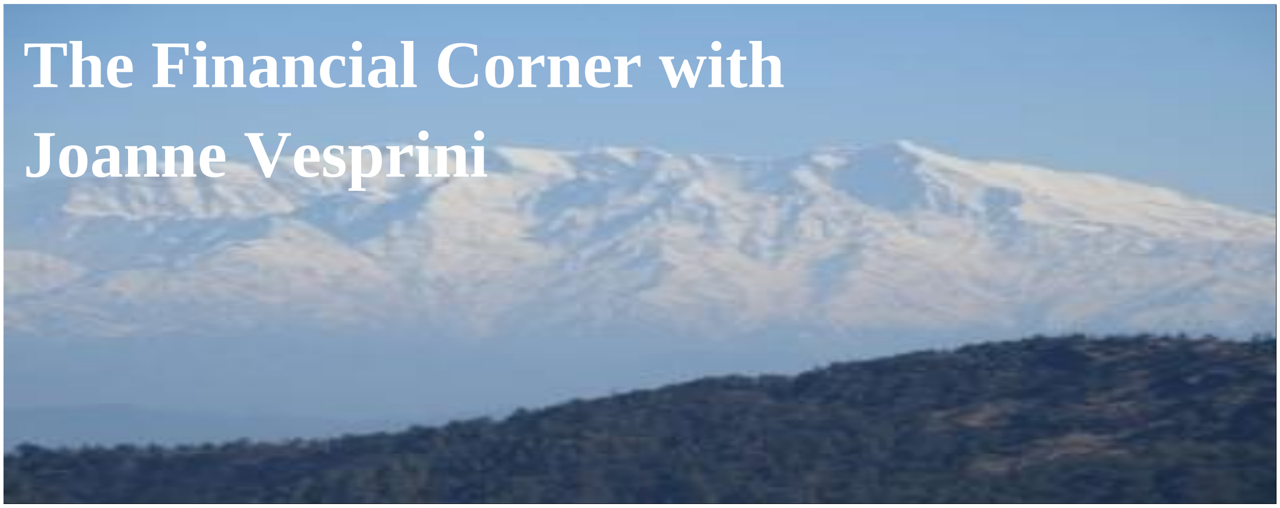
The Financial Corner with Joanne Vesprini



Himalayas

A quarterly newsletter filled with practical wealth management advice that covers various aspects of financial well-being

Winter 2018

- Coping with the correction
- TFSA reminder

My thoughts,

As we reach the end of the year this quarter is finishing as it started, very tumultuous. We have had a plethora of global events and geopolitical issues this quarter; the riots in Paris over increased gas prices and taxes, Brexit being delayed, weaker oil prices, US & China unresolved trade issues, Italy's budget concerns, US mid-term elections, the US FED unexpectedly raising interest rates in December, Huawei CFO detained in Canada for allegedly violating US sanctions to Iran, journalist murdered in Saudi Arabia's Istanbul embassy and of course all the daily headlines out of the US.

Given the significant market fluctuations we have experienced in the past couple of months this quarter's newsletter is only focused on this correction and an update on the Tax Free Savings Account (TFSA). It includes an article that addresses the issues pertaining to the correction.

I know it's difficult to remember, while in the midst of extended market fluctuations, that volatility is a normal part of long-term investing. It's hard not to be swayed by sweeping opinion and the latest news headline. It's best to ignore the media noise in order to avoid a knee-jerk decision to make changes to your portfolio that may impact your long term plans. I will gladly meet with you to address any concerns/questions you may have to reassure you that your portfolio is structured to manage the risk with downside protection during corrections and recessions.

On behalf of Shelly, Chelsea and I please enjoy the holidays with your family and friends and we wish you all the best in the New Year!

Joanne

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RBC Wealth Management
Dominion Securities

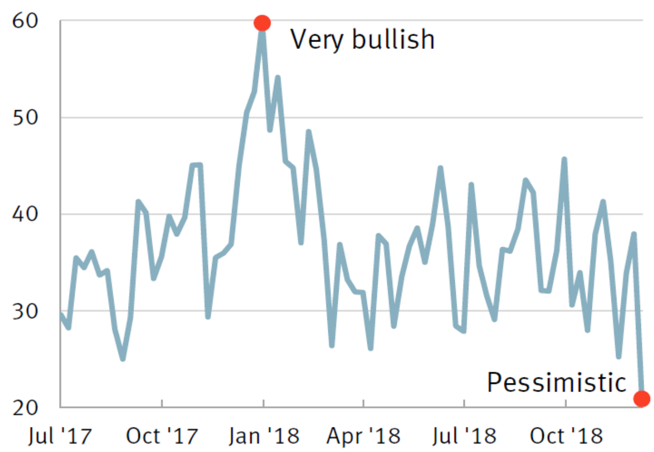
Coping with the correction

By Jim Allworth – Vancouver, RBC Dominion Securities & Kelly Bogdanova – San Francisco, United States RBC Capital Markets

While the correction has frayed investors' nerves and could persist, we don't think it's heralding the demise of the bull market. The U.S. economy remains in gear, and with valuations nearing a sweet spot we remain comfortable holding a Market Weight position in equities.

Bullish sentiment has plunged

American Association of Individual Investors (AAII) U.S. Investor Sentiment Bullish Readings



Source - RBC Wealth Management, AAII, Bloomberg; weekly data through 12/13/18

The U.S. stock market has been in a correction since early October, joining many of its global peers that had been weak months before that. The major U.S. averages have given up 12% to 13% from their peak levels so far. There have been bouts of heavy selling followed by rallies, but prices have not yet reached down to levels that have attracted sustained new buying. We think that point is getting close, but the road from here to there could still be a rough one. As investors look to 2019 and beyond, the underpinnings that gave them such confidence— big fiscal spending budgeted for 2018 and 2019, corporate and personal tax cuts, and upbeat management guidance—now have given way to concerns about the impact of Fed tightening on the 2020 economy and earnings. And as usual there's a long list of challenges close at hand, including: a potential partial U.S. government shutdown, the U.S.-China trade confrontation, difficult political crosscurrents in Washington, parliamentary chaos in Britain around Brexit, fractious politics throughout the EU, heightened tensions between Ukraine and Russia, and weak crude oil markets.

Still in gear

As concerns mount among investors, fear can take hold and push share prices and the broad averages down a long way in a short time. Some sort of convulsive drop cannot be ruled out.
That said, we regard this as a correction and not something more; we think the market advance that began in 2009 has further to run. Our principal reason for holding this view is that the U.S. economic expansion remains in gear, as do those of most important economies. The overt tightening of credit conditions and deterioration in the labor market that would tell you a recession is on the way are not yet in evidence.

Our forecast for 2019 U.S. GDP growth is at 2.5%, with most quarterly postings expected to be in the low "2s." That would be markedly slower than the "tax-cut-juiced" quarterly readings delivered in Q2 and Q3 of this year.

Quarterly GDP growth rates that subside back toward the 2.2% lower-than-average rate that prevailed from the end of the recession in 2009 until the beginning of this year should keep inflation tamed, in our view. This, in turn, should permit the Fed, once it puts the expected December rate hike in place, to stay on hold through much of next year. Without more aggressive credit tightening, we expect the U.S.

economy will keep on growing through 2019 and into 2020. So, too, should corporate profits and the value of businesses

All values in U.S. dollars and priced as of December 17, 2018, market close, unless otherwise noted.

Fear factor

But before a market advance to what we expect will be new high ground can get underway, this current correction has to run its course. On that front, several measures of momentum and participation are at or approaching deeply oversold levels. Fewer than 25% of stocks in the S&P 500 are registering upward weekly price momentum. On a daily basis only 16% are giving positive readings. Both of these can go lower still, but sustainable rallies have often begun from such levels.

Optimism and complacency have given way to pessimism and some fear. The most recent U.S. survey of individual investors by AAII showed that only 21% of respondents rated themselves as "bullish" about the market's prospects for the next six months. Near the January peak, fully 60% put themselves in that category. In early October the reading was 46%. The percentage of those characterizing themselves as "bearish" has risen to almost 50%, the highest level since early 2016. Extremes of pessimism are usually unsustainable, suggesting a market low may not be far away, at least in time.

Major economic indicators still in expansion mode

RBC Wealth Management U.S. economic indicator scorecard

Indicator	Status		
Yield Curve (12-month to 10-year)	✓	–	–
Unemployment Claims	✓	–	–
Unemployment Rate	✓	–	–
Conference Board Leading Index	✓	–	–
ISM New Orders Minus Inventories	✓	–	–
Fed Funds vs. Nominal GDP Growth	✓	–	–
	Expansion	Neutral	Recessionary

Source - RBC Wealth Management, Bloomberg, FRED Economic Data St. Louis Fed

Searching for the sweet spot

Valuations are becoming more compelling. At the peak in February and again in September, the S&P 500 was flirting with a price-to-earnings (P/E) ratio of 20x based on trailing 12-month earnings. These are levels from which annual gains tend to be in the low single digits, on average, and sometimes negative. At today's levels the P/E multiple is a fraction below 16x. The range of 14x to 16x current earnings has historically been something of a "sweet spot" for stocks, with the S&P 500 typically delivering all-in returns close to 15% one year out, on average.

Multiples elsewhere are even lower. Canada's TSX, for example, is trading at a 15% multiple discount to the S&P, an unusually wide disparity. The MSCI Emerging Markets Index and MSCI World ex USA Index are both trading well below their 10-year averages.

We expect corporate earnings to grow moderately in major markets in 2019. The U.S. growth rate should decelerate the most, mainly because the outsized, positive year-over-year impact of corporate tax cuts will no longer be contributing. Slower economic momentum should also rein in profit growth. We anticipate S&P 500 earnings will rise in the mid-to-high single-digit range for the coming year—admittedly a slower pace than 2018, but enough to support modest price gains, in our assessment.

Recognizing resilience

If a major market peak is occurring, it is not conforming to history. None of our major recession indicators are flashing red, let alone yellow. We remain comfortable holding a Market Weight position in overall equity exposure in global portfolios and in U.S. equities—in other words, investing at the long-term strategic allocation level. The U.S. economy and earnings should provide support for modest gains in major indexes in 2019. We think the market has the capacity to absorb economic cooling, ongoing tariff risks, political headwinds, and monetary policy uncertainty, albeit with volatility.

A quick reminder about Tax-Free Savings accounts…

The Tax Free Savings account is a flexible savings vehicle in which investment income earned in this account is tax-free. The maximum amount you can contribute is limited to your TFSA contribution room. The total TFSA contribution limit from 2009 to 2019 is $63,500. The annual TFSA dollar limits from 2009 to 2019 are as follows:

Year	TFSA annual dollar limit
2009–2012	$5,000
2013–2014	$5,500
2015	$10,000
2016–2018	$5,500
2019	$6,000

The annual contribution limit is indexed to inflation and rounded to the nearest $500. You automatically accumulate contribution room each year (starting in 2009) if you were a resident of Canada at any time during the year and you are at least 18 years of age. You actually don't have to open a TFSA or file an income tax return to earn contribution room. Your income level also has no bearing on your contribution room. Although the Canada Revenue Agency (CRA) will track your contribution room, you should also maintain your own records to keep track of your TFSA transactions.

Keep in mind that your contribution room decreases with any contributions you make, including re-contributions of funds you have withdrawn in previous years. Any investment income earned within your TFSA or the value of your investments held within your TFSA will not affect your contribution room.

Please contact us if you would like more details on how the TFSA might work in your portfolio.