GROW TOGETHER

June 2020

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President’s Message

Matt Evans, CFA
President & CEO, CWB Wealth Management

To open the previous issue of ***Grow Together*** – my first at the helm of CWB Wealth Management – I shared my personal conviction that growth is the residue of change. I would like to open the current issue by invoking the second, no less important, concept from the title of this newsletter: growing *together*.

Our focus on growing together is perfectly suited to the moment, as we have recently completed the acquisition of T.E. Wealth and Leon Frazer & Associates. This is a bold step forward for your wealth management firm. Alongside our established teams in CWB Wealth Management and CWB McLean & Partners, we now bring recognized financial planning and investment management talent at a significantly increased scale to our key markets across the country. The transaction brings more than 140 experienced staff in Vancouver, Toronto, Calgary, Montréal and Québec City, and adds approximately $6 billion to CWB’s assets under management and advisement. This increases our total wealth assets under management, advisement and administration to approximately $8 billion, strengthening CWB’s position as a leading player in the Canadian private wealth industry.

We have learned a great deal through our effort to build relationships and trust with our new teams over the past several months.

> **“I have come away from this experience supremely impressed with their skill, their competence and their integrity.”**

Like the teams you rely on within CWB Wealth Management and CWB McLean & Partners, the trust placed in T.E. Wealth and Leon Frazer & Associates by their clients is well-earned, and well-deserved. It truly is a privilege to join forces and grow together with our new colleagues.

So what comes next? In the short-term, it is business as usual. Stability, continuity and minimizing disruption are the immediate top priorities. Client teams, services, and offerings within our individual businesses remain the same, and I will continue to lead CWB’s wealth organization. In keeping with our commitment to stability, we are very pleased that Mark Arthur will continue to lead T.E. Wealth and Leon Frazer & Associates as President and CEO of CWB Private Investment Counsel, and Jim Andrews has joined CWB Wealth Management in the role of Chief Operating Officer. Jim most recently held the position of Executive Vice President, Client Experience and Business Development with T.E. Wealth and Leon Frazer & Associates.

Over time, our leadership team will work together to evaluate the shared strengths of our teams and our complementary growth opportunities. As we do so, CWB’s core values – which I introduced in our previous issue – will keep us grounded and ensure our strategic choices create value for our clients and our people, while unifying our teams around a shared sense of purpose.

The three months since we announced the acquisition have been truly extraordinary. Together we experienced a remarkable global response to the COVID-19 pandemic alongside a historically volatile episode in the market. More recently, bearing witness to profound social unrest has troubled all of us as it has put a spotlight on racial injustice and inequality. Our team is racially diverse, and many of us are deeply affected by what we have seen.

As we continue to care for our clients and for each other, we recognize the imperative to acknowledge that some people have privilege while others do not. We are committed do our part to listen, learn and take action to ensure that we are contributing to making positive change for a more just society.

The challenge to lead an organization through such dramatic and disruptive moments is significant. Recently I was encouraged by the perspective shared by Steven Bright, a long-time client of T.E. Wealth. Writing to address the economic realities of COVID-19 in T.E. Wealth’s current issue of *Strategies*, Mr. Bright pointed out that, “Canadians are adapting their skills to new endeavours, neighbours are looking after each other, and an enhanced sense of collective effort fuels the country forward.” This is an encouraging, inclusive, and hopeful point of view, and one we would all do well to amplify.

Our priority through the past three months of working at a distance from our clients and from each other has been to contribute to your peace of mind. The team effort was extraordinary as we found creative ways to be effective without the conveniences of the office environment around us. I am proud of what we have accomplished together and inspired by how our people have lived our values. Going forward, I am confident that CWB Wealth Management will continue to grow together as we strengthen our capabilities to create value for our clients, our people and our communities.

Matt Evans, CFA
President & CEO, CWB Wealth Management

That 70's Show

Scott Blair, CFA
Head of Research
CWB Wealth Management

The time we live in now feels unprecedented. The longest bull market in history ended just a few months ago (March 2020) only to be followed by the quick and deep bear market that saw global markets fall more than 30% in just a few weeks. The market has now sharply rebounded off the lows (Figure 1) at the same time as we've seen over 40 million North Americans lose their jobs due to COVID-19. How does this make sense?

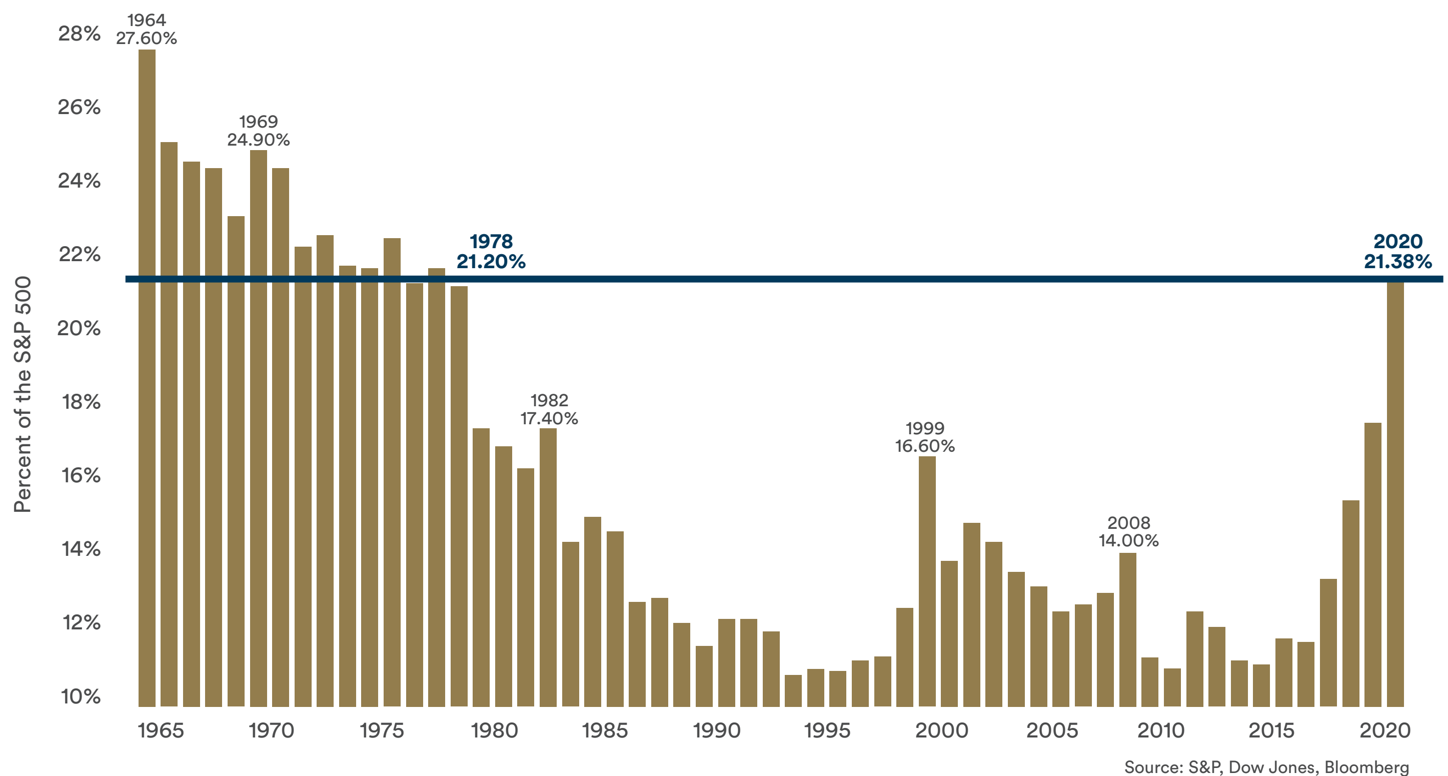
The market is always looking forward and anticipating the future, which is why investors often get positive just as the economy appears to be at its worst. With countries loosening lockdown restrictions, the market is anticipating that Q2 2020 will be the worst of it for the global economy and that we will soon enter a recovery period, albeit one that will likely be long and bumpy. So is the stock market recovery just a case of investors looking forward or is there something more going on?

We believe there is something more going on. If you look under the hood, the market's rally off the lows is not quite as strong as it may appear. We are seeing a concentration level in the market that we have not seen in over forty years - longer than most current investors have been active in the markets (Figure 2). As of mid-May, five stocks accounted for over 21% of the S&P 500 index (Facebook, Apple, Amazon, Microsoft, and Google or FAAMG). Just four years ago, the top five stocks in the S&P 500 accounted for less than 12% of the index, and even during the dot-com bubble of the early 2000's, the top five stocks in the S&P 500 (Cisco, Microsoft, GE, Intel and Exxon) made up just 18% of the market cap.

Figure 1: S&P 500 Performance Year-to-date

Source: Bloomberg

Figure 2: The Five Largest Stocks in the S&P 500



Source: S&P, Dow Jones, Bloomberg

As investment managers, we typically preach diversification. However, when a few stocks are driving the overall market, diversification tends not to work as well. As of the end of May, the S&P 500 was down about 6% year-to-date (USD) while the average stock in the S&P 500 was down about 13%.

> **"FAAMG stocks have had a very dramatic impact and have made the recent market recovery seem more powerful than it actually has been, with most stocks still down double digits in the U.S."**

Mark Twain is credited with saying, "History doesn't repeat itself but it often rhymes." Although he likely was not referring to the stock market, the quote is one many investors believe in. One period that rhymes with today is the early 1970's. Back then, there were a group of stocks referred to as the Nifty 50 that consistently drove the market higher. These were large growth stocks with bright futures; companies that were considered to be 'buy and hold forever' investments. Many were, and still are, household names such as IBM, 3M, and Coca-Cola. They traded at very high multiples, yet investors continued to bid the stocks higher with little regard for valuation. The result was predictable; eventually the market corrected in a recession and the Nifty 50 held up poorly with some of the stocks falling upwards of 90% from their highs.

There are several important lessons we can learn from the early 70's:

1. **Today's leaders are often tomorrow's laggards.** Many of yesterday's leaders such as JC Penney, Sears, Xerox and Eastman Kodak do not exist today or are greatly diminished companies.
2. **Valuation matters.** McDonald's traded at over 70x earnings in the early 70's. Despite being a long-term success story for investors, if you had bought the stock at the end of 1972 it would have taken you twelve years to recoup your money!
3. **Sector diversification is key.** Buying all the stocks in the Nifty 50 would have provided a proper quantity of names to diversify a portfolio. However, the portfolio would be concentrated in just three main sectors: consumer, healthcare, and technology.

Today's market returns have been concentrated in just a few names. We have used the U.S. market as an example but the same applies to other markets like Canada, where a company like Shopify has really driven index returns. This makes it tempting to blindly chase yesterday's winners to ever-higher valuations, but that does not guarantee success and often creates excess risk for investors.

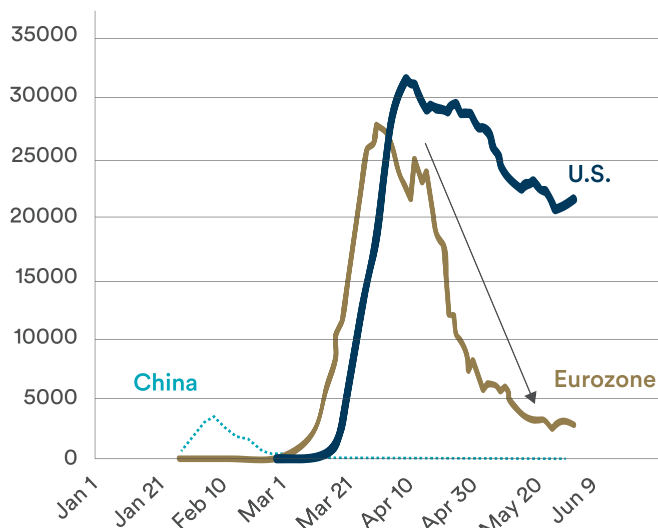
We think today's market is rhyming with the past, not repeating. We do not necessarily see a Nifty 50 type correction in today's FAAMG stocks, but we do think that caution is warranted on some of the more highly valued members. As we stated earlier, there is a large bucket of stocks that have not fully participated in the recent market recovery rally. There are outstanding opportunities within this bucket and many of these companies are held in our portfolios. A well-diversified portfolio can also include recent winners like the FAAMGs and we do hold names such as Apple, which trades at a reasonable multiple for its level of future growth (22x Forward P/E). Our job is to understand and evaluate the opportunities the market is giving us for the future and not just to invest in something that has done well in the past.

Plotting the EU Recovery

Ric Palombi, CFA
Director of Research
CWB McLean & Partners
Wealth Management

COVID-19 hit Europe before North America, with larger countries like Italy, Spain and France at the epicenter of the virus outbreak. Cases ramped up quickly in March before peaking around the beginning of April and started to decline mid-month (Figure 3). The COVID-19 playbook in most of Europe (Sweden being the main outlier) should look familiar to us. Social distancing, essential workers only, and general lockdown were the standard of the day and are now being rolled back gradually as they are in Canada and the U.S. But how has Europe faired economically, what has been the government response and what does it mean for Europe from an investment standpoint?

Figure 3: 7-Day Average COVID-19 Cases in China, U.S., Eurozone



Source: Cornerstone Macro

Europe has taken a two-pronged approach to combatting the virus-induced downturn. First is the European Central Bank (ECB) response with the main program being the Pandemic Emergency Purchase Program (PEPP). This program is a temporary asset purchase program that was dubbed as ECB President Christine Lagarde's "Whatever it takes" moment, a reference to then President Mario Draghi's famous speech of 2011 to save the Euro. This program was recently upsized to €1,350B and will allow for bond purchases to support market liquidity and to keep interest rates low. The program will last until at least June 2021 and more importantly, it allows for flexibility in the amount of bonds that can be purchased from economically weaker countries like Italy, Spain, and even Greece. We see this as a very powerful circuit breaker to keep peripheral interest rates and spreads from countries like Italy low and more inline with Germany.

From a fiscal perspective, the European Union (EU) and individual European governments have indicated plans to spend over €4.0T to fight off the economic impact of COVID-19. Some of the initiatives will be jointly financed by all EU countries (for the first time ever) and distributed as grants to the most affected regions and countries. It is much larger than was expected, involving issuance on a scale not seen before with no repayment obligation for the grant portion. If all initiatives are enacted it could well be the fiscal equivalent of "Whatever it takes". Even before the next round of stimulus, the combined impact of monetary and fiscal policy represents nearly 44% of the EU economies (Figure 4).

Figure 4: Global Monetary and Fiscal Stimulus to Fight COVID-19 Impact

	POTENTIAL CENTRAL BANK LIQUIDITY INJECTION		POTENTIAL FISCAL STIMULUS		CENTRAL BANK LIQUIDITY INJECTION AND FISCAL STIMULUS	
	$TLN	%GDP	$TLN	%GDP	$TLN	%GDP
U.S.	$6.21	29.0%	$3.30	15.4%	$9.51	44.4%
EUROZONE	$1.78	13.3%	$4.01	30.2%	$5.79	43.5%
JAPAN	$1.03	20.0%	$2.08	40.3%	$3.11	60.3%
U.K.	$0.25	9.0%	$0.14	5.1%	$0.39	14.1%
CHINA**	$1.33	9.3%	$1.22	8.4%	$2.54	17.7%
OTHERS*	$0.68		$2.35		$3.03	
GLOBAL	**$11.27**	**13.0%**	**$13.10**	**15.1%**	**$24.37**	**28.1%**

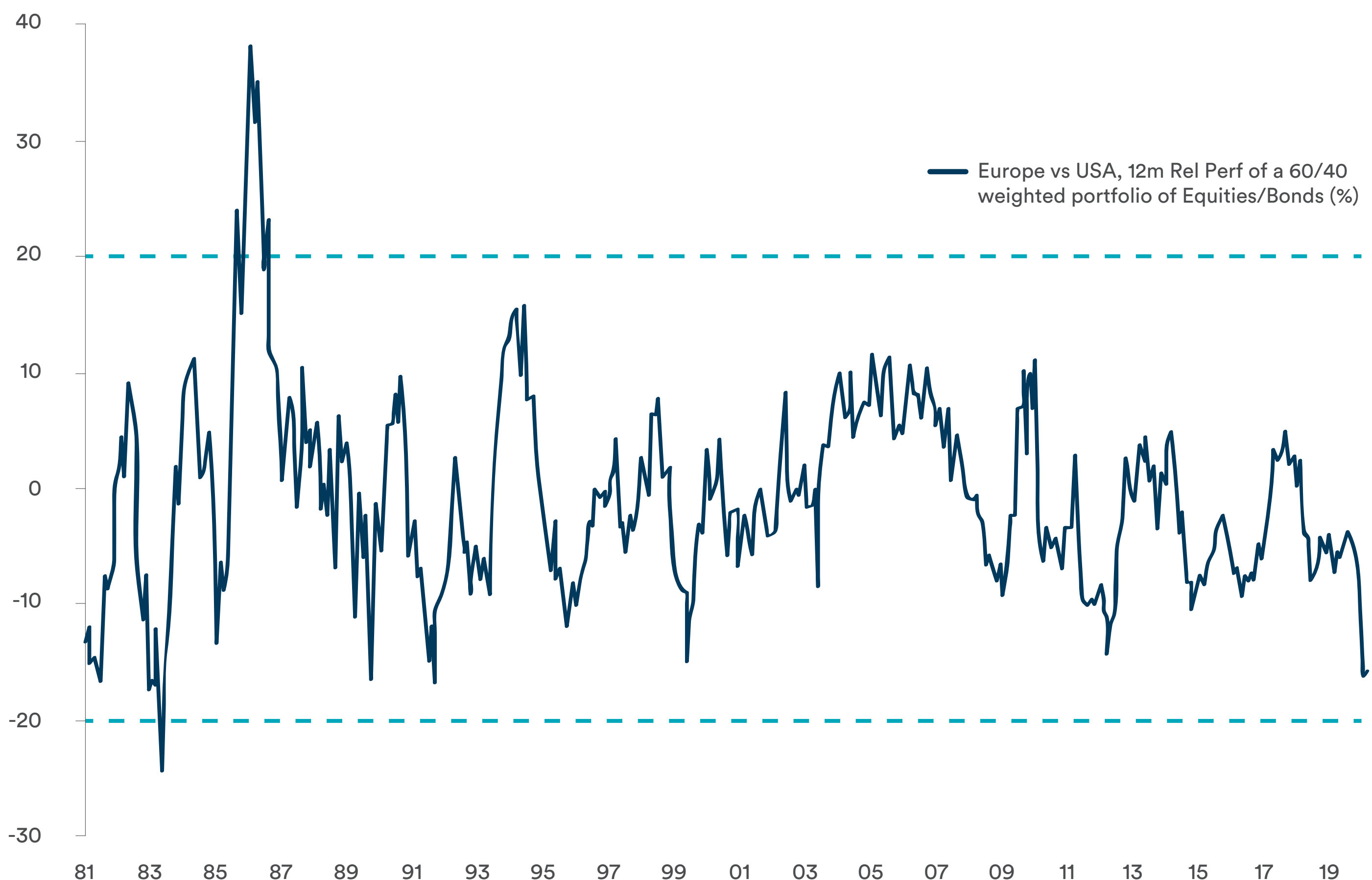
*incl RoW and ADB, IMF, WB **China CB stimulus incl liq injections and other activities, e.g. re-lending, RRR, direct small business lending, etc.

Source: Cornerstone Macro

The initiatives outlined above are much needed. The Eurozone economy has been weaker than the North American economy for a couple of years now. This year will see a recession called in Q2 (end of June) before starting to recover in Q3. Overall 2020 should be another laggard year for Europe, but 2021 looks a little stronger.

From an investment perspective, Figure 5 is quite telling. Despite all the stimulus measures the EU has enacted and all that may come, a European portfolio of 60% equities and 40% bonds has underperformed its U.S. equivalent by nearly 20% over the past 12 months, a 30-year low. We see this as a compelling opportunity to take advantage of this underperformance by having European exposure to a global portfolio.

Figure 5: 60/40 Europe vs U.S. Portfolio Performance



Source: Morgan Stanley

Preparing for Disability

Kim Stevens, CFP®, CLU®, CHS
Senior Planner
CWB Wealth Management

The evolving COVID-19 situation, which has caused sudden and unexpected changes in all of our lives, has me feeling a little unsettled and very much grateful for the safeguards I have in place. It is also a reminder of how random life can be and how quickly things can change.

This situation also strongly reinforces the wisdom of always having an emergency fund and a store of goods on hand to assist us in weathering anything that comes our way. Those that did not prepare for the virus found themselves scrambling to find toilet paper and standing in lines at Costco only to find that what they needed was not available. The lesson in this is that the wise among us prepare in advance as a hedge against risk.

> **"Statistically, 1 in 3[1] will be disabled for a period of 90 days or more sometime in their working life before age 65. The average duration of a disability that lasts at least 90 days is over 5 years[2]."**

Could you take a 5-year leave of absence without income and still maintain your lifestyle, while continuing to preserve the preparations you have made for your retirement? There is an erroneous belief among many Canadians that most disabilities come from traumatic injuries deriving from one's own carelessness or the negligent acts of others.

The truth is that only 10% of disabilities come from an accident and that chronic conditions are six times more likely to lead to disability.[3]

Driving these sickness claims are things such as mental illness, cancer, cardiovascular disease, and musculoskeletal diseases such as arthritis, MS and fibromyalgia. Many Canadians believe the risk of a disability period is removed if one lives a healthy lifestyle. Even though great lifestyle choices can reduce the odds, there is still a risk of becoming subject to an illness that could lead to a disability.

Misconceptions on Adequate Protection

There are many ways Canadians think they have adequate protection for themselves and their families should disability strike. The following are the top six misconceptions regarding contingency plans and their flaws:

1. **Spouse will become income provider:** Often the spouse is called upon to become a caregiver or a caregiver is hired which increases the expense burden. Frequently, the spouse is not able to earn enough income to replace the lost income.
2. **Borrow from family and friends or start a GoFundMe:** This might work for short-term disability, but could you rely on this as a solution if it were a long-term disability? It would be difficult to rely on your loved ones and the kindness of strangers for income in the long run.
3. **Workers Compensation:** This only provides protection for disability that occurs on the jobsite. If you are disabled on the way to or from the jobsite, or in any other way, there is no coverage. It is also very difficult to prove a jobsite-related illness, hence it is largely injury-only coverage. Lastly, Workers Compensation tends to be aggressive about moving people off claim.
4. **Canada Pension Plan (CPP) disability benefit:** This is only available for severe and prolonged periods of disability. The benefit amount for most Canadians is woefully inadequate. The 2020 maximum CPP disability benefit is $1,387.66/month, but the 2019 average CPP disability payment was just $1001.15/month. There is an additional benefit amount of $255.03 per dependent child.[4]
5. **Sell assets and cash in investments, including RRSPs:** This is truly a bad idea. It puts your future retirement goals in jeopardy, and sooner or later you will run out of assets to sell. If you are cashing in RRSPs, a tax burden is created. Future tax-free growth is also foregone and can never be recouped. Further, the timing of your disability may occur during a downturn in the market, which will accelerate the drain on your assets as you draw upon them for support.
6. **Group Long-term Disability (Group LTD) insurance plans:** Most Canadians do not understand the coverage they have under these plans. They don't realize that there is often a definition of total disability in the plan that changes after two years on claim from Regular Occupation (can't do your job) to Any Occupation (can't do any job). This change in definition pushes most disabled employees off claim at the two year mark.

continued on next page

[1] Statistics Canada, Commissioners disability table A
[2] Statistics Canada, Commissioners disability table A
[3] World Health Organization – Disease and Injury country estimates (Retrieved Nov 2013)
[4] Canada.ca

Furthermore, Group LTD plans have a “non-evidence maximum” benefit amount that caps the amount of disability coverage, regardless of income. Hence, high income earners, almost invariably, have a low income replacement ratio and are under-insured for the risk of loss of income due to disability. For example, if the Group LTD plan provides a maximum of $2,500 per month in disability benefits, as is often the case, then someone earning $100,000 would only have 30% of their income replaced during a period of disability. By comparison, with an individually-owned Disability Insurance policy, that coverage could be topped up to $5,200 per month in disability benefits for a 62.4% income replacement ratio. The maximum permitted “all source” disability income benefit permitted is 85%. However, the higher the income, the lower the percentage coverage that insurance carriers will offer. Keep in mind that if the premiums are paid with after-tax dollars, the benefits provided during a claim are tax-free.

Business owners are especially at risk if they are relying on Group LTD for coverage. This is because Group LTD only covers “Total Disability”. A business owner is likely to struggle into the office, shuffle some papers and make some phone calls making him or her only partially disabled and, therefore, ineligible for claim even if there is a loss of income. Further, Group LTD benefits are payable based on recent earned income and business owners often pay themselves dividends; hence, they have no earned income and, despite paying premiums, will not receive a disability income benefit.

Random events can and do occur, leaving us potentially at risk. We always encourage our clients to focus on what’s within our control – in this case, it means having proper preparations should you encounter disability (preparing for the crisis *well before* it arrives!). If you cannot afford a 5-year leave of absence, you need to review your disability protection plan, with a view to purchase some individually-owned quality disability insurance even if you are covered under a Group LTD plan. At CWB Wealth Management, we pride ourselves on offering financial peace of mind for all of life. If you need support to ensure you have the right plan in place, please reach out to our Wealth Advisory Services team.

Connect with us

CWB Wealth Management provides clients with financial peace of mind. If you’d like to connect with us, please call **1.855.292.9655** or email **info@cwbwealth.com**.

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