December 31, 2016

MARKET COMMENTARY

## Q4 IN REVIEW

For the first time in the last six years, in relation to U.S. equity performance, Canada took the lead in market performance! In 2016, every quarter, including this last one, exhibited strong gains for Canadian equities as resources showed signs of life. The S&P/TSX Composite Index (the "TSX") advanced 4.5% over the 3 month period ending December 31, 2016. This marks the fourth consecutive quarter in which the TSX has recorded positive performance. Overall, just 4 out of 11 market sectors contributed to the Index's advance which showed it was not universal, and highlights the importance of actively monitoring sectors. The TSX's Financials and Energy constituents stood out as the biggest contributors, returning 11.5% and 6.9% respectively.

After stocks got off to a rough start to the year – posting one of the worst months for January in many years – markets began to rebound in late February. Recognizing we are affected by global events, the second market-moving episode occurred at the end of June when the U.K. voted to exit the European Union, roiling worldwide markets. As the initial shock from the Brexit vote began to wear, investors returned to fundamentally analyzing stocks and the gap in relative performance once again began to shrink. Short term turmoil from events such as Brexit reinforces the value of long term investment and discipline.

Global stock markets continued to move higher in December, fueled by hopes of growth-inducing policies from the new Trump administration. While the long-term implications of Trump's suggested policies range from unclear to outright negative, in the short-term, investor focus has been on the positive effects of lower taxes and infrastructure spending, thus sending the markets sharply higher since the election. A lot of the positive effects seem priced in though, with valuation levels at historical highs. Both the US and Europe is estimated to be 25-30% below peak spending on infrastructure. Real public spending in the US is at an extreme low and politicians have access to funding at record low interest rates.

On the resource side of the market, OPEC agreed to a production cut over the quarter; the agreement reduces global production to 32.5 million barrels per day, while giving Iran some room to raise production. Non-OPEC countries were being asked to cut production by about 600,000 bpd. The agreement was an incremental positive for oil producers and oil countries, and may help on the margin to boost inflation in some countries.

Other events that will continue to affect markets in 2017 include Canada signing a free trade agreement with Europe. CETA will remove 98% of tariffs and officials hope it will generate an increase in trade worth $12B a year.

Although we witnessed a series of economic shocks in 2016, we ended very positively with equities positioned at historic highs in North America.

**Source**: Mawer Investment Management, Brown Advisory, Carnegie Asset Management, Louisbourg Investments

| Market Snapshot | 3 mth (%) | YTD (%) | 1 yr (%) | 3 yr (%) | 5 yr (%) |
|---|---|---|---|---|---|
| **S&P/TSX Total Return** | 4.54 | 21.08 | 21.08 | 7.06 | 8.25 |
| **S&P 500 Composite Total Return ($ Cdn)** | 6.28 | 8.61 | 8.61 | 17.66 | 21.21 |
| **MSCI EAFE ($ Cdn)** | 1.67 | -1.53 | -1.53 | 6.83 | 13.13 |
| **MSCI Emerging Markets Free ($ Cdn)** | -1.82 | 8.26 | 8.26 | 5.71 | 7.45 |
| **FTSE TMX Canada Bond Universe Total Return** | -3.44 | 1.66 | 1.66 | 4.61 | 3.22 |

**Source:** Manulife Asset Management
*Performance histories are not indicative of future performance. An index cannot be purchased directly by investors.

# A New Year's Resolution to improve your Portfolio Management

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I find January 1st to be magical. The meter gets set back to zero and provides an opportunity for a "do-over". For many, that do-over often includes becoming healthier or getting on top of your finances.

So how do you achieve your do-over goals? One key step is to recognize the danger of living on "automatic". Consider that the average person makes almost 35,000 decisions a day. Many of those decisions we don't think about – like putting on the seatbelt when we get into the car. This is our brain's way of freeing itself to deal with more complex issues. However, many of us fall into the trap of going on automatic for more important decisions.

Charles Duhigg, in his book "The Power of Habit", identifies a three-stage loop or pattern that your brain falls into – (i) a cue which triggers (ii) a routine that generates (iii) a reward.[1] This cycle gets imprinted into your brain and becomes habit. To change the habit, Duhigg suggests, you need to reprogram the routine that the cue triggers. The key first step is to understand what the cues are for your habit. So if you like to snack while you watch TV, the cue might be the TV, the routine might be eating a whole bag of chips, and the reward might be the pleasing crunch and salty taste. Changing that habit requires substituting the unhealthy routine – chips – for a more healthy routine – carrot sticks and celery.

The reward, or incentive, that follows the routine is important because it helps us address a key failing of human beings – we are very short-termed in focus. In other words, "(w)e prefer the gratification of a slice of cake today rather than a carrot tomorrow."[2] One way to successfully imprint the new habit is to identify a reward or incentive that will offset the current reward associated with the habit you want to change.

Similar habit loops occur in investments. News in the media about a particular stock can cue a habit of selling stocks in the portfolio that had a bad news day or buying new stocks for the portfolio that had a good news day. This was the finding by researchers Barber and Odean

[1] Duhigg, Charles. *The Power of Habit: Why we do what we do in life and business.* Vol. 34. No. 10. Random House, 2012.
[2] Vitality Institute, Canadian Leadership: The Ottawa Charter for Health Promotion After 30 Years, http://thevitalityinstitute.org/canadian-leadership-ottawa-charter-health-promotion-30-years/, p. 2

in a 2008 paper. Their review of investor trading data supports the view that individual investors traded on news while institutional investors typically did not. In an earlier paper, Barber and Odean found that active traders underperformed the market by 6.5% annually.[3]

2017 promises to be an interesting year for the markets. We are almost 8 years into a bull market and there are headwinds looming. Add to that mix, the new normal of low returns. McKinsey estimates US equity returns of 4 – 6.5 per cent per annum over the next 20 years, less than the 7.9 per cent per annum realized between 1985 and 2014 but roughly in line with the 6.5 per cent per annum average over the last 100 years.[4] There will bound to be news over the next 12 months.

As Barber and Odean conclude, the news driven trading "patterns we document here do not generate superior returns. We believe that most investors will benefit from a strategy of buying and holding a well-diversified portfolio. Investors who insist on hunting for the next brilliant stock would be well advised to remember what California prospectors discovered ages ago: All that glitters is not gold."[5]

You can easily substitute a different routine for the stock market news cue. Go back and look at the investment goals and investment policy statement that was set up at the outset. Remind yourself as to what you are investing for and why. Talk to your Investment Counsellor and revisit your goals. That is why goals-based investing is the cornerstone of the Manulife Private Wealth approach.

[3] Barber, Brad M., and Terrance Odean. "Trading is hazardous to your wealth: The common stock investment performance of individual investors." *The journal of Finance* 55.2 (2000): 773-806.

[4] McKinsey Global Institute, Diminishing Returns: Why Investors May Need to Lower their Expectations, May 2016

[5] Barber, Brad M., and Terrance Odean. "All that glitters: The effect of attention and news on the buying behavior of individual and institutional investors." *Review of Financial Studies* 21.2 (2008): 785-818, p. 814.

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