The Stan Clark Financial Team's

PERSPECTIVES

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Volume 12 - Issue 3 April 2021

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Due to our innate *availability bias*, we assume whatever disaster is on the news — violence, abduction, unethical corporations — will soon happen to us. As I discuss in this month's behavioral finance article, such assumptions can if unchecked prompt us to make panicky, unwise investment decisions. In our *Quarterly Economic Update*, Michael Chu and I examine why the stock market continues to prosper in the pandemic. And Elaine Loo reveals the wisdom of looking back over 100 years of stock performance: The past really can inform the future.

Stan

CIBC Wood Gundy

Behavioral finance

How the news can hurt your investment decisions

By Stan Clark - Senior Investment Advisor

You see a graphic TV news report about an earthquake. At once you think: *It could happen here, too*. You are on edge for days, even weeks.

You read an item about a mass shooting. You fear for your safety on the streets. You hear about a child being abducted. You worry that your own child is next.

You read about an executive going to jail for insider trading, or about corporate greed. You start believing all publicly traded companies are bad.

In this issue, I'd like to show how the news can hurt your investment decisions.

The fact is, once people hear dramatically bad news, they tend to overestimate the probability of it recurring. This is a psychological phenomenon called the availability bias.

Take shark attacks. These hardly ever happen. But when they do, many people become so frightened they stay out of the water for a while, if not indefinitely. The fact is, *it's in everyone's nature to estimate what is likely to happen based on what is most current in their memory*. This is especially the case with vivid, unusual or emotionally charged events.

In truth, of course, you are likely to survive even a massive earthquake. Our streets are no more dangerous today than yesterday. As for child abduction? Extremely rare. But the news by its very nature focuses on the exceptions or the dramatic. And because this is what the news mostly reports on, we regard these exceptions as the norms. As a result, we feel less safe on the streets, etc., and indeed more at risk everywhere, than we really are.

The same is true about public companies. Most of those who work in public companies play by the rules. Unfortunately, the availability bias can lead people to react too strongly to negative reports about unethical behaviour in the corporate world. For that reason, they may shy away from owning stocks. And that's a shame, because stocks generally produce high returns to shareholders. In the U.S., stocks have averaged 11.1% a year compounded over the past 100 years. No other major asset class comes close to this: not gold, not bonds, not real estate.

This is not to say there aren't problems. Let's face it, greed and dishonesty have always been part of society, in every line of work. Even noble professions such as academia, the church and medicine include some people who lie, cheat, steal or defraud.

But dishonesty and wrongdoing cannot be that big a factor in the corporate world. Otherwise, the average returns to shareholders would not be as high as they are! Most people working for these companies are simply trying to produce real profits and help their companies grow. Their incentives and interests are usually very closely aligned with those of their shareholders.

The way to deal with availability bias, so that it doesn't negatively affect your investments, is to consciously try to keep a balanced perspective on events. Remember: Investing works best when you diversify and take a long-term approach.

So, don't get caught up in the latest bad news or scandals. Don't let them overly affect your investing decisions. Recognize that recent, emotionally charged events are just that: recent events. They are seldom indicators of recurring probabilities. It's natural to fear they are – but that fear has little basis in reality, and allowing it to overly affect your decisions can seriously harm your wealth. ■

The fact is, once people hear dramatically bad news, they tend to overestimate the probability of it recurring. This is a psychological phenomenon called the availability bias.

Team Talk:

Meghan Jones
Administrative Assistant

May 15, 2020 Sechelt, BC

Other than working from home, what have you been up to this past year?

My partner, Adam, and I got engaged last May and have been trying to plan a wedding for the fall of this year. It is proving to be more difficult than we had anticipated and my heart goes out to all of the couples who have faced similar challenges during Covid. We have still managed to enjoy our engagement, however, and look forward to celebrating with our friends and family when we can!

I turned 30 in June and spent a few summer weekends up at our cabin in the Okanagan. We recently purchased a condo in New Westminster and will be moving to our new (bigger!) space at the end of the month. As well, we welcomed two nephews into the world in early 2021 and are very excited to meet them in the near future.

Other than that, enjoying the sunnier weather and keeping in touch with our friends. It's been a busy year despite the trials we have all faced, and I feel there is finally light at the end of this tunnel. All my best and stay safe!

Investing

Quarterly Economic Update: Why stock markets have continued to thrive

By Stan Clark, Investment Advisor, and Michael Chu, Investment Advisor

Strong start to the year

It's already been about a year since the pandemic began for us. No doubt you'll recall what happened a year ago: Markets experienced a big, panicked drop, followed by a surprisingly quick recovery. Since the recovery, markets have continued to go up, setting new records – bolstered by economic expansion, low interest rates and growing corporate earnings.

The first quarter of 2021 was positive for most stock markets around the world. At home, the TSX was up 8.1%. The World Equity Index, a gauge of stocks around the world, was up 3.6% (in C$).

In 1937, real GDP growth came in at 5%, but the S&P 500 was down 35%! One reason stocks fell so much was that the economy slowed. The slowdown eventually turned into a recession that lasted until 1938.

The highest growth with a down market was in 1941. GDP growth was up double digits; nevertheless, the S&P 500 was down 11%. In that instance, it was World War II that spooked investors.

So, it's rare for a stock market to fall when the economy is booming. But it's also rare for the stock market to boom during a nasty recession as it did in 2020. Maybe the market has anticipated all the good news. Or, we could be in the beginning of one of the strongest economic expansions since the 1990s.

	1st Quarter 2021	Trailing P/E	Trailing Earnings Yield	Dividend Yield
Canada	8.1%	23.9	4.2%	2.9%
U.S.	4.8%	34.0	2.9%	1.4%
Europe	3.1%	24.7	4.1%	2.4%
Japan	-1.5%	24.9	4.0%	1.9%
EAFE (Europe, Australasia, Far East)	2.2%	25.2	4.0%	2.3%
Emerging Markets	1.0%	21.5	4.6%	1.9%
World	3.6%	30.4	3.3%	1.7%

Source: Bloomberg

Crashing during an economic boom

When stock markets are at record highs, many wonder when the crash will come. Over the past year the stock market's relationship to the economy has felt very strange. Why was the market so strong while the economy was reeling? Maybe investors should be worried. Or, just maybe the economy is gearing up for the best economic growth we've had in decades.

Ben Carlson of Ritholtz Wealth Management looks at the relationship between economic booms and stock market performance. Again, it's been a year since the economy was essentially put on ice. In the second quarter of 2020, this led to the worst economic contraction on record, annualizing at -34%. Yet somehow we are now on track for an economic boom in the U.S.! Analysts expect 8% economic growth in 2021 and an unemployment rate of 4% by year-end. The IMF (International Monetary Fund) is almost as enthusiastic, having raised their estimate of U.S. economic growth to 6.4% (from 5.1%). This would represent the strongest economic growth rate since 1984.

With the markets in record territory, now we must ask: Has the stock market ever crashed as the economy soared? It's rare – but it has happened.

Going back to the 1930s, there's a good relationship between short-term GDP growth and stock market performance, especially during high growth. As expected, higher economic growth coincided with higher average stock market returns. However, averages can hide outliers.

Increasing earnings

Top economist Ed Yardeni raised his earnings forecast for the S&P 500 for 2021 from $175 per share to $180 per share, and for 2022 from $190 to $200. This is an 11% increase from 2021 to 2022. Yardeni would have raised his 2022 estimate more but these are after-tax earnings, and he also expects higher corporate taxes.

One reason for higher earnings forecasts is the fourth round of relief checks going out to Americans. Yardeni states that business surveys are high, indicating strong business activity. This is highly correlated with revenue growth, which is expected to go up 10-15% this year. There is also a strong outlook for profit margins, which tend to rebound after recessions and during recoveries, along with productivity.

What does this mean for the stock market? While Yardeni raised his earnings estimate, his price target for the S&P 500 remains the same as before: 4300 at the end of this year and 4800 at the end of next year, about 24 times earnings (or 4.2% earnings yield) for each year. The reason he didn't set his target prices to go up more was to leave some wiggle room on valuations, as he expects interest rates will be slightly higher. Yardeni says that normally his valuations would come down in a rising rate environment. But he thinks that valuations will remain elevated because of fiscal and monetary policy that will continue to flood the economy.

Positive economic developments

Positive economic surprises continue to come out of the U.S. The manufacturing index (ISM) came out better than expected, at its strongest level since 1983. Manufacturing strength helped offset COVID-related restrictions in the service sector. Over 1.6 million jobs were added in the first quarter, lowering the U.S. unemployment rate to 6%. There's still room for improvement on the job front, but much progress has been made to get back to normal.

Also, in Canada

The Canadian economy also did better than expected. The first-quarter GDP is estimated to grow by 6% annualized. New COVID restrictions might temper that, but if it does achieve such growth it means that the economy is just 2% smaller than it was pre-pandemic.

More taxes coming?

Higher taxes have been a big topic on both sides of the border. The issues doesn't just involve paying for all the pandemic stimulus; it also involves income inequality.

What can we expect in Canada? Canada's 2021 Federal Budget will be announced on April 19th, around the same time as you're receiving this newsletter. The upcoming year's budget should focus on post-pandemic economic recovery, though many are concerned about potential tax increases. Now, it's not generally our practice to speculate. Even so, it's possible to see changes in the months or year ahead involving capital gains inclusion rates, principal residence exclusion, income tax and wealth taxes.

Hopefully, taxes won't increase too much or at all. The government must balance the recovery as well as work on reducing the deficit. Plus, the politics of tax increases at this time is probably extra unpalatable. At least interest rates are super low, so the government can afford to be patient. However, increasing the capital gains inclusion rate would probably be the "easiest" change; as well, it targets upper-income Canadians more. The inclusion rate has been 50% for the past 20 years. Previous increases have been announced ahead of time – giving investors time to tax-plan. But, as we've seen in other areas, anything can happen.

Inflation

Inflation has been low during the pandemic. That makes sense. Low inflation is what happens during a recession: It's hard to get a pay raise and it's also hard for business to push through price increases to the consumer. We're starting to see some inflation, but for the most part inflation is still below where central banks want to see it. In the short term, the winter storm in the U.S. caused oil price to go up, which also affected other products such as plastic. But these pressures on inflation seem temporary. Perhaps they will cause a short spike in inflation readings, which may cause some volatility in the stock markets. But in the longer term, there seems to be enough economic slack that too much inflation will hopefully not become too much of an issue.

Enjoy the ride

Wharton School Finance Professor and author of *Stocks For the Long Run* Jeremy Siegel expects stocks to keep rallying for the rest of 2021. However, Siegel advises investors to be cautious once the Federal Reserve adjusts its ultra-accommodative policies. He thinks stocks could go up 30 to 40% before they go down 20%, when the Fed eventually responds to inflation.

Siegel believes the economy will be strong this year as restrictions are lifted and activities like travel pick up again. He believes this will unleash inflationary pressures higher than what the Fed predicts, and that will force the central bank to act to slow things down.

One of the key reasons Siegel thinks stocks can still rally despite a pick-up in inflation is that owning stocks is still better than owning cash. According to Siegel, if there's inflation, you would rather be in the stock market where corporations have more pricing power than ever in the last two decades. But if the Fed steps in aggressively in response, the markets could react, causing a short-term correction.

Emerging markets

How have emerging markets countries fared during the pandemic? On the surface, it seems like emerging markets have done about the same as developed markets in terms of infections and deaths, though with extreme variation between countries. But if you look deeper into the data, it seems like they were reporting fewer infections than they actually had. In terms of excess deaths over normal, some emerging markets countries have been amongst the worst.

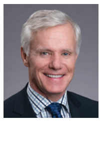
But economically emerging markets have done better, suffering less of an economic decline last year. Plus, their economic forecasts are better going forward.
Being dynamic economies, having young populations and limited lockdowns have been helpful to these countries. Their stock markets are still well priced, in terms of P/E ratios, compared to other countries, especially the U.S.

Looking ahead

After a full year of worry about the destructive effects of the pandemic, investors now focus on a return to "normal." Indeed, the vaccines are a meaningful turning point, but delays in vaccination and the spread of variants could still be disruptive to the economy. Governments and central banks will need to navigate a tightrope between economic recovery and inflation.

The stock market at near-record levels reflects a degree of optimism that leaves them vulnerable if expectations are not met. Although earnings have also been good, valuations are slightly elevated compared to historical averages. But, remember that prices of many stocks are still reasonable when comparing earnings yields to interest rates. So, we remain cautiously optimistic about the future, although expect lower-than-historical-average returns for stocks, bonds and most other assets.

We can never be sure of what will happen in the short term. As we urge in all our reviews, it's important to have a time-tested financial plan, to base your asset mix on that plan, and to not try to time the short-term ups and downs of the markets. This is the most reliable way to reach your long-term goals and to avoid the high risks that market timing entails. ■



Stan Clark is First Vice-President, Portfolio Manager and Senior Investment 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.

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.

Asset Allocation

Stocks vs. bonds over the past 100 years

By Elaine Loo, Associate Investment 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.

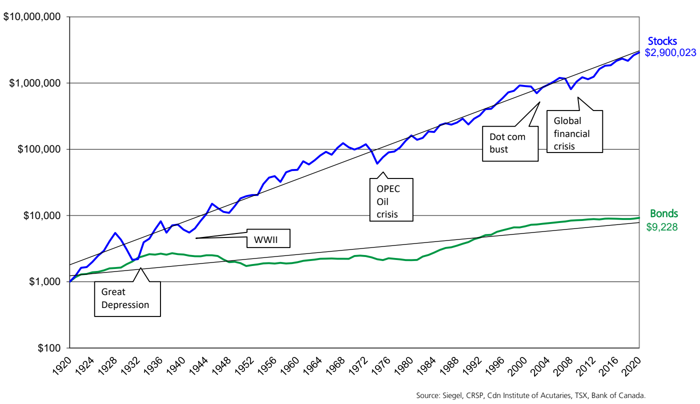
Let's look at stocks-vs.-bonds returns over the past 100 years. Think of The Tortoise and the Hare as a story about asset allocation: of bonds, which appreciate slowly and appear reliable; and of stocks, which can appreciate strongly and quickly, but appear risky. Which is your best bet? The answer depends on what kind of race you're running.

The past 100 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 the time. 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 100 years, if you owned equal amounts of Canadian and U.S. stocks you would have enjoyed average annual growth of 11.1% (in Cdn dollars) for an inflation-adjusted (real) return of 8.5%. Over the same period, Canadian bonds averaged 4.9%, or real returns of just 2.3% per year.

Here's a graph showing 100 years of growth in stocks vs. bonds. If you started with $1,000 in each, you would now have over $2.9 million with stocks, but only about $9,000 with bonds. Remember that these are in "real" dollars, after adjusting for inflation.

Real Growth from $1,000 - 1921 to 2020



Here's a table showing the average percentage growth in stocks vs. bonds over the past 100 years. It also compares the differences in median total dollar growth over various time horizons.

Growth in stocks vs bonds 1921 to 2020

	Average Nominal Returns	Average Real* Returns	Real growth from $100,000** 1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	11.1%	8.5%	$8,517	$53,088	$117,037	$211,897	$360,877
Bonds	4.9%	2.3%	$2,306	$9,672	$18,507	$29,103	$36,966
Inflation	2.6%						
Difference in growth (real $)			+$6,211	+$43,415	+$98,530	+$182,795	+$323,911
Difference in growth	2.3x	3.7x	3.7x	5.5x	6.3x	7.3x	9.8x

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

* "Real" returns are nominal returns after subracting inflation

** "Real growth from $100,000" is the median real growth over different time periods, showing the effect of compounding.

The average real returns from stocks were 3.7 times higher than those of bonds. If you started with $100,000 in bonds, this would have grown by about $36,966 after 20 years. The same amount invested in stocks would have grown by $360,899 – nearly ten times as much!

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 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. The worst 10-year period for bonds was lower than the worst 10-year period for stocks. The chance of losing money over any 10-year period was nearly seven times greater for bonds than it was for stocks. Over any 10-year period, stocks did better than bonds 89% of the time. And, over 15- and 20-year periods, stocks beat bonds every time and never failed to beat inflation. The worst return for stocks over 20 years was a profit of $100,942 above inflation! So, based on history, it seems that the longer you can invest for, i.e., your investment horizon, the less risky stocks are and the riskier bonds become.

The key takeaway here is that one type of asset isn't always better. How long you can invest for 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. ■

Elaine Loo is an Associate Investment 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.

CIBC Wood Gundy

The Stan Clark Financial Team

Where planning, investing and behavioral finance meet

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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. We experience the psychological phenomenon availability bias when we:

    a) Panic-buy large quantities of a consumer product in short supply

    b) Hear dramatically bad news and overestimate the probability of it recurring

    c) Decide to buy stocks that are widely advertised

    d) Switch off the news and relax so we won't see anything unpleasant.

2. The United States looks set to:

    a) Have an unemployment rate of 4% by year-end

    b) Enjoy 8% economic growth in 2021

    c) Have revenue growth in 2021 of 10-15%

    d) All of the above.

3. It makes sense that inflation is low in a recession. It's hard to get a pay raise and it's also hard for business to push through price increases to the consumer:

    a) True

    b) False.

4. In looking at the past 100 years of stock performance, we discover:

    a) All the stocks we wish we had invested in.

    b) What a difference having a cellphone would have made back in the day

    c) The world seems scary now, but it likely won't be all that different: History repeats itself

    d) How simple life used to be.

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 April 30, 2021.

Trivia challenge runs April 1 - 29, 2021. 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.