

# Looking Forward A Time for Reflection

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As the world continues to adapt to the effects of COVID-19, the equity markets continue to look to better days ahead, generating positive returns across all major markets. With markets having largely recovered from the downturn in the spring, it is worth hitting the pause button to reflect on this year and to look forward to the next few years. Investors should think deeply about their emotional capital or psychological resources. As markets declined in March, investors were genuinely panicked and may have chosen to cash in part or all of their equity exposure only to miss the market upturn over the last six months. Now is a good time to prepare yourself and your portfolio for the next couple of years.

In *The Limits of Safety*, Scott Sagan of Stanford University when speaking of environmental disasters like Chernobyl commented, "Things that have never happened before happen all the time." This phrase resonates with investors because it seems to be the one consistent behaviour in markets - the moment one thinks they are certain about the future, things change. Consider an investor in 1980 when six of the top 10 weights in the S&P were energy companies. Over the following decades, oil consumption would only increase, world economies grew, interest rates declined dramatically, all of which should have accrued to the benefit of energy investors. Yet 40 years later, the entire energy industry would barely make it into the top 10 of the S&P. Today, technology stocks dominate the top S&P weights and their future seems as bright as energy did in 1980. Perhaps this is a cautionary tale for the abundance of confidence investors currently have about the ascendancy of technology companies. While the illusion of certainty can result in horrendous investment decisions, dealing with uncertainty is a cornerstone of a successful investment approach.

Firstly, investors should evaluate their fixed income exposure. The current yield on government bonds has proven to be a good predictor of 10-year returns and one can calculate what the best return on fixed income will be should interest rates

drop to zero during the next year or two. Currently, 10-year government bonds yield 0.60% and if rates drop to zero, your total return will barely be 4%. Fixed income has had a tremendous 40-year run as rates consistently declined. In this period of relative calm, investors should think about the role that fixed income should play in their portfolios.

Secondly, investors should consider the potential volatility in equities and what their emotional reaction would be should there be a decline in equity prices. Every investor likes to believe that they would be a buyer in the middle of a panic yet most are not emotionally prepared and end up selling at the worst possible time. Now is the time to prepare yourself for all of the potential once in a lifetime events that may happen in the future - visualization and preparation provides the best chance of success. Moreover, investors should ask themselves if they can tolerate the volatility that equity markets can experience.

While there are no easy answers to the issues above, it is worth taking the time to speak with your Wealth Consultant to make sure that your investment policy asset mix is appropriate. When you least think you have to deal with issues is the best time to focus on them. You will be addressing them from a position of calm and logic rather than panic and emotion.

\*Cidel is an operating name of Cidel Asset Management Inc.