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THE STAN CLARK FINANCIAL TEAM'S

PERSPECTIVES

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You're a pilot, flying at night. You don't feel your plane tilting. By checking your instruments, you'll know to restore the plane to level flight. There are some similarities here to investing, as I discuss in my behavioral finance article. In another article, I share new research showing the value advisors provide in sound investment and financial planning. Michael Chu alerts us to *survivorship bias*, i.e., fund managers' performance numbers that only show the performance of surviving funds, not those that were shut down or merged.

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

TRUST YOUR INSTRUMENTS OVER YOUR SENSES

By Stan Clark, Senior Wealth Advisor

Almost 27 years ago, on the evening of July 16, 1999, John F. Kennedy, Jr. crashed his plane into the Atlantic Ocean. Kennedy was an experienced pilot who had flown that route, New York City to Cape Cod, many times. What happened – and how does it relate to behavioral finance?

According to the U.S. National Transportation Safety Board, the probable cause of Kennedy's accident was his "failure to maintain control of the airplane during a descent over water at night, which was a result of spatial disorientation."

Spatial disorientation can happen like this. A pilot is flying in dark or hazy conditions where he cannot see the horizon, and cannot tell, using his eyes alone, if he is level or not.

He becomes distracted for a moment. While he's distracted, his plane gently tilts. The tilt happens so gradually he doesn't notice. To him the plane still feels level.

If the pilot follows his instruments and changes back to level flight, he will then feel as if the plane is leaning the other way. This experience is known as *the leans*, because of the compelling urge to change from the level flight back to the tilted one. But a pilot who is well-trained in flying with instruments will resist that feeling. He will trust his instruments, and keep the plane level.

However, a less experienced pilot can be overwhelmed by his feelings. He may, as JFK, Jr. did, override his instruments and mistakenly change back to the tilted position. Things then go from bad to worse. The plane's tilt causes it to point down, speed up and lose altitude. The pilot takes more actions that feel right – but are in fact opposite to what he should be doing. The plane enters a spinning nosedive, called a *graveyard spiral*, and crashes.

Being powerful, our feelings, emotions and intuitions exert compelling influences on us. They have evolved over hundreds of thousands – in some cases, millions – of years. While indispensable, these senses sometimes lead us astray. Just as our senses were not developed to deal with flying, they were also not developed to deal with many other modern phenomena.

Take investing. The world of investing can play tricks with your mind, just as darkness, haze and clouds can obscure a pilot's vision when flying. The modern world's information overload; our complex interrelationships with each other in personal matters and in business; and the media's influence on us – all of these are as different from what our ancestors faced as flying is from walking. As a pilot's senses can point him in the wrong direction when flying, our feelings, emotions and intuition can lead us astray in investing.

That's why it is important to have a set of investment instruments to guide us. That's also why it's important to follow and trust those instruments – especially when they are telling us something different from what we feel with our senses.

Having a set of rules, guidelines and strategies to guide your decisions will help you avoid being overly influenced by your emotions. It will help you determine which way is up and which way is down in the world of investing. And that can make the difference between reaching your long-term goals – or falling short.

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TEAM TALK

Off the Clock with Tom Cowans

What have you been up to lately?

We had a busy second half of 2025, moving at the end of summer from South Surrey to the north shore of Vancouver – we are just about out of all the moving boxes! The kids have thoroughly enjoyed making lots of friends and getting to know their new school. We've all settled in and I'm certainly enjoying the shorter commute to the office!

Ryan is coming to the end of grade 2 and Ellie PK3 – the time has flown by. We spend our evenings and weekends doing lots of fun activities and trying to explore everything the north shore has to offer. Ryan enjoyed his first winter playing minor hockey (lots of early mornings!) and I'm now volunteering at his local Beaver Scouts and cricket club.

We had a lovely family holiday to Maui in January and recently just finished our first cruise from San Diego back to Vancouver which was so much fun.

This summer we'll be hosting family and friends from England and enjoying everything BC has to offer while staying close to home.

Tom is a Portfolio Manager and Wealth Advisor with the Stan Clark Financial Team.

On a ferry ride to Vancouver Island last summer.

INVESTING

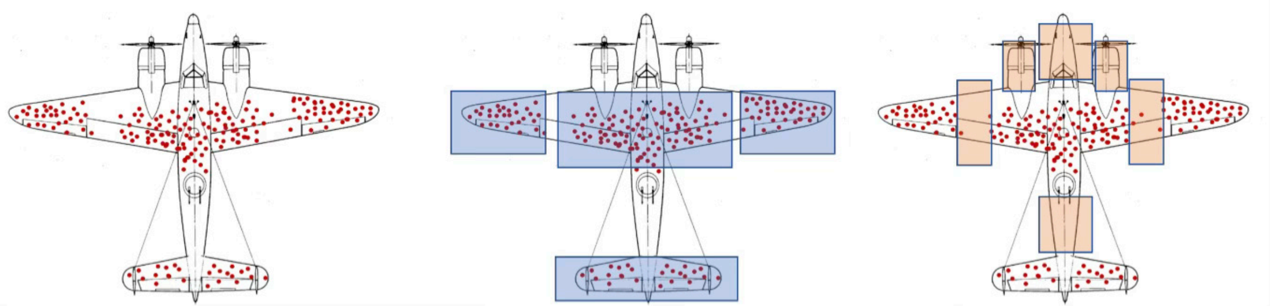
SURVIVORSHIP BIAS: THEY DON'T MAKE 'EM LIKE THEY USED TO

By Michael Chu, Senior Wealth Advisor

During World War II, statisticians were tasked with figuring out where to add armor to planes to minimize losses. In response, they studied the bullet holes on planes that had returned from dangerous missions.

At first the statisticians wanted to reinforce the most damaged areas (blue shade). This seemed to make sense – but, they soon realized, was a mistake. The returning planes could survive hits in those areas.

The planes that were hit in the most critical areas were the ones that did not return. So, instead, the statisticians decided to reinforce the areas with the least damage on the returning planes, where a hit would likely be fatal (orange shade).



It is tempting, as the statisticians initially did, to go with a compelling first impression. In another example of one, many highly successful entrepreneurs like Bill Gates and Mark Zuckerberg dropped out of college. Maybe college isn't that important, after all? But accepting this first impression ignores the vast number of people who dropped out and failed. We rarely hear stories about the failures.

"They don't make 'em like they used to!" We often hear this about older appliances, cars or clothing. But we're only seeing the high-quality older ones that have lasted – have survived –through the years. Masses of lower-quality items from that era have long since broken down and been forgotten. Nobody remembers, say, that creaky sofa from 10 years ago.

Meet survivorship bias

In a previous article, "Benchmarks: When average is much above average," we discussed investors who achieve returns equal to market-index returns. This achievement, we noted, actually puts these investors well above the average investor. That's because most investors' performance falls well short of the market – and not by trivial amounts, either.

For stock indexes, the average shortfall is likely in the range of 2-3% per year. This is for a variety of reasons, such as market timing and behavioral biases. But another reason is that many investors use mutual funds, and the majority of mutual funds underperform their benchmarks.

As discussed in the previous article, this is based on the S&P Indices Versus Active (SPIVA)[1] study of actively managed funds that attempt to beat the market, but mostly end up failing in Canada, the U.S. and internationally.

One key element of the SPIVA study is that it adjusts for *survivorship bias*. This bias is extremely important to consider when evaluating the historical returns of a manager's funds. About 40% of mutual funds that existed 10 years ago have either been shut down or merged with other funds. Usually it is the poorly performing funds that have been closed. The performance numbers shown by fund managers therefore only show the performance of the surviving funds, which creates a biased representation of actual past performance.

Let's say that, at the beginning of the year, there are three funds: A, B and C. After a year, fund A underperformed. Fund B did average. Fund C outperformed. Because of its underperformance, fund A was shut down at the end of the year. Now, a year later, if we are analyzing funds, only fund B and C exist. Mutual fund investing looks like a good idea because the performance has been at least average or better. The reason: poorly performing fund A has "disappeared" from the record books.

A good study will adjust for survivorship bias by looking at what funds existed at the beginning of the period. In the above case, this would involve all three funds. Only looking at the two good funds that survived to the end of the year would create a significantly unfair bias in the study.

SPIVA makes an adjustment to remove this bias in three ways. First, it includes all funds that existed the beginning of the study period. Second, it shows the survivorship rate for each fund category. And third, SPIVA calculates peer-average returns for each category. The first adjustment, that of including all funds, is the most important. The other adjustments give us more information when making investment decisions.

Let's look at some numbers from the SPIVA study about survivorship bias. At the beginning of the study, there were 701 equity mutual funds. Only 83% survived to the end of the period five years later. That means 119 funds were closed down – likely due to poor performance. After all, who would shut down a well-performing fund?

If the study didn't include those 119 funds, the overall performance of mutual funds for the last five years would be overstated. It's even worse over the last 10 years, as only 61% of funds survived. A decade ago, 741 funds existed, but only 452 would show if you did a basic search today. The other 289 funds have, you guessed it, "disappeared."

So, whether its classic cars, college dropouts or mutual funds, don't just go with your first impression. Remember to think about survivorship bias, as it can have a big impact on your conclusions. We can do this by looking at failures as well as successes – and by making sure we have all the data.

[1]*SPIVA Canada and SPIVA US*

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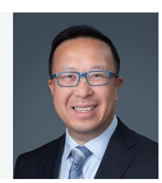

FINANCIAL PLANNING

THE VALUE OF AN ADVISOR

By Stan Clark, Senior Wealth Advisor

Canadian investment regulators have steadily increased disclosure requirements for the costs investors incur when working with advisors. We've always been in favour of full transparency, so we applaud these changes.

But it does raise the question: Once you know your costs, how do you determine the value an advisor provides in return for those costs? Only by assessing this value can you decide whether the costs are worth it.

Two large and reputable investment firms, Vanguard Group and Russell Investments, have each published research to quantify the value that advisors can add through sound investment and financial planning advice.

Vanguard estimates this value at 3.00%[1] per year, while Russell puts it at 3.85%[2]. The firms' research includes the value of practices such as: setting an appropriate asset allocation; avoiding common "behavioural" errors; and taking advantage of goals-based planning, systematic rebalancing, tax-efficient investing and related practices. As both firms advocate low-cost index investing, their estimates do not include any value added by the potential outperformance of market indexes. This is an additional area where the Stan Clark Financial Team has added value in the past – and we hope to continue doing so.

Below, we'll touch on a few of the broad areas covered by this research.

Asset Allocation – setting an appropriate Equities Target

Vanguard lists Asset Allocation as their #1 point. They are referring mostly to setting an optimal allocation between equities and fixed income, which our team calls an Equities Target. Vanguard says this value is "significant but too unique to quantify, based on each investor's time horizon, risk tolerance, and financial goals."

By doing careful financial planning and providing good coaching, an advisor can help you safely invest a higher percentage of your portfolio in equities than you might otherwise have. The added value here can be significant. For example, if you maintained an average equities mix of 80% to 90% over the past 10 years, compared with the 60% to 70% mix in typical balanced funds, your returns would have averaged 2% to 3% higher per year, even if they achieved only average index returns.

Avoiding market and investment timing errors

Both Vanguard and Russell rank Behavioural Coaching as the largest area of advisor-added value, with Vanguard assigning it a value of 1% to 2+% and Russell assigning it 1.95%. In describing Behavioural Coaching, both are mostly referring to avoiding timing mistakes when buying and selling different types of investments.

Their and others' research shows that natural human behaviour causes most investors to underperform because they too often enter and exit their investments at the wrong times. They buy after prices have risen and sell after they have fallen. This is very hard to avoid, even for the smartest people. However, working with an advisor who will help you avoid these errors can add substantial value over time.

Financial and Estate Planning

We'll use the above heading to refer to a host of other areas where Vanguard and Russell say advisors can add value. Through these Financial and Estate Planning areas, advisors can help save you money directly in a variety of ways. For example, they can assist you in setting an optimal equities target, thereby avoiding market timing (see above). And, advisors can provide a host of intangible benefits, such as a sense of clarity and control over your financial future.

Extra value through our stock strategies

We believe our team does a pretty good job at delivering the 3% to 4% value that Vanguard and Russell describe in their research. In addition, our team has developed and refined numerous "strategies" for selecting and monitoring our stock portfolios.

Since we started offering these strategies in managed portfolios 17 years ago, they have outperformed their benchmarks by +2.57% per year, before fees[3]. The average mutual fund, by contrast, has underperformed by approximately -1.07% per year, before fees. The difference between our strategies and the average mutual fund has therefore been +3.64% before fees.

Plus, our fees tend to be lower than for most mutual funds. We can't guarantee this outperformance will continue, but the spread has been improving rather than worsening over time.

Summary

While there are costs involved in working with an advisor, hopefully the value added will be much higher than those costs. If you pay 1% in costs and receive 4% or more in added value, that represents a very good return on investment.

[1] *The Vanguard Group, "Putting a value on your value: Quantifying Vanguard Advisor's Alpha®", July 2022*

[2] *Russell Investments, "2022 Value of an Advisor Study", May 2022*

[3] *Stan Clark Financial Team Disciplined World Equity composite performance*

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SCFT TRIVIA

Test Your Knowledge

Thank you for reading this month's newsletter. Test your knowledge with our trivia questions! Each question relates to one of the articles featured in this edition. See how many you can get right, and check your answers at the bottom of the page. Good luck and happy quizzing!

Hint: You can find the answers inside this newsletter.

1. When flying at night, a pilot may not notice his plane has tilted. In what is known as the leans, the pilot feels no need to adjust the plane. A well-trained pilot will:

a. Resist that feeling. Instead, using his instruments, he'll return the plane to level flight.

b. Go with the flow. If everything feels fine, it must be fine.

c. Avoid such problems by never flying at night.

d. When flying, always take a lucky rabbit's foot along.

2. Investing is similar to night flying in that circumstances can play tricks with the mind. It's easy to be distracted by, for example, information overload, our complex interrelationships with each other in personal matters and in business, and the media's influence:

a. True

b. False

3. Two recent studies on the value of having an investment advisor cite the beneficial practice of:

a. Setting an appropriate asset allocation.

b. Avoiding common "behavioural" errors.

c. Taking advantage of goals-based planning, systematic rebalancing, tax-efficient investing and related practices.

d. All of the above.

4. Another study, S&P Indices Versus Active (SPIVA), reveals actively managed funds that attempt to beat the market, but mostly end up failing. The SPIVA study adjusts for survivorship bias, which refers to:

a. The total accuracy of fund managers' performance reports over the past decade.

b. The healthy state of all managed funds, with none ever having been merged or closed.

c. Fund managers' numbers that show only the performance of surviving funds, thus creating a biased representation of actual past performance.

d. The natural longevity of all managed funds.

Answers: 1. A, 2. A, 3. D, 4. C

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