# GROW TOGETHER

CWB Wealth Management Newsletter | **July 2019**

## Message from David Schaffner, President and CEO

### Navigating Uncertainty

I always find it funny when the media talks about how uncertain the future is, and how that is affecting the markets. When has the future ever been certain? I think the better question is whether the level of uncertainty is higher or lower than normal, and what this means for our decision making.

In this issue's article "Predicting the Future", we see how even perfect knowledge of the top performing stocks over a number of decades would not have resulted in an investment portfolio whose value went up in a straight line. There would still have been many periods of volatility and even negative returns. While we can objectively look back in time to determine how an optimal portfolio of stocks would have delivered spectacular returns, it is not a realistic exercise. The reality is that during the periods of volatile and negative returns the average investor would have found it hard to continue with the strategy. We are humans, not machines, and our behavioural biases would have made it incredibly difficult to stay invested in even an optimal portfolio.

While our investment teams cannot predict the future, they do make decisions based on the likelihood of what the future might look like and on whether levels of uncertainty are much higher or lower than normal. Given that we make these probability-based decisions, you may ask why not just sell all stocks and move to cash, and vice versa, when we are uncertain about whether stocks can continue to increase in value over the next year? Aside from a one-year period being too short relative to the time horizon for most investors' goals, we have never seen anyone in the investment business consistently being able to get entirely out of, and back into, stocks at the right time over a number of market cycles.

Our job as your financial stewards is to use time-tested ways to invest through the future. While there aren't any guarantees for the future, we can use our experience, knowledge and processes to give you the best odds of reaching your financial goals with the level of risk that is appropriate. Investing isn't a one-time forecasting event. It is a process of working with you over time on your evolving plans to ensure your goals are current and the solution is still the right one.

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# Predicting the Future

by CWB Wealth Management Research Team

The Back to the Future movies, featuring a young time-travelling Michael J Fox, were a big hit in the 1980's. In total, there were three installments of the franchise. In the second movie, the villain, Biff, got hold of an almanac that had the results of future sporting events. Biff used the book to place bets and amass a fortune. Recently, we read an article by Alpha Architects, a research firm, called "Even God Would Get Fired as an Active Manager" which reminded me of these movies. The authors ask a simple question, "if God is omnipotent, could he create a long-term active investment strategy fund that was so good that he could never get fired?" Their conclusion? God would get fired.

Imagine if you could take a newspaper (or a screen shot) with today's stock quotes and go back in time. You would be able to create the perfect portfolio or you could simply buy the stock that will perform the best in the future and hold it until today (who needs diversification when you know the future!). Your returns would be fantastic. You might decide to become a professional money manager and bring on clients. Imagine how satisfied they would be to receive these exceptional returns! But would they? To answer that question let's look a little deeper into the study.

Alpha Architects went back to 1927, created a portfolio of the 50 best performing stocks over the next five years in the S&P 500 and held those stocks for the five years. They then rebalanced the portfolio by buying the best performers over the next five years and repeated this process until 2016. The outcome was fantastic. The "God" portfolio returned 29.37% per year vs 9.87% for the S&P 500 (Figure 1).

**Figure 1:** Imagine getting an annualized 30% return!

| | "God" Portfolio | S&P 500 |
|---|---|---|
| **Annualized Performance from 1927 to 2016** | 29.37% | 9.87% |

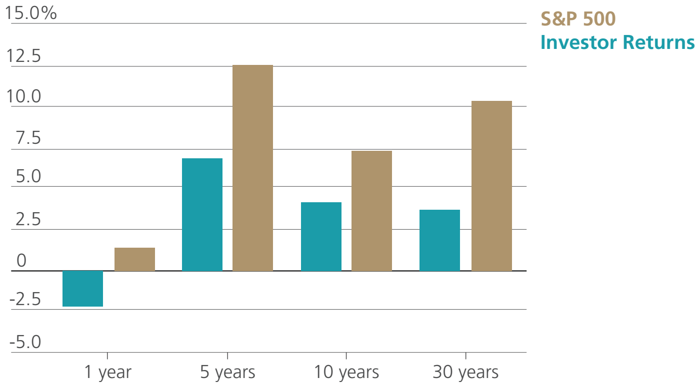
Source: Alpha Architect

Despite exceptional long term performance, there were still bumps in the road. Over the 90 years of the study, there were nine times that investor returns fell 20% or more. Think about that for a second. Even with perfect hindsight on what will outperform in the next five years and the spectacular long term performance that this hindsight guarantees, investors would still have some rough patches.

Our point is that to be a successful investor you need to think long term. No matter what the strategy is, there are going to be bumps along the road. The key is to stay the course. DALBAR, a company which regularly publishes studies on investor behaviour looking at flows in and out of investment funds, makes this point that over the long term equity investors consistently underperform the market (Figure 2). Why is that? One of the primary reasons is that they time the market by becoming more cautious when the market is falling and more aggressive when it is doing well. Essentially, individual investors tend to buy high and sell low rather than just staying invested for the long term.

**Figure 2: Missing Out**

Annual returns, average U.S. equity mutual fund investor and S&P




Figures are as of Dec. 31, 2015. S&P 500 performance include dividends

500

Source: Dalbar
The Wall Street Journal

In summary, none of us have a Delorean that travels back in time like Michael J Fox. If we did, we'd be able to generate huge amounts of wealth, but it would still come with some ups and downs. That's just the way the markets are. The key tool we have to overcome this problem is a solid long term plan and a consistent strategy that keeps us invested through good times and bad.

# Driving Slower

by CWB McLean & Partners Research Team

It isn't easy to predict the future even in the best of times, let alone in times like today where the global economic system is under threat from a trade war between the two giants: U.S. & China. Our job as investment managers is to assess the various paths that events could go down and assign probabilities to each outcome. It was our assessment that it would be in the best interest of both U.S. & China to negotiate a trade deal quickly, and hence we believed – and continue to believe – this was the most likely outcome. The path to a signed deal is, unfortunately, proving to be more treacherous than we believed. One tweet from President Trump sent everything awry in May, proving that even with proper assessment, things don't always go as you expect.

Another way to look at this – a real life example – is from Saket Mundra, CWB McLean & Partners Research Analyst, who made plans with his family in March for a trip to the Fairmont Hot Springs in June. We know how unpredictable Calgary weather can be, however the probabilities of a snow storm in June was low… yet, snow (and lots of it!) was exactly what they encountered on their drive up to Banff in early June.

Needless to say, their spirits were dampened driving with summer tires on a highway clad with snow. Saket and his wife knew this wasn't the safest bet and had doubts about continuing the journey. They planned to turn around and go home until his five year old daughter exclaimed, "Papa, I LOVE the snow! I want to go to the hot springs. Can you just drive slow and we can still go?" She had embraced the snowy weather in light of what seemed like a lucrative reward - a dip in the hot springs. The little one had a better sense of odds, or in our parlance "risk/reward", as she wasn't perturbed by the unexpected hiccup on the way and encouraged them to stay the course. When we heard this story, we couldn't stop ourselves from comparing it with the stock markets and think, "expect the unexpected". Especially the last twelve months, bear stark parallels to his story. From trade war to truce and then a big fall out – nothing has gone according to expectations or plan. All of us had our moments of doubt. Should we sell or stay the course?

It is exactly at these moments why we have a disciplined process and philosophy to fall back on. As the "Twitter risk" has increased and renewed threat of U.S.-China trade resurfaced over the last couple of months, we have re-examined the risk/reward on our stocks which would be most impacted by a prolonged trade war. We made some adjustments to allocate away from those stocks we deemed most impacted, moving to cash or reallocating to other stocks with better risk/reward characteristics. As encounters of the 'unexpected' increased, it made us realize that we must drive slower but still move forward to the ultimate destination.

One action we took in our portfolio akin to "driving slower" was to trim our holding of Baidu, a web search engine (much like Google) that is dominant in China. Due to worsening economic indicators in China and increasing domestic competition for advertising dollars, Baidu reported poor results for its latest quarter. Our assessment was that it would take some time for Baidu to improve its results, and if the U.S.-China trade war worsened, shareholders were more likely to sell down Baidu due to the lack of visibility such a scenario would entail.

However, given that Chinese stocks were fairly beat up at the time, we determined that it would be best to maintain our allocation to Chinese equities. We thus added to our existing position in Alibaba, the dominant e-commerce player in China. The Chinese government was heavily stimulating the local economy and given Alibaba's position as a net importer of goods in to the country, we expected that it would perform well; or at the very least, it would outperform Baidu. The switch from Baidu to Alibaba thus lets us keep moving forward, but in the near term, it improved the risk/return skew of the portfolio.

# What to consider for an effective business succession plan

by Wealth Advisory Services

In an ideal world, every business owner would have a succession plan or exit strategy right from day one. Realistically, many business owners don't have the answers to the fundamental questions they need to consider when it comes time to think about stepping away from their business. Will a family member take over the business? Will the business be sold? Do they even know the value of their business and how much they could realistically sell it for?

The best place to start a succession plan is with what the business owner wants for the business once they walk away. Whether it's having a family member take it over, selling the business or simply shutting it down, business owners need to have the end in mind in order to start planning appropriately.

A lifetime of hard work and sacrifice can make it hard for business owners to place a dollar value on their company and then hand over the reins to someone else. It is important to remember the actual act of business succession planning doesn't mean that you have to sell your business tomorrow. However, it is valuable to go through the step by step logic of what needs to be done so there are no surprises or rushed decisions.

The worst-case scenario for a business owner is when there isn't a succession plan and something happens to the owner that forces them to step back, such as a health crisis; they could quickly discover that their business might not be worth as much as they were hoping. Creating a plan and having it in place can help ensure that business owners aren't faced with tough decisions that could put a damper on their hopes and dreams for retirement or their next business venture.

The best-case scenario is that the business owner has had proper protection measures in place so their business continues to run in the way they want after they retire. Knowing what needs to happen in advance, they've made the improvements to make sure that the business has a higher chance of success. This can include nurturing relationship building between clients and subsequent managers for transferring goodwill from the original owner, as well as setting employees up for being taken care of and retained over a period of time once the owner has stepped away.

Succession plans and exit strategies should start as soon as possible, ideally at least three years before the date when they want to actually sell their business. Once complete, the plan should be revisited every year thereafter as the business evolves. Businesses can change significantly from year to year, as even small changes in a business can have a big impact on the overall planning. Changes in the business owner's health, in the personal wishes of the business owner or external factors like a company being heavily leased in real estate can all impact the ultimate decisions that need to be made regarding succession.

The CWB Wealth Management team works together with existing advisors, to help create a comprehensive plan that's spearheaded by a single planner. CWB Wealth Management's Senior Planners are able to outline all the variables that a business owner needs to think about in order to see their business continue to flourish after its transition. They also bring the clarity and confidence that all of the individual pieces are working together.

Get in touch with CWB Wealth Management today to find out how we can help ensure your business has the right succession plan in place for the next phase of your life. You can reach us at info@cwbwealth.com or 1.855.292.9655 to help get you on the right path.

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