PWL PERSPECTIVE

JANUARY 2019

Photo Credit: **Shweta Shrivastava**, Greece Portfolio Manager, PWL Montreal

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In search for Alpha – Why having an advisor is your best bet for better performance

Alpha – Larry Swedroe, the famed author and financial advisor, called it the "Holy Grail of investing." The relentless pursuit of Alpha, those magical gains over and above the markets returns, has been proven as perilous and futile a quest for investors as the pursuit of the Grail was to many Arthurian legends characters.

With the broader adoption of index - or evidence-based - investing, the cornerstone of PWL's investment philosophy, is the quest for Alpha all but over? What then can cater to the thrill of the hunt for investors; this intrinsic need to do better and try to get more out of every dollar invested?

Vanguard, the behemoth that now manages more than $5 trillion in assets, reframed the concept of Alpha in a 2015 research paper, refining the definition further and further since then. The real Alpha, they posit, is the advisor Alpha, meaning that the real observable performance gains stem from the trust relationship one establishes with a qualified advisor. Their analysis identifies 3 dimensions where advisors can bring extra value: Portfolio construction, Wealth Management and Behavioural Coaching. They go so far as quantifying the actual value of advice to "about 3%" of returns.

That number represents the sum of all the benefits a great advisor can bring, through cost-effective portfolio construction and the efficient management of wealth through rebalancing, withdrawal and contribution strategies and tax efficiencies. The value of these two prongs, while significant, are easily surpassed by the benefits provided by what's at the heart of the actual relationship with your advisor: the behavioural guidance that your trusted advisor will provide. Investor behaviour, in bad times, but also in good times is disproportionately responsible for the overall outcome of any investment strategy. Behaviour detrimental to performance often find their roots in biases that we all share. For example, the bias for action common to most investors, will uncite us to buy or sell when market movements occur, often hurting our long-time prospects through increased transaction fees, and tax inefficiencies. The role of the advisor, as the name implies is to offer perspective and act as a trusted sounding board when life's many forks in the road come into view.

Staying the course - or not - does not require blind faith. To the contrary, working with an advisor demonstrates the discipline that is required to analyze, course-correct if necessary and seize opportunities where they really are to be found.

Believing in "Passive Investing" only means using the real levers of wealth management, not the tall tales of treasure hunters. Focusing on what you can actually control, in life and in wealth, offers the clearest path to achieve peace of mind.

While we can all appreciate a great story, our PWL advisors are there to make sure yours contains the words "happily ever after".

Thank you for the confidence and trust you place in us. We wish everyone a healthy and happy 2019. ❖

Cameron Passmore
Portfolio Manager & Member of the Board

James Parkyn
Portfolio Manager & Vice-Chairman of the Board

Brenda Bartlett
CEO, President & Member of the Board

Anthony S. Layton
Portfolio Manager & Chairman of the Board

Why it feels so bad when markets drop: Loss Aversion

Ever wonder why it feels so much worse when markets drop a few percentage points than when they climb by the same amount? To put it simply: because we are normal. As humans, we are more averse to losses than we are enthusiastic about equivalent gains.

Peter Guay
Portfolio Manager

Meir Statman, a professor of finance at Santa Clara University, is a pioneer in the field of behavioral finance. In his latest book, *Finance for Normal People: how investors and markets behave* (Statman, 2017), he explains that we "are willing, on average, to accept a 50-50 chance for a potential gain or a loss, only if the potential gain is at least 4 times as large as the potential loss." To frame it in the context of stock market gains and losses, a 2.5% loss in the stock market takes a 10% gain to elicit in us an equal and opposite level of emotional reaction.

This emotional ride that we all feel varies considerably based on our gender, our age and even across countries. For instance, whereas in North America, a potential gain must be about 4 times as large as the potential loss in a 50-50 chance scenario for us to accept the risk, China and Vietnam, that ratio drops to 3 times. In other words, the Chinese and Vietnamese cultures are less averse to losses than North American cultures (Statman, 2017).

Source: Statman, M. (2017). Finance for normal people: how investors and markets behave. New York: Oxford University Press.

As we develop a deeper understanding of the implications of this very human behavior, we start to see it all around us. **Avoiding short term pain at the expense of long-term gain leads us to make poor decisions over and over.** Credit card companies prey on this when they offer exceedingly low minimum payments, in order to keep us paying interest for as long as possible on our credit card balances. Casinos and lotteries make the potential gain seem immense, while they very slowly drain our wallets by a thousand little outlays.

Our reaction to downward moves in stock markets can have the same negative effect if we allow ourselves to fall prey to our loss aversion impulse. While selling on the downturn might make us feel good in the short run, it will inevitably hurt over the long term as inflation slowly grinds away the value of our un-invested cash.

If you're feeling bad about the latest stock market swings, call your advisor and lean on him or her to help you overcome the impulse. You'll thank yourself down the road for it. ❖

Photo Credit: **Martin Dallaire**, *Victoria (BC)*
Senior Director, Marketing & Communications, PWL Montreal

Photo Credit: **Rebecca Solyom**, *Sainte Justine (QC)*
Executive Assistant & Communications, PWL Montreal

Not All ETFs Are Created Equal

In recent years, exchange-traded funds (ETFs) have enjoyed a lot of good press. And rightly so: they remain the best building blocks for diversified portfolios. But there are now more than 760 ETFs on the Toronto Stock Exchange, and only a small number deserve a place in your portfolio. So how do you separate the wheat from the chaff?

It helps to remember what made ETFs so attractive in the first place, and to focus your search on the funds that meet these criteria:

A passive strategy. When ETFs first hit the street almost three decades ago, they were designed to deliver the performance of well-known stock indexes, and for many years ETFs were virtually synonymous with passive investing. But today almost all new ETFs are designed to beat the indexes, not match them, and they're using increasingly exotic strategies to differentiate themselves.

Broad diversification. Traditional ETFs allow you to get the broadest possible diversification, with some funds including thousands of individual stocks. Funds like these ensure you're not overly exposed to the risks of individual companies or economic sectors. Most new ETFs, by contrast, have more narrowly focused strategies and may be concentrated in small market niches.

Low cost. Competition has driven costs lower than ever: it's now possible to build a portfolio of index ETFs for less than 0.10%. But ETFs with active strategies—while cheaper than most mutual funds—routinely have fees that are at least six or seven times higher than that. To deliver on their promise of market-beating returns, they will need to overcome that significant cost hurdle, and the evidence is clear that most funds are unable to do so.

Here at PWL, our preference is for ETFs based on these core principles. We're always on the lookout for new funds that can better control risk, reduce taxes, or lower costs, but we rely heavily on traditional ETFs, not their trendy counterparts. This isn't about being nostalgic, or "old school." It's about choosing a strategy based on evidence, not marketing. ❖

Dan Bortolotti
Portfolio Manager

BYAs

Business Women of the Year - Celebrating Canadian Women Entrepreneurs

In business, the custom of sharing ideas and solutions can be invaluable. This is especially true for women entrepreneurs who learn so much from each other's stories and experience. Thankfully, Canadian organizations such as the Women's Business Network of Ottawa (WBN), provide a supportive networking environment for women business leaders in the National Capital Region.

As a long-time member of the WBN, I am proud to announce that starting this year, PWL Capital will be the title sponsor for a series of events culminating with the Business Women of the Year Awards gala in April 2019.

Since 1981, the WBN has been an important whose mission supports, promotes, empowers and recognizes business women. As a leading champion for the female entrepreneurial spirit, the WBN offers amazing networking and mentorship opportunities for its members.

Even as many women are beginning to rise to the entrepreneur call, the numbers are still showing a skewed representation in business owners. When the Federal government looked at the small and medium sized business landscape in Canada, it found that only 15.7 of them were wholly owned by women.

One explanation might lie with the difficulty for women entrepreneurs to access venture capital. A study out of the US last year found that only 2% of all venture capital invested went to women-led start-ups. This situation certainly is in need of a major improvement and with more and more women joining venture capital firms, we can hope for better representation.

We believe representation begins with recognition and the WBN Business Women of the Year Awards is a step in the right direction. ❖

Nancy Graham
Portfolio Manager

Client Experience Tailored for You

What is the customer experience? By definition, customer experience is the result of all the interactions that a customer can have with a brand or a company. Of course, all organizations claim to offer the most satisfying experience to their customers.

François Doyon La Rochelle
Portfolio Manager

For some customers in the financial services industry, a good customer experience will come down to the simple performance of their portfolios. At PWL Capital, providing you with the best financial results is obviously our number one concern, however, our added value for you and your family is also reflected in our integrated wealth management service offering. These include financial planning, retirement planning, estate planning, tax planning and insurance needs analysis, in collaboration with external specialists.

Cathia Adjami
Investment Advisor,
Financial Planner

That being said, we believe that your customer experience goes beyond professional services and the relationship of trust between you, your advisor and his or her team. That is why many initiatives have been undertaken to improve our service to you. Three of our four offices were expanded and renovated to provide you with conference rooms that meet your expectations. In addition, in order to improve your web experience and provide you with more readily available educational content (articles, videos and podcasts), we have completely reviewed the navigation and structure of our website. The latter is now also mobile-friendly. Finally, to increase the security of your personal information, we have developed and implemented the "document vault" which allows the electronic sharing of documents in a secure way as well as "e-signature" that allows the secure completion of documents online. Rest assured that we are constantly on the lookout for new trends in technology to improve the quality of service that we provide you with.

Our quest to provide you with an unparalleled customer experience is fueled by listening to your needs, so feel free to send us your questions and concerns. At PWL Capital you are always at the heart of it all. We invest each in every year with the goal of providing with peace of mind when it comes to your wealth. ❖

Is the Millennial's Relationship with Money Different than Other Generations?

We graduated in the middle of the worst financial recession since the Great Depression. At a time when it is difficult to get a full-time job and the reliance on the gig economy has become more common, student debt is ballooning. We're criticized for our lack of job loyalty, even though incentives to be loyal, like defined benefit pensions, have essentially disappeared in the private sector. Average housing prices have skyrocketed, with major cities like Toronto and Vancouver pushing up prices in smaller cities in their vicinity.

Expected returns are lower than historical returns. While interest rates on our large mortgages are low, it also means that we'll need to save more to reach our goals or take more risk to get there. While several millennials were traumatized by the great recession, they are still taking risk in the market. Given that our incomes are lower but our spending preferences aren't much different from previous generations based on research by the Federal Reserve, taking more risk might be the only way to keep up.

Whether it's truly harder for a millennial than any other generation isn't the question. The question is how can millennials achieve their goals? As advisors, the answer to that is no different from any of our other clients. Listen to each individual client's wants, needs, goals, and experiences, create a plan tailored to them and invest their money in conjunction with that plan, not anyone else's. We see many millennials with the same goals as any other generation had: buying homes, funding children's educations, retirement. While the cards might be stacked against us, there is hope. We're the most educated generation in history and with the increased uptake of Exchange Traded Funds and Index Mutual Funds, it is easier than ever for millennials to invest well from the start. ❖

Susan Daley
Portfolio Manager

Photo Credit: **Angelica Montagano,** *Costa Rica*
Marketing Assistant, Social Media, PWL Montreal

Should you invest or pay off your mortgage?

Do you have a mortgage? What about an investment portfolio? If so, when does it make sense to use some of your investments to pay off your mortgage? Unfortunately, most people tend to think of their mortgages and portfolios in isolation from one another so the conclusion is often flawed.

In thinking about using investments to pay off debt, many homeowners prefer to keep their portfolio intact, even if it means taking longer to pay off their mortgage. It's typically assumed that the higher expected returns from the stock market will earn more than relatively low mortgage rates will cost, especially while interest rates remain low. It's all about context however.

What if you're not allocating 100% of your assets to stocks? In that case, a more sensible approach might be a two-step tango between your mortgage and your portfolio: (1) Divest some of your fixed income investments to pay off the mortgage, which (2) increases the equity allocation of what remains.

Having a mortgage exposes you to **leverage risks**. In contrast, investing in stocks exposes you to **market risks**.

Let me illustrate with an example. Using PWL Capital model portfolios' expected returns as a guide:

Most people would initially prefer Scenario 1, i.e., keeping the larger portfolio and chipping away at their mortgage over time. After all, with the 50/50 portfolio expected to earn 4.68% per year and the mortgage costing 3% per year, the preference at first seems "obvious."

Scenario 1: Portfolio + Mortgage

Investment Portfolio:	$900,000 (50% stock / 50% bond mix) **Expected annual return: 4.68%**
Home value:	$500,000
Mortgage:	$400,000 **Annual rate: 3%**
Total net worth:	(900,000 portfolio + $500,000 home) – $400,000 mortgage = **$1 million**

Scenario 2: Mortgage Paid Off Using Fixed Income

Investment Portfolio:	$500,000 (95% stock / 5% bond mix) **Expected annual return: 6.09%**
Home value:	$500,000
Mortgage:	$0
Total net worth:	900,000 portfolio + $500,000 home – $0 mortgage = **$1 million**

The problem is, this is not a fair calculation. It fails to factor in that keeping the mortgage represents a substantial amount of leverage risk – about four-fifths of the value! Scenario 2 actually represents the same amount of risk, shifted into market risk instead.

Having a mortgage and a conservative portfolio, or having no mortgage and an aggressive portfolio – render the risk and return characteristics very similar.

Mortgage debt is usually thought about in isolation. I believe it should be considered along with evaluating the risk and return characteristics of your portfolio. When possible paying down mortgage debt while increasing the portfolio's equity allocation can result in equivalent risk and return characteristics, while eliminating a fixed expense. ❖

Benjamin Felix
Associate Portfolio Manager

Work Anniversaries

As the great Vince Lombardi use to say: "The achievements of an organization are the results of the combined effort of each individual." We want to celebrate the success and contributions of our great colleagues as we wish them happy work anniversaries.

20 YEARS

Cheryl Gillies
Portfolio Manager
Graham Team

10 YEARS

Shweta Shrivastava
Portfolio Manager
Layton-Guay Team

5 YEARS

Amanda Dalziel
Investment Advisor
Toronto Team

5 YEARS

Benjamin Felix
Associate Portfolio Manager
Passmore Team

5 YEARS

Dan Bortolotti
Portfolio Manager
Toronto Team

5 YEARS

Katherine Pineda
Operations and Compliance Agent
Corporate Team

5 YEARS

Rebecca Solyom
Executive Assistant & Communications
Layton-Guay Team

5 YEARS

Susan Daley
Portfolio Manager
Waterloo Team

5 YEARS

Tessa Felix
Investment Advisor, Culture Lead
Passmore Team

New to the PWL Family

Alanna

Born on **July 13. 2018**

Proud Parents:
Teodoro & Daniella Masciotra,
Financial & Tax Analyste
Parkyn-Doyon La Rochelle Team

Oliver Patrick

Born on **Dec 6. 2018**

Proud Parents:
Kelly Moore & Peter Guay,
Portfolio Manager
Layton-Guay Team

Photo Credit: **Abejane Alvarez**, *PEI Marketing Assistant, Graphic Artist, PWL Montreal*

Welcome to All Our New PWL Employees

Thanks to our sustained growth, we have been able to add new talent to our teams to uphold our commitment to provide you with personal service.

Anne Griffith
Operations Administrations
Passmore Team

Carol Harding
Accountant, Family Office Specialist
Passmore Team

Geena Nguyen
Portfolio Manager Assistant
Layton-Guay Team

Leigh Walker
Portfolio Manager Assistant
Graham Team

Rachelle Kelly
Front Office Leader
Ottawa

Connecting & Networking

Members from our **Ottawa office** and **Ottawa Mayor Jim Watson** are shown here at the 2018 Christmas Cheer Breakfast which helps raise funds for underprivileged individuals and families.

Peter Guay was **Rob Carrick's** very special guest this past October as a panelist for the Globe and Mail's Invest like a Pro conference series.

The PWL teams members are a well-travelled group. The pictures in this issue were shot by them exploring the world. "Not all those who wander are lost", J.R.R. Tolkien.

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