Assante
WEALTH MANAGEMENT

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Important Information:

Your December statements for non-registered accounts contain yearend tax information, including your advisory fees which may be deductible. Please keep your December statements so you can find them at tax time.

The deadline for RSP contributions is March 1st. RSP contribution receipts are mailed out weekly through RSP season, so please watch your snail mail.

Or you can get all this info online by logging into your account at www.assante.com. The login ID and account numbers can be found on your statements.

2017 Review

By now you will have received your 2017 statements, including the rate of return now published on your December Assante statements. Most clients will see their returns for the year were in the 9 -11% range. Even better, clients in the Private Client Program will see 5 year returns in the 10 -13% range.

The 5 year returns are spectacular. They were led by the US markets and we were extremely fortunate to have our portfolios significantly weighted to the US. I don't need to tell you not to expect returns like that for awhile.

One remarkable thing about 2017 was the absence of volatility: the largest decline during the year was about 5% (in April) vs the average intra-year volatility of more than 14%, making 2017 a 1 in 100 smooth ride.[1]

Fourteen percent and no volatility. Nice, but don't expect it to continue. More on this shortly.

Big Picture

The US market returned 19% in 2017 (S&P500), easily outpacing the Canadian TSX at 9%, and especially the Canadian Small Cap Index at a dismal 0.3%. Europe gained 25% according to The Economist, in response to improving economies and very cheap stock prices.

The highest market category returns in 2017 were the eye-popping 28% in emerging markets. These economies had their financial houses in order after their currency crisis of 1998, so they avoided the crisis of 2008-9. Now they are reaping the benefits of their financial discipline and improving global trade. Internally, greater individual economic freedom is driving strong economic growth, as it magically does.

1 Fidelity Investment Research, Leadership Series, January 2018

Government bonds struggled in 2017, as the Canadian bond index returned 2.2% and the Citi World Government Index returned only 0.4%.[2]

Corporate bonds were sharply mixed, as losses of -0.6% in US corporates reflected rising interest rates there, while in Canada corporate bond returns squeezed out yet another positive year, returning 3.5%, as corporate credit quality continued to improve[3].

As of late January, bond yields were moving higher (and prices lower) because the global economy is recovering from the financial crisis. Rising interest rates and falling bond prices (they move in opposite directions) prompted Bill Gross, star bond manager, to claim the 'bear market in bonds has begun'.[4]

Tech Stocks Again

The US market was dominated by technology stocks in 2017, eerily reminiscent of, but not quite the same as 1999. Although the S&P500 technology subindex comprises less than 23% of the total index market value, tech contributed 45% of the total index return: the techs' return of 37% was almost double the broader index of 20%. So a quarter of the stocks by market value contributed almost half the return of the entire index.

Technology in turn is dominated today by the FAANGs [Facebook, Amazon, Apple, Netflix, and Google]. So if you didn't own these 5 stocks, you would have great difficulty keeping up with index returns.

2 FTSE, TMX per Tacita Capital, Citi World per Globefund

3 Source: Tacita Capital, Asset Class Returns, Dec 2017, returns in C$

4 Financial Times, January 29, 2018

The FAANGs are the sharp point of a broader trend of growth stocks outperforming value stocks over more than 5 years. The Russell 3000 Growth Index 12 month return of 30% was exactly double the Russell Value return of 15%, continuing outperformance of 4 and 3 full points/year over 3 and 5 years (to Nov 2017).[5]

The FAANGs are on a collision course with public reaction to wildly profitable monopolies strongly shaping public opinion via compulsive/addictive behavior, while accepting zero responsibility for any of it. Time will tell, but the regulatory drums are already beating sharply louder in Europe…

Value vs Growth Style

Growth-style stocks, especially the FAANGs referred to above, have led the US markets since the crisis, but value-style stocks are widely recognized to have generated the higher returns over longer periods. Most of your managers are value managers, so their performance will tend to lag in markets such as this.

Asset Mix

Much more important is that the US managers' returns were far greater than their Canadian counterparts, and your portfolio actually had a significant allocation to the US.

Asset mix is more important than performance <u>within</u> an asset class.

This is because the difference between asset classes, such as US and Canadian equities, is usually greater over time than the difference between best and worst managers within the asset class.

5 RBC Global Asset Management January 2018

So the fact that you actually experienced the 5-year returns between 7% and 12% puts your experience far beyond most Canadians, who have more like 5 or 6% of their investments in the US, according to industry data.

Making Sense of Returns

Interpreting investment returns is one of the trickiest things in investing. Insight requires context from comparison to other things, such as your financial plan, other similar managers, and various indexes, which in turn, requires understanding how the other things differ from your portfolio, and whether these differences bode well or poorly for the future.

Sounds simple but it isn't. See 'Dunning-Kruger Effect', or 'The Psychology of the Big Mistake', www.chrishoran.ca.

Focus: Managers vs the Index

The table below shows the returns from your managers and indexes. The Canadian small cap managers are grouped separately because their behavior is so much different from the main market.

Canadian Equity

Returns to December 31, 2017

	1 Year	3 Year	5 Year	10 Year
CI Can-Am Small Cap	-0.3%	5.2%	10.7%	8.0%
CI Cdn. Small/Mid Cap	4.6%	6.1%	8.4%	5.2%
Mackenzie Cdn. Small Cap	8.2%	5.8%	10.9%	5.7%
TSX Small Cap Index	0.3%	4.5%	2.5%	-0.7%
CI Cdn. Investment	6.3%	4.9%	9.2%	4.3%
Signature Canadian	15.8%	8.5%	11.2%	5.8%
Mackenzie Cdn. Growth	14.2%	12.4%	16.0%	7.5%
Cundill Cdn. Security	6.5%	3.4%	8.2%	6.2%
SPX TR Index	9.1%	6.6%	8.6%	4.7%
Cdn. Equity Peer Index	6.8%	5.2%	8.4%	3.5%

Source: GlobeFund

US Equity

Returns to December 31, 2017

	1 Year	3 Year	5 Year	10 Year
CI American Small Co.	6.0%	10.0%	17.3%	9.2%
CI American Value	9.6%	8.9%	17.0%	7.5%
Cundill US	6.5%	8.2%	16.2%	7.2%
Mackenzie US Mid Cap (H)	16.2%	7.0%	11.8%	9.1%
Mackenzie US Mid Cap	11.0%	11.1%	17.6%	12.7%
Mackenzie US Growth	14.8%	8.7%	-	-
Russell (3000) Growth US$	30.8%	15.4%	16.9%	11.2%
Russell (3000) Value US$	14.5%	10.3%	12.7%	7.7%
S&P 500 TR (C$)	13.8%	14.4%	21.3%	11.1%
S&P 500 US$	19.4%	9.1%	13.4%	6.2%

(H) = Hedged
Source: GlobeFund; Russell per FTSE Russell, returns in USD, to Feb. 2, 2018

Managers Beat the Index

Index returns are theoretical and do not include management or advisory fees, so they do not compare directly to your manager returns, which have both management and advisory fees deducted. Management fees vary, but for rough illustrative purposes, an index management fee is around 0.5% in Canada, and my Assante advisory fee is 1% to total around 1.5%. So to compare the manager to the index you would deduct 1.5% from the index returns in the table.

You can see that the Canadian managers trounce the index in the 5 and 10 year timeframes, and all but Cundill Canadian are equal to or better than the index over 3 years as well (you'll have to deduct the 1.5% fees in your head). Small cap managers have hammered the small-cap index over all periods, and even beat the TSX over 3, 5, and 10 years.

So let me put an end to the idea that managers don't beat the index. As I have always said, 'Sometimes they do, and sometimes they don't.' But most of your Canadian managers, apples to apples, over the 3, 5, and 10 year horizons, have.

And not just by a little bit. Over 5 years to December 2017, all your Canadian Equity managers but one beat the index by 2 – 7 full points/yr. Dina DeGeer's Canadian Growth beat the fee-adjusted index by almost 9 full points per year over 5 years. More importantly, many of you have had DeGeer in your portfolio for many years, including the last 5.

So next time someone tells you that managers don't beat their index, pull out this newsletter and slap them about the head … Seriously, the performance gap in Canadian Small Cap - the index producing a loss over 10 years while the managers return 5%, 6% and 8% per year - would be unacceptable to you.

Currency: The plot thickens

The S&P500 index is shown two ways: to a US investor (called 'local currency'), and in C$, which is how a Canadian investor would see it. Interpreting US investments is more complex because of the currency fluctuations. A decline in the C$ boosts the return from USD investments, and vice versa.

You can see that the S&P500 index 1 year return in C$ is lower than the USD return. This is because the C$ strengthened during 2017, making US investments less valuable. However, the 3, 5, and 10 year returns are higher in C$ because the Loonie has weakened over those periods.

Currency also complicates the interpretation of your US managers' performance. You could say that you want your manager to 'beat the index', but which one? Before currency or after?

You can't just say 'whichever does better', because that would require foresight of currency fluctuations, which is impossible. Since most managers partially hedge the currency, my advice is to expect the manager to be roughly in between the USD and C$ returns of the index. You can see that this is generally the case in the 5 and 10 year timeframes. Shorter timeframes such as 1 and 3 years have more variability, which is understandable.

Synchronized Global Growth

The centre of the emerging world is China.

It is very exciting from a global human welfare perspective to see a billion people in China alone moving out of the $400/year poverty of communism. Americans like to demonize the Chinese, but the improvement in Chinese living standards over the past 30 years may be the biggest improvement in the largest number of lives over the shortest time in human history. The Chinese middle class population is now the same size as the United States (about 105 million).

We should celebrate that the Chinese are adopting Western-style individual economic freedoms as fast as they possibly can. Americans whine that China isn't a democracy, but there is almost nothing today about US democracy that anyone wants to emulate. (One big point about democracy is you get to change your leaders. We and the Americans can only hope to do a better job of that ourselves.)

Five of the world's large developing populations – China (1.5bn), India (1.2bn), Philippines (100m) and Malaysia (30m) are sporting economic growth rates over 6%. Pakistan (180m) and Indonesia (250m) are over 5%, and Turkey at 75 million is growing at 11% (all figures from The Economist).

Other global short points

The zeitgeist today is strongly reminiscent of the 1980s – the markets are cooking along and nobody believes it can last. All through the 80's news (papers, in those early days of your advisor's career) referred to the market 'recovery', as if markets were tentative, recovering, trying to get back to where they were before the 20% interest rates and crushing bear market of '81-'82.

Meanwhile, markets spent most of the 80s making new highs in what turned out to be the greatest bull market of all time. It wasn't until the next decade, the 1990's, that media began to refer to the 80's as 'the go-go 80s'; and only then to raise anxiety about the 90s...

So don't expect media writers, whose only goal is to disturb you so you keep clicking, to be writing about how great things will be.

The negative perception today has much to do with the narrow, self-reinforcing nature of digital newsfeeds. News, as always, tolerates very little room for positive thinking. Optimism is greeted with a derisive sneer, as if people with a positive view are obviously short a few facts.

So here are a few facts:

US unemployment at 4% is the lowest in 17 years. A weakening US dollar is a boost for US manufacturing exports, and will naturally shrink the US trade deficit. The US corporate tax package reduces US corporate tax from among the highest in the world closer to average, providing an incentive for companies to repatriate offshore profits and invest in the US.

Canada, Japan, Mexico and the others (except the US) are proceeding with the Trans-Pacific Trade Agreement (TPP). The TPP is exciting because it is providing leadership to the US, and because the positive power of trade is widely misunderstood by the anti-globalization crowd.

Surging global economic growth boosts the fortunes of global US companies from Caterpillar tractors to P&G cosmetics.

Brazil and Venezuela

Two unfortunate dark spots: one is Brazil, struggling with democracy as 40% of its congress members are under investigation for corruption. The other is Venezuela, with the world's largest and most accessible proven oil reserves, has been wrecked by the late and former socialist hero Hugo Chavez. Venezuela is now forecast by the Economist to contract by more than 12% this year – a total 20% peak-to-trough decline (to date) in GDP and 40% decline in per capita GDP. The shelves are empty, the population is fleeing, and chaos looms.

The unfortunate part of the Venezuela saga is that it was so unnecessary and so predictable. As Margaret Thatcher said, 'The problem with socialism is you soon run out of other people's money'.

Market Correction Imminent?

Of course. Yes, of course a correction is imminent. Normal intra-year volatility is 14% and we haven't had so much as a ripple on the pond since February 2016, while the market is up 50% in that time. Forget the crystal ball, a pet monkey can tell you we should expect a correction. Any time now.

The point was pounded into the ground like a proverbial tomato stake in the November newsletter, 'Move to Cash?': the fatal error is to accept the implied imperative from the pet monkey that 'you should do something about it'.

Because the future hasn't happened yet, you have no idea when a correction will begin; no idea how much the market will go up before it begins; no idea how far it will fall when it does happen, and so you have no idea when to get back in.

You have to be exquisitely correct twice, which nobody has been able to do consistently.

The way to handle the expected correction is the same way we have always handled them: First, expect it. Corrections are as common as winter (literally) they just aren't as predictable. When you know they are normal, you begin to lose the urge to 'do something'.

Second: ignore it. It's what experienced investors, from Warren Buffett on down, all say to do[6].

In the meantime, synchronized global growth is looking good.

6 Mainstream media writers and bloggers don't have any money of their own and they don't have responsibility for other people's money; if they did, they'd be running a financial advisory business and earning multiples of their writing income. And they would NOT suggest you try and time the markets

Book Review

Reclaiming Conversation: The Power of Talk in the Digital Age
Sherry Turkle

The book is a fascinating look into the unintended consequences of the hyperconnected digital world. Turkle's interviews and research over many years reveal how the addictive snippets of digital noise, masquerading as communication, take us unwittingly into an unsatisfying, superficial world, away from the deeper human connections that are the foundation of understanding, and a rich personal life.

Young people reveal growing discomfort or anxiety with face-to-face personal conversation. They prefer texting because multiple edits allow them to 'curate' themselves to perfection before hitting 'send'. But this curated perfection is not their true selves; it is a façade. Fake news.

Face-to-face conversation is where we learn and practice the 'empathetic arts': to make eye contact, to listen, and attend to the feelings of others. Turkle finds people with extensive digital interactions detect a dissatisfaction with the shallowness or lack of emotional intimacy in their relationships.

Constant digital connection encourages compulsive device-checking, even at the most intimate moments, which is an obvious distraction from the person you are with, (who can resist their device when the little light is winking at them?) with predictably destructive results.

Turkle shows how real time face-to-face conversation allows the mind to wander much deeper into the connection with the other person. A conversation can meander into places neither person imagined at the beginning. Conversation is much more effort, stressful, even risky, because in real time you can't 'curate' yourself. But it's much more honest, the real you, and therefore the connection is much more rewarding.

Even the silences, for instance, in conversation have a profound role: the unconscious mind can fill a silence with a creative idea, or sometimes a silence provides the emotional bond of a shared experience. Silence in a digital exchange is the opposite; it's a distancing or disconnect.

Sherry Turkle is the Abby Rockefeller Mauze Professor of the Social Studies of Science and Technology at MIT.