Leib Zeisler

Letters from Leib

WINTER 2018-2019

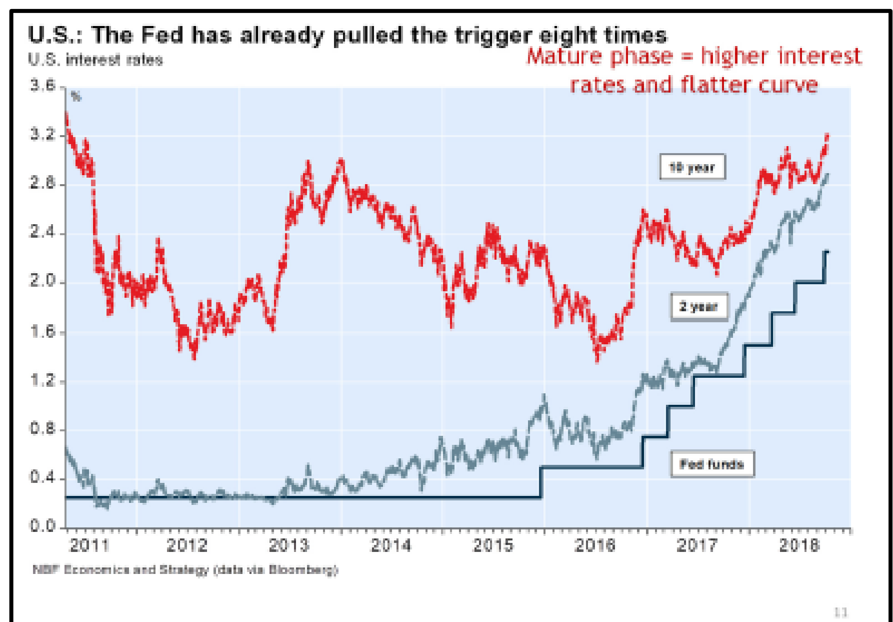
Summary

For over a decade, government policies drove record bull markets in stocks, bonds, real estate, and collectables. It has been a good run but the investment landscape is changing. These changes are structural and investors should consider the potential impacts on their portfolios. Coming after an amazing period of record setting highs, 2018 will be remembered as a year of declines as ninety percent of asset classes are in negative territory at the time of this writing. Cyclical market declines and year-end tax loss selling create opportunities for investors to lay foundations for future prosperity.

Key Issues

The tail winds that have pushed markets forward since 2008 (albeit not in a straight line) have shifted. Rising interest rates now offer investors alternatives. Global shortages in both skilled and unskilled labour are placing upward pressure on inflation. Government debts are a concern for policy-makers and limit flexibility. Corporate debt is at an all-time high. Geo-political turmoil, trade wars, and currency fluctuations are adding risk. Much longer life spans are challenging personal financial plans, pensions, and health-care policies. As economies appear to be slowing, most analysts believe that investors are moving into a period of muted returns.

All changes are not necessarily bad and, in some cases, there are opportunities to capitalize on them. Income orientated investors will be able to lock-in higher interest rates and dividend yields. Investors with conservative portfolios will have opportunities to add to core positions.

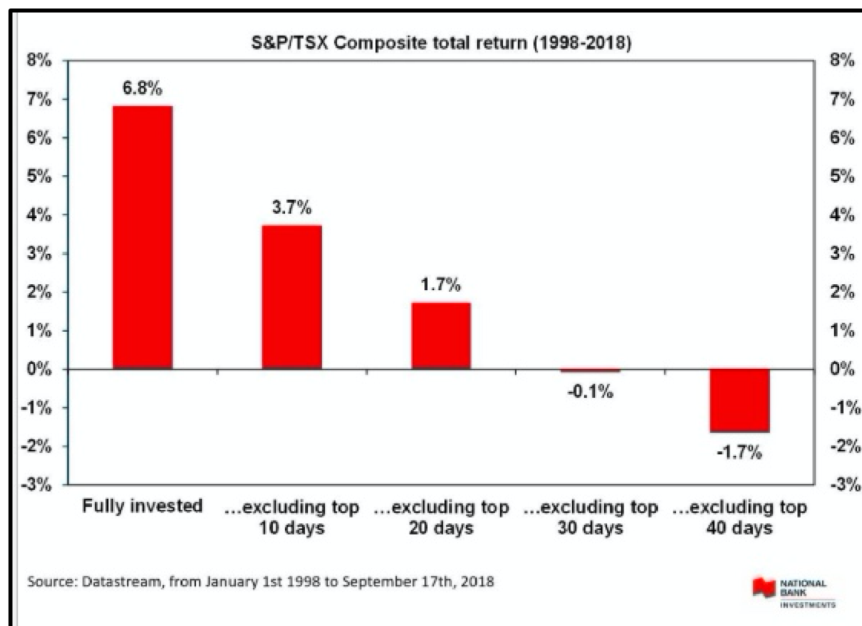


Sophisticated risk-oriented investors seeking growth will have time to acquire positions in emerging markets and a rising generation of global companies. The operational thought here is to recognize that structural changes are occurring and think about what they mean for you and your portfolios.

Interest Rates

After moving downwards for over thirty years, from 1982 to November 2016, interest rates around the world have slowly begun to rise. We do not know how high or how rapid this movement will be. Government, corporate, and personal debt levels are at all-time highs; as interest rates rise, the costs of debt servicing will grow dramatically. The Congressional Budget Office, which provides non-partisan analysis for the US Congress, predicts that Washington could be spending more on debt servicing than on Medicaid by 2020; by 2025 interest costs could exceed all nondefense discretionary outlays. Some analysts believe that many major national economies are not strong enough to withstand a rapid run up in interest rates without tipping the world into recession. Investors should continue to maintain their flexibility but as rates rise layering in fixed income securities over time is a prudent diversification strategy to even out portfolio yields and provide a steady stream of income.

Core positions in reliable dividend paying companies with strong balance sheets have a history of weathering economic uncertainty and bouncing back quickly when markets recover. Our clients have a solid base of holdings in this asset class, including Canadian financials, utilities, real estate companies, and American industrials. As the accompanying chart shows, it is better to hold onto core positions and ride through periods of market weakness and not try to time the swings. This is especially true when dividends are factored into rates of return. Investors more focused on capital gains are getting paid to wait, and investors relying on cash flow will be getting dependable income.



This being said, **weaker markets present an opportunity to buy well.** Over the past year we have been building and holding cash positions in our client accounts in anticipation of market weakness and in order to rebalance and reposition portfolios for the future.

Value-oriented investors should be looking at companies and global markets that have been driven down by unique internal and external factors that are expected to eventually pass. Examples here include the United Kingdom (Brexit), China (trade wars), Canada (unable to get oil to world markets).

The next round of wealth creation may well come from companies headquartered outside of North America. Investors with a sufficiently long timeframe who are able to handle a higher degree of risk should be looking at rising global giants, particularly those headquartered in Asia where economies are robust and have great growth potential. For example, nine of the world's top twenty technology companies are in China. According to McKinsey & Company, greater China will overtake the US as the world's largest fashion market next year. For safety, it is prudent to focus on companies that trade on North American exchanges and are bound by American reporting rules.

The Demographic Conundrum

Longer life spans and rising inflation, even at modest levels, are impacting financial plans and global economies. Retirees and pre-retirees need to have realistic financial plans and review them regularly. The leading cohort of the baby boom generation is now well into their retirement years. If this is your stage of life, you probably require predictable and, hopefully, rising cash flow. Depending upon your circumstances (age, health, wealth base, family obligations), it is also important to invest a portion of your portfolio for growth. Even gradual rises in living costs, taxes, and inflation will significantly erode savings over the long term. As most financial planners today recommend planning for 95 years of age, investing too cautiously could mean inadequate funds later in life.

New investment products and data-driven investment processes are changing the marketplace. Indexing, ETFs (exchange traded funds), and digital advisors that rely on mathematical algorithms aim to make the investment process straightforward and more affordable. They are also making it increasingly interconnected. Some give the illusion of a diversified portfolio while offering what is essentially a restricted investment profile. Some have a limited track record and untested features. There are pros and cons to all of these products. We use ETFs in your portfolios to lessen risk and gain exposure in highly competitive and emerging sectors. In the past these have included QQQ (which tracks 100 of the largest non-financial (primarily technology) stocks listed on the NASDAQ exchange), IBB (an index that tracks high-growth biotechnology and pharmaceutical companies listed on the NASDAQ), and the PPA (an index of US-listed stocks involved in the aerospace and defence industries). We do not use these products to invest in Canadian banks and utilities as it is more cost effective and potentially more profitable to own them directly, and we can overweight those companies and industries we want to own and underweight those we wish to avoid. In the future, we will continue to seek out ETF opportunities in these and other areas, including AI, transitional energy, and emerging markets.

For individual investors, particularly younger investors, over-reliance on passive strategies limits the potential to build wealth. A well-structured portfolio should include some investments that are less correlated with standard baskets. In the past, many of our clients benefited from holding positions in K-Bro Linen (whose shares are too illiquid to be included in most ETF programs), Canadian Hydro (which at the time was too small to be followed by these programs), and Canopy Growth (too unpredictable).

The Team

Our team provides exceptional client servicing, well above and beyond industry standards. We really do believe that you, our client, are our priority. I know that you all share with me in extending good wishes to Erin and Rebecca on their upcoming maternity leaves, starting December 24th, 2018. In their absence, we are pleased to announce that Amrita Basu and Santana Enica will be joining us on January 2nd, 2019.

Many of you may remember Amrita, as she worked in our office during the on-boarding process this summer. Santana joins us from her Senior Account Manager role

at Royal Bank of Canada, where she has worked since 2007. Erika, Amrita and Santana will work together to continue to deliver outstanding client service.

National Bank's commitment to Western Canada. National Bank is a long-term backer of the oil patch. It lends to 110 energy companies, the most of any of the big banks. Its energy portfolio is worth approximately $8 billion, up almost $2 billion in the past two years. National Bank support for this sector has been "unwavering", says Arun Chandrasekaran, Managing Director of Investment Banking. "We're not going to react to these short-term blips. And short-term could be three months, six months, nine months. It doesn't matter." *Globe and Mail*, November 30, 2018.

In conclusion, I believe that investing involves more than just buying stocks and bonds and that my job involves more than just selling products. I enjoy engaging with clients to discuss your portfolios and your financial needs, and then working with you to develop strategies and an overall financial plan that responds to both your circumstances and the larger investment environment.

I am very honoured and humbled by your response to my move to National Bank Financial. You had to do a lot of paper work to transfer your accounts, and your commitment speaks to the long term, trusting relationships we have had together for all these many years.

Thank you and best wishes to you and your family for a year of health, peace, and prosperity in 2019.

Sincerely,

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