over 100% of the TSX return. U.S. equity markets were more broadly represented, but did have three sectors posting marginal negative year returns. As the year closed, markets sensed improving economic conditions, driving interest rates higher and igniting the financial sector (a 2020 under-performer) as well as the energy sector (a 2020 under-performer) to start 2021 as leading sectors.

With economic activity slowed by surging new COVID-19 cases throughout the world, 2021 could see gradual improvement. Weather conditions will improve as spring develops and the vaccine rollout should accelerate in all countries, while remedies and treatment techniques continue to improve. Government stimulus will be relentless in efforts to support and ignite the economy, as tolerance for and benefits of lockdowns evaporate.

At the time of this writing, global economic conditions were improving on multiple levels. Interest rates had broken through levels of resistance, signalling developing global growth momentum and improving commodity prices reflected the impact of increasing demand on historically low inventory levels. Oil prices – with the help of a Saudi production cut – had also moved above the pre-COVID-19 level of $50 per barrel. Not surprisingly, the U.S. dollar continued weakening and the CAD$ pushed through the $0.78 level. In total, these were all very "pro" global growth momentum and sufficient enough to improve prospects for 2% inflation or more.

In 2020, financial markets seemed the polar opposite to economic reality. However, economic reality was very robust in hindsight, just from a very low level, and left many in its wake. Equity markets in 2020 anticipated corporate margin expansion for the successful and adaptable companies that survived and thrived. Now into 2021, will financial markets continue to telegraph broad economic success and reopening? Recent moves in interest rates and commodity prices are powerful global growth indicators that tilt the probabilities in favour of successful economic reopening. Overwhelming government stimulus is powerful economic growth insurance, as we saw in the Great Recession.

Of course, the growth in government deficits can't be ignored. Tax increases will surely be coming, but it would seem reckless for governments to spend so much to support and ignite economic growth and then choke growth with tax increases. Tax increases in 2021, if any, would be expected to be very targeted and negligible enough so as not to derail business reopening. Current low interest rates will continue to provide governments cover on the interest costs of deficits; however, the government's saviour will be economic reopening and the tax revenue generated by it.

Although the future is always uncertain, economic reopening is expected to continue, and the rate of reopening success will be debated, for sure. We expect interest rates to continue their upward trend, as will commodity prices. Pent-up demand for all things consumer – forfeited over the last nine months – will see stellar demand. In addition to commodities, financials, technology, consumer discretionary and industrials are favoured to benefit from the broadening economic reopening. Global growth momentum would also favour the Canadian dollar and its economy.

With interest rates poised to rise from generation-low levels, portfolios should be biased to equity. However, 2020 proved again how violent equity market volatility can be, so each should be positioned in a portfolio consistent with one's unique risk profile.

Planning, process and discipline are valuable tools to navigate volatility and take advantage of others' emotion and randomness.

We salute all our heroes in health care and first responders for the sacrifices they and their families are making for all of us!

Steve Lester

Staying the course

Strategies to help you maintain confidence through all types of markets

Daily market fluctuations highlight why a combination of discipline and perspective is key to reaching your investment goals. One way to achieve this fine balance is by having a plan and sticking to it through all types of market conditions. This may sound easy, but investors have been put to the test in recent years. Veering off course from a carefully thought-out plan can turn a temporary loss of confidence into a realized loss on an investment portfolio. Here are five strategies that can help you minimize the impact of market fluctuations and help you feel confident about reaching your long-term goals:

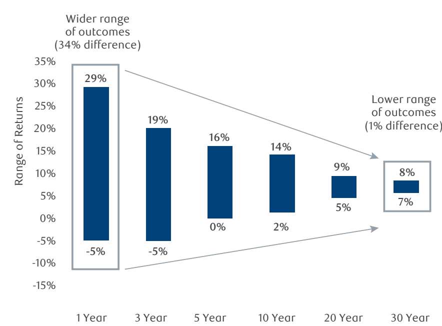
By having a plan, and sticking to it, you can "stay on course" to achieving your long-term investment goals.

1. Use time to your advantage

Investors who maintain perspective and stay mindful of their investment time horizon have a better chance of reaching their investment goals than those who react to short-term market fluctuations.

Staying invested and trying not to "enter and exit" the markets when volatility increases can help reduce fluctuations over the long term. The longer an investment is held in a portfolio, the less chance it has of incurring a negative rate of return. This is because fluctuations in value tend to smooth out over time as the impact of market volatility diminishes. Moreover, years of strong equity markets can outweigh periods of decline, resulting in long-term returns that outperform other asset classes.

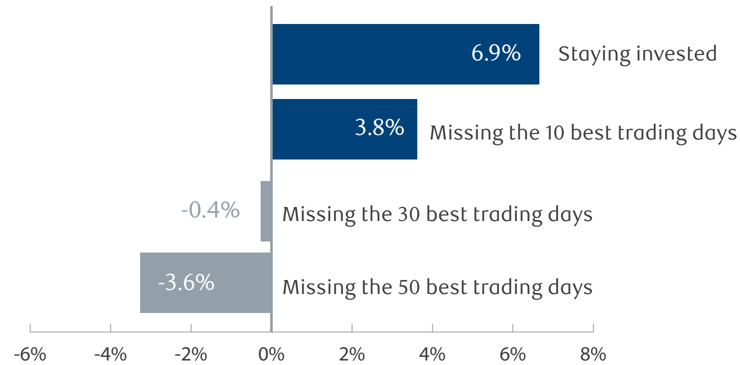
The volatility of a diversified portfolio decreases over time



* Rolling 1-, 3-, 5-, 10-, 20- and 30-year average annual returns from January 1989 to December 2019. Diversified Portfolio represented by 2% Cash, 43% Fixed Income, 19% Canadian Equities, 20% U.S. Equities and 16% International Equities. Cash represented by FTSE Canada 30 Day TBill Index; Fixed Income represented by FTSE Canada Universe Bond Index; Canadian Equities represented by S&P/TSX Composite Total Return Index; U.S. Equities represented by S&P 500 Total Return Index; International Equities represented by MSCI EAFE Net of Taxes Total Return Index. Source: Bloomberg, RBC Global Asset Management.

Why it's best to stay invested

Missing just the 10 best days in the market over the past 10 years would have reduced returns significantly.



Based on the annualized returns of the S&P/TSX Composite Index for 10 years, ending December 31, 2019.
Source: Bloomberg, RBC Global Asset Management.

2. Maintain discipline

History shows that by maintaining discipline and perspective during market downturns, a patient investor will often be the one rewarded when markets return to an upward path.

As market volatility increases, investors have a natural tendency to want to move into safer investments, hoping to avoid further losses. However, this move can result in needlessly locking in losses on investments that, given time, are likely to recover. A key to overcoming this emotional reaction is to refrain from trying to time the market. Selling at the wrong time and missing just a few days of a market recovery could have a significant long-term impact on your portfolio.

3. Diversify your portfolio

Diversification, long considered the golden rule of investing, remains key to reducing portfolio volatility and risk.

Diversification means including in your portfolio a combination of investments from different asset classes, including cash, fixed income and equities, as well as different industry sectors, geographic areas and investment styles. Financial markets do not move in concert with one another and individual asset classes will perform differently in any given year. At any time, one asset class may be leading the market, while the others lag.

Diversification can help reduce the impact of market volatility on your overall portfolio by combining assets that react differently to changing market conditions. As the chart (next page) shows, it can be difficult to predict which asset classes will lead the market each year and which ones will underperform.

A strong case for diversifying your investment portfolio

2015	2016	2017	2018	2019
US Equities 20.8%	CDN Equities 21.1%	EM Equities 28.3%	US Equities 3.8%	US Equities 25.1%
INTL Equities 19.0%	US HY Bonds 14.3%	INTL Equities 16.8%	Global Bonds 1.9%	CDN Equities 22.9%
Balanced 6.5%	US Equities 8.6%	US Equities 14.1%	CDN Bonds 1.4%	INTL Equities 16.5%
CDN Bonds 3.5%	EM Equities 7.3%	CDN Equities 9.1%	Cash 1.3%	US HY Bonds 14.0%
EM Equities 2.0%	Balanced 6.5%	Balanced 8.8%	Balanced -1.3%	EM Equities 12.9%
Global Bonds 1.9%	Global Bonds 3.5%	US HY Bonds 6.4%	US HY Bonds -2.9%	Balanced 9.9%
Cash 0.6%	CDN Bonds 1.7%	CDN Bonds 2.5%	INTL Equities -6.0%	CDN Bonds 6.9%
US HY Bonds -2.7%	Cash 0.5%	Global Bonds 1.8%	EM Equities -6.9%	Global Bonds 6.9%
CDN Equities -8.3%	INTL Equities -2.5%	Cash 0.6%	CDN Equities -8.9%	Cash 1.7%

All performance is in C$. Source: RBC Global Asset Management Inc. as of December 31, 2019.

Equities				Fixed income				
CDN Equities Canadian Equities	US Equities U.S. Equities	INTL Equities International Equities	EM Equities Emerging Market Equities	CDN Bonds Canadian Bonds	US HY Bonds U.S. High-Yield Bonds	Global Bonds Global Bonds	Cash Cash	Balanced Balanced Portfolio
S&P/TSX Composite Total Return Index	S&P 500 Total Return Index	MSCI EAFE Total Return Index	MSCI Emerging Markets Total Return Index	FTSE Canada Universe Bond Index	ICE BofAML US High-Yield BB-B Total Return Index	FTSE World Government Bond Total Return Index	FTSE Canada 30 Day TBill Index	55% Equity / 45% Fixed Income

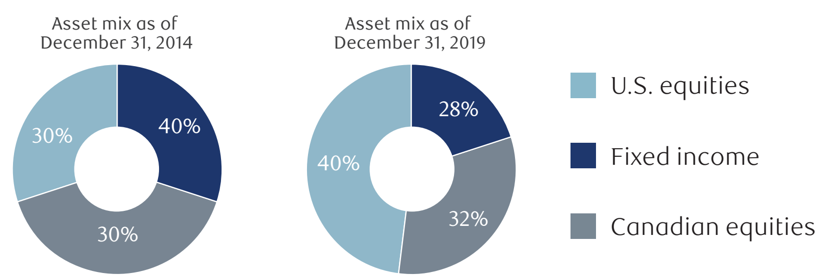
Reacting to short-term market "noise" by making dramatic portfolio changes, like moving in and out of the markets, can have a negative impact on achieving your long-term investment goals.

4. Regularly rebalance

Market fluctuations can often cause a shift in how your assets are divided in your portfolio (also known as asset mix drift), leading to a very different asset mix — and investment experience — than originally intended.

Rebalancing is one of the more effective ways to stay on track to reach your investment objectives. Not only does it help keep your portfolio aligned with your investment goals, it also gives you the opportunity to lock in gains from one asset class and redeploy them to other asset classes that have become relatively inexpensive. Investment portfolios that are regularly rebalanced and adjusted tactically can take advantage of shorter-term opportunities without losing sight of the long-term strategic allocation.

The impact of portfolio drift



Canadian equities: S&P/TSX Composite Total Return Index. Fixed income: FTSE TMX Canada Universe Bond Total Return Index. U.S. equities: S&P 500 Total Return Index. All performance in C$.
Source: RBC Global Asset Management.

5. Invest regularly

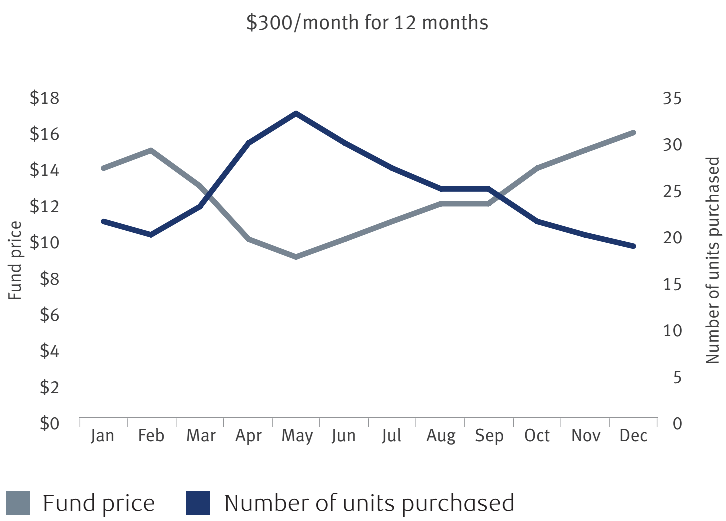
Investing a fixed amount on a regular basis ensures that your investment strategy remains a priority through all types of market conditions.

By contributing smaller amounts of money to an investment plan on an ongoing basis (bi-weekly, monthly), regular investing acts as an anchor to help you maintain discipline when market conditions become volatile.

Regular investing also provides the opportunity to help smooth out returns over time, ultimately reducing overall portfolio volatility. This is achieved because investing a fixed dollar amount on a regular basis gives you a chance to buy more investment units when prices are low and fewer units when prices are high, thereby producing a more level investing experience over the long term.

Investing regularly in a fluctuating market

$300/month for 12 months



Source: RBC Global Asset Management.

Where do you go from here?

The five strategies outlined above can help you stay focused and feel confident about reaching your long-term investment goals. Talk to us about these strategies to help ensure you stay the course and maintain confidence through all types of markets.