MARKET RESEARCH PRIVATE CLIENT RESEARCH

Market Snapshot – April 2016

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Live Longer and Prosper

by James Gauthier

When thinking about investment time horizons, a common refrain from investment pundits is that it is important to “think long term”. But what is long term? There doesn’t seem to be much of a standard definition.

Beyond the problem of not knowing exactly what “the long term” is, a more serious potential issue from an investment standpoint is the risk of not thinking long term enough. This could be a catastrophic problem because if your thinking is not long term enough, you run the risk of outliving your savings.

In this piece, we will do our best to define “the long term” within an investment context. We will also offer insight and an important tip that may be helpful in ensuring you don’t outlive your investments.

Time Horizons and Thinking Long Term

Dr. David Sinclair, co-director of the Paul F. Glenn Center for the Biology of Aging at Harvard Medical School, has hypothesized that the first person to live to 150 has already been born. Let’s think about this from the perspective of an investor. Once most individuals make it to retirement (say, 65), they generally start becoming more conservative when it comes to their investment decisions. This is because income levels typically fall off and savings become the primary source of expense funding.

An investor with a good financial advisor will probably have a game plan in place that aims to ensure the investor easily has the ability to fund a quality lifestyle up to a certain age, say 85 or 90, with room to spare. So for someone who retires at 65, we are talking about a time horizon of 20 to 25 years. We think that is pretty long term. But what if we change the thinking and make the assumption that the investor will live to 150. We don’t think anyone would dispute the notion that 85 years, without a question, is long term.

Knowing that you have a time horizon of 85 years, would it make sense to make the appropriate adjustments in your investment portfolio? We would hope so. You would want to ensure the portfolio is built to grow so it is equipped to finance many more decades of life. In addition, knowing your time horizon in 85 years should trigger some sort of adjustment in spending patterns (or the very decision to retire at 65 at all, but that’s a totally different article).

Our view is that thinking about the possible extremes of human longevity should provide perspectives for the typical investor. The point is that, with the possible exception of those deep in their eighties or nineties, most investors probably have time horizons that are longer than they think. If you are ill-prepared for the long term, you may be in trouble.

Here are some numbers related to life expectancy in the Canada:

	Age	Number of Years Left
Life Expectancy at Age 50	84.7	34.7
Life Expectancy at age 60	85.3	25.3
Life Expectancy at age 70	86.7	16.7

Source: OSFI

Put in this perspective, could it be concluded that those approaching retirement or even a few years into retirement should still invest with the long term in mind? Canadians aged 50, 60 or 70 can expect to have, on average, 35, 25 and 17 years left to live, respectively. Those numbers seem like the long term in our books. These numbers are just averages, and many of us (fingers crossed) will exceed them, and if the age-defying research of Dr. Sinclair is right, these numbers will seem like the short term.

Portfolio Positioning for the Long Term

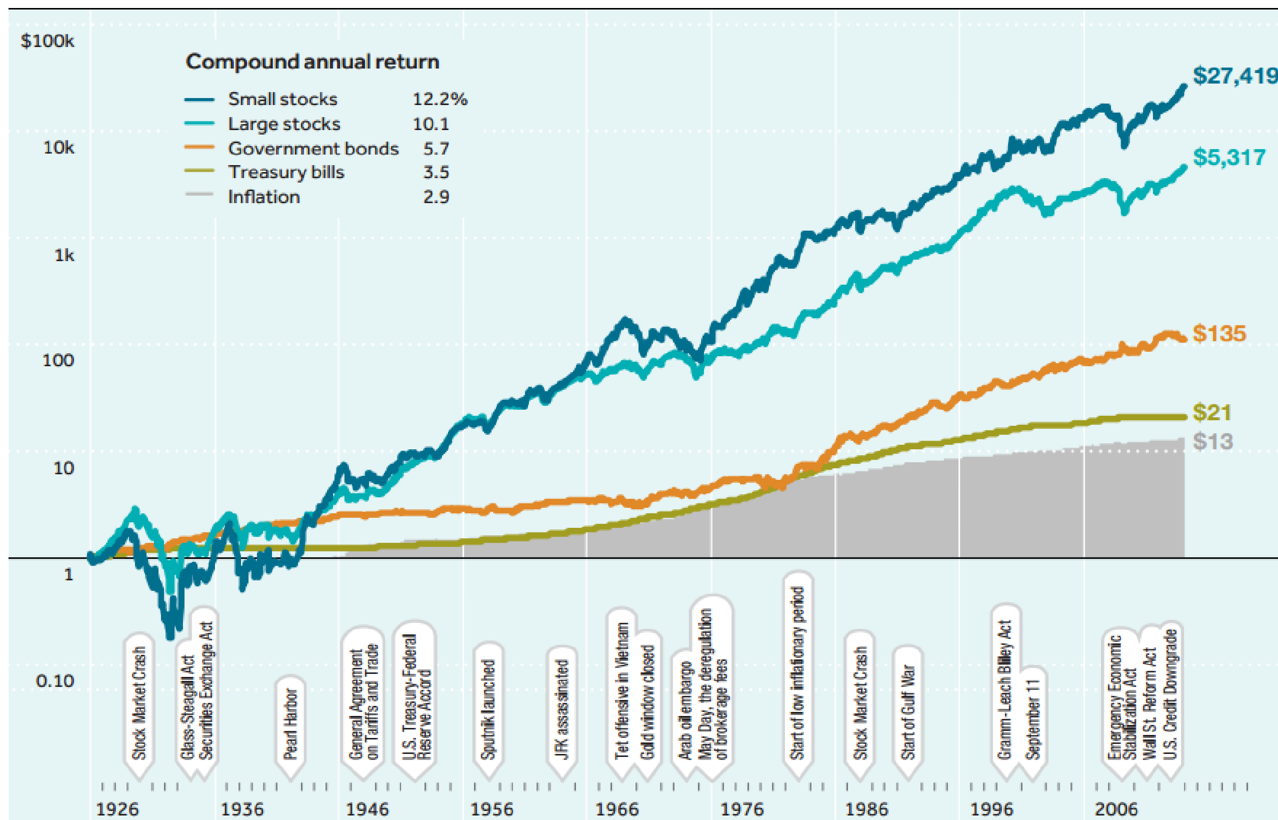
Because you are reading this, we are assuming that you are fully engaged with a HollisWealth advisor who is ensuring you will have the ability to meet your financial objectives by maintaining a portfolio of investments that is made up of the appropriate mix of products.

When it comes to investing for the long term, the biggest risk is being too conservatively invested. Maintaining a conservative positioning is appropriate in some cases, however, the average investor requires some growth out of the portfolio in order to

meet his or her objectives.

Chart I illustrates how much $1 across a variety of asset classes would have grown over the very long term. The point here is that if growth was a requirement, sticking with a portfolio with a significant allocation to stocks would have been your best bet. Sticking with bonds and short term guaranteed investments would have generated positive returns too, but not much beyond the rate of inflation. The numbers in the chart speak for themselves.

Chart I: Growth of $1, 1926-2014 (U.S. Data)



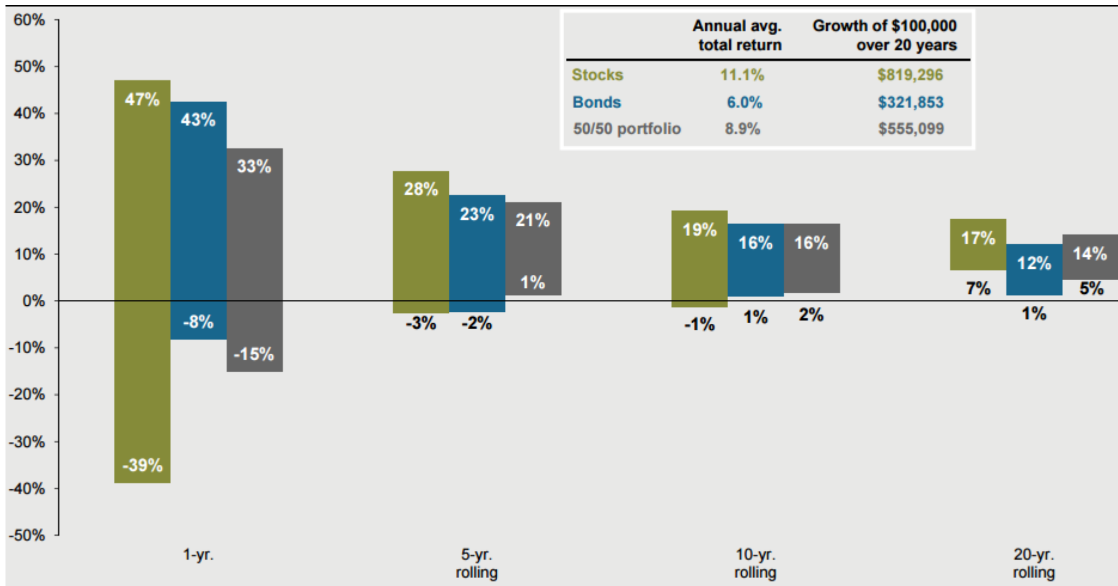
Note: Small stocks in this example are represented by the Ibbotson® Small Company Stock Index and large stocks are represented by the Standard & Poor's 500® Index. Government bonds are represented by the 20-year U.S. government bond, Treasury bills by the 30-day U.S. Treasury bill, and inflation by the Consumer Price Index.

Source: Morningstar, Ibbotson

A key reason investors position themselves conservatively is because they don't want to lose money. That makes sense. In retirement, there generally is not much income coming in, so safety of capital is at top of mind for many. Take a look at Chart II. The range of return one would have experienced from the stock market on a one year basis over the past 65 years is rather extreme. For someone with a time horizon of, say, 3 years, recovering from a one year loss of 10%, 20% or 30% would have been quite difficult. If you extend the time horizon, however, recovering from losses would have been a breeze. In fact, history shows us that losses in diversified portfolios of stocks over the very long term have rare.

Now observe the bars on the far right of the chart. Based on the time period considered, the worst annualized return for stocks over any 20 year rolling period was 7%. If you annualized 7% over 20 years, you'd basically have four times your original investment. And that was the WORST case scenario.

Chart II: Range of Stock, Bond and Blended Total Returns, 1950-2015



Source: JP Morgan Asset Management

Of course, we can't predict the future, but we can guarantee that stocks will continue to be volatile in the short term. When it comes to performance, it's anyone's guess which asset class will come out on top over periods of three, five or ten years. But when it comes to time horizons that are measured in decades, we firmly believe that stocks are the best way to grow wealth for the typical investor.

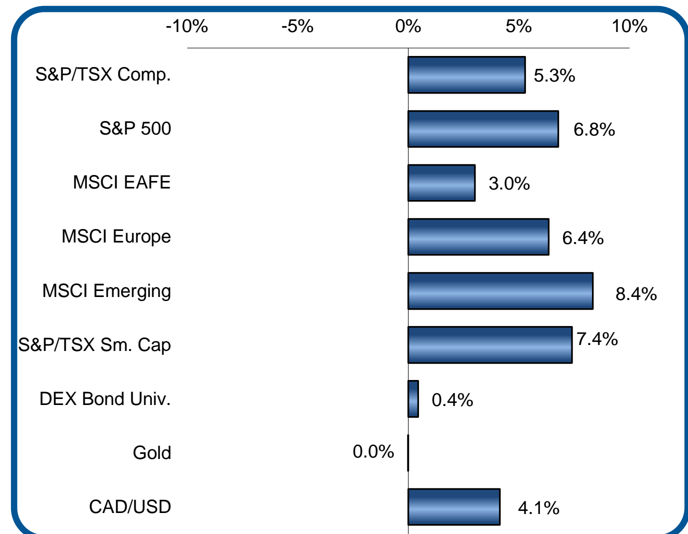
That said, investors with truly long term time horizons needn't worry about the short term fluctuations in stock prices. More importantly, if a retiree is hoping to maintain a lifestyle of a high standard, a portfolio that is at least partially exposed to individual stocks or equity funds where the right combination of earnings growth and valuation are the focus would seem to be in a position where the risk of outliving their savings is reduced. Without such an approach, the simple alternative involves downgrading one's lifestyle, adjusting life expectancy, or some combination of the two. Neither seems like a good option to us.

Everyone's individual circumstances are unique, so please be sure to consult with your advisor to ensure your portfolio is positioned most appropriately for you.

MONTHLY OVERVIEW

After a rocky start to the year, global equity indices posted strong gains in March. The TSX finished the month up 5.3%. Energy stocks were the biggest gainers, climbing just over 9%, as the weaker U.S. dollar fuelled an advance of 13.6% in WTI crude oil. The Canadian healthcare sector saw its value get cut in half due to a plunge in Valeant Pharmaceuticals which reported a fourth quarter loss and slashed its outlook for 2016 revenue. South of the border, the S&P 500 traded up 6.8%, putting the year-to-date performance in the green at 1.3%. Gains were also chalked up overseas; in Europe, the Stoxx Europe 600 Index rose 1.5%, while gains in Asia were much more distinct, with the Shanghai Composite Index up 11.7% and the MSCI Asia Pacific Index adding 8.7%. (All returns in local currency terms).

1 MONTH RETURNS



Source: Bloomberg, All Returns are TR and in Local Currency

Canadian GDP for January grew for the fourth consecutive month at 0.6%, which was double that of market expectations and was also the fastest clip in two and a half years. The roaring start to 2016 was due to robust gains in manufacturing, a jump in the retail trade sector and rebounding exports. Scotiabank Economics projects that Q1 growth is tracking at a 3.7% pace, assuming flat readings in February and March In order for quarterly growth to be less than 3% overall, an average reading of a two-tenths of a percent loss would be required over the next two months.

Canada's second largest industry – manufacturing – has proven to be resilient and has provided much needed optimism so far this year in the face of the commodity rout that had dragged on growth through 2015. January manufacturing sales leapt 2.3%, far exceeding economists' expectations for an increase of half of a percent, and posting a new sales record of $53.1 billion. Eight of the ten provinces exhibited growth, with Ontario leading the pack with a 3.9% gain. In addition, sales growth figures for November and December were also revised upward, to the tune of 1.4% and 1.7% respectively. March's Manufacturing PMI also inched up into expansion territory, to 51.5 from 49.4 in February, after seven months of contraction (PMI figures below 50 indicate contraction). This recent data appears to be providing evidence that strength in non-energy related sectors due to a weaker loonie and strong U.S. economy is finally beginning to materialize. This has been much-anticipated by the Bank of Canada as it aims to shift the economic growth focus away from the energy sector.

In the U.S., all eyes were on the Federal Reserve. As widely expected, the Fed kept its benchmark interest rate unchanged after its two day policy meeting which ended on March 16. Although stronger job gains and signs of economic expansion moving forward were still referenced as means to increase rates, risks posed from global economic and financial developments appear to be increasingly cited as considerations to keep rates low. Based on CME Fed Fund futures data, the implied probability of a rate hike in April is near zero and under 20% in June just ahead of the "Brexit" vote. Based on the futures data, the better half of investors do not expect any rate increases until as far out as December. The employment situation remains resilient, however, with monthly jobs gains continuing to add over 200,000 a month, and the rate of unemployment firmly within the normal long run range as defined by the central bank.

Early in March, the European Central Bank announced additions to its monetary easing efforts. The new package included a 10 basis point cut to the deposit rate to -0.4%, a €20 billion increase to monthly asset purchases to a total of €80 billion, and decreases to both its main refinancing rate and marginal lending rate. In addition, the range of assets to be purchased each month was expanded to include corporate debt as well. This came after Eurozone consumer prices showed a decline of 0.2% in February. The CPI improved slightly in March, however, remained in negative territory at -0.1%. Another interesting development out of Europe is that Hungary's central bank has joined the negative interest rate club, setting its overnight deposit rate to -0.05%. Although the Hungarian National Bank is the sixth to go negative, it is the first emerging market. (See March's monthly for more on negative interest rates).

MARKET OUTLOOK

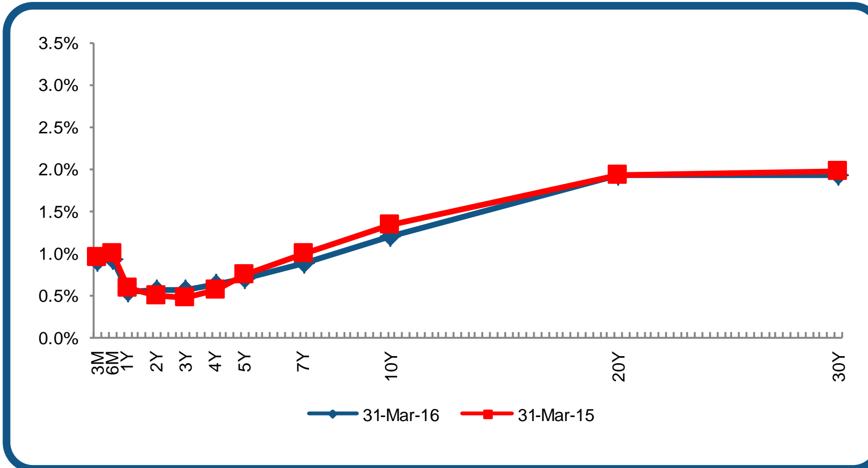
The volatility that sent ripples through global equity markets during the first two months of the year has calmed on the heels of the stabilization in oil prices as of late and a more dovish tone from the Fed as a result of it. It is widely suspected that the Fed could stay on hold until at least the fall given continued investor concern regarding global growth, as well as other economic and political factors including the "Brexit" vote set to take place in June. At home, the BoC is unlikely to change the benchmark overnight rate anytime soon given the upbeat economic data so far this year and as it waits to observe the potential boost from the recent fiscal budget.

Monthly Market Statistics: March 2016

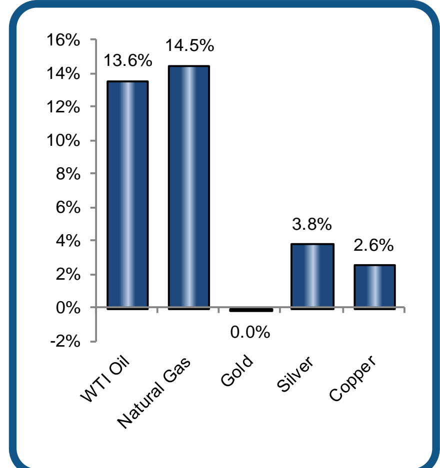
Total Return Index Returns (Annualized After One Year)

	Local Currency Returns							Canadian Dollar Returns						
	1M	3M	6M	YTD	1YR	3YR	5YR	1M	3M	6M	YTD	1YR	3YR	5YR
TSX Composite	5.3%	4.5%	3.1%	4.5%	-6.6%	5.0%	2.1%	5.3%	4.5%	3.1%	4.5%	-6.6%	5.0%	2.1%
S&P 500	6.8%	1.3%	8.5%	1.3%	1.8%	11.8%	11.6%	2.4%	-4.9%	5.1%	-4.9%	4.2%	21.3%	18.3%
MSCI EAFE	3.0%	-6.4%	-0.4%	-6.4%	-10.8%	6.9%	6.7%	2.2%	-8.9%	-1.5%	-8.9%	-5.7%	11.3%	8.9%
MSCI World	5.3%	-1.8%	4.4%	-1.8%	-4.0%	9.5%	9.0%	2.5%	-6.3%	2.1%	-6.3%	-0.6%	16.5%	13.5%
MSCI Pacific	5.1%	-9.2%	-1.4%	-9.2%	-12.0%	7.7%	8.2%	2.8%	-9.6%	1.7%	-9.6%	-5.5%	10.1%	9.2%
MSCI Emerging	8.4%	2.8%	4.4%	2.8%	-7.4%	2.3%	1.7%	8.6%	-0.8%	3.2%	-0.8%	-9.6%	3.9%	2.0%
TSX Small Cap	7.4%	8.5%	9.7%	8.5%	-5.7%	-0.6%	-5.0%	7.4%	8.5%	9.7%	8.5%	-5.7%	-0.6%	-5.0%
Global Small Cap	7.0%	-0.9%	4.0%	-0.9%	-4.7%	9.5%	8.7%	4.0%	-5.4%	1.9%	-5.4%	-1.2%	16.6%	13.3%
CDA Bond Uni.	0.8%	1.4%	2.4%	1.4%	0.8%	3.9%	5.2%	0.8%	1.4%	2.4%	1.4%	0.8%	3.9%	5.2%
CDA 1-5 Yr Bond	0.3%	0.4%	0.9%	0.4%	1.1%	2.3%	2.8%	0.3%	0.4%	0.9%	0.4%	1.1%	2.3%	2.8%

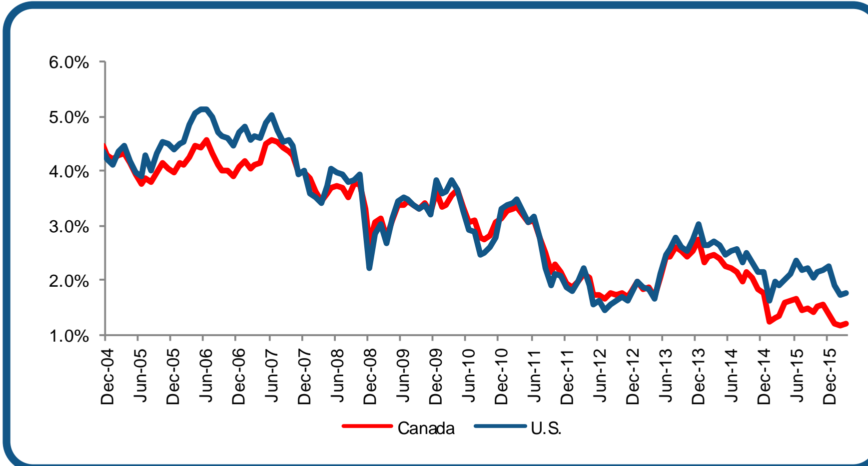
Canadian Yield Curve



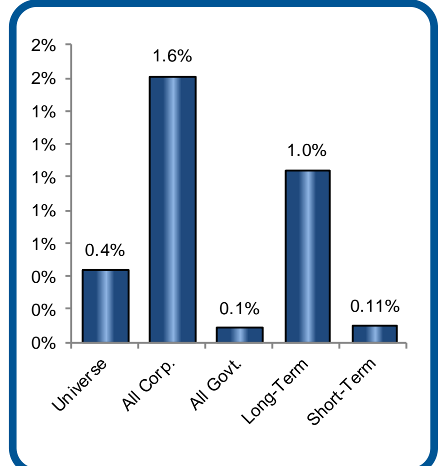
Commodities Performance (1M)



10YR Government Bond Yields



FTSE/TMX Bond ETFs (1M)

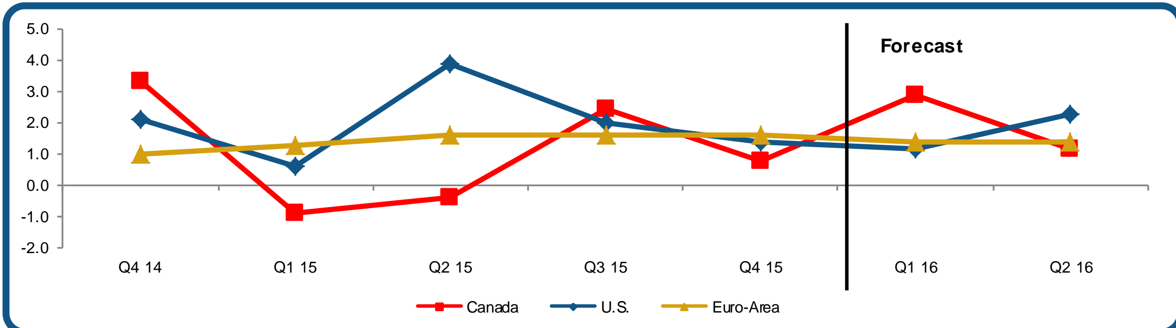


Source: Bloomberg, iShares.ca

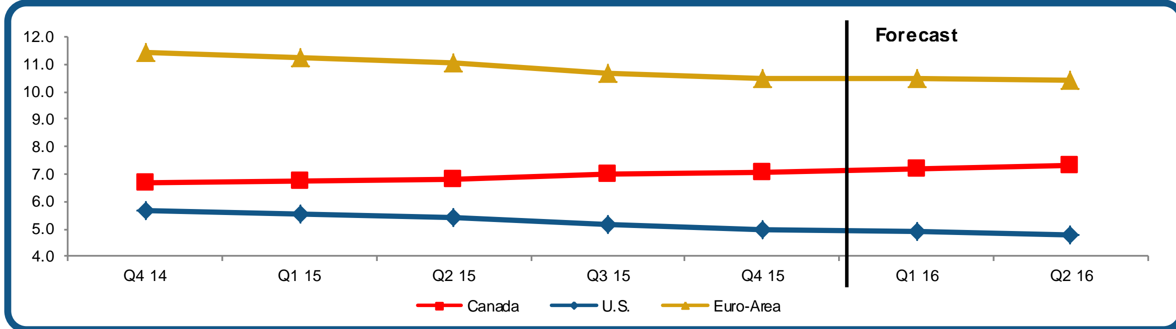
HollisWealth®

Economic Statistics

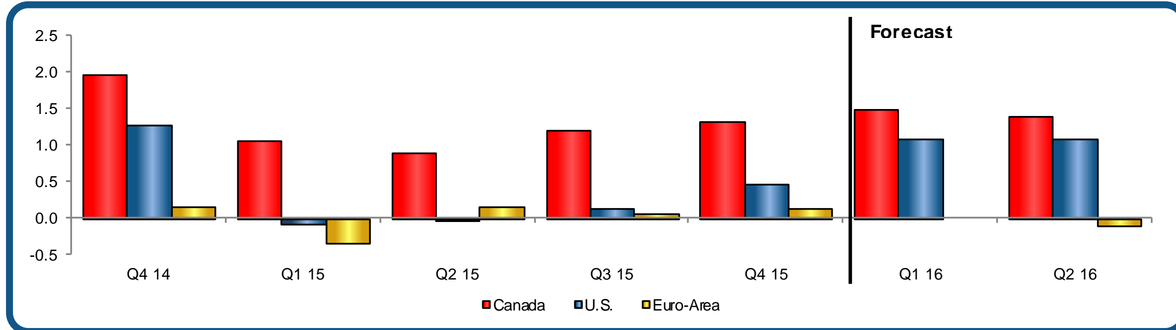
Real GDP (%)



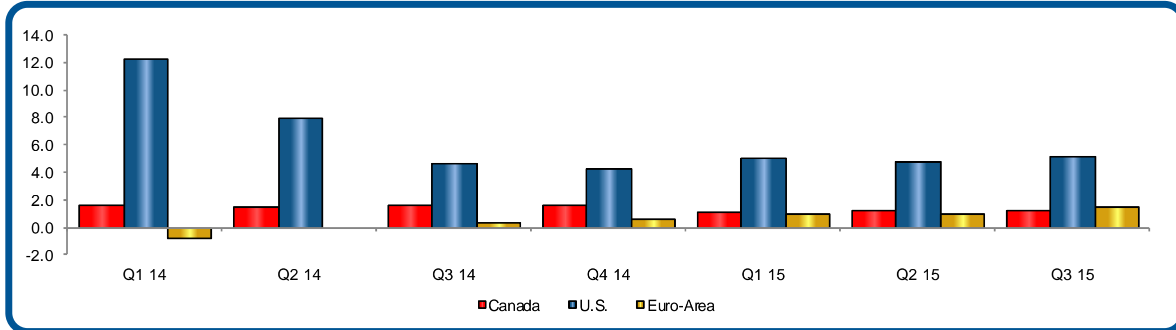
Unemployment Rate (%)



Consumer Prices (YoY %)



Housing Prices (YoY %)



Source: Bloomberg

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