THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

IN THIS ISSUE:

Volume 14 – Issue 6 **September 2023**

STAN CLARK
Senior Wealth Advisor

Once we humans reach an opinion, we don't like budging from it. As I explain in this month's behavioral finance article, *cognitive dissonance* is the discomfort we feel when confronted with new information. We have to be wary, as this dissonance can lead us to uninformed decisions, including in our investments. Michael Chu looks at the benefits of international diversification in stocks as opposed to buying only U.S. ones. Thinking of that all-important first home purchase? Tom Cowans has strategic advice for both buying now – and planning long-term.

Stan

Stan Clark is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

Behavioral Finance

BEWARE OF COGNITIVE DISSONANCE: IT UNDERMINES FACTS, LEADS TO POOR INVESTING DECISIONS

By Stan Clark, Senior Wealth Advisor

When we humans reach an opinion we often stick to it, no matter what. Psychological research shows that even a host of countervailing facts may not be able to budge us one inch from that opinion.

Let's look at a major cause of this common phenomenon, known as *cognitive dissonance* – and how it can undermine facts and lead to poor investing decisions.

Cognitive dissonance is the mental discomfort we feel when new information conflicts with our previously held ideas or beliefs. By making us reluctant to accept the new information, cognitive dissonance is a significant source of confirmation bias. It is also our tendency to seek, interpret or remember only information that confirms our preconceptions.

It leads us – and please bear with me here – to engage in what's known as *dissonance reduction*. That is, we try to resolve our discomfort by tending to notice and accept only information comforting to us. We ignore or modify information that conflicts with existing beliefs. And, we tend to consider or remember only the information that confirms our existing beliefs.

Most people try to sidestep situations that give rise to cognitive dissonance. To avoid psychological conflict, some will even ignore potentially relevant information. Instead, to maintain psychological stability, they rationalize holding fast to their beliefs and understandings.

Consider smokers. They almost certainly know that smoking is unhealthy. But, used to the relaxation of lighting up, they tend to ignore the evidence or minimize the likelihood that smoking could seriously affect them.

So, what has all this to do with investing?

Often investors similarly go to great lengths to rationalize their previous decisions. This happens especially when they've based those decisions on highly subjective factors. To protect their rationalized decisions, these investors may go so far as to avoid selling when the investment proves to be a mistake. This allows a losing investment to get even worse.

Cognitive dissonance may also prevent them from selling something they've made a profit on, even when it becomes overpriced, as in a stock bubble. Such bias may well be what kept many people from selling their tech stocks in early 2000; or from selling their Las Vegas real estate in 2007, before prices collapsed.

Investors may also turn down the chance to buy stocks they've been negative about – even when conditions change or prices fall low enough to make the stocks worthwhile. For instance, very few people saw the financial crisis building to the extent it did in 2008. And, of those who happened to sell before the stocks fell, very few would have been able to change their minds quickly enough to buy back in when those same stocks hit their lows in early 2009.

What can you do to avoid the errors caused by cognitive dissonance?

When you are uncomfortable about something,

TEAM TALK

Sylvia Ellis
Senior Estate Planning Advisor

Sylvia & Mom in Austria - March 2023

You had planned to visit Austria with your mother in 2020 and were finally able to in March 2023. How was the trip?

My mother hadn't been back "home" for many years. Seeing her reunite with her brother and sister was incredibly special. Her sister, Mitzi, lives in Graz and brother, Sepp, in a small town called Dechantskirchen. We met at Sepp's home along with several of their friends. We also stayed at the same hotel where my parents had their wedding reception 62 years ago. It was fun. Thankfully my cousin and Aunt Mitzi speak English!

Any other highlights?

My husband, Craig, and his family were in Ireland at the same time for his birthday, which is on St. Patricks' Day. I flew over to meet them to celebrate. Everyone told us that going into Dublin on St. Patrick's Day would be super crowded. With half a million people there, they were right! At least we could say we've done it.

stop. See if you can find the inner conflict that's making you feel that way. Always be on the lookout for behaviours and decisions whose main purpose is to reduce the mental discomfort you may have about new information – and about opinions that conflict with your views.

Above all, don't become married to your beliefs. Don't grow overconfident about their accuracy.

Recognize that you are human and that almost any belief or opinion you hold could be contrary to the facts. As Mark Twain said, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."

Try to adopt the view that being able to admit you're wrong and change your mind is a sign of wisdom and maturity. Your portfolio will thank you.

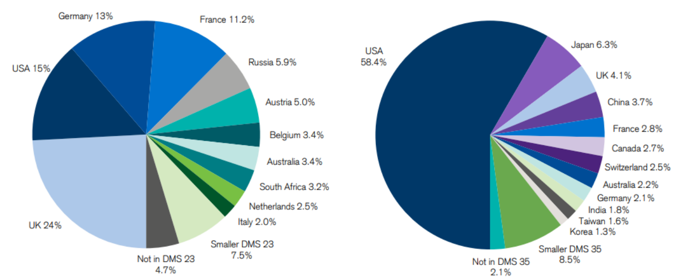
Asset Allocation

THE CASE FOR INTERNATIONAL DIVERSIFICATION

By Michael Chu, Senior Wealth Advisor

The United States currently makes up about 60% of the global stock market by market capitalization. Of course, mixes ebb and flow over time. The graph below shows the sizes of stock markets around the world at the end of 1899 vs. the start of 2023. As you can see, the U.S. stock market was only 15% but has since grown to dominate the rest of the world.

Relative sizes of world stock markets
end-1899 (left) vs. start-2023 (right)



Sources: Elroy Dimson, Paul Marsh and Mike Staunton, DMS Database 2023, Morningstar; data for the right-hand chart from FTSE Russell All-World Index Series Monthly Review, December 2022. Not to be reproduced without express written permission from the authors.

Even when we look at just the past decade, U.S. stocks won hands-down vs. their foreign counterparts. So the question arises: What's the point of owning international stocks? A valid question, not just in terms of performance, but also in that the U.S. has the majority of the biggest and best companies in the world. And many of these companies are multinational and get a decent portion of their revenues from overseas. So again, based on this, what's the point of owning international stocks?

Chart #2: America vs. The World (Annual Returns)

Timeframe	World ex-US	S&P 500
1970-1978	10.9%	4.6%
1979-1984	9.8%	15.4%
1985-1988	41.4%	17.8%
1989-1999	7.8%	19.4%
2000-2007	6.1%	1.7%
2008-2021	3.6%	11.0%
2022-2023	-3.0%	-8.1%

Source: Ben Carlson

Well, as usual, the devil is in the details. Ben Carlson of Ritholtz Wealth Management did a study going back to 1970: U.S. stocks were up 10.5% on average, while international stocks were up 9.1%. The U.S. stocks were still faring better, but not by a huge margin. Interestingly, the annual win percentages were about the same: The U.S. stock market was better 28 times and international stocks were better 25 times. Above are the annualized returns over various periods.

As you can see in chart #2, U.S. stocks enjoyed a huge run coming out of the Great Financial Crisis in 2008. But international stocks did much better in the 1970s, '80s and early 2000s. Much of the U.S. outperformance has taken place during the latest cycle. In fact, if we look at returns from 1970-2012, the annual returns between U.S and international stocks are almost exactly the same.

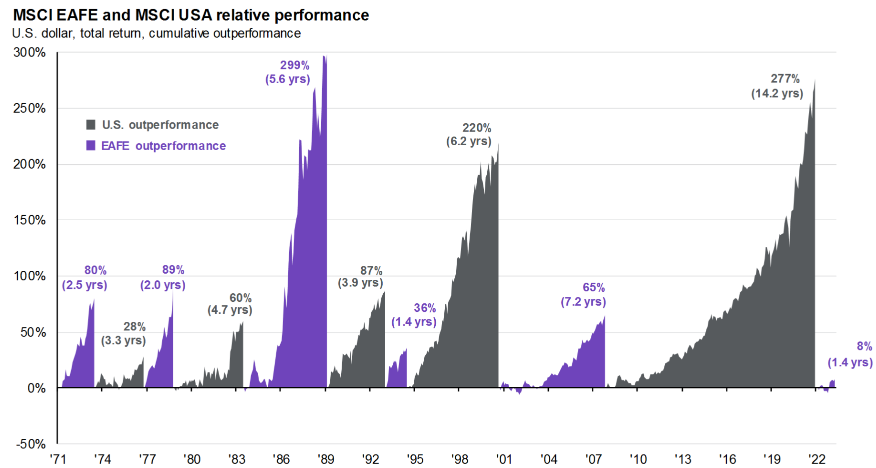
Chart #3 does a good job of visualizing the length of relative performance. With a very long 14-year run for U.S. stocks, perhaps a reversal is in order?

Cliff Asness of AQR Capital Management has also put out a research piece about the strength of U.S. stocks. Asness says that since 1990, the vast majority of the U.S. outperformance has been due to changes in valuations. In 1990, U.S. valuations were about half compared to international stocks. But at the end of 2022, U.S. stocks were 1.5 times international stocks. If you adjust for the tripling of valuations, then the difference in earnings growth is not significant. Chart #4 is a visual representation of how valuations have changed.

Basically, international stocks went from being relatively expensive to relatively cheap, while U.S. stocks went from relatively cheap to relatively expensive. Will this trend continue? It's possible, but probably not. AQR concludes, "International diversification is still worth it, even if it hasn't delivered for U.S.-based investors in 30 years. Most of the U.S. equity outperformance during this period reflects richening relative valuations, hardly a reason for raising or even retaining U.S. overweights today. If anything, historically wide relative valuations point the other way. Today is an unusually bad time to take the wrong lessons from the past. Unfortunately, rarely has doing the right thing been so hard (and it's never easy)."

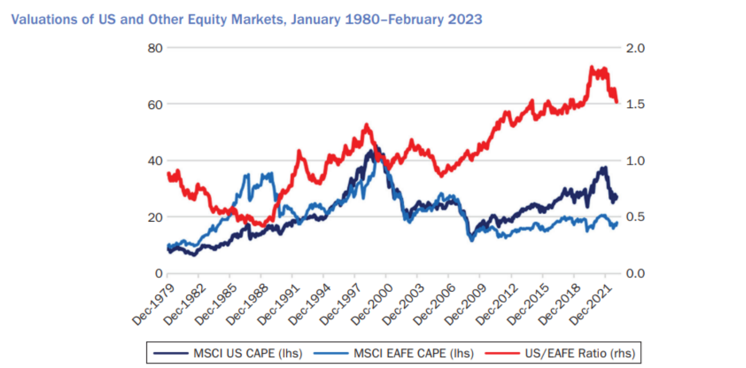
Diversification is hard because there's always something that's going to underperform – but nobody knows what it will be. If we only knew someone who could predict the future, there would be no need to diversify. Perhaps the lesson from all this is that we should just view diversification as giving up the ability for a grand slam so you don't strike out at the plate. Or, going for that huge golf swing over the water... We might hit it over, but more times than not, it's better to take two conservative and more reliable shots. Investment-wise, this is like accepting good and consistent returns to avoid the potential for terrible returns.

Chart #3



Source: FactSet, MSCI, J.P. Morgan Asset Management.
Regime change determined when cumulative outperformance peaks and is not reached again in the subsequent 12-month period.
Guide to the Markets – U.S. Data are as of April 30, 2023.

Chart #4



NOTES: Country-level CAPE (cyclically adjusted price-to-earnings ratio) metrics are created by comparing the recent equity index price with 10-year past average earnings. The EAFE composite is created by taking country-level data and weighting it according to the MSCI weights.

SOURCE: Bloomberg, MSCI, Consensus Economics.

Michael Chu is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Michael is a specialist in investment research and information technology.

Financial & Estate Planning

BUYING YOUR FIRST HOME

By Tom Cowans, Wealth Advisor

You've finished school. You've got the job. You're settled in your city. What's next? Buying your own home, of course!

Buying a home is often the first – and largest – financial decision people ever make. Your first step: Look at what you can afford and how you will pay for it.

You will need to save for your down payment – at least 20% to avoid the Canada Mortgage and Housing Corporation (CMHC) insurance premium. You'll also need to save for closing costs, typically 2% to 5% of the purchase price. And be sure to budget for any strata/ maintenance fees and property tax.

If you're like most home buyers, you will have to finance your purchase with a *mortgage*, a loan that uses the home you buy as security. Your mortgage payments build your personal equity, as opposed to renting, where your money goes directly to the building or unit owner.

When you apply for a mortgage loan, your credit score will factor into the interest rate you pay. The higher your credit score, the easier it is to get a loan at a lower interest rate. Personal finance expert and author Preet Banerjee, host of the Oprah Winfrey Network's *Million Dollar Neighbourhood*, and financial panelist on CBC's *The National*, provides tips on when buying is more attractive than renting. Banerjee advises you to:

- Have a sufficient down payment saved up.
- Consider staying put once you do buy (for at least 10 years – with the option to rent out during that time).
- Have enough money left over every month for both saving and living a balanced life – this ties in with how much of a down payment is required and how much you feel comfortable putting down. Ideally you should still be able to contribute to your retirement savings as well as building equity in your home.

In the long term, owning a home is typically a wise investment. Home prices usually rise with inflation. Over time the return on this kind of investment (especially when factoring in the impact of leverage) can be substantial, coupled with the fact that principal residence sales are not currently subject to capital gains tax.

Buying your first home and building equity is your first step on the property ladder. It gets you into the housing market and allows you the potential to trade up to better homes as your circumstances allow. The key to your first purchase is to be creative and strategic in your approach. You will likely have to compromise on your first home; that's okay. Stay focused on the long-term opportunities that being on the property ladder can bring.

Buy to wait instead of waiting to buy

Realize that your first place likely won't be your last! Despite real estate prices continuing to rise across many parts of Canada, the recent development of work-from-home technologies and the improving transit infrastructure have opened up real estate possibilities that weren't possible before.

Your first purchase will likely not be perfect. Try to compare buying your first place to getting your first job. You can upgrade your job, right? Well, you can also upgrade your home! You can either wait for the upgrade to happen – or you can plan for the upgrade and eventually make it yourself.

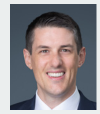
Here are other tips for first-time home buyers:

- Make a wish list of wants vs. needs. Identify what is important to you, e.g., if you don't have a car, being near transit is a need.
- Talk to a mortgage broker or your bank about your financing options. Interest rates are currently a lot higher than they were one to two years ago. It is worth looking at shorter-term options, depending on where interest rates are forecast to be in the next few years.
- Find a realtor who is right for you.
- Have patience! The right place will come along.

One source of down-payment funds for a first-time buyer can be a tax-free withdrawal from a Registered Retirement Savings Plan (RRSP) under the Home Buyers' Plan (HBP). I encourage you to check out the CRA RRSP Home Buyers' Plan online. You'll see that this plan allows you to withdraw up to $35,000 tax-free from your RRSP for the purchase of your home, with the caveat that these funds must be re-contributed in the following 10-12 years.

In late 2022 the federal government passed legislation to create the new Tax-Free First Home Savings Account (FHSA). This new registered plan will give prospective first-time home buyers the ability to save $40,000 (annual contributions capped at $8,000) on a tax-free basis towards the purchase of a first home in Canada.

Like an RRSP, contributions to an FHSA will be tax-deductible. Withdrawals to purchase a first home, including from any investment income or growth earned in the account, will be non-taxable, like a TFSA. The new legislation confirms that a first-time home buyer can use both the FHSA along with the existing HBP to purchase their first home. You will also be able to transfer your annual $8,000 contribution limit from an existing RRSP. CIBC Wood Gundy anticipates launching this account in early 2024.



Tom Cowans is a Portfolio Manager and Wealth Advisor for the Stan Clark Financial Team at CIBC Wood Gundy.

SCFT Trivia

Play our trivia – support the cure!

For every correct entry we receive in our trivia contest, the Stan Clark Financial Team will contribute $1 to CIBC's "Run for the Cure" to raise money for breast cancer research. Each correct entry will also be entered into the draw for this month's prize. Email or phone in your entry today.

Answer all four questions to be entered into the draw for this month's prize. *Hint: You can find the answers inside this newsletter.*

1. Cognitive dissonance is the mental discomfort we feel when new information conflicts with our previously held ideas or beliefs. The effect of this dissonance can be that we:

   a) Undermine the importance of facts and make poor investing decisions.

   b) Become reluctant to accept any future new information. The dissonance thus becomes a significant source of confirmation bias.

   c) Decide that the only way to maintain our psychological stability is to cling to our previous understandings of situations.

   d) All of the above.

2. When new information comes our away, we can avoid the discomfort of cognitive dissonance by:

   a) Simply ignoring the new info. What we don't know can't hurt us.

   b) Seeing if we can find the inner conflict that's making us feel that way.

   c) Remembering the reasons why we developed our existing beliefs in the first place.

   d) Thinking of existing beliefs as old friends. Why abandon them?

3. In a study going back to 1970, Ben Carlson of Ritholtz Wealth Management found that U.S. stocks did better than international stocks 28 times, while internationals did better than U.S. ones 25 times:

   a) True b) False

4. For first-time home buyers, one source of down-payment funds can be a tax-free withdrawal from a Registered Retirement Savings Plan (RRSP) under the Home Buyers' Plan (HBP). With this Plan, you:

   a) Get all the money you want now, but forfeit the chance to save up for retirement.

   b) Can't really take out enough to make a withdrawal worthwhile.

   c) Withdraw up to $35,000 tax-free from your RRSP for the purchase of your home, with the caveat that these funds must be re-contributed in the following 10-12 years.

   d) Will have no excuse to ask mom and dad for their financial help in home-buying.

Email answers to: **stanclarkfinancialteam@cibc.ca** or call (604) 641-4361

One prize winner will be chosen by a draw from all those who submit correct answers. The draw will take place on September 29, 2023.

Trivia challenge runs September 1 - 28, 2023. No purchase necessary. There is one prize to be won. Simply complete the trivia questions correctly to be entered in the draw. Limit 1 entry per person.

Chances of winning depend on number of eligible entries and whether you correctly answer the trivia questions. Open to adult Canadian residents (excluding Quebec). For full challenge rules, write to: The Stan Clark Financial Team, CIBC Wood Gundy 400-1285 West Pender St, Vancouver, BC V6E 4B1. © Stan Clark 2023

CIBC WOOD GUNDY | The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: 604 641-4361 | Toll-free: 1 800 661-9442 | Fax: 604 608-5211 | Email: stanclarkfinancialteam@cibc.ca | www.stanclark.ca