Chris Horan
Financial Advisor

CI ASSANTE WEALTH MANAGEMENT

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Assante Capital Management Ltd.
4211 Yonge Street
Suite #222
Toronto, ON M2P 2A9

Phone: (416) 216-6532
Email: choran@assante.com
Website: www.chrishoran.ca

Chris provides financial planning, investment planning and full implementation services to about 100 families.

We are pleased to welcome new clients. New clients should have $1 million or more of investable assets.

The Signal and the Noise

As a glorious summer gave way to fall, we have returned to a degree of social normalcy – even a couple of dinner parties with friends - and investment markets continue well, climbing the Wall of Worry, as they tend to do.

In the 4th week of August the US market (S&P500), representing the market value of the 500 largest publicly listed companies in the United States, reached 4486. The significance of this number is only that it is double the low of March 2020, the bottom of the Covid Bear Market. As I write in mid-November the S&P500 is around 4700, a glorious 39% above the pre-Covid high.

Correction Imminent?

Correction? Yes. Of course. Imminent? As always. Sorry, but the market declines every year at some point, and the average of those declines is 14%[1]. And no, we don't even try to miss the declines. Some people do, because it looks easy. Peter Lynch said 'More money has been lost trying to avoid the declines than in the declines themselves'. Warren Buffet said he doesn't know anyone who knows anyone who can do it consistently.

Good news: you don't need to time markets at all to be very successful investing. Ten years ago the S&P500 was around 1200. The arguments in favor of trading out back then were exactly the same as today: the recovery will stall, market is overvalued, and on and on. We did actually experience corrections of almost 20% in October 2011, 10% in September 2015, January 2016 (worst start to a year since the 1930s!!), November 2018, and the bear market of March 2020. Yet today we are at 4700, almost 4-fold higher.

1 JP Morgan, Guide to the Markets

This demonstrates clearly the foundation of our investment philosophy: **'The declines are temporary, the advances permanent'**. The buy-and-hold investor does well – twice the average, as we will see. Corrections are the noise. The trend is the signal.

Investor Behaviour

Dalbar, a leading US market research firm, recently updated its data on how the average investor has fared over the last 20 years. The message: very poorly.

20 years, September 2021, annualized

Real Estate Index	10.0%/yr
S&P500 Index	7.5%
60/40 Portfolio	6.4%
40/60 Portfolio	5.9%
Bond Index	4.8%
Average Investor	**2.9%**
Inflation	2.15%

JP Morgan Guide to the Markets, September 2020 p 64

The numbers show that the average investor dollar had a return of 2.9% per year over the 20 years to September. This is 3.5% less per year than the 6.4% from a portfolio of 60% equities 40% bonds, 3.0% less than the 5.9% from a more conservative 40/60 mix, and almost two full points per year less than bonds. Per year.

The reason for this terrible but typical investor underperformance is because people tend to trade too much and poorly, invariably putting more money into something that has already gone up, and fleeing after it has gone down. Successful investing requires the opposite.

You can see that if we do nothing more than prevent these 'Big Mistakes', the investor's return increases by somewhere between 2% and 4.5% per year. Probably the most important value I provide is helping people avoid these Big Mistakes. The benefit of counter-instinctive behavior is a return two or three times what your neighbor is likely to earn. Thus I say, the value of good advice is multiples of my 1% fee.

Signals and Noise

Our Stone-Age brains are hardwired to be super-sensitive to danger signals. Alarm is the default response to novel stimulus. This worked well on the savannah 10,000 years ago, but it doesn't work so well today, when we are drowning in useless noise. Fighting the noise, focussing on the signals.

The signal is the important information, the recurring patterns that guide us towards our investment policy that historically has not failed. Noise is all the data points flying at you like snowflakes hitting your car windshield at night. Noise is the jagged interruptions of the signal that conspire to throw you off your course.

Classic examples of signals are:

- the long term return equity markets is 10% per year; this turns $1 invested in 1990 into $2,500 by 2020
- 75% of annual returns are positive;
- 84% of 3-year periods are positive;
- 97% of 5-year returns are positive.

Classic examples of noise are:

- The 57% decline in equity markets over 08/09 as the US banking system was detonated
- The 49% decline in 2000/03 as the tech stocks blew up
- A flu pandemic, inflation at a 30-year high, and so on.

Not only does the noise of daily news distract us, the noise in investment markets themselves drowns the signal. We all know equity markets are volatile. Very volatile: the average intra-year volatility of 14% discussed above completely swamps the long-term return of 10%. News media exploits our alarm reflex with deadly efficiency. The signal is lost in the noise.

Data vs Anecdote

Much of our opinion about Covid is based on anecdotal evidence. Anecdotes are bits of evidence. They tell us what <u>can</u> happen, illuminating the potential range of possibilities. Anecdotes help open our eyes, and are important in formulating hypotheses to test.

Anecdotes are not data. Forming well-founded views of anything, be it investment characteristics or Covid transmission, is the process of moving from anecdote to statistically robust inference. But as Dierdre McCloskey said, ‘Data does the heavy lifting’. A collection of anecdotes might sketch out the perimeter of something, but data tells you where the centre of gravity is.

Anecdotes are dangerous, both in investing and Covid. It is too easy for an anecdote to leave out a crucial detail that changes the message.

Covid

Covid has turned us into amateur virologists. And it has turned many virologists and professional medical people, and unfortunately, many other people who should not be commenting at all, into powerful purveyors of popular perception.

Editorials and comments by well-meaning and knowledgeable medical people are often misquoted and manipulated by media commentators (who don’t know the difference between a virus and a bacteria) into the most alarming perspectives possible. The pandemic is pure heaven for Trump-starved journalism.

Covid is a case study in the development of strongly polarized public opinions. Starting from rapidly changing scientific information, misunderstood or poorly understood science and non-science, all of which is communicated lightning-fast through politicized lenses. No wonder we’re stressed.

Alarmism

Your advisor has struggled mightily with writing about Covid, because of the strongly-held yet widely-polarized views. A newsletter isn't the place. Books will be written.

I will only say I do agree with Dr. David Fisman of U of T School of Public Health, quoted in the Post October 6, 'The global reproduction number suggests the pandemic is ending: the number of people each infected person goes on to infect is going down; deaths are trending down. I don't think we'll be in this for another year.'

Fisman's comments could easily have made a wonderfully positive headline: **"Pandemic ending" says U of T Epidemiologist**. But instead they were buried in the last 2 paragraphs of a half-page article actually headlined, '(We should) have known this is really bad'.

OK, one comment: What are we seeing in the news? Case rates going up, especially cases in vaccinated people. And especially to make certain political leaders seem inept. Or Florida seem 'crazy'. Of course.

We are not reading about the plummeting mortality, even in places like Brazil, which is now lower than the US, or about Florida, whose current mortality isn't much different from ours. Mortality approaching zero is not scary. Or political.

We are not hearing about how vaccinated people are having almost no trouble with variants: for instance, 98% of people hospitalized with Covid in Ontario as of mid-October are unvaccinated (Globe, 10/22).

We are not hearing much about why Quebec has 15% more total deaths than Ontario, when Ontario has 80% greater population. Or why Alberta's September case spike is given wide visibility in the Federal election, while Quebec's total mortality per capita is about twice Alberta's (Our World in Data, 11/1) … the level of politicization and propaganda here should be disturbing to all of us. Is it public health or is it partisan politics?

The Go-Go 80s

This is much more profound than the trite 'Need to sell newspapers', because today's mass media is reinforcing a mass groupthink and mass depression. My formative example is from the 1980s, when I first entered the business and began studying information. It has been repeated endlessly through my career.

The bear market of 81-82 drove the Canadian equity market down almost 50%, and the Dow Jones in the US down about 27%. The Dow bottomed below 800 in August 1982, and then roared back as interest rates declined and economies boomed. Yet financial journalism remained relentlessly pessimistic all through the 80s, certain that the booming market was a 'dead cat bounce' and stock markets would crash again to hit new lows. As the decade progressed, the Dow Jones doubled, and then tripled, ending the decade around 2500.

The 80s were punctuated by the crash of October 1987 – a dramatic 23% decline in a single day – Proof of the End of the World As We Know It. Except the boom continued for another 13 years, the Dow rising another four-fold to over 10,000.

Here's the thing: it wasn't until the market decline of the early 1990s that financial journalism suddenly switched and began to refer to the 'Go-Go 80s'. I kid you not. The 1980s, the dismal decade of looming disaster, was suddenly transformed by journalistic magic to the 'Go-Go 80s'.

The magical transformation was, of course, merely sleight-of-hand to make the 1990s look bad. The good news is never good news. It is always a foil to introduce by contrast the next disaster.

The critical point to keep in mind is this: **You will never see a news video (or read) about the Covid pandemic being finished.** You may read about Covid mortality hitting new lows, but even this good news will occur only in the immediate vicinity of a claim 'that it could get worse'.

We need to start pushing back against the Covid alarm. See that news media, with very few exceptions (The Wall Street Journal is one exception), will be beating the Covid panic to death until the next panic arrives, at which point Covid will be dropped like SARS in an instant.

We need to work consciously to frame an informed - never mind positive - worldview.

And remember Fisman's quote, '...the pandemic is ending'.

Economic Perspective

Although the economic reopening from the pandemic is a key economic and market driver, it is not the only one. We are experiencing two other unprecedented forces: fiscal stimulus and monetary stimulus, both of which are on cross-currents of inflation/deflation. These cross-currents hold great danger for investors, and the outcome is highly uncertain.

Fiscal Stimulus

Governments have cushioned the economic effect of lockdowns with a flood of money, known as fiscal stimulus, much of which was transfers to individuals. A ton of this cash is sitting on the sidelines: household savings in the US is about $2 trillion higher than normal, waiting to be spent on goods and travel. For perspective, $2 trillion is about 20% of US GDP.

The economy is in early stages of recovery. Demand is recovering faster than supply; so much faster that shortages are everywhere from computer chips to shipping containers, bicycles, boats and cars. Europe and the UK are short of truck drivers and natural gas, and the resultant price spikes are shutting down fertilizer manufacturers, among other things. Europe is also short of natural gas, while China and India are experiencing acute coal shortages. Their energy consumption is up 15% over last year (Economist 9/25). They are booming back.

Shortages have constrained the recovery somewhat, pushing economic growth out into next year: the US economic growth forecast for 2021 was recently downgraded to 5.9%, while 2022 was boosted to 3.8%, according to Drummond Brodeur of CI Global Asset Management. This is not a problem, since growth normally trends at about 2%, so 3.8% is still very strong, providing a solid support for corporate earnings and market valuations.

Monetary Stimulus

In addition to the fiscal stimulus, governments have printed money on an unprecedented scale. This means that the fiscal stimulus referred to above has been paid for, not by taxation (which removes money from people's hands), but by printing new money.

The central banks, who print the money at the government's bidding, have signalled that they intend to begin cutting back, or 'tapering' the monetary stimulus in 2022. Taking money out of the economic system is dangerous and tricky. It's like taking the punch bowl away from the party: remove it too soon and you spoil the party; leave it too long, and you risk a bad (inflation) hangover, or much worse, as the Germans will remind you.

Inflation, Deflation

The fear du jour is inflation. A serious run of inflation like the 1970s would be a nightmare for investors, no question. The 70s were a worse time for investors – particularly retirees - than the 1930s. The German inflation of the 1920s lit the world on fire. The fear of inflation is not misplaced.

Inflation is 'always and everywhere a monetary phenomenon'. It is caused by printing too much money, which dilutes its value. It is obvious that there is a chance that inflation is reignited. The risk is real.

However, today's price spikes are the result of supply disruptions, which are temporary and will likely be resolved as workforces get back to work. Temporary disruptions cause price shocks, especially in the face of strong demand. Price shocks might look like inflation, but they are not. Already lumber prices, after having tripled in the past year, have fallen back to pre-Covid levels in a few weeks as supply comes back into balance with demand (Daily Commercial News, 10/5). This is the way markets work.

My forecast: a year from now, inflation will appear to moderate as these price spikes fall out of the year-over-year comparisons.

Deflation

The world has been facing a deflationary impulse for about 20 years. Inflation and interest rates have trended down, starting in Japan after their real estate bust of the 1990s (and the near-implosion of their banking system), to Europe with their high debt and low growth crisis of the 2010s, and the American's financial crisis, which was both a real estate bust and a banking implosion.

This deflationary trend has bond yields at or near zero in Japan; US 10-year yields are 1.4%; with inflation around 2%, this is a negative yield after inflation. European yields are, most bizarrely, negative before inflation, which means more negative after inflation.

We don't understand the deflationary impulse. We don't fully understand the linkage between money supply, interest rates and inflation like we thought we did. We don't understand why inflation is so persistently low in the face of such significant printing of money. It seems to be a combination of demographics (retiring boomers don't need to borrow like they once did, so economic activity doesn't respond to low interest rates like it did), low-growth policies and high taxes rather than encouraging productivity through capital investment and practical education.

Choppy Waters

Never before has the world faced a global economic shutdown, combined with unprecedented fiscal and monetary stimulus, against this deflationary background. Unwinding the stimulus is a highly uncertain matter and will almost certainly be a noisy affair. Remember the market gyrations of the 'Fiscal Cliff'?

The Signal Again - Stocks as Inflation Hedge

Shares of companies are one of the best long-term inflation hedges. This is because companies can raise their prices to maintain their income as costs go up. The earnings and dividends continue to grow over time, providing support to share prices.

This is on top of the far more important role companies play, which is to develop new products and services to move the world forward. Since 1991 prices have doubled due to inflation, while the dividend of the S&P500 companies has quintupled, according to Nick Murray, long-time industry commentator. In 1991 the S&P500 was about 750; today it is around 4500, six-fold higher.

And this growth looks likely to continue. Dividends paid by companies in the S&P500 were a record $59 in 2020, the year of the pandemic, according to Bloomberg. This year, Bloomberg indicated the S&P dividend will rise again to $61; the estimates for 2022 and 2023 are $66 and $70 respectively. Should these increases materialize, the dividend will have increased by 18% in just 3 years. In fact, Murray says the dividend has compounded since 1960 at an annual rate of 6%, almost twice the inflation rate over the same period.

And the dividend is just part of the equation. Companies don't pay out all their earnings as dividends; they reinvest typically more than half their earnings back into the business in new technology and equipment to improve their product quality, develop new products and so on. Which is where the growth over time comes from. This is why the total return on stocks is more like 10%, not just the dividend growth of 6%.

The Middle Class Kingdom

Looking forward, China has another half a billion people climbing into the middle class. India, encumbered with the bureaucratic burden of the 'Permit Raj', is moving slower, but still expects growth of over 8% for 2021 (Economist).

China's growth alone will add more than half an entire Canadian economy to world GDP each year. China, India and the rest of Asia are estimated to add 1.6 billion people to the middle class between 2020 and 2030, according to the Brookings Institution; a truly astounding achievement in the story of human progress. You can bet that these people will be looking for more of everything from engineering and pilot training to toothpaste and tourism, and that some of this demand will be boosting the fortunes of the world's top 500 companies.

All this adds up to a bright outlook for earnings and equities.

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Book Review

Leave Me Alone and I'll Make You Rich; How the Bourgeois Deal Enriched the World
Deidre McCloskey and Art Carden
University of Chicago Press, 2020, 189pp.

Liberal market economics, commonly called capitalism, is under fire from almost everywhere these days, so it is gratifying to have an excellent book arguing the virtues of liberalism.

Leave Me Alone is a wonderfully readable yet detailed explanation of how liberal economics has enriched the West by some 100-fold, and in a most ethical way. Written with intellectual rigour as well as a touch of humour, McCloskey and Carden occasionally poke fun at themselves, while punching hard - and well - at the critics of capitalism, especially those who think they've done their jobs by pointing out the faults while offering no workable alternative.

The book is a tour of how the lucky adoption of the **idea** of individual liberty, first in Holland and then in England in the 1600s, freed creative minds and gave rise to the incredible number of innovations commonly called the Industrial Revolution. This 'creative destruction' was allowed to overrun the entrenched orthodoxies of the previous centuries and produce the Great Enrichment, the increase in incomes from an average of $3/day before 1700 to over $170/day today (USA, Norway, Switzerland are over $200).

Critics like to claim liberal capitalism is based on greed, colonialism, slavery, oppression, child labour, and so on. McCloskey and Carden take each of these 'Original Sins' apart and show why the Great Enrichment was not dependent on them. Slavery for example was actually the primary mode of societies for all of history, and it was in fact liberalism's respect for the individual that got rid of slavery.

Similarly, alternate explanations (education, science, resources, railways, property rights, capital) are persuasively disassembled as 'not the fairy dust' that produced the Great Enrichment. The idea of individual liberty is really the key difference.

Probably the most important message, and one that will (and should) undoubtedly disturb the critics of capitalism, is that a liberal market society occupies the ethical high ground of fairness and equality. Because each individual is unique, it is not possible for any of us, much less the state, to know what is best for another individual. Economic externalities, the interventionists' favorite excuse, are almost always a reason for me to coerce you into something that I think is good. Liberal capitalism isn't perfect, but holding individual rights paramount is a good starting point.

McCloskey is Distinguished Professor Emerita of Economics and of History, and Professor Emerita of English and of Communication, at the University of Illinois at Chicago, and author of two dozen books. Carden is Professor of Economics at Samford University in Birmingham.