RBC Wealth Management
Dominion Securities

INVESTMENT & WEALTH MANAGEMENT
Today and for the Next Generation

With Nick Foglietta **April 03, 2017**

Challenge your biases

Sometimes our human mind works in ways that trap us in our biases. The investment world is full of these types of traps and one has to make a conscious effort not to get caught.

You see, we love to read and follow what reinforces how we believe or think.

If you like a certain politician, you watch news that is positively biases toward that person. If you are a bull on stock markets, you follow other people who are bulls. If you are religious, you read books that reinforce your religious view. It applies in almost any category of thought!

My goal is to follow at least as many people I disagree with in areas where I am strongly biased to always try to challenge myself and my views.

This week I am going to use two articles I read in the past week to challenge you to think of things a different way.

The ideas are related.

Whether you agree or disagree with the two schools of thought, I challenge you to think about the ramifications they represent to investors and policy makers of the present time!

"The biggest mistake I made was believing that if I cast a beautiful net, I'd catch only beautiful things"

-The OA series

Tactical Equity Income Model Portfolio Record

Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: 50% stocks 50% cash
S&P/TSX 60 Closing Value: 15,548
TSX 200 Day Moving Ave: 14,965

% Above/Below 200 Day Moving Ave: **3.90% Above**

Levels for change: to 100% stocks - **TSX 15,713** and 100% cash at **14,217**

In This Issue

Money Heaven

First, let's look at the stereotypical view: Increases in global net worth are permanent. If prices decline *somebody* captures the winnings so the global net worth is preserved.

Nothing could be further from the truth.

John Hussman used the example of the shares of General Electric to showcase an example of what actually happens.

"To understand how paper wealth vanishes, recognize that market capitalization is merely the product of two objects: the number of shares outstanding, and the price of those shares.

For example, there are currently nearly 9 billion shares of General Electric outstanding. If a dentist in Poughkeepsie sells a single share of GE to some buyer, just 10 cents below the price of the preceding trade in the stock, fully $900 million dollars of market capitalization is instantly erased from the U.S. stock market as a result of that one $30 stock trade.

Nobody "got" the $900 million. The lost market capitalization didn't "go into" bonds, or real estate, or gold, or cash on the sidelines, or anything else. It just plain vanished.

Conversely, if our dentist buys a single share just 10 cents above the preceding trade in the stock, fully $900 million dollars of market capitalization is instantly "created" as a result of that one $30 stock trade."

So now, see the big picture.

The US stock total valuation on March 1st, this year was over $34 trillion. It is often stated by the media as newly created "wealth" by the market.

As the example shows above, however in a stock market correction only a small fraction of this wealth is ever cashed in upon by anybody. Real estate prices work exactly the same, by the way.

I am not making a prediction…I am stating a fact.

Why does it matter? Because to float the high valuation of asset prices incredible amounts of borrowing (debt) is employed. But when asset prices fall, the amount of debt outstanding remains the same.

This means there is less "collateral" in the financial system to give comfort to lenders to leave the loans outstanding.

Just think about it for a while. You can easily imagine why the Central Banks are so afraid of a drop in stock and real estate prices.

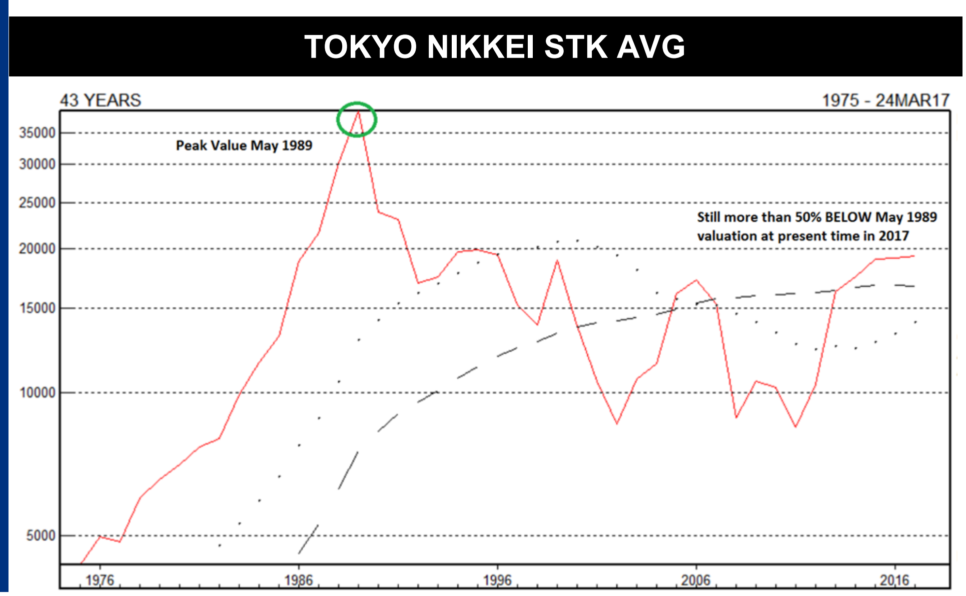
Buy and Hold Breakdown

To beef up my wealth management skills, I have been reading articles and books by the so-called “wealth management gurus.” Nick Murray is the industry standard when it comes to the wealth management guru mentality.

In a nutshell, Nick Murray would advise clients that they should *always* hold a large percentage of their net worth in stocks…that the stock market will always bounce back from a decline…and the job of your advisor is ‘to protect you from yourself’ in a bear market by holding your hand and convincing you to not sell in a panic.

Now here is the rub: Historically, the Nick Murray position is only always true during a credit expansion. This is absolutely critical to grasp! Once the credit bubble stops growing it can take more than a generation for asset prices to reach the level they were at during the credit expansion.

Let me cite two examples: The first example is the Japanese stock market index.



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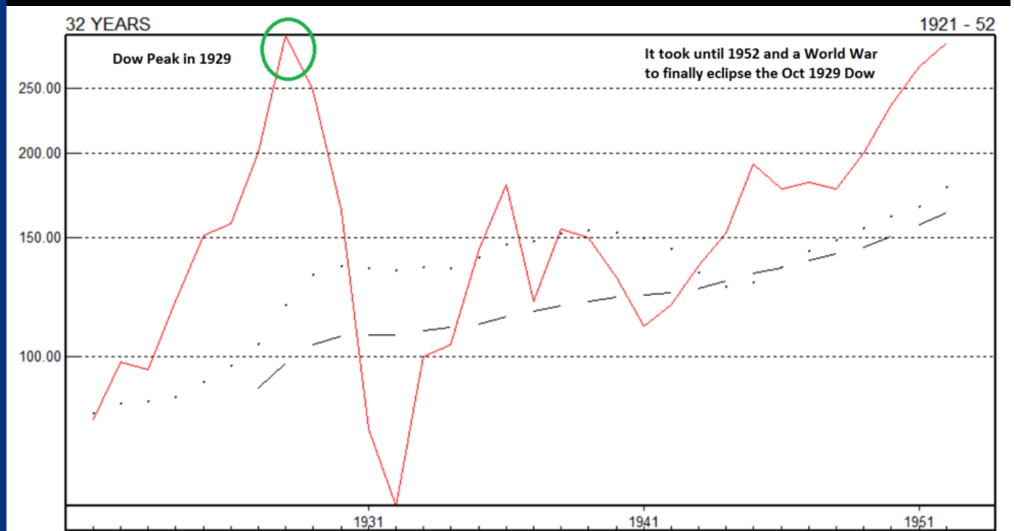
Imagine how the "buy and hold" investor has felt during those 28 years (if they lived long enough)! Japan was a debt fueled "bubble" that burst and had a degenerating demographic profile attached in the background…where have I ever seen that before?

At times when I have brought up this example I have been told: "yah, but it can't happen in the US…" Sorry, it already has!

The chart below shows the Dow Industrial Average from 1921 to 1952. After the stock market crash of 1929, it took until early 1953 to get back to the pre-crash high.

DOW JONES INDUSTRIAL



The common denominator in both of these "generational bear markets" was that they started when <u>credit bubbles stopped growing</u>.

Let me be clear, I have no problem with the buy and hold strategy. What I do have a problem with is telling people it *ALWAYS* works.

There are rare times when it fails.

So here is a question for you to ponder:

Did the 2008 credit crisis <u>conclude</u> the credit bubble that started after the 1987 stock market crash and Alan Greenspan's penchant for managing the economy via interest rates and printed money?

If you answer "yes," then you should be safe using a buy and hold strategy for years to come. If you answer "no" then a credit contracting event is still in our future and you should employ a strategy that controls for that possibility.

Tactical modeling, as per the TEAM model, will work to avoid the vast majority of a long term bear market due to a credit contraction should it happen.

Seeing Your RBC Wealth Management Accounts Online

The majority of clients already have access to their portfolios online, but it has been a while since I have featured the benefits of having online access, so here is a short reminder.

- Totally secure access that carries the RBC Dominion Securities 100% Online Security Guarantee.
- Convenient consolidated view of all your account balances, individual holdings, current market value, recent transactions, and order status.
- Option to select paperless statements if you want to cut down on paper mail.
- Available 24 hours a day, 7 days a week.
- Access to statements going back 7 years… cuts down on saving statements.
- Connects to RBC Online Banking profile so you can see everything on one page.
- Real time transfers to your RBC Wealth Management accounts from RBC bank accounts.
- Information services including real time quotes, market news, RBC research reports and personal Watchlists.
- DS Online Help desk is there to serve you with questions.

If you would like to set up your online access please call Megan at 250-729-3226.

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