Market Update

February 2020

Important Topic: Benefits of Diversification

First and foremost, diversification argues that one should not put all of one's eggs in one basket. Not knowing which basket will outperform in the short term, and knowing that each basket plays a role in the long term success of the portfolio, we invest across a broad range of asset classes.

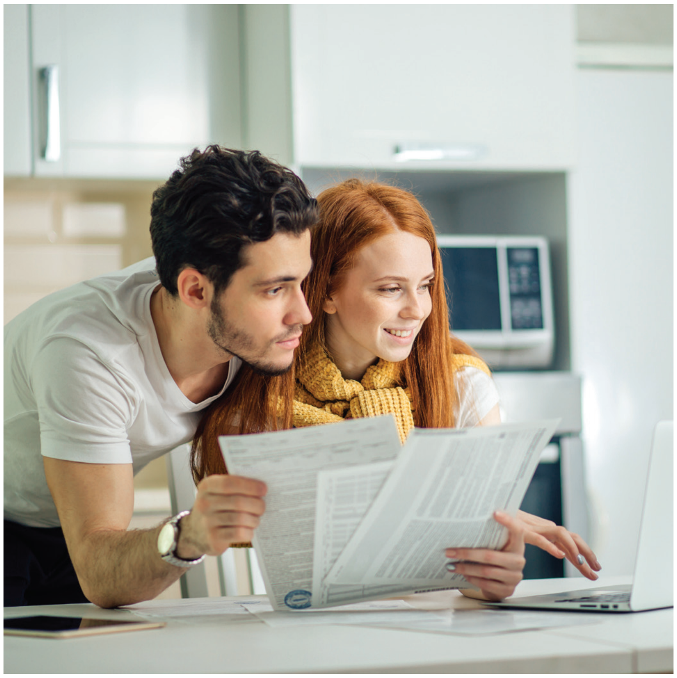
Second, one attempts to combine asset classes that are not correlated. What this means is that while some asset classes are performing poorly others are performing well. This has two very important benefits.

The first benefit is that one has a less volatile experience. Instead of violently rising and falling at the mercy of one asset class, additional asset classes dampen the volatility and allow one to sleep better at night.

The second benefit comes from our rebalancing. Assuming, as shown over time, that asset class returns revert back to their long term averages, we want to sell parts of those asset classes performing above their long term average and we want to buy parts of those asset classes performing below their long term average. By doing this we are able to buy pieces that are 'cheap' and sell pieces that are 'expensive'. This is not always easy. Emotionally we like to buy more of what is doing well and find it hard to buy that which is performing poorly.

Importantly, note that switching from one to another is not a matter of market timing. It is a matter of market performance. If we put $50 dollars in two different asset classes and after two years one has $60 and the other has $52, we move $4 form one to the other – regardless of what is going on in the market.

It is the discipline to act that is difficult. But that is one of the reasons we are here.



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The last week of February saw one the fastest, if not the fastest, 10% declines in the stock market. Additionally the decline was broad based. While the decline has been attributed to the heightened fear over continued spread of the Coronavirus, companies that have no or limited connection to the virus and its repercussions where equally hit.

I am therefore of the belief that the much of what we saw was a selling of the indices. Over the past few years Index investing has become very popular. It offers quick diversification and a broad exposure to a basket of stocks. It is less risky than trying to pick one or two stocks and the price of the indices has gotten quite low. However, now when one is panicked, one sells the index, sells the entire market, without distinction of which stocks should be sold and which should not.

The result is that some excellent stocks have been sold to levels that our managers are finding attractive.

While we all know that this 'correction' will fade into the history books (though it may take time), in the present, the change in mood feels permanent. But it is not. Prices can only fall so far before buying begins again. And we are starting to see that. We have been through many downturns in the past and we will see this one through as well.

As always, I ask that we focus first on your long-term plan – which was built specifically with the expectations of unexpected market downturns, exactly as the one now playing out.

Second, to remind ourselves of the long term history of markets ups and downs - and appreciate that every downturn (whatever the cause) passes and markets rise to new highs.

Our plans are all based on simulations of the future where the future is bleaker than the past. We are planning to experience equity markets that go through 10% corrections more than once a year, 20% corrections more than once every three years and 50% corrections at least every 40 years. In other words we built a plan to weather these storms. Such corrections are painful, and in some, induce real fear, but we must remain focused on our use of the markets to provide attractive returns over the long-term knowing they will not do so, many times, over the short term.

Looking forward, we believe the economy will take a hit from the effects of the coronavirus but that while earnings will be lower they remain at acceptable levels. Political uncertainty and volatility remain high (as always), inflation remains benign and interest rates are now even lower. As a result, we remain concerned in the short term, neutral to positive in the medium term and positive in long term. We continue to hold our positions and invest cautiously.

Lastly, it is time to consider preparing any additional savings and cash holdings for investment. The markets fall 10% on average every year, but if markets fall further we will have the rare opportunity to invest.

Portfolio Update

For the Month, the bond market was up 0.5%, the Canadian market was down 5.9%, the US market was down 7.9%, International markets were down -7.7%, the Emerging markets were down 1.8%, the Real Estate market was down 7.9% and the preferred market was down 3.8%. (Reuters 2/28/20)

Year-to-date, the bond market was up 3.2%, the Canadian market was down 3.7%, the US market was down 7.8%, International markets were down -10.2%, the Emerging markets were down 5.8%, the Real Estate market was down 7.3% and the preferred market was down 3.6%. (Reuters 2/28/20)

Have a great month and let us know if there is anything we can do for you,

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