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SPRING ISSUE

MANULIFE PRIVATE WEALTH INSIDER

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Does the Bear enter our lives in 2018?

The first quarter of 2018 was certainly an interesting one; from the largest daily losses by points in the history of the Dow, to a market rebound later that month. It felt like an amusement park ride at times.

Recent American policy on trade has led to a level of volatility not seen in a long time, and have many questioning whether we are due for a major correction.
While no one enjoys volatility for its own sake, the role of an active investment manager is to garner opportunities from solid company fundamentals that will be rewarded regardless of political noise.

History has demonstrated time and again in the investment industry, that acting in a vacuum of real information and data often leads to poor outcomes. This is precisely why the average retail investor often underperforms both industry benchmarks and institutional investment managers.

Studies have shown that the average investor is twice as sensitive to losses as they are to gains. Human behavior is such that when you experience market volatility and losses, the tendency is to act rapidly, which thereby crystalizes the loss. It has been found that frequent portfolio evaluation, when combined with a higher sensitivity to losses can leave many investors emotionally drained and with underperforming investment portfolios.

Small investors also tend to enter the market as securities are rising rapidly, which leads to buying near the top. The role of a manager and investment counsellors is to ensure that one does not become their own worst enemy in trying to time the market. While no one should believe a bull market can run forever and as we are in the 9th year of this bull market, we are definitely closer to the end than the beginning in our opinion.

People have been calling the end of this bull market for the last 2 years and those who pulled their money out would be fuming on the sidelines as they watched the markets climb another ~25%. Building a structured portfolio and investment strategy that can endure volatility, is how you can model your portfolio to align with your long-term goals.

When the Brexit referendum vote result was announced, the market reaction was dramatic but quickly stabilized over the following days in the absence of any real changes. Too often investors trade based on conjecture rather than waiting for true facts.
We have seen the similar events unfold this quarter first with the NAFTA negotiations, and more recently with the US/China trade squabble. In the absence of real data, making a leap out of investment accounts is really a leap of faith or gamble.

This is a great time to take a long look at your financial goals to ensure that they are unchanged, and that the timelines remain the same. If something has changed, work with your investment counselor to update your investment policy statement and adapt your portfolio to match your goals.

There are opportunities in all markets be they up or down, bull or bear. It is the diversification of a portfolio that helps assists with down side protection and overall return. Perhaps the most important activity one can do is ensure you are watching the longer-term gain, while ignoring the short-term fluctuations.

So while the bull may be getting tired, there is no need to flee the markets and we believe there will still be opportunities during new periods of volatility as we move further into 2018.

Glen Brown MPhil., CFP, TEP
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NEW! Knowledge development podcast – The Private Wealth Podcast

About the Podcast

The Private Wealth Podcast is an exclusive series that highlights unique and insightful private wealth solutions for clients. With new topics every quarter, we welcome advisors with the opportunity to develop their knowledge and further their client relationship.

Estate & Tax Planning for Canadians with U.S. Connections

On March 28, we welcomed Hemal Balsara and Susannah Roth, Tax and Estate specialist to discuss estate and tax planning for Canadians with U.S. connections.

In order to appreciate U.S. tax issues, we need to appreciate whether these U.S. tax issues are applicable to a person. Susannah and Hemal discuss what the definition of a U.S. person is and given the recent legislative changes in the U.S., how this affects estate and transfer taxes.

The call then dives more in-depth to how an individual should plan for estate taxes as well as issues that may arise when an American person is involved or when Canadian corporations are in the mix.

At the end of the call, Susannah provides practical considerations for listeners to consider with regards to cross-border planning.

Podcast Replay

If you missed the live call and would like a replay, please visit our website to access the recording. Click here to tune into the podcast.

Growth or Value in 2018?

After solid gains in 2017 technology stocks have continued to lead the way in 2018. However, the enthusiasm for growth stocks isn't what it used to be.

The return of the VIX in February reminded investors that gains equities do not come without risk.[1] Despite the return of more volatile markets, the bullish trend has still favored growth stocks. The most notable have been information technology stocks since the beginning of the year. Year to date the Nasdaq has gained 6.4% while the overall S&P 500 has gained 1.47%.[2,3] But is it time for new leadership to emerge to shepherd this market to new heights?

Part of the argument for a change in the leadership of the trade lies in the doctrine of economic cycles. General economic theory suggests that in the middle stage of an economic expansion, which we define as moderate inflation, interest rates and capacity utilization, is where base materials and technology firms, also known as growth stocks, tend to do very well. This has tended to be true in the recent past as base material stocks recovered well in 2016 and the expansion in technology stocks has been remarkable over the last couple of years. In the late stage of the cycle, which is defined as a period of rising interest rates and a flattening yield curve, energy and services companies such as financial have historically been very profitable.[4] Stocks in these sectors are typically known as value plays. Recent trends are suggesting that we are leaving the middle stage and entering the late stage which may account for the some of the recent volatility seen in the overall equity markets in the month of February.

Supporting the argument that we may well be at the end of the middle stage and entering the late stage lies in the earnings growth forecasts for 2018.

While the consensus for growth in earnings on the S&P 500 is an eye popping 17%, the sectors that are expected to lead the pack are energy, materials, information technology and financials. Interestingly the greatest change in earnings growth expectation versus a year ago belongs to the energy sector which has been known to do well in the beginning of the late stage of an economic recovery. Following the recovery in the price of crude oil, as measured by west Texas intermediary (WTI), earnings for the combined 11 subsectors are expected to grow by 82.3% in 2018.[5] This could translate itself nicely into gains for patient investors.

Another consideration is the tremendous run that some of the largest US tech firms have enjoyed. Apple, Microsoft, Facebook, Amazon and Google accounted for a quarter of the return of the S&P 500 in 2017. These firms have done a spectacular job of growing their businesses around the globe and their profits growth is a testament to their success in doing so. This aspect has not been lost on governments outside the United States and some are looking to take steps to get their share of the tax revenues. Several European Union (EU) member states are locked in court battles with these companies. They argue that global tech companies pay less than half of the taxes that that traditional brick and mortar EU businesses do, yet they are allowed compete in their markets with impunity.[6,7] Challenges of this sort tend to happen when sectors do well and is rarely rewarding for shareholders until these matters shake out. We do not have to look too far back to remember the royalty increases for energy firms in Alberta back in 2007 when WTI was reaching all-time highs.[8]

All things considered the US stock market should produce gains for investors in 2018 given the earnings growth momentum across the various sectors on top of the tax reform recently legislated. Once new leaders congruent with the present market cycle emerge, investors could be richly rewarded for their patience and discipline.

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1 https://seekingalpha.com/article/4144413-vix-traders-see-feb-returns-plus-30-percent-minus-95-percent
2 http://quotes.wsj.com/index/COMP?mod=mdc_uss_dtabnk
3 http://quotes.wsj.com/index/SPX?mod=mdc_uss_dtabnk
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8 http://www.cbc.ca/news/canada/calgary/alberta-increases-royalties-charged-to-energy-companies-1.649434

To learn more about Manulife Private Wealth, contact your financial advisor today.

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