TD Wealth

Flip-Flopping

An exclusive newsletter from William Barlow, CFA, CIM®, B.Sc., Vice President, Portfolio Manager, TD Wealth Private Investment Advice

2019 Vol. 4 of 6

What makes a bias particularly pernicious is that we all recognize this bias in others, but not in ourselves.

Moving the Markets:

Trade appears to be the driving force behind daily movements in the major indices, and the recent de-escalation in tension between the U.S. and China appears to have helped risk markets stage a short-term comeback. Longer-term, declining interest rates have left long dated bonds yielding less that most other investments, thus seemingly to set up a unique environment for stocks

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One of the most interesting aspects of investing, and probably the reason that it can be challenging to master, is the role that psychology plays with our decision making ability– or perhaps better put, decision making *inability.* This is owing to the difficulty we have making optimal decisions, when viewed through the lens of process as opposed to outcome. Nowhere is this better exemplified than the mental hurdles involved in changing ones mind. In fact, most of us would rather knowingly hang on to erroneous and unprofitable opinions than publicly change our mind for many reasons.

There are countless studies on decision making, and most would agree that an optimal decision isn't always a profitable one, which for many is hard to swallow. In the world of business and investing, if success is attributed to positive outcomes alone, we may be setting ourselves up for a bigger failure down the road. If, on the other hand, success is based on making the right decision with the information available at the time the decision was made, we might define this success much differently. This is where we turn to the benefits of changing opinions when the facts change.

The barriers to changing our minds are countless. Anchoring, loss aversion, the endowment effect, ego, overconfidence, laziness (inertia), and consistency bias, are just the tip of the iceberg. Think of the ongoing political debates north and south of the boarder. When you see a politician ridiculed for changing their mind, this individual may be labeled a 'flip-flopper,' with serious negative implications. Think also of the proud owner of a particular car, who consistently makes the case that no other car is as reliable or sexy, that is until they move on to a another make, this is the endowment effect where we place a higher value on what we own. For one final example, think of your peer who has read one economics book and is now the resident expert on all things trade and tariffs, failing to realize that this overconfidence likely clouds a topic that is very difficult to understand in practice. Whatever the obstacle to changing ones mind, the result is less than optimal decision making that leads to less than optimal results, over time.

This manifests itself in the investing world in many ways as well. I can't tell you how often I've heard from clients that want to wait for a particular holding to return to profitability before selling at a loss, regardless of the original reason for making the investment in the first place. Do we think the aggregate market cares what price we paid for a security? The net result over time is we may end up hanging onto poor positions for too long, with no reason other than the challenges in changing ones mind. The same can be said for a financial plan, whereby regardless of the circumstances, a plan isn't updated to account for new information, leaving portfolios potentially far out of line with actual objectives.

In order to remedy the inherent biases we all have, we need to train, or in a worse case scenario, trick ourselves into changing our minds as circumstances change. In my opinion the best way to do this is to have a plan and a process, based on evidence, that may give you the best opportunity to succeed over time. Being wrong is part of the investment and planning process. It is the ability to understand and embrace this reality that makes most plans successful.

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What I'm Reading: *A Gentleman in Moscow* by Amor Towles. If you're tired of tuning into the news only to see the likes of Boris Johnson and Donald Trump name calling their colleagues via Twitter, allow this book to transplant you to a more civilized time. Describing post-revolutionary Russia as more civilized is a bit risky, but the story and writing will do the explaining. A great book and one I wouldn't hesitate to recommend from the fiction shelf.

Who I'm Following: In keeping with the recession theme, Merrill Lynch pointed out the obvious in a research note from early August: recession risks are rising. They also point out that expansions don't die of old age, and that there are cases of GDP growth going on for over two decades without a recession, most notably in Australia. The reality is, although Merrill is pegging a 20% chance for a recession over the next 12 months, there isn't enough data available which would support making significant changes to one's plan and portfolio based on this alone. A long and healthy retirement will see multiple recessions, and unless there is a valuation component providing hints, the probable course of action is to stick with the underlying plan

Market Folly: Yield curve mania is here, and it appears it is in vogue to talk about the time series of interest rates. The recent recession signals given by the yield curve appears to have caused the market to gyrate more than usual, and punditry to increase unabated. The thoughtless if/then model of thinking should probably be avoided with most economic indicators, but arguing that the most recent inversion is a good thing is probably an error as well. Over at the Calculated Risk blog, it was importantly noted that this might not be as useful as other inversions, given the level and direction of current interest rates

Reason to be Optimistic: Declining interest rates are good for stocks, unequivocally. Although the activity across the yield curve is undeniably suggesting the global economy is slowing, the evidence may suggest without a lot of room for debate, that a declining interest rate environment may be good for riskier assets, saying nothing of longer-term unknowns. Right now the yield on major indices is higher than 30 year bond rates in the U.S. and Canada which begs the hypothetical question, "Would you rather own the market for 30 years, or lend money to the government to be repaid in 30 years?"

Outside the Office: Both Henry and John are off to school. Henry in Junior Kindergarten and John in pre-school 3 mornings each week. It's said often but worth repeating just how quickly the time goes. Henry, who also learned how to ride a bike this summer, will be donning his Spiderman backpack while John will have his oversized and near empty Batman backpack at the ready.

Select Benchmark Returns – August 31, 2019

Asset Class	YTD	1 Year	5 Years	Asset Class	YTD	1 Year	5 Years
S&P/TSX Composite (Canada)	14.8%	1.1%	1.02%	**CDN Bond Index**	8.7%	9.55%	3.95%
S&P 500 (US)	13.76%	2.71%	12.33%	**CDN Short Term Bond Index**	3.34%	4.54%	1.96%
MSCI Europe	11.36%	-2.39%	1.66%	**CDN Long Term Bond Index**	16.4%	16.14%	6.64%
MSCI Emerging Markets	4.21%	-3.99%	0.75%	**US$/CDN$**	2.62%	-1.8%	-3.97%
MSCI Far East	6.54%	-4.50%	4.73%	**S&P TSX Energy**	-13.93%	7.58%	-7.85%
MSCI World	15.63%	0.84%	6.75%	**S&P TSX Materials**	23.42%	23.89%	2.12%

Source: TD PAIR, TD Securities

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