BAKER & EDWARDS FINANCIAL

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NEWSLETTER – SUMMER 2018

We hope you either enjoying this heat wave, or finding ways to stay cool!

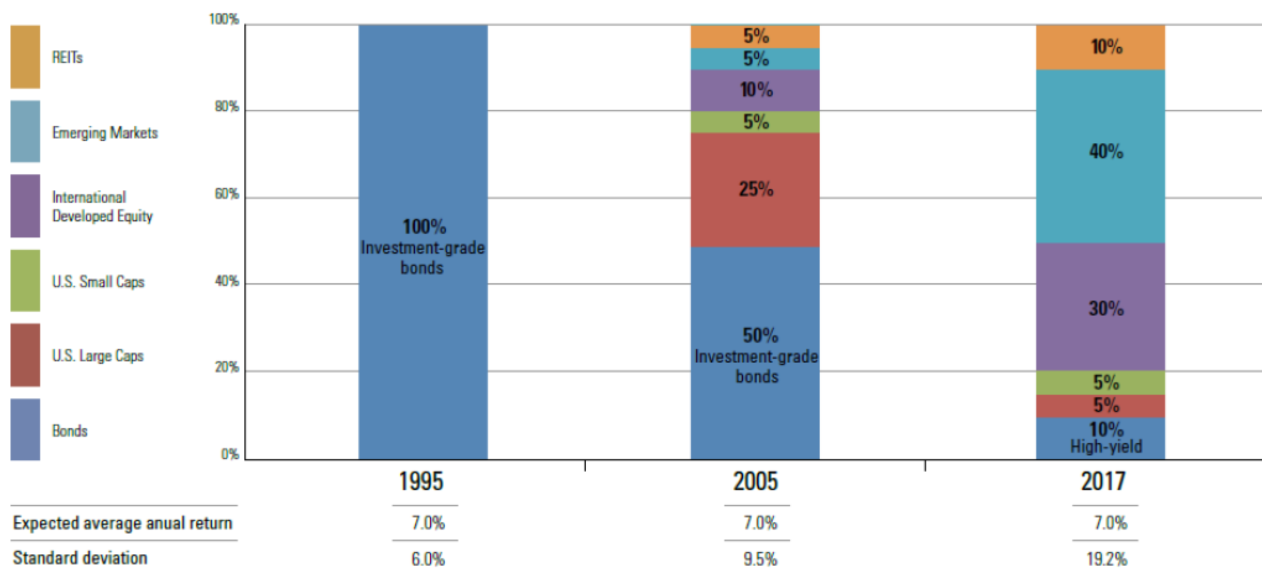
Some world markets have been very hot this year as well – the US S & P 500 index is only a couple of points away from a record, and the TSX index set a record high in July. You will not find that your mutual funds have matched this performance however. This is because the gains have been very concentrated in a select few of the giant technology companies and oil producers. Most global markets have only slight gains, bonds and other fixed income products show small losses.

Since owning technology companies is risky and fixed income products are earning nothing, what should an investor do? We believe that diversification is more important than ever – both by type of investment and also by geography, and that we must choose managers who have the widest scope in terms of what assets they can invest in, where in the world they can invest, and the flexibility to change quickly.

The following chart from Signature Advisors and Bloomberg illustrates how the investment world has changed in the past 22 years. If you wanted to earn a 7% return in 1995 you could invest 100% of your money in investment grade bonds. To earn the same return in 2017 you would have needed 6 different types of assets and your risk would have increased 3 times.

The Challenge in Canada

Estimates of what investors needed to earn 7%



Clients have increased risk 3.2x to generate the same return.

Sources: Research Affiliates, Bloomberg, Larry Berman

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The big question on all our minds of course is; "What will the U.S. President do next?" When Trump says the U.S. will easily win trade wars he really means that the U.S. will lose less – this is true because the U.S. is not nearly as dependent on trade as most other countries. His trade battles are supposedly aimed at reducing the large American trade deficits but seem to overlook the fact that with unemployment below 4%, there are simply not enough workers left in the U.S. to build the production capacity to replace the imports. Already the supply of new homes is dwindling because the home builders cannot find enough skilled workers – and of course they would not be allowed to use immigrants!

The underlying problem that does not get addressed by the politicians is that the U.S. has been a massive over-consumer for more than a generation. Excess consumption means too little savings, which means that the U.S. draws in the savings of the rest of the world to finance its consumption. Tariffs will increase the cost of many goods, thereby increasing inflation and probably causing the Fed to increase interest rates even more. At some point this is likely to tip the U.S. economy into recession.

So far markets (especially those most dependent on trade) have corrected somewhat but uncertainty is rising and more corrections are likely. The U.S. market has not corrected to this point because U.S. companies are showing strong profits (partly because of the tax cut) and their outlook is quite positive for the next couple of years.

Geopolitical risks from North American free trade, the Middle East and others along with disruptive technologies and the sharing economy (Airbnb, amazon & Uber for example) all translate into higher volatility as the world adapts to these new realities.

This is certainly a time for caution, but it is not a time to sell your investments because of panic. You are investing to meet your long term goals and a short term downturn should not be a reason to deviate. Look back at 2008 for a reference point – it only took a year or so for markets to recover from what seemed like the worst situation we have ever encountered. For equity portfolios we recommend using managers who ae only looking to find 30-40 of the best companies in the world. For balanced portfolios we recommend using managers who have the greatest flexibility in terms of type of assets and geography.

Speaking of funds, Invesco is changing the names of its Trimark funds in order to simplify and focus their worldwide attention on the Invesco brand. All the Trimark funds will now use the Invesco name only. The funds still have the same managers that we are familiar with. We are also finding that the entire mutual fund industry is becoming much more competitive in terms of lowering the fees that you pay and the levels at which you can achieve additional discounts. We would be glad to show you how to make use of these changes.

Several studies over the years have proven that people who use a financial advisor end up with significantly higher assets and less stress than those who don't. The key word is USE. It is not enough for you to set up a monthly contribution plan and just let it run. The plan needs to adapt as your life and circumstances change and this requires regular reviews. We would love to meet with you to catch up on your needs, circumstances and goals. Just let us know when it is convenient for you!