The Stan Clark Financial Team's

PERSPECTIVES

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Senior Investment Advisor

Fear is a prime motivator in investor herding, or following what others do rather than thinking for oneself. I look at what causes such fear – and how to avoid it. In Part 4 of Behind the Numbers, Michael Chu looks at ways to measure a company's growth. Continuing her discussion of Return Assumptions for Financial Plans, Sylvia Ellis cautions against simple return assumptions especially when there are cash flows. Sylvia also describes CIBC's annual Miracle Day, this year on December 2, when the Stan Clark Financial Team donates all fees and commissions for kids in need.

Stan

Behavioral finance

Herding, Part 2: How to avoid fear-based herd behaviour

By Stan Clark - Senior Investment Advisor

In the last issue, we began our look at the disturbing phenomenon of *herding* in the stock market. You'll recall that herding occurs when large numbers of investors chase after the same investments at the same time. Or, when they sell their investments in a panic because of bad news, or their anticipation of bad news.

In this issue, I'd like to zero in on fear, one of investors' prime motivators for herding – and what we can do about that fear.

This powerful emotion has caused almost every major stock market crash, including: the Great Crash of October 1929; Black Monday on October 19, 1987 (believe it or not, my first day in this business!); and most recently, the pandemic-related crash in February and March of 2020.

What kinds of fears cause markets to fall, often to levels far below what are justifiable by any measure? It can be almost anything: terrorism, political problems, wars, earthquakes or, of course, pandemics. These can ignite turmoil in the markets without really having a significant effect on overall long-term corporate profits. The problem is, once investors start selling out of fear, their behaviour tends to become self-perpetuating.

What can you do to avoid being hurt by fear-based markets? Behavioral finance research shows the need to be guided by a plan or set of rules that serves your particular short- and long-term financial goals. Above all, it involves sticking to your rules, no matter how panicked you feel.

With stocks, it's easier to stick to the rules if you understand how our free-enterprise economic system works. True, our system is subject to booms and recessions. But companies operating within the system are, as a whole, very good at adjusting to changes and finding ways to make money – profits – over time. And you, as a shareholder, share in those profits, both through dividends and increased share prices from reinvested company profits.

Behavioral finance research shows the need to be guided by a plan or set of rules that serves your particular short- and long-term financial goals.

Yet, even knowing all this, your emotions may still overrule your logic. To stick to your rules, it may help to change some of your behaviours.

For example, you could stop watching business and investing shows, and quit reading the business pages of the daily papers. Or, press the mute button when the nightly newscaster starts talking about the economy. Daily news is laden with emotion and focused on the short term. If you need to feel in touch, read high-quality weekly or monthly publications. You'll feel a lot calmer about your investments and long-term strategy.

It also helps *not* to track your portfolio's value day to day, or even month to month. Yes, you do need to ensure that your portfolio is being managed according to the plan and strategies you set up for it. However, monitoring short-term results will give you little information of true value. Short-term performance is mostly influenced by luck and random noise, and will only cause you to become emotionally involved.

In the end, the best approach is to trust in the plan and strategies you adopted. Realize that they won't work in every period. But, if properly designed with built-in resilience, they will give you the best chance of succeeding over time. ■

Team Talk:
Reflections on 2020

This month, we've decided to do something a bit different with our Team Talk section.

2020 has been a very unusual year for us all. Our team members have taken some time to reflect back on the past year, and they want to share their thoughts with you.

Martha

This has been a unique year, for better and for worse. Sadness and fear around the world, yes. But also the realization that we can face the unexpected in ways we never imagined: adapting to circumstances, to rules, without losing serenity – and infusing our lives with hope.

Elaine

The year 2020 has definitely been a unique and memorable one, with lots to be happy for and lots not to be. I very much feel for those who have suffered from the pandemic, from deaths to sickness to loneliness. I do, however, feel fortunate that those around me have managed to stay safe and healthy. And I am very hopeful that 2021 will...

Continue reading more reflections from the Stan Clark Team at the end of this issue.

Investing/Financial planning

Behind the Numbers, Part 4: Earnings momentum

By Michael Chu, Investment Advisor

There are many ways to measure growth. For a young child, we might first think of using the change in height. But there are other ways, such as physical coordination or speaking ability.

Similarly, there is more than one way to measure a company's growth. In this fourth part of our series "Behind the Numbers," we are going to discuss *earnings momentum* – which refers to the growth in earnings of a company. When evaluating companies on growth, we focus on three things: quarterly earnings momentum, earnings surprises and estimate revisions.

Quarterly earnings momentum is the quarterly rate of change in annual earnings. For example, let's say a company's annual earnings were $2.20 per share. And, a quarter ago, the annual earnings were $2.00. This implies that annual earnings have grown 10% in the quarter. In the short term, stocks with strong earnings growth generally outperform those with weak earnings growth.

Earnings surprises looks at how much the most recent earnings were above or below expected earnings. In other words, how much analysts were surprised. Suppose a company recently reported earnings of 70 cents per quarter, resulting in clean earnings of 66 cents, after adjusting for one-time gains (or losses). If analysts had expected earnings of 60 cents, then this company had an earnings surprise of 10%. In the short term, stocks that beat expectations generally outperform those that miss expectations.

You will have noticed in this last example that the earnings number needed adjusting. This is why having clean numbers is important! Without the adjustment, the earnings growth would have been overstated. Usually the numbers we see in the newspaper or on the Internet are unadjusted. While we can still use those numbers for discussions, it's generally not a good idea to use them for making decisions as they may not be accurate.

Estimate revisions looks at how analysts' earnings estimates have changed. Have their estimates increased, decreased or stayed the same? In our example, the company had good earnings that were above expectations. This could result in analysts revising their future numbers upwards.

The analysts might have been expecting $3 per share for next year. But now, after the seeing the latest results, they might revise their future expectations higher – perhaps to $3.30, resulting in a positive earnings revision, and a 10% increase in their estimates. In the short term, stocks with increasing earnings expectations generally outperform those with decreasing expectations.

In a long-term study using these three variables, researchers divided all Canadian stocks into five groups, sorted by earnings momentum, and calculated returns generated by each group. Here's how the returns looked from 1985 to 2018 (33 years):

Variable	Top Group	Bottom Group
Quarterly earnings momentum	10.0%	-0.4%
Earnings surprise	13.1%	-1.0%
Estimate revision	12.5%	-2.6%
TSX benchmark return: 8.1%		

Source: CPMS

As you can see, the overall results from investing in high-earnings momentum stocks (the top group) are very good and outperformed the market. Conversely, the returns from stocks with low momentum are relatively poor.

Now, this might make momentum investing look easy: Buy high momentum and avoid low momentum. But keep in mind that, unlike value investing, which is slow and steady, using only momentum variables also means high volatility and high turnover. This is why we use a combination of variables, including value and momentum, to get the best of both worlds. We'll talk about this some more next time. ■

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

CIBC Miracle Day: Making a difference for kids in need

By Sylvia Ellis, Senior Estate Planning Advisor

This year, the annual CIBC Miracle Day will be held on December 2. On that special day, we at the Stan Clark Financial Team will donate all fees and commissions to the CIBC Children's Foundation.

CIBC founded the Children's Foundation, a registered Canadian charity, in 1984 with the belief that by working with our clients, employees and children's charities, we can make a difference for children in need.

CIBC covers all administrative costs associated with running the Foundation. That means 100% of all funds raised on CIBC Miracle Day go to children's charities across Canada. Since inception, CIBC Miracle Day has raised over $100 million for children's charities across Canada – and $256

million globally.

The Foundation has three areas of focus:

- help for high-needs children
- healthy, active living
- well-being and enrichment

With its goal of improving the quality of life for children in need, CIBC Children's Foundation is dedicated to helping them prepare for future successes. By focusing on health, education and well-being, the Foundation provides these children with the opportunity to participate in programs that might not otherwise be accessible to them. Such enrichment opportunities are vital in supporting young people in the formative years, encouraging personal and professional growth.

The Stan Clark Financial Team is proud to be a part of CIBC Miracle Day. As we do every year, we invite you to suggest causes that are close to your heart. Last year at your suggestion, we directed funds to 17 charities, including:

Sunshine Foundation – Since 1987, Sunshine has been fulfilling custom-made dreams for Canadian kids living with severe disabilities or life-threatening illnesses.

BC Adaptive Snowsports – Formed in 1973, Adaptive Snowsports enhances the quality of life for children and youth with physical and cognitive disabilities, and for their families and volunteers, by providing opportunities to experience the joy, freedom, and health and wellness benefits of adaptive sports.

Cassie + Friends – The only charity in Canada dedicated 100% to the pediatric rheumatic disease community, Cassie + Friends has raised over $1.5 million since 2007. These funds help transform the lives of kids and families affected by juvenile arthritis and other rheumatic diseases. Working with patients, caregivers, healthcare professionals, researchers and other friends, the charity provides life-changing support, education, community and research to help kids and families face the ups and downs of life with a chronic condition.

HEROS – The Hockey Education Reaching Out Society is a volunteer-driven charity that uses the game of hockey to teach life skills and empower Canada's marginalized youth. By providing a safe and stable environment for young people to succeed, connect and learn, HEROS guides its participants to become constructive citizens within their communities.

The Bloom Group – Originally founded in Vancouver's Downtown Eastside in 1961 as the St. James Community Service Society, Bloom's mission is to support the most vulnerable people in our community through the provision of housing, health and social services.

We thank you in advance for your support! And, as noted above, we warmly encourage you to let us know about any Canadian children's charities you would like us to consider. ■

Sylvia Ellis is the Senior Estate Planning Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Sylvia provides support to the team in projecting and planning client financial affairs.

Financial planning

Return Assumptions for Financial Plans, Part 2: When 7% is not 7%

By Sylvia Ellis, Senior Estate Planning Advisor

In part two of our series on return assumptions for financial plans, let's look at how – even if the average return is the same – the path, or order, of returns can make a big difference in financial projections. By *path of returns*, we mean when the up and down years occur, especially relative to when we are adding or withdrawing money.

Previously, in part one, we discussed how we determine a future rate assumption. As you'll recall, we base it on the returns over the past 100 years, to capture all the ups and downs and the long-term trends. The average return for stocks over the past 100 years is 10.8%. To be conservative, we use around 7% for our financial plans, that is, 4% to 5% above inflation.

However, this is where things start to get complicated, as 7% doesn't always *mean* 7%. Many financial plans will just determine a long-term return assumption and then apply it for the life of your plan. But if there are cash flows to consider – deposits and withdrawals to your plan – then things aren't that simple.

Here's a brief example about the path, or order, of returns. Let's say that for the past three years, stocks were down 10%, then up 10%, and then up *another* 10%. The average return for the three years is 2.9%. What if the sequence was backwards: first up 10%, then up another 10%, then *down* 10%? The average is still 2.9%! So, what's the big deal? It seems like the path of returns doesn't matter. Again, the problem occurs when we introduce cash flows: deposits and withdrawals.

Using average returns can sometimes not be what it seems. In fact, it can actually be dangerous, especially over the long term. Consider the following three scenarios, shown in the chart, for a retired investor who has regular withdrawals of $35,000 at the end of each year. Note that all three scenarios have average returns of 9% and take place over 10 years. In scenario one, called *negative returns first*, we have a shaky start, with a few negative return years in a row, then a few average years, followed by a few good years. In scenario two, average returns, we have *average returns* throughout all 10 years. Scenario three, *positive returns first*, is the opposite of scenario one: We start with a few good years, then a few average years, followed by a few bad years.

A typical gut reaction is that all three of these scenarios produce the same end result, since the average returns are the same. However, as you can see at the bottom of the chart, the final values are in fact very different from each other. Scenario three has a much higher final value, almost double compared to scenario one – even though the average returns are the same.

		Scenario 1: Negative returns 1st		**Scenario 2: Average returns**		**Scenario 3: Positive returns 1st**	
Age	Year	Returns	Value	Returns	Value	Returns	Value
60			$500,000		$500,000		$500,000
61	1	-7.0%	$430,000	7.0%	$500,000	23.1%	$580,500
62	2	-7.0%	$364,900	7.0%	$500,000	23.1%	$679,596
63	3	-7.0%	$304,357	7.0%	$500,000	23.1%	$801,582
64	4	-7.0%	$290,662	7.0%	$500,000	7.0%	$822,693
65	5	-7.0%	$276,008	7.0%	$500,000	7.0%	$845,281
66	6	-7.0%	$260,329	7.0%	$500,000	7.0%	$869,451
67	7	-7.0%	$243,552	7.0%	$500,000	7.0%	$895,313
68	8	23.1%	$264,812	7.0%	$500,000	-7.0%	$797,641
69	9	23.1%	$290,984	7.0%	$500,000	-7.0%	$706,806
70	10	23.1%	$323,201	7.0%	$500,000	-7.0%	$622,329
Average return		**7.0%**		**7.0%**		**7.0%**	
Value after 10 years			**$323,201**		**$500,000**		**$622,329**

Source: Stan Clark Financial Team

If you are going to be withdrawing money, a strong start will make a big difference in the end. The reason for this is that the withdrawals happen regardless of whether the market is up or down. If our retiree initially has a few bad years in the market (scenario one), during which he must still take out money, then that will have an *extra* downward impact on the portfolio, since there are fewer re-investable dollars left after each of the bad years. Then, when the market recovers, there are actually fewer assets to recover with! So, 10 years later, there will be less money.

In scenario three, a *cushion* (greater re-investable dollars) is built up because of strong initial performance, even after the withdrawals. Then the cushion softens the blow of the down years that occur. In the end, this leaves a higher final value.

Now you can see how the path, or order, of returns can have a significant effect on financial projections. So, a good financial plan needs to be deeper than a simple return assumption. No one knows when the good, average or bad return years are going to occur. How do we adjust for that in our plans? We'll talk about our solution in part three. ■

Sylvia Ellis is the Senior Estate Planning Advisor for the Stan Clark Financial Team at CIBC Wood Gundy. Sylvia provides support to the team in projecting and planning client financial affairs.

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. Fear is a prime motivator in investor *herding*, or following group behaviour instead of thinking for oneself. Such fear can result from:
   - a) Terrorism, political problems, wars
   - b) Earthquakes
   - c) Pandemics
   - d) All of the above.

2. To evaluate a company's growth, the Stan Clark Financial Team looks at, as just one example:
   - a) *Quarterly earnings momentum*, the quarterly rate of change in annual earnings
   - b) Daily newspapers
   - c) Nightly newscasts
   - d) Hourly Internet updates.

3. In devising effective financial plans, the Stan Clark Financial Team bases *future rate assumptions* on:
   - a) A proven-successful cookie-cutter approach
   - b) The returns over the past 100 years, to capture all the ups and downs and the long-term trends
   - c) The average return for stocks over the past six months
   - d) Total optimism, that is, being confident the entire market will constantly go up with no blips.

4. On annual CIBC Miracle Day, this year on December 2, the Stan Clark Financial Team will donate all fees and commissions to help children with high needs achieve healthy, active living, well-being and enrichment:
   - a) True   b) False.

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 Dec. 31, 2020.

Trivia challenge runs Dec. 1 - 30, 2020. 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 2020

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Where planning, investing and behavioral finance meet

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Team Talk: Reflections on 2020

Martha

This has been a unique year, for better and for worse. Sadness and fear around the world, yes. But also the realization that we can face the unexpected in ways we never imagined: adapting to circumstances, to rules, without losing serenity – and infusing our lives with hope.

Elaine

The year 2020 has definitely been a unique and memorable one, with lots to be happy for and lots not to be. I very much feel for those who have suffered from the pandemic, from deaths to sickness to loneliness. I do, however, feel fortunate that those around me have managed to stay safe and healthy. And I am very hopeful that 2021 will bring a much healthier year for us all!

Heather

2020 has taught me that adapting to change is what helps us survive. Normally at the start of every year we set goals for ourselves and for our families. Although these goals are still important, 2020 became a year of appreciating what we already have.

Jocelyn

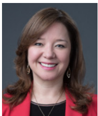
What a year 2020 has been. It's been a year of changes, a year of challenges, a year of sorrow and concern, but also a year to remind us of what is truly important. For me, I'm looking forward to a time in the future where we do not have to socially distance and we can be free to celebrate life's little milestones with family and friends. Be safe, and take care of yourself and your loved ones.

Meghan

If 2020 has taught me anything it's that, for better or worse, the last few months have changed the world as we know it. It has also made clear what really matters to me as a woman and a human: health, family, and the well-being and safety of my community.

Michael

2020 has been full of challenges and changes. I think we learned a lot about ourselves this year: taking for granted many of the things we miss, but also being thankful for the truly important things we have endeavoured to keep.



Sylvia

This year has been a challenge for many. For me, I've learned to be more patient, to adapt to things quicker than I ever imagined and, on a fun note, to be more creative. We've all had to slow down, re-examine what's important in our lives and be grateful for our families, friends and co-workers. To all, I wish a happy and healthy 2021.

Johnny

2020 changed everyone's plans. Erin and I were supposed to get married in May 2020 but unfortunately had to cancel those plans. We decided to do a small wedding in July with immediate family and some close friends on Bowen Island. It ended up being something that we still really loved and felt fortunate to be able to go through with. Many people were able to adapt and change this year – which reminds me how resilient we all are.

Stan

First, my heart goes out to all those who experienced death, disease and loneliness this past year. In many ways, it is good to say goodbye to 2020. The year was a grim reminder of how fragile and unpredictable life can be. At the same time, it was a glowing testament to how resourceful people and their companies can be in times of need. Let's all hope for a much kinder, gentler 2021!