IN FOCUS

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IAIC
Independent Accountants' Investment Counsel Inc.™

The Quarterly Commentary

The decade that gave us one of the longest-running bull markets in history is now behind us. What lies ahead? 2020 presents a fresh new set of challenges and opportunities to consider – with geopolitics and trade sure to take centre stage as the year unfolds. In this article, we review the notable events of 2019 – which proved to be a robust year for the markets, despite some ups and downs – and shed light on how we diversify our clients' portfolios to weather the elements ahead.

2019 ended on a positive note, in sharp contrast to the declines that investors experienced at the end of 2018. November was the strongest month in the quarter for all global markets, with index returns between 1.9% and 3.4% in local currencies. The U.S. led the way during the fourth quarter and was the top performer among geographic regions for 2019. For Canadian investors, U.S. market performance was limited by a fall in the U.S. dollar. Interest rates remained unchanged in Canada during the fourth quarter, which helped to lift preferred share prices to a total return of 3.9% for the last three months of the year.

At this time last year, investors were absorbing the impact of stock market declines of more than 20% over the fourth quarter of 2018. Prices had fallen rapidly in response to the U.S. Federal Reserve Board's ("the Fed") economic outlook and reading of the economy and the direction that the central bank was pushing monetary policy as a result. While the Fed had pushed up short-term interest rates during 2018, the bond market was pushing up prices at the longer end of the yield curve (meaning long-term rates were falling), leading to a flattening yield curve, a condition that has often been followed by an economic recession. The market was clearly signalling that the inflationary pressures the Fed was attempting to get in front of were unlikely to materialize and an overheated economy was not a near-term risk. Markets responded accordingly, pricing negative growth into stock prices. In late 2018, all indications pointed to the Fed continuing to increase interest rates throughout 2019, despite trailing economic indicators that suggested both U.S. and global growth were slowing.

In January of 2019, the Fed reversed its position, citing slowing growth and global trade tensions, and made three downward moves to its target rate throughout the second half of 2019. This response by the Fed signalled acknowledgement of the need for caution and patience and the concerns of investors. In turn, markets responded positively, with North American indices (Dow Jones, S&P/TSX Composite Index and S&P 500) gaining between 19.1% to 28.9% over the course of 2019.

As we begin a new year, we are closely monitoring three issues from a macroeconomic perspective. Two geopolitical issues – the heightened risk of war in the Middle East and the U.S. presidential election – may translate into some market volatility in the coming months. We'll also be watching the direction of interest rates, which are correlated to numerous factors, including employment, inflationary pressures and forecasted growth in both the U.S. and global economies.

In the Middle East, the U.S. attack on a prominent Iranian general has elevated tensions between the two countries and increased the possibility of war in the region. This threat puts the world's oil supply at risk. Approximately 20% of the world's crude moves by tanker through the Straight of Hormuz. The targeting of this pinch point and potential attacks on refineries in the region could lead to higher oil prices in the coming months. The immediate response to the U.S. attack was a jump in the price of both oil and gold. If the region further destabilizes, investors may begin to price additional risks into equity markets.

Mike Williams
CFA, MBA

Advising Representative

The pending U.S. presidential election in November and the impeachment cloud hanging over U.S. President Trump are also top of mind for investors. A controversial figure, President Trump has presided over extended economic growth, record-low unemployment and U.S. stock markets that have rallied and responded to a more favourable business environment (the Dow Jones has climbed over 70% in four years). The elephant in the room is the national debt, which exceeds $20 trillion, and an annual deficit which has ballooned to nearly $1 trillion. Critics blame the tax cuts of 2017 for a shortfall in revenue and slowing U.S. economic growth. Future administrations are going to have to address a slowing U.S. economy and a mounting deficit. The market fears some of the social spending proposals being advanced by Democratic Party contenders may compound the national debt. Investors will no doubt be paying close attention to the election polls and other developments as the election campaign intensifies throughout the year.

In the near term, interest rates will be a key driver for both fixed income and equity investments. After an extended period of economic expansion, the unemployment rate has hit record lows. With decent growth in the fourth quarter, housing starts have recovered from the lows reached 10 years ago but have not yet reached the levels recorded between 1996 and 2006. A global economic slowdown, fuelled in part by newly imposed tariffs and trade tensions, has continued to be a headwind for global exports.

How will the Fed respond to the current developments? According to the CME Group's Fed Watch Tool, the aggregate probability is that the Fed will either maintain its current target rate of 1.50%-1.75% or cut the rate again sometime in 2020. This prognosis presumes that an overheated economy fuelling inflation is no longer a Fed concern and, to the contrary, that U.S. economic growth will continue to slow down, potentially reducing earnings expectations going forward. At the same time, lower interest rates reduce corporate financing costs thereby improving earnings. As a result, declining economic growth combined with lower resulting interest rates can have a somewhat offsetting impact on stock prices. While the risk of a pullback persists, if economic growth continues on a positive trajectory, stocks should continue to outperform fixed income in the near term.

In Canada, over 71,000 jobs were lost in November, driving the unemployment rate up 0.4%, to 5.9%. This employment decline follows slowing job creation over the previous six months. If this trend continues and results in weaker consumer spending and housing market performance, the Bank of Canada may be forced to lower its overnight lending rate, currently pegged at 1.75%.

In the new year, we believe mitigating interest rate risk should be a key consideration. The use of a relatively short "bond ladder" that extends out five years (with an average duration of approximately three years) helps to reduce the impact of changes in interest rates on the bond allocation of our clients' portfolios. Within the equity allocation, securities are classified and diversified according to the focus of the industry they operate in. Our portfolios are structured to include stocks with offsetting behaviours to changes in interest rates and other macroeconomic events. For instance, stocks in the Utilities sector tend to benefit from lower interest rates, while stocks in the Financials sector tend to benefit from higher rates. This type of portfolio diversification reduces market volatility associated with the ups and downs of an economic cycle and market shocks. The current tensions in the Middle East further highlight the need for diversification among industries. For example, the conflict may result in higher oil prices, which would benefit oil producers, but would also result in higher costs for companies that consume large quantities of fuel as part of their operations.

When constructing client portfolios, we diversify by systematically providing exposure to all major economic sectors using a mix of individual stocks and bonds. We believe that this thoughtful, diversified approach to portfolio construction reduces the risks associated with market volatility. Within our stock selection, we continue to favour dividend-paying issuers to provide further portfolio stability. While we may at certain times shift the balance between sectors and either increase or decrease the ratio of income-producing securities (bonds and preferred shares) to equity in response to the macroeconomic climate, our strategy is to always diversify each portfolio from the outset. This strategy ensures we are always meeting our clients' specific investment goals and maintaining our investment discipline rather than reacting to geopolitical events.

How The Markets Performed

Jordan Carter, CIM

Advising Representative

It was another positive quarter for markets as they concluded an impressive 2019 calendar year after the decline to end 2018. The US led the way during the final three months of the year and moved to the top of the geographic regions for 2019 performance. November was the strongest month for each of the regions with index returns between 1.9% and 3.4% in local currencies. The US market performance was limited by a fall in the US dollar, reducing returns for Canadian investors and making relative outperformance of the S&P500 even more impressive. Interest rates remained unchanged in Canada during the fourth quarter, which helped to lift preferred share prices to a total return of 3.9% for the last three months of the year.

Key Indicators		Dec-19
90 Day Tbill		1.66%
CPI (Y/Y) (Aug)		2.2%
$U/$C		$0.77
Major Market Returns	3 Month Total Return	12 Month Total Return
S&P/TSX Composite	3.2%	22.9%
S&P/TSX Preferred Share	3.9%	3.5%
S&P 500 Composite (C$)	6.8%	24.5%
MSCI EAFE (C$)	6.0%	16.5%
IAIC Equity Sector Benchmarks		
Consumer	-3.8%	9.6%
Financial	0.2%	16.9%
Utilities	0.4%	19.1%
Industrial	6.8%	37.2%
Resource	6.5%	18.6%

Understanding the Registered Retirement Income Fund (RRIF)

Your RRSP is designed to receive contributions during your working years to help save for your retirement. At some point however, you will want, or need, to convert your RRSP to an income-paying vehicle to help meet your retirement income needs. You can convert all or part of your RRSP to the following options at any age, although federal rules mandate that you convert all of your RRSP by the end of the year in which you turn 71:

- Cash out your RRSP: The lump sum payment would be treated as taxable income in the year it is received, likely pushing you into a significantly higher tax bracket.
- Purchase an annuity: This is purchased from an insurance company, using some or all of your RRSP value, creating a guaranteed payout to you based primarily on your age, health and prevailing interest rates. There can be survivor benefits for your spouse, and a variety of other guarantees, though these options would lower the guaranteed payments. Typically there is no residual benefit for your estate.
- Convert to a Registered Retirement Income Fund (RRIF): The RRIF is essentially a continuation of your RRSP, as you can retain all the investments you held in the RRSP. Investment income continues to grow tax-free. The essential difference is that the RRIF is designed to pay out an income to you over the year, which you can receive as monthly, quarterly or annual payments.

Many opt to convert their RRSP to a RRIF, as this allows you to maintain your current investment portfolio, provides flexibility in amounts withdrawn, and the entire residual balance can flow tax-free to a surviving spouse upon your death. If there is no surviving spouse (or dependent child), the residual balance would be a taxable asset to your estate. Withdrawals from a RRIF are treated as fully taxable income. If you and your spouse are both age 65 or older, you can elect to split this income on your tax returns to equalize income and potentially reduce your overall taxation. In addition, your RRIF withdrawal would be eligible for the federal pension tax credit.

Consult your accountant and financial planner a few years in advance of turning 71 so that you can determine the best plan for conversion of your RRSP.

Steve Rapson
CFP

Senior Financial
Planner

Once you have converted your RRSP to a RRIF, you are required to withdraw at least the "minimum amount" as income in the following year. This minimum amount is a prescribed percentage set by the federal government, where a higher age dictates a higher mandated minimum withdrawal. If you have a younger spouse or common-law partner, you can elect to base the minimum calculation on their age to reduce this mandated required RRIF withdrawal amount.

You also have the option to withdraw more than the minimum amount, should it be needed or desired, without restriction. However, if you have a 'locked-in' RRIF, where funds came from a locked-in RRSP or pension, then you would be subject to a maximum withdrawal limit in addition to the minimum RRIF payment.

The minimum withdrawal amount is a percentage calculation, based on your age and the value of your RRIF on December 31 of the previous year, using the following schedule:

Age at Start of Year	Minimum Withdrawal Factor	Age at Start of Year	Minimum Withdrawal Factor	Age at Start of Year	Minimum Withdrawal Factor
65	4.00%	75	5.82%	85	8.51%
66	4.17%	76	5.98%	86	8.99%
67	4.35%	77	6.17%	87	9.55%
68	4.55%	78	6.36%	88	10.21%
69	4.76%	79	6.58%	89	10.99%
70	5.00%	80	6.82%	90	11.92%
71	5.28%	81	7.08%	91	13.06%
72	5.40%	82	7.38%	92	14.49%
73	5.53%	83	7.71%	93	16.34%
74	5.67%	84	8.08%	94	18.79%
				95+	20.00%

Keeping Our Record of Your Personal Information Up To Date

In order for our investment management team at IAIC to make appropriate investment decisions for you, we must always be up to date on your personal circumstances that are relevant to your financial situation and objectives.

For example, a material change in any of the following could impact our decision-making:

- Marital status
- Job / business
- Income / net worth
- Health
- Personal residence (especially a move to outside of Ontario)
- Investment time horizon (when do you need cash in the future)
- Appetite and capacity for investment risk
- Investment objectives

If you experience any of these types of changes in your life, please inform us directly, either by phone or electronically (see contact information below).

We are required to keep your personal information up to date. It is our practice that if we have not had a meaningful conversation with you in the past year about your personal circumstances such as those listed above, we will reach out to you directly in order to update our records and determine if any investment strategy changes are needed. We may reach out to you by phone, letter or electronically. In these times of identity theft, if you are uncertain at all about the legitimacy of our request for information, please contact us to verify that the request is indeed legitimate and originating from IAIC.

We look forward to hearing from you!

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Oliver Lee,
B.Math

Vice President
IALIA

Life & Living
Benefits

IALIA
Independent Accountants'
Life Insurance Agency Inc.™

How we can help

Second Opinion Service

Before you buy, we can assist by providing you with a second opinion. Our clients have found this service helpful in ensuring that the purchase they are making is the right decision for them and that they are receiving the best product for their needs.

Analysis of your current insurance policies

You may have insurance policies that you purchased many years ago and would like to review how they work and if they are still needed. We can help to explain these policies to you, summarize the insurance policies and determine if it still makes sense to keep them.

Determining if you need insurance and how much

With proper information gathering and needs analysis we will determine what you need and how much. Our recommendations will be supported with the numbers and facts.

Shopping the market for the best products

If you already have a good sense of whether you need life insurance and how much, we can help by analyzing the market place to find the best product for you. We will review price, features and quality to recommend the best product. With access to all the key insurance carriers in Canada, we will provide you with a recommendation that puts your needs first.

For more information, please visit www.ialia.ca or contact your advisor.

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