The Stan Clark Financial Team's

PERSPECTIVES

In this issue...

Pg. 1 CAUTION: Biases won't disappear just because we know about them

Pg. 2 Time in the market vs. timing the market

Pg. 3 Financial planning is important – and well worth it!

Pg. 4 SCFT Trivia

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The important thing is to be aware we have biases. Or so we like to believe. In fact, as I discuss in this month's behavior finance article, the biggest trap of all with biases may be that knowing about them makes us confident we are free of them. Michael Chu looks at the tempting, but ultimately unreliable, strategy of trying to time the market as opposed to staying in it for the long haul. And Sylvia Ellis explains the importance of financial planning – and why we shouldn't put it off.

Stan

CIBC Wood Gundy

Behavioral finance

CAUTION: Biases won't disappear just because we know about them

By Stan Clark - Senior Investment Advisor

In past issues, we've discussed biases that affect our thinking and financial decisions. Biases can fool us on everything from hindsight to predictions, and to putting too much confidence in recent events.

We all like to think we are rational. But most of our biases are caused by the limitations of our rational mind. Our subconscious mind has an amazing influence over our conscious mind and our actions.

At the end of my articles on financial behaviour, I usually devote some space to a *prescription*. I suggest how to avoid falling into the financial traps caused by biases. But maybe, with biases, the biggest trap is thinking that just because we know about them, they will go away. They won't!

Let's turn our attention for a moment to science, specifically the *big trap* concept. Have a look at his drawing of two tables:

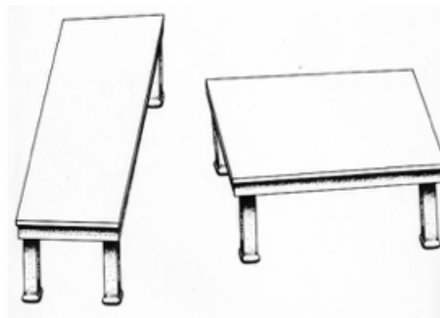


Table A **Table B**

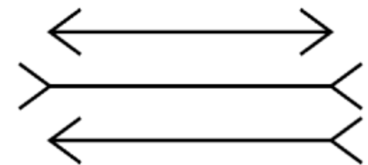
Table A, on the left, looks much longer and narrower than Table B, on the right. You can try turning the page sideways or upside down. But no matter how you view it, Table A looks long and narrow, with B shorter and wider by comparison.

Now try tracing the top of table A onto a piece of paper and then overlay this onto Table B. Are you surprised? Tables A and B are exactly the same size and shape!

There's something yet more amazing. Even once you know the tables are the same size, even if you've cut them out so your eyes can see this for themselves – when you turn back and look at the original pictures, *they still look very different*. No matter how many times I do this, and believe me I've tried it many times, it's still hard for me to mentally grasp that the two tables are the same size.

Merely knowing they are the same doesn't change our perception – our *feeling* – about them.

Now here's another example. Called the Müller-Lyer Illusion, it and consists of a set of arrow-like figures. Which of the three shafts looks the longest and which the shortest?



Doesn't the one at the top, with the two arrowheads, look the shortest? And doesn't the one in the middle, with the two tails, look the longest? Now place a straight-edge ruler along the ends of all three shafts. You will discover the shafts are all the same length. Once again, even when you *know* they are the same length, they still look to be different lengths. So much for the saying "Seeing is believing"!

These two examples show that our visual perception often leaves much to be desired. Our perception can be strongly affected by subtle differences. And it's very important to realize that knowing about perception errors doesn't get rid of them.

In financial decisions, we are similarly faced with a host of biases or illusions. For example, *confirmation bias* causes us to filter and interpret information in a way that distorts the truth. *Hindsight bias* causes us to believe things are much more predictable than they really are.

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
CDN Bonds 9.7%	EM Equities 15.6%	US Equities 41.6%	US Equities 24.4%	US Equities 20.8%	CDN Equities 21.1%	EM Equities 28.3%	US Equities 3.8%	US Equities 25.1%	EM Equities 16.6%
Global Bonds 6.5%	US HY Bonds 15.4%	INTL Equities 31.0%	Balanced Portfolio 11.9%	INTL Equities 19.0%	US HY Bonds 14.3%	INTL Equities 16.8%	Global Bonds 1.9%	CDN Equities 22.9%	US Equities 16.1%
US HY Bonds 5.7%	INTL Equities 14.4%	Balanced Portfolio 16.8%	CDN Equities 10.6%	Balanced Portfolio 8.2%	US Equities 8.6%	US Equities 14.1%	CDN Bonds 1.4%	INTL Equities 16.5%	Balanced Portfolio 10.0%
US Equities 4.3%	US Equities 13.1%	CDN Equities 13.0%	Global Bonds 9.4%	CDN Bonds 3.5%	EM Equities 7.3%	CDN Equities 9.1%	Cash 1.3%	Balanced Portfolio 15.5%	CDN Bonds 8.7%
Balanced Portfolio 1.1%	Balanced Portfolio 8.7%	US HY Bonds 7.1%	CDN Bonds 8.8%	EM Equities 2.0%	Balanced Portfolio 6.0%	Balanced Portfolio 9.8%	Balanced Portfolio -1.1%	US HY Bonds 14.0%	INTL Equities 6.4%
Cash 0.9%	CDN Equities 7.2%	EM Equities 3.9%	EM Equities 6.6%	Global Bonds 1.9%	Global Bonds 3.5%	US HY Bonds 6.4%	US HY Bonds -2.9%	EM Equities 12.9%	Global Bonds 6.0%
CDN Equities -8.7%	Global Bonds 5.3%	Cash 1.0%	US HY Bonds 4.3%	Cash 0.6%	CDN Bonds 1.7%	CDN Bonds 2.5%	INTL Equities -6.0%	CDN Bonds 6.9%	CDN Equities 5.6%
INTL Equities -10.3%	CDN Bonds 3.6%	Global Bonds 1.0%	INTL Equities 3.7%	US HY Bonds -2.7%	Cash 0.5%	Global Bonds 1.8%	EM Equities -6.9%	Global Bonds 6.8%	US HY Bonds 5.1%
EM Equities -16.4%	Cash 0.9%	CDN Bonds -1.2%	Cash 0.9%	CDN Equities -8.3%	INTL Equities -2.5%	Cash 0.6%	CDN Equities -8.9%	Cash 1.7%	Cash 0.6%

Source: Bloomberg

A recipe for losing money

Timing the market is usually a recipe for losing money. Historically, the market is up two-thirds of the time. So, right away, the odds are stacked against someone getting out of the market at a so-called "right" time. Actually, many investors typically increase their stock holdings just before downturns and decrease them just before rallies. This is because these investors focus excessively on recent performance. They also make long-term predictions based only on recent performance – and that's probably the last thing you should do. The chart above shows the top-performing markets each year, sorted from best to worst. As you can see, it looks quite random. The best performers for one year don't usually repeat the year after. In fact, there's an argument for investing in the worst performer for a big comeback the year after.

Let's say you got out of the market successfully by selling at the top. Okay, but you still have to get back in at some point. Deciding when to do that is going to be just as hard. Warren Buffett advises that, if you're going to even attempt to time the market, at least do the opposite of current trends: "…if [investors] insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful."

Obviously, this is easier said than done. Perhaps Buffett is hinting to not even try! Waiting until you feel safe in the market is not a good way to invest. Valuations tend to be better during tough times and more expensive during good times. Sometimes the market can come roaring back quicker than expected. 2020 provides a great example: After the bottom in March, the S&P 500 rallied 18% in just three days. The market continued to recover, despite the ongoing recession and pandemic. The market regained its previous high by mid-August – just six months later.

If an investor insists on trying to time the market, they better be right, down to the exact day! Over the last 20 years, just missing the market's best five days would have reduced your portfolio by almost half compared to simply staying in the market. Missing the best 30 days would have reduced your portfolio by 80%. Of course, missing the worst days would help stem your losses. The truth is, however, that a market timer is much more likely miss an up day than a down day.

Stock market declines are not uncommon. They can be stressful. But remember that declines have always been followed by recoveries. This is what we mean when we say that stocks' returns compensate for their volatility. There's no denying that stocks are volatile. In fact, over shorter time periods, stock returns are highly variable. But over longer periods, especially 10 years or more, stocks have given much better returns with less chance of losing. Since 1927, 88% of 10-year rolling periods for the S&P 500 were positive. Even three-year periods were 77% positive. Attempting to avoid the declines by timing the market will most likely give you lower returns over time.

So, if we can't time the market, then what *can* we do? Here's what. We set a target equities mix based on your own personal circumstances. Then we rebalance your mix back to your target when it varies notably by a predetermined amount. This will help you benefit from the volatility with a systematic method of buying low and selling high. *It's about time in the market*, not timing the market. Time in the market allows investors to better position themselves for better long-term results. A long time horizon that benefits from the power of compounding is much more impactful and generally more successful than the mirage of market timing. ■

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.

Financial & Estate Planning

Financial planning is important – and well worth it!

By Sylvia Ellis, Senior Estate Planning Advisor

People make plans for vacation travel. They also create plans for home renovations, weddings and even shopping trips. Why is it, then, that most people don't have a plan for their most important long-term financial decisions?

It's partly because financial planning can be daunting. You have to integrate so many factors: income, spending, savings, assets, liabilities, risk tolerance, family situation, goals… The list is indeed lengthy. And for your financial plan to work, all of these need to fit and be coordinated with each other.

But it's well worth the effort. A good plan will help you:

- save enough money to invest to reach your goals
- eliminate, reduce and defer income taxes
- determine the right asset mix for you
- protect your family against financial losses from death, disability or serious illness
- make sure your estate is distributed according to your wishes.

Because financial planning can be complicated, it's only human nature to put it off. Or, if people do create a plan, many become overwhelmed by putting it into effect. They let the plan lapse and it becomes outdated. Meanwhile, taxes, inflation and the wrong investments are limiting or diminishing their wealth.

We've found that the easiest way to avoid being overwhelmed with planning is to break it down into manageable, bite-sized pieces. Don't try to do everything at once; focus on what's most important and urgent. And treat your financial plan as an ongoing process rather than a one-time event. That way, you can always make solid progress on a schedule and time-frame you can work with.

At The Stan Clark Financial Team, we use a four-step cycle:

Step 1: Clarify your situation and your goals

This is where we take the time to discover what you are about: family, work, needs, goals and dreams. As with taking a trip, you need to know where you are and where you want to go in order to figure out how to get there.

Step 2: Create a personal financial plan

Once we have a clear understanding of your situation and goals, the next step is to put numbers to everything. This will help you answer the basic questions, such as: When can I retire? How much retirement income will I need? What size estate will I leave my family? From here, we review all of your financial affairs and identify the top priorities for you to act on.

Step 3: Customize your investments to fit your plan

Your investments are a very important tool to help you achieve your life goals, so we need to get them on the right track as soon as possible. Together we review your plan and preferences and determine the strategies and guidelines we will use to manage your investment portfolio. We then monitor your portfolio, make necessary changes and report to you on a regular basis.

Step 4: Complete your financial action plans

Here we work through the priorities identified in your personal financial plan, on a schedule suitable to you.

Once we're finished, we go back to Step 1, review your situation and goals and start the process over again. We also do a "plan vs. actual" to see how you are progressing relative to your last plan. We recommend doing this every year or at least once every two years – or whenever your personal circumstances change significantly.

Planning helps avoid rushed, ill-considered and emotional decisions. Anything that's important to you deserves to be well-planned. This includes your finances! ■

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. The biggest trap with having biases may be that:
   - a) We place too much trust in people who have charisma.
   - b) We think that once we are aware of our biases, they will go away. They won't!
   - c) We pay too much attention to celebrity news.
   - d) We think we know everything.

2. Hindsight bias causes us to:
   - a) Get angry at people we have liked up to now.
   - b) Like people we used to dislike.
   - c) Look back on our lives with a rosy perspective.
   - d) Think, after the fact, that events were much more predictable than they really were.

3. Historically, the market is up two-thirds of the time. So, the odds are stacked against someone getting out of the market at a so-called "right" time.
   - a) True   b) False.

3. Among other advantages, a good financial plan will help you:
   - a) Save enough money to invest to reach your goals.
   - b) Eliminate, reduce and defer income taxes.
   - c) Protect your family against financial losses from death, disability or serious illness.
   - d) All of the above.

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 September 30, 2021.

Trivia challenge runs September 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. © Stan Clark 2021

CIBC Wood Gundy

The Stan Clark Financial Team

Where planning, investing and behavioral finance meet

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Stan Clark is an Investment Advisor with CIBC Wood Gundy in Vancouver, BC. The views of Stan Clark do not necessarily reflect those of CIBC World Markets Inc. This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. Clients are advised to seek advice regarding their particular circumstances from their personal tax and legal advisors. Insurance services are available through CIBC Wood Gundy Financial Services Inc. In Quebec, insurance services are available through CIBC Wood Gundy Financial Services (Quebec) Inc. If you are currently a CIBC Wood Gundy client, please contact your Investment Advisor. CIBC Wood Gundy is a division of CIBC World Markets Inc., a subsidiary of CIBC and a Member of the Canadian Investor Protection Fund and Investment Industry Regulatory Organization of Canada.