CIBC PRIVATE WEALTH

THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

IN THIS ISSUE:

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Humans have an *addiction to prediction*. The more information we have, the more confident our predictions. However, as I discuss in this month's behavioral finance article, too much information can diminish the accuracy of our predictions – and lead us to unwise decisions. Michael Chu describes the customized benchmarks we use to show how your portfolio is doing. Studying 153 years of returns, Elaine Loo reveals the long-term advantage of stocks over bonds. And Tom Cowans supplies definitions of, and differences between, stocks and bonds.

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

MORE INFORMATION INCREASES CONFIDENCE – BUT WHAT ABOUT ACCURACY?

By Stan Clark, Senior Wealth Advisor

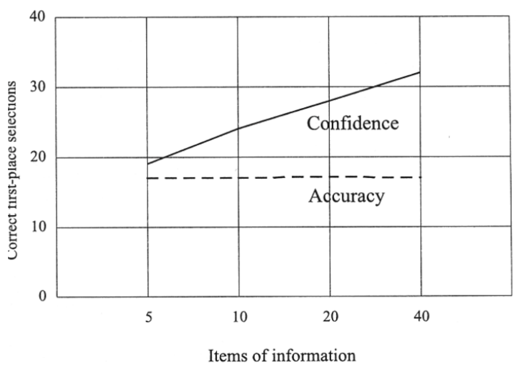
In the late 1980s, Massachusetts Institute of Technology (MIT) psychologist Paul Andreassen conducted an experiment. First, Andreassen asked each of his business students to select a portfolio of stocks. Then, he split the students into two groups. The first group only saw changes in the prices of their stocks. The second group received a steady stream of financial information through TV, newspapers, company contacts and industry analysts.

Surprisingly, the first group, with less information, ended up earning more than twice as much as the well-informed group. For the second group, being exposed to extra news was distracting. These information-saturated students became focused on the latest rumours and gossip. They believed all that extra information would allow them to anticipate the market – but they were wrong.

Previously, I have discussed our *addiction to prediction*: humans' strong, natural craving to make predictions. We do this even though we aren't in fact very good at predicting such complex things as the economy, company earnings or the stock market. I've also discussed *overconfidence*: how most people think they are better at things than they really are, and how such overconfidence can lead to trouble.

As the MIT study showed, more information tends to increase our confidence. But it does little to improve our accuracy in forecasting – and may actually reduce it.

In another example, eight veteran horse-racing handicappers were progressively given five to 40 pieces of information they considered important for picking winners. As the graph below shows, their confidence rose as the information increased – but their number of winners did not.



Source: Adapted from Paul Slovic, "Behavioral Problems Adhering to a Decision Policy," IGRF speech, May, 1973.

In still another example, clinical psychologists received background information on a large number of cases. The psychologists were asked how likely it was they could make a correct diagnosis with the information provided.

As the amount of information increased, the psychologists' confidence rose dramatically. Their accuracy did not. With very little information, they thought they'd get 33% right. Actually, they *did* get 26% percent right.

When the information was increased fourfold, they expected to correctly diagnose 53% of cases. But they were right only 28% of the time! More information made them much more confident, but no more accurate.

TEAM TALK

Michael Chu
Senior Wealth Advisor

Bull of Wall Street, New York Nov. 2023

What have you been up to?

I started mountain biking this past summer. I quickly learned that this is quite different from regular biking and that I'm quite a scaredy cat. I persisted, but will stick with the more moderate trails!

I travelled to New York in November. Even though it was quite chilly, it was a great time to visit as it was dry and the Christmas decorations were mostly up. It has been many years since my last trip to New York, but the classic spots are still very special: Wall Street, crossing the Brooklyn Bridge to Dumbo, Statue of Liberty, Times Square and the endless museums.

My biggest highlight was the 9/11 Memorial. Brings back lots of memories and learned some new things too. The Natural History Museum was very impressive... could spend the entire day there!

Food, while amazing, was expensive. Good excuse for more NY pizza.

Study after study has shown that simple statistical models are often better at making accurate predictions than well-informed experts – all of whom are subject to behavioral bias.

Here's another instance. A group of university counsellors received transcripts, test scores, vocational tests, application essays and other information about high school students. The counsellors became highly confident they could accurately predict the grades those students would get at university. But a basic mathematical formula that had only two variables – the students' average high school marks and their scores on a single, standardized test – made far more accurate predictions than the counsellors did.

To avoid behavioral biases, the Stan Clark Financial Team uses disciplined stock strategies based on objective factors proven to produce good returns over long periods. We also consciously guard against being influenced by extraneous, but seemingly important, information. This, we believe, will help us produce better-than-average returns – and better returns than the majority of investors who use more subjective approaches.

Asset Allocation

BENCHMARKS: HOW DO YOU KNOW HOW WELL YOU'RE DOING?

By Michael Chu, Senior Wealth Advisor

In any area of life, it's important to know how well you are doing. But how can you *objectively* know this? Benchmarks or comparisons are useful tools, whether for tracking your fitness levels, your kids' report cards or your investment portfolio.

At the Stan Clark Financial Team, we regularly provide performance reports on your investment portfolio. These reports show how your portfolio has grown – and also compare it to relevant benchmarks. But keep in mind that there are no perfect benchmarks. It depends on what you are trying to do.

We can include mainstream benchmarks like the TSX Composite or the S&P 500 index returns. But while TSX and S&P are often used, they aren't always the best or fairest comparisons. If your portfolio is not invested 100% in Canadian or U.S. stocks, then comparing to it the 100% Canadian stock TSX Composite or the 100% U.S. stock S&P 500 would be like comparing apples to oranges.

What we do is take it a significant step further. We provide a benchmark customized to you.

Let's use a real-world example. Our AMA World portfolio is geographically broken down about 40% in Canada, 40% U.S., 13% EAFE (Europe, Australasia and Far East) and 7% emerging markets. So, instead of comparing to an index that is only TSX (Canada) or only S&P 500 (U.S.), we'll combine the relevant indexes to make it fair and useful. In this case, it would be 40% TSX, 40% S&P 500, 13% MSCI EAFE and 7% MSCI Emerging Markets indexes. Now we're comparing apples to apples.

So far, that's just the stock side of the custom benchmark. We also factor in your asset mix. Let's say your target mix is 70% in stocks. That means 70% of the custom benchmark will be as above and the remaining 30% will be fixed income. For fixed income, we use 50% Canadian treasury bills (T-bills) and 50% Canadian bond index.

Now we combine the equity benchmark and fixed income benchmark to get your final custom benchmark. This makes it a fair comparison and lets you see how you are doing relative to the markets. Over the years, if your mix changes or our model changes, we will make the necessary changes to the benchmark as well.

That being said, common indexes don't always tell the full story and might not be as fair as they seem. For example, sometimes the index doesn't truly represent the average stock market performance because of weighting methodology. It's important to keep this in mind. Nevertheless, the benchmarks are still very useful.

Here's some of the math using last year's index returns. Starting from the left, we have the index returns. Next we multiply them by the allocation. Finally, we combine the results using your asset mix to get your own customized benchmark. And now you can see how you're doing.

Mainstream index returns		**Your portfoilio**					
		Equities breakdown					
TSX	11.8% x	Canada	40% =	4.7%			
S&P 500	23.5% x	U.S.	40% =	9.4%			
MSCI EAFE	15.7% x	EAFE	13% =	2.0%		**Your asset mix**	
MSCI Emerging Markets	7.7% x	Emerging Markets	7% =	0.5%			
				16.7% total equities	x	70% equities	= 11.7%
		Fixed income breakdown					
T-bills	4.9% x	T-bills	50% =	2.5%			
Canadian Fixed Income	6.7% x	Canadian Fixed Income	50% =	3.4%			
				5.8% total fixed income	x	30% fixed income	= 1.7%
						Your total benchmark	**13.4%**

Asset Allocation

STOCKS VS. BONDS OVER THE PAST 153 YEARS

By Elaine Loo, Wealth Advisor

In Aesop's fable *The Tortoise and the Hare*, slow and steady wins the race. But is that really how it works in life? When it comes to investing, slow and steady can be a recipe for near-certain losses.

Reliable performance data first became available in 1871. So, let's look at stocks-versus-bonds returns in the 153 years since. Think of *The Tortoise and the Hare* as a story about asset allocation: of bonds, which appreciate slowly and appear reliable; and of stocks, which can appreciate strongly and quickly, but appear risky. Which is your best bet? The answer depends on what kind of race you're running.

The past 153 years have been wildly volatile: inflation, deflation, a deep depression, two global financial crises, explosive growth, two World Wars, embargoes, assassinations and worldwide pandemics. We often forget how frightening things seemed at such times. Although the world may seem scary now, it's likely that the period ahead won't be all that different from some of the periods we've experienced in the past. History repeats itself; you just don't know which part of the past you're going to get! But the past informs the future. By studying history, you can get a good idea of the range of possible outcomes going forward.

Data shows that, over the past 153 years, if you owned equal amounts of Canadian and U.S. stocks you would have enjoyed average annual growth of 9.5% (in Canadian dollars) for an inflation-adjusted (real) return of 7.4%. Over the same period, Canadian bonds averaged 4.5%, or real returns of just 2.4% per year.

Here's a graph showing 153 years of growth in stocks vs. bonds. If you started with $1,000 in each, you would now have over $53 million with stocks – but only about $38 *thousand* with bonds. Remember that these are in "real" dollars, that is, adjusted for inflation.

Here's a table showing the average percentage growth in stocks vs. bonds over the past 153 years. The table also compares the differences in median total dollar growth over various time horizons.

153-Year Returns

Growth in stocks vs. bonds 1871 to 2023

	Average Nominal Returns	Average Real* Returns	Average real growth from $100,000**				
			1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	9.5%	7.4%	$7,416	$47,101	$112,165	$187,523	$308,811
Bonds	4.5%	2.4%	$2,400	$10,023	$19,953	$30,459	$49,129
Inflation	2.1%						
Difference in growth ($)			+$5,016	+$37,078	+$92,212	+$157,064	+$259,681
Difference in growth	2.1x	3.1x	3.1x	4.7x	5.6x	6.2x	6.3x

Source: Siegel, Shiller, CRSP, Cdn Institute of Actuaries, TSX, Bank of Canada.

* "Real" returns are nominal returns after subracting inflation

** "Real growth from $100,000" for 5 to 20 years is the median real growth, showing the effect of compounding.

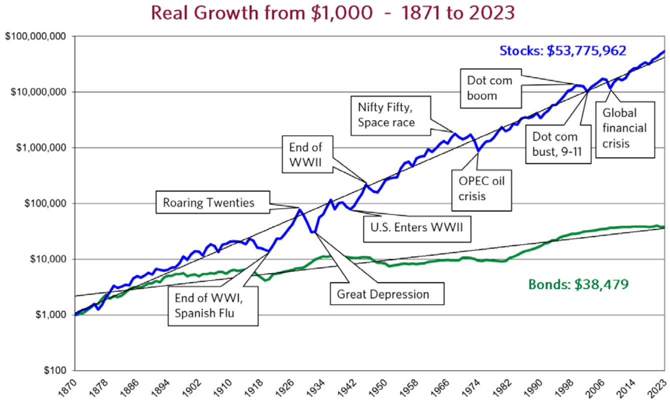
The average annual real returns from stocks were more than three times higher than those of bonds. However, because of compounding, the difference in returns grows to more than six times after 20 years: a profit of $308,811 for stocks vs. only $49,129 for bonds, on an initial $100,000 investment. So, the benefit from stocks grows as the time horizon gets longer.

Now you may be asking: But aren't stocks much riskier than bonds? Yes and no. The stock market is volatile in the short term, making stocks seem risky. But if you invest for the longer term, that is, more than five or 10 years, history shows that down markets have almost always been more than offset by up markets, giving reliable returns for stocks after inflation.

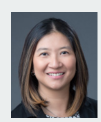
Inflation can actually make bonds riskier than stocks over the long term. Over five-year periods stocks did better than bonds 74% of the time; the chance of a negative return with bonds was nearly twice that of stocks. The average extra return for stocks was 37% higher, compared to only a 9% increase in the worst return. Over 10-year periods the worst return was about the same, and yet the median returns for stocks were 5.6 times as high. Over 20-year periods, stocks beat bonds nearly every time and never failed to beat inflation. As well, stocks' median return was 6.3 times that of bonds. By contrast, bonds lost to inflation 15% of the time, with the worst period being a loss of nearly 30% in real purchasing power. So, based on history, the longer your investment horizon, the less risky stocks are, and the riskier bonds become in comparison. At the same time, the extra returns from stocks vs. bonds grow dramatically.

The key takeaway here is that one type of asset isn't always better. How long your money is likely to be invested is critical in determining the right mix for you. If you only have a few years to invest, then most of your money should be in bonds. If you have savings earmarked for needs five to 10 years or more from now, consider investing more of those savings into stocks.

Real Growth from $1,000 - 1871 to 2023



Source: Siegel, Shiller, CRSP, Cdn Institute of Acutaries, TSX, Bank of Canada.



Elaine Loo is a Wealth Advisor for the Stan Clark Financial Team at CIBC Wood Gundy.

She is responsible for the day-to-day monitoring and maintenance of client accounts and investment portfolios.

Financial Planning

STOCKS VS. BONDS: WHAT'S THE DIFFERENCE?

By Tom Cowans, Wealth Advisor

Previously we've discussed both Registered Retirement Savings Plans (RRSPs) and Tax-Free Savings Accounts (TFSAs). It's also important to talk about what to invest in.

There are many types of investments: individual stocks, bonds, preferred shares, mutual funds, exchange-traded funds... The list seems endless. We can't cover every type of investment here, but we'd like to look at the two main groups of investments or asset classes: *stocks* and *bonds*. Almost every type of investment is made up of one or the other, or a mixture of the two. Stocks and bonds are very different, and the balance between them can really affect your returns and your risk.

First, let's examine the difference between stocks and bonds. Then, second, how best to allocate money between them.

Stocks

In simple terms, stocks represent ownership in a company. If a company does well, it's likely that the stock price will go up. The reverse is also true: If a business performs poorly , the stock price will likely go down. When we talk about doing well or poorly, the most important measure is the company's *profits*, a.k.a. its earnings, which are simply its revenues less its expenses. Those earnings belong to the owners of the company, those who own its stock.

The tricky thing is, it's not just the past earnings that determine how a company's stock price fares. It's mostly what investors think the future earnings will be. Another important factor is the dividends you can expect, that is, the part of the earnings that a company decides to pay out to its owners.

With stocks you will participate in the company's ups and downs. But future company results are uncertain. Add in human psychology and you get volatile stock markets. It's true that, over the short term, anything can happen with stocks. But over the long term – that is, over 10+ year periods – stocks as a whole have been reasonably safe. That's because earnings across all companies tend to be very persistent. And, over the long term, the large short-term price swings tend to cancel each other out. In the long term, stocks have provided the best returns for any major asset class.

Bonds

With bonds, you are lending money to a government or company for a specified term. The bonds pay you interest. Then, at the end of the term, you get your money back.

Bonds are generally viewed as safe investments, as you should be getting all your interest payments and principal back. But bonds are not all the same, especially corporate bonds. Bonds have credit ratings to indicate the risk level of not getting the interest you expected, or even of not getting all your money back.

If the interest rate on a corporate bond is a lot higher compared to an ultra-safe bond, it's a good indication that the risks are also a lot higher. And, that things might not go as expected. Remember: There's no free lunch!

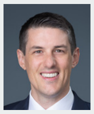
The right mix

Now that we generally know what stocks and bonds are, how to decide what amount of money to have in each? Each group has its advantages and drawbacks. Since everyone's circumstances are different, the mix of how much to have in each varies from person to person.

From the outset it might seem that stocks are the way to go. They're often a more exciting route and the potential returns are attractive. However, a balance is important, and the mix has a huge impact on your portfolio. The right mix depends on a lot of factors, but essentially revolves around your needs, how long you are investing for and how much volatility you can handle. One of the worst things to happen would be suddenly needing your savings and being forced to sell your stocks in a down market. It's a scenario you'd find very difficult to recover from.

When you are younger, you can usually take some risks. If you are saving for retirement and it's a long time from now, you might be comfortable taking more risks with your investments. But what if you are saving for something in the near future, like a car or a place of your own, or a growing family? In that case, it makes sense to be more conservative. Again, everyone is different. We encourage you to create a mix that is right for your unique situation.

As we get older, things change and our mix can change, too. It's important to pause every so often to see where things are at, and then reassess as needed.



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. It's human nature to try to figure out the future. Our addiction to prediction leads us to compile as much information as possible, which:

   a) Is particularly useful for deciding what investments to make.

   b) Makes us confident, and in decision-making, confidence always pays off.

   c) Is notably less reliable than using simple statistical models. The latter are often better at making accurate predictions than well-informed experts – all of whom are subject to behavioral bias.

   d) Frees you up from having to study statistics.

2. The Stan Clark Financial Team provides you with regular, customized reports showing how your investment portfolio has grown. As part of our process in preparing these reports, we:

   a) Compare your portfolio to relevant benchmarks.

   b) Recognize that relying on the results of various markets might not be an accurate guide. For example, if your portfolio is not invested 100% in Canadian or U.S. stocks, then comparing to it the 100% Canadian stock TSX Composite or the 100% U.S. stock S&P 500 would be like comparing apples to oranges.

   c) Also recognize that that there are no perfect benchmarks that are useful for all scenarios.

   d) Do all of the above.

3. A survey of growth in stocks and bonds over the past 153 years reveals that, if you'd started with $1,000 in each, you would now have over $53 million with stocks – but only about $38 thousand with bonds. (These are in "real" dollars, that is, adjusted for inflation.)

   a) True b) False

4. In deciding the right mix of stocks and bonds for your portfolio, be sure to consider:

   a) Going 50-50 on them. That way you're giving stocks and bonds an equal chance to make money for you.

   b) Factors that revolve around your needs, how long you are investing for and how much volatility you can handle.

   c) Buying a lot of high-risk stocks. Some are bound to pay off big-time.

   d) Opinions you hear on TV and read online. Always trust media experts.

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 March 28, 2024.

Trivia challenge runs March 1 - 27, 2024. 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.

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

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