The Stan Clark Financial Team's

PERSPECTIVES

In this issue...

Volume 9 - Issue 2 March 2018

Stan Clark
Senior Investment Advisor

In this issue, I review Michael Lewis's fascinating, insightful *The Undoing Project – A Friendship That Changed Our Minds*, about the two founders of behavioral finance: Daniel Kahneman and Amos Tversky. Michael Chu looks at the results our team achieves from our stock selection process. Sylvia Ellis provides highlights of the recently announced BC Budget. And Elaine Loo updates a previous report on how stocks vs. bonds have fared over the past 100 years.

Stan

CIBC Wood Gundy

Behavioral finance

The Undoing Project – a friendship that changed our minds

By Stan Clark - Senior Investment Advisor

In my December article on behavioral finance, I wrote about one of the pioneers in that field, Richard Thaler, who won the 2017 Nobel Prize in economics. In this issue, I'd like to review a 2016 book, *The Undoing Project – A Friendship That Changed Our Minds*, about the two men who started behavioral finance.

One reviewer said *The Undoing Project* might well be Michael Lewis's best book ever. That's quite an accolade for an already celebrated author with six *New York Times* best-sellers. Three of those – *The Blind Side, Moneyball and The Big Short* – became highly acclaimed, Hollywood blockbuster films.

With *The Big Short*, about the 2008 financial crisis, and *Flash Boys*, about high-frequency trading, Lewis has proven to be a master at making complex subjects simple and interesting. He's done the same with *The Undoing Project*.

I loved *The Undoing Project* for three reasons:

First, Lewis did a wonderful job explaining some key lessons of behavioral finance. Before, prevailing theories of economics and finance assumed that most people made judgments and decisions rationally and consistently. This assumption led to conclusions that supported supposed experts who sought to beat the markets using their superior brain power; and who said the markets were efficient and largely unbeatable.

Behavioral finance documented that, people make *significant* and *systematic* errors in their judgments and decisions. Lewis shows how this helped *undo* much of the reigning belief system.

I also loved Lewis's colourful stories about the two main characters: Daniel Kahneman and Amos Tversky.

Born in Tel Aviv, Kahneman spent his early childhood in France, where his family was forced into hiding from the Germans during World War II. He moved to British Palestine after the war, just before the creation of Israel. Tversky was born and raised in Haifa, British Palestine. Both men played pivotal roles in the Israeli defence force in the wars following Israel's creation. Their early lives helped shaped their later work.

Second, I enjoyed Lewis's account of how the collaboration between these two very different personalities resulted in the genius of their creativity.

Tversky was a larger-than-life, extroverted, super-optimistic, mathematical genius. Many smart people claimed he was the smartest person they ever met.

Kahneman was introverted, prone to introspection and pessimism. Described as "Woody Allen without the humour," he constantly questioned his own thinking. Kahneman saw the errors he made and assumed others made the same ones. This provided much of the fodder for his and Tversky's joint investigations on human nature.

Their partnership started when Kahneman invited Tversky to give a guest lecture to one of his classes at Hebrew University. Kahneman did the unthinkable: He questioned Tversky's findings. Tversky, to his credit, recognized the value of Kahneman's mind, and that his colleague could add to his own thinking.

Their most productive period was the 1970s, working side by side at Hebrew University. In 1978 they moved to North America to two different universities. Although they still collaborated, their separation caused them to drift apart.

Tversky died of cancer in 1996 at age 59. Kahneman won the Nobel Prize in Economics in 2002 for the work they did together.

Kahneman originally coined the term *The Undoing Project* to describe the psychology of people attempting to undo, in their minds, events they wish hadn't happened. Kahneman put much thought into this, partly because of the regret he felt for having drifted apart from Tversky.

One can only imagine how much more we might have learned about our minds if that amazing partnership had carried on longer. ■

Team Talk:

Sylvia Ellis
Senior Estate Planning Advisor

Enoshima, Japan 2017, Sylvia with Uncle Tsutomo-san

You were in Japan last May. How was the trip?
It was our second venture there and we still haven't scratched the surface! We spent time in Tokyo, Kyoto, Mt. Fuji, Kamakura and Enoshima. The picture above is of me and my dad's brother, Tsutomo Sato. We spent two days with him exploring Kamakura and Enoshima. Behind us is Sagami Bay where the epicenter of the Great Kantō earthquake in 1923 occurred devastating Tokyo and the port city of Yokohama.

How about the food?
For more of a fun dining experience, Craig and I visited Tapas Molecular Bar at the Mandarin Oriental in Tokyo. Think "science" meets "food". Located on the 38th floor, the view of Tokyo is outstanding. With only eight seats, you need to book well in advance. We also dined at another limited seating restaurant, Sushi Bar Yasuda. We learned of ex- New York chef, Naomichi Yasuda, through Anthony Bourdain's, Parts Unknown. He's a jokester so be prepared to eat well and be entertained!

What's on the horizon?
After visiting my family in Austria and Japan over the last several years, it's Craig's turn! We head to the UK to visit his in Darlington. We'll also take in a Manchester United soccer game!

Investing

Strategy returns – and risks

By Michael Chu, Investment Advisor

Over the last 100 years, the stock market has averaged 11.6%. That's a very good long-term track record. But that's just the average. At the Stan Clark Financial Team, our goal is to get better-than-average returns without taking on more risk.

In past *Perspectives* articles, we've discussed in detail our stock selection process, from the principles of behavioral finance to our disciplined, rules-based process, including the specific variables that we use. While it's important to discuss what goes into our strategies, it's also important to review the results.

Further to our *Year-End Review* last month, we thought it would be useful to discuss our stock strategy performance in more detail. Our stock strategy decisions are based on back-tested models. *Back-testing* means we decide on a reasonable and logical set of rules, then test those rules by going back by using historical data to see how they would have done. Some of our back-tested models go back over 40 years. We've been investing with real money this way for almost 25 years.

We've been able, for all of our accounts, to consolidate returns that follow the same specific model. This track record of actual results now goes back nine years. Although nine years is pretty substantial, normally we wouldn't consider it long enough to make reliable decisions. However, in this case, we can make good decisions because they're backed up by decades of statistics.

In 2017, our strategies did well. They each outperformed the market except for one, which slightly underperformed.

The table shows our strategies that have long-term track records. Over the last nine years, our five Canadian strategies, the *Disciplined Canadian Stock* composite, averaged 15.5% per year vs. 10% for the TSX composite benchmark.

For the last nine years, our five U.S. strategies, the *Disciplined U.S. Stock* composite, averaged 16.5% vs. 15.3% for the S&P 500 benchmark (in U.S. dollars).

Our *Disciplined World Equity* portfolio uses all 12 of our strategies and is invested around the world. The returns for the last nine years were 14.7% vs. 11.5% for the benchmark.

Our second global portfolio, *Dividend Select World Equity*, is also invested around the world, but has a slightly higher weighting in Canada and dividend payers. The average for the last seven years was 12.5% vs. 9.2% for the benchmark.

It is important to note that these returns do not include fees.

It is also important to note that it's not easy to beat the benchmarks. Just ask any mutual fund manager. In the last five-year period, only 2% of U.S. equity funds outperformed their benchmarks. Similarly, less than 7% of global equity funds beat their benchmarks. This is according to the *S&P Indices Versus Active Funds (SPIVA) Canada Scorecard*, which reports on the performance of actively managed mutual funds in Canada.

It's also about looking at risk

A good strategy isn't just about returns. It's also about looking at risk. Over the long term, taking on higher risk means you should be compensated with higher returns. It's our objective that our strategies also come out ahead when looking at risk.

There are two main ways we reduce our strategies' risk. Firstly, we have many different types of strategies. For example, value- or growth-oriented. Secondly, our strategies invest around the world. Over time, styles change and things come in and out of favour. And geographically, some areas do much better than others. Having many different types of strategies, and investing internationally, helps ensure that you have good, diversified exposure. The result is more consistent returns.

We do have off-years. These are unavoidable. But a bad year is often made up for in the following years.

In summary, our disciplined method of investing in stocks has given us a good track record of better-than-market returns – while taking on less risk. ■

Stan Clark Financial Team Strategy Returns (annualized)

		Strategy Composite	Benchmark	Outperformance (per year)
Disciplined Canadian Stock	9 years	15.5%	10.0%	5.5%
Disciplined U.S. Stock	9 years	16.5%	15.3%	1.3%
Disciplined World Equity	9 years	14.7%	11.5%	3.2%
Dividend Select World Equity	9 years	12.5%	9.2%	3.4%

Stocks vs. bonds over the past 100 years – UPDATE

By Elaine Loo, Associate Investment Advisor

In Aesop's fable of The Tortoise and the Hare, slow and steady wins the race. But is that how it really 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 fixed-income investments, 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 really 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 feel of the range of possible outcomes going forward.

Data from the University of Chicago show that, over the past 100 years, if you owned equal amounts of every U.S. stock excluding the smallest 20%, you would have enjoyed average annual growth of 11.6%, for an inflation-adjusted (real) return of 8.7%. Over the same period, fixed-income investments averaged 4.2%, or real returns of just 1.3% per year. So, the real returns from equities were nearly seven times higher than those of bonds. If you started with $100,000 in bonds, this would have grown by about $28,000 after 20 years, using real returns. That same amount invested in stocks would have grown by $413,000 – 14 times as much!

The table above summarizes the growth in stocks vs. bonds over the past 100 years.

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 long 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.

100 Year Returns

Growth in stocks vs bonds 1918 to 2017

	Average Nominal Returns	Average Real* Returns	Average real growth from $100,000: 1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	11.6%	8.7%	$8,717	$53,942	$125,106	$238,389	$413,487
Bonds	4.2%	1.3%	$1,314	$7,993	$16,063	$23,215	$28,270
Inflation	2.9%						
Difference in growth ($)			+$7,403	+$45,949	+$109,042	+$215,175	+$385,217
Difference in growth	2.7x	6.6x	6.6x	6.7x	7.8x	10.3x	14.6x

Source: Siegel, CRSP, Barclay's Capital, U.S. Dept of Labor, U.S. Dept of the Treasury

* "Real" returns are returns after subracting inflation

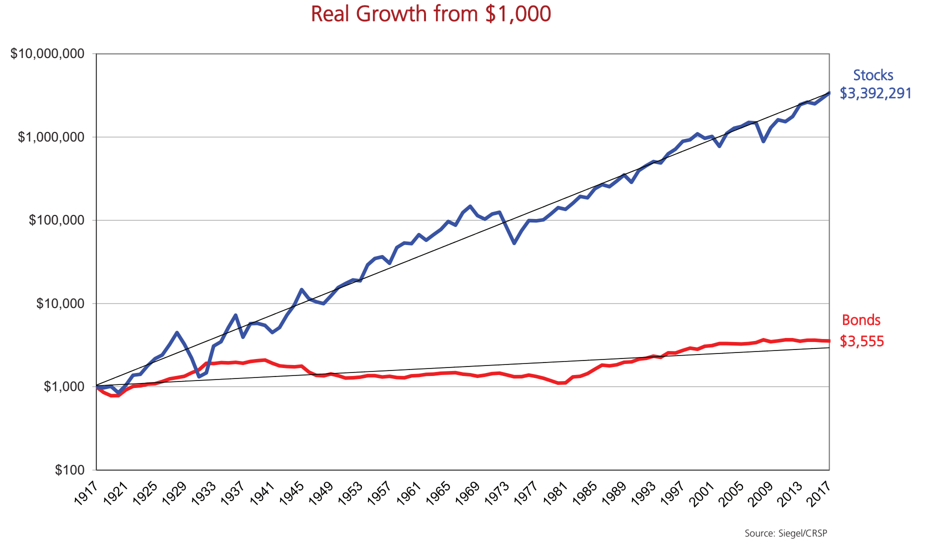
Below is a graph illustrating 100 years of growth in stocks vs. bonds.

Inflation actually makes bonds riskier than stocks over the long term. The return during the worst 10-year period for bonds was 10% 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 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 $81,000 above inflation! So, based on history, it seems that the longer 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 than another. 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 your money should be mostly in fixed income. If you have savings earmarked for needs five to 10 years or more from now, consider investing more of those savings in 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.

100 Year Returns — Growth in stocks vs bonds 1918 to 2017



Financial Planning

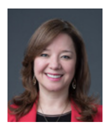
2018 BC Budget Highlights

By Sylvia Ellis, Senior Estate Planning Advisor

On February 20, 2018, the BC NDP announced its first full budget, prepared by Finance Minister, Carole James. It focuses on housing, affordability, childcare, and increasing services. Below are some of the highlights:

1. **Elimination of MSP Premiums** – What would our neighbors south of the border think with their high cost of medical insurance! Ours are about to be eliminated, from a personal standpoint anyway. The budget will eliminate Medical Service Plan premiums on Jan. 1 2020. As part of eliminating the premiums, the province will put in place a new payroll tax for employers starting on Jan. 1, 2019.
2. **Affordable Child Care benefit** – The province is providing support to parents who have their children in licensed child care facilities. A new credit will see up to $350 per month go directly into licensed child care that will see the savings passed onto parents.
3. **Housing** – The budget has included funds for affordable housing for students, indigenous peoples, women and children fleeing abuse, and others.
4. **New speculation tax** – Starting this year, the provincial government will apply a 0.5 per cent speculation tax on homes owned by people who don't pay taxes in British Columbia. The tax goes up to two per cent in 2019 and will stay at that rate going forward. This is targeted at foreign and domestic homeowners who do not pay income tax in BC. As well, individuals who leave their homes vacant.
5. **Property Transfer Tax** – Effective Feb. 21, there will be a hike on the property-transfer tax from three per cent to five per cent on properties worth more than $3 million.
6. **PST increased for luxury vehicles** – If you're looking to buy a new, expensive car, be prepared to pay more! The PST for luxury vehicles with a purchase price between $125,000 and $150,000 has been increased from 10% to 15% and those over $150,000 will see an increase to 20%.
7. **New and upgraded health facilities** – For the Metro Vancouver region, this includes a renewal of Vancouver General Hospital's Operating Room with 16 new universally-sized operating rooms, a 40-bed perioperative care unit, and other facility upgrades. Construction is expected to begin in early-2019 for a completion in 2021.
8. **BC Ferries fare freeze and reduction** – This one I personally like as I travel to Victoria every two months or so to visit family. The provincial government will freeze the fares on the three major coastal routes: Swartz Bay-Tsawwassen, Duke Point-Tsawwassen, and Horseshoe Bay-Departure Bay. This means the planned fare increase on April 1, 2018 has been cancelled. As well, there will be a 15% fare reduction on non-major routes and a restoration of the 100% seniors discount on passenger fares from Monday to Thursday.
9. **New Campsites** – Enjoy camping? If you've camped before, you know that sometimes it's hard to get a reservation without planning well in advance. Perhaps the Government's plan to add 1,900 sites to BC Parks may help out.

These are just some of the highlights. More information can be obtained from the BC Government website *bcbudget.gov.vc.ca.*



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.

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