Questions & Answers from April 2022 About World Events & Markets

Please note that the answers below are broad answers to the topics and your individual situation may be different. If you have any questions about your financial situation specifically, please feel to reach out to us directly for more specific advice.

Why is the stock market going down right now?

The main driver of the stock market sell off is central bank "easing", meaning increasing interest rates to offset the highest inflation we have seen in decades.

For most of the time since 2008, the government "central banks" of the world have been buying bonds from banks and other large institutions. Why were central banks buying bonds? The US Federal Reserve (and other central banks) was putting more cash into the economy at a time when people were out of work and banks were afraid to loan money. This money was used to invest by institutions and people. Investing stimulates growth, the economy and the stock market.

With inflation running high in 2022, central banks could no longer keep pumping money into the economy and risk even higher inflation. As a result, they have said that they will stop buying bonds and will increase interest rates which is now affecting stock prices. Without bond buying, large institutions have less cash to invest into the economy. With higher interest rates, it is more expensive for companies to expand and grow and more costly for investors to borrow to invest. The economy slows down to the point where we may enter a recession and the stock market falls to reflect lower corporate earnings.

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How long will the stock market decline?

Nobody knows. Looking back at past market declines, they can last as little as a month (like in March 2020), or they can last multiple years (the 2007 to 2009 decline during the financial crisis). However, looking back into history, both of these periods turned out to be great buying opportunities if you were able to grit your teeth through the tumultuous times. Our view (in our practice) is that the stock market is oversold now but we are reluctant to make significant new purchases yet due to the continued volatility from uncertainty about inflation and how interest rates may go.

How do we know when the stock market decline is over?

During the March 2020 stock market drop, Jordan on our team kept a daily diary of his thoughts during the decline. Here is what he wrote on March 23rd, the day the market bottomed (stopped falling):

I had to force myself to write an entry today as the bad news is getting harder and harder to write about as the virus spreads every faster with no sign of slowing. The S&P500 was down 2.93% as US lawmakers failed to pass a stimulus bill…I almost feel resigned to the fact that the stock market will remain lower for longer.

The very next day the US stock market started a record climb that lasted through 2021. But even on March 24th, nobody knew that the bottom had been reached as many market forecasters were calling for even lower lows. The bottom is something we can only know in hindsight.

So, if the experts don't know when the decline will stop, why would you want to invest in the market now? Well this recent article from JP Morgan explains how if you missed just the best 10 days in the market from January 2002 to January 2022, your annualized return would have only been 5.21%. If you stayed invested the market the entire time, your return would have been **9.40%.** The catch here is that

seven of the best ten days over the past 20 years happened within two weeks of the ten worst days. In other words, if you sold when the market was dropping and sat in cash, you would have missed the best days a well.

No one may know when the market will stop falling but we do know that staying invested is extremely important with a core set of securities, even during times of volatility.

How is the Ukrainian war impacting the stock market?

The war is affecting multiple fronts right now. Russia is a large producer of oil and due to the sanctions on the country, the price of oil has gone up. Ukraine, Russia and Belarus are also large producers of wheat and fertilizers which is having the effect of increasing agriculture price. But generally, the war is not being attributed to the 2022 stock market decline as the event is regional and Russia is not a large global economy.

Are there good opportunities to buy investments "on sale" right now?

We are always researching securities to try and find fundamentally strong companies which are sitting below their highs. Currently there are high quality investments down -20% or more that we feel will fully recover and go higher over 3-5 years. But these securities could go lower in the short term if the markets continue to fall. You must be prepared to accept that. You can never predict the bottom of a market decline. What is most important is that you are comfortable that the price you pay is reasonable for the security at the time of purchase, regardless of the conditions around you at the time.

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In the face of the highest interest rates in more than a decade, how should my portfolio design change?

With interest rates in the 3%-4% range for the first time in many years, it is more attractive now to invest on the fixed-income side of the portfolio. A regular 3.50% interest rate can be more appealing in some situations than a stock that averages 8%/year but comes with a lot of volatility.

We are purchasing many more GICs and corporate bonds with maturities in 3,5 and 10 years to lock in these much higher interest rates. Our opinion is that interest rates will rise through much of this year but may decline again in a year or two if the economy slows down.

Why are some of my corporate bonds showing negative returns currently and what should I do about it?

Interest rates and bond prices are inversely correlated. This means as interest rates go up, bond prices go down. Prices on your statements will show the current market price for the bond which moves every day.

We purchased your corporate bond with a fixed return at the time of purchase. This means you get the return regardless of whether the current price moves up or down.

As long as you hold the bond to maturity the price change on your statement is irrelevant.

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If stock market declines go on for several months, do we need to get more defensive in our portfolio construction?

Not necessarily. First it depends on the age and stage of life you are at. It depends on what is already in your portfolio, including investments held elsewhere we may not know about. It depends on your stress level. It depends on the length of time until the goal for the money is needed.

Also note that defense is achieved many ways – holding bonds, cash and GICs is always good defense. Owning securities in defensive industries like healthcare and utilities means you don't even have to leave the stock market to get defensive.

Defense also means paying down your debt, staying in the workforce longer, avoiding huge expenditures (e.g., new cars) in a year when the stock market is down and saving to buy stocks when they are down significantly.

If I have a mortgage, what should I do right now?

When interest rates rise, the traditional strategy has been to "lock in" a fixed rate to insulate yourself from facing higher interest rates upon your next maturity. With rates poised to jump at least three times in 2022, hopefully anyone with a large mortgage has already locked into a multi-year closed rate to ride out these higher rates. We do feel there is a good possibility rates come down again in the next few years.

Is portfolio diversification still important in these market conditions?

Absolutely. We believe that proper diversification across asset classes, regions, and industry sectors remains one of the best ways to manage volatile markets like the one we are experiencing so far in 2022.

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No one can consistently predict which kind of an asset or sector will be leading the market in any given year. All investment portfolios in our practice are diversified and tailored to a specific asset mix, keeping in mind comfort level with risk, time horizon, and long-term goals & objectives. Different asset classes and markets go up and down at different times, so combining them allows the higher and lower performing parts of your portfolio to offset each other.

It is also worth noting that volatility has historically been higher over shorter periods whereas the impact of volatility becomes less noticeable over longer periods of time. As such, having a diversified portfolio in place makes it easier to stick to your investment plan in difficult short-term market periods.

Inflation is at a 40-year high, what can we do to position the portfolio?

A good way to combat inflation is to reflect on which sector perform well during these times.

Railways transport consumer goods as well as commodities such as oil, energy, wheat and more. This is an indirect way to invest in inflationary hedge investments.

Consumer staples stocks (food and beverages) can often pass the rising costs of goods to the consumer without materially impacting price. This can be viewed as a good way to hedge against inflation. Furthermore, consumer staples stocks are products that every consumer needs to survive and therefore can be considered defensive during rising inflation and market volatility.

Utilities companies that can raise your fees can be a good inflation hedge. So can bank stocks that raise dividends over time. Rental real estate where you can raise rents on tenants due to inflation can be an inflation hedge. And commodities in agriculture and resources offer an inflation offset but can come with a lot of price volatility and inconsistent long-term returns.

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Even purchasing an annuity as a pension plan with some of your savings can be built with an annual inflation increase to keep up with a rising cost of living.

I hear gold, oil and other commodity related investments are performing well. Does it make sense to add these to my portfolio?

Commodities have been viewed as an "inflation hedge". This has caused some investors to buy these investments when the markets are volatile and during rising inflationary periods.

However, there are several things to keep in consideration when evaluating these more volatile securities:

- Commodities are usually traded in US dollars meaning your investment will not only rise and fall with the underlying security, but also rise and fall of the currency.
- Gold has performed well with rising inflation however the past thirty-year annualized return is less than the US stock market. Therefore, guessing on which year it will perform better is challenging.
- Commodities do not pay dividends. Some oil and gold mining stocks may pay dividends however these dividends are not guaranteed.

Looks like Bank of Canada will continue to rise rates, should I wait before buying new GICs?

Not necessarily. The Bank of Canada will continue to increase interest rates to fight inflation but is hard to predict when this will end. It may take a few months or more than a year to happen. If rate increases end suddenly, GIC rates could drop and you could end up missing the peak.

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