Rebalancing Your Portfolio

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Market timing and asset allocation are two very different investment activities. A market timer believes that they can accurately predict the short-term movements of security prices, significantly enough to create a financial gain. We are opposed to market timing because we do not posses the extraordinary skills required to consistently and profitably predict the random short-term movements of capital market prices. In contrast, asset allocation is a risk management tool used by portfolio managers and other financial professionals to continually weigh the prospects of different asset classes such as stocks or bonds, considering the current financial environment and the established trends within that financial environment. Asset allocation is a procedure that is used to ensure that investors remain within their tolerance for market risk. We won't rebalance investment portfolios simply because of the communication style of Donald Trump, or because of the current trade negotiations surrounding NAFTA (now USMCA) or for any other macro event such as declining emerging market currencies. We will rebalance investment portfolios to ensure investors achieve their investment goals at their desired level of risk and that includes managing the weights of equities and fixed income within an investment portfolio.

We don't know when the current bull market in equities will end. In August 2018 the Standard and Poor's 500 (S&P 500) set the record for the longest bull market rally in history. If the S&P 500 posts a positive return for this calendar year, which now appears likely, it will be the first time in history that it has achieved a positive return for ten consecutive years. A bull market is defined as a consistently rising stock market without a decline of twenty percent. The last time the S&P 500 fell twenty percent from its high was in 2009, during the great financial and housing crisis. Most investors have had the good fortune of participating in this bull market; as a result, their investment portfolios have a greater weight in equities than in the past. Being overweight equities over the past ten years has been the right investment decision, especially since fixed income, with low interest rates, have offered smaller returns. Now is the time to rebalance an investment portfolio that is well outside its asset allocation parameters.

Let's be clear. We believe in investing in equities for the long run. Many of the portfolio managers at BCV hold only equities in their personal portfolios. We are still bullish on the global economy and the financial performance of many specific companies, but we do find that equity valuations are less attractive than in the past and interest rates have somewhat improved. We believe that equities will outperform fixed income over the next five years. Having said that, we do have concerns that equities will not have the same strong returns as they have during the past five years and they will likely experience considerable volatility. We might even experience a bear market. Fixed income is a good insurance policy and acts as a shock absorber.

After the strong gains that we have experienced in equities over the past decade, rebalancing is prudent if the equity allocation in a portfolio is at the very high end of one's equity risk tolerance level. Owning more fixed income to protect against downside is the right approach but it does come with a cost. When we sell equities to rebalance we must live with the fact that most equities that we sell will increase in price over time. We also recognize that taking profits can lead to capital gains taxes, leaving less capital to reinvest. Those are the costs of prudent risk management of financial assets. We encourage you to contact your portfolio manager or the advisor that referred you to BCV to determine if rebalancing your investment portfolio now is the right investment decision for you.

Time is Everything – The Rationale for Long-Term Investing

Michelle Smith, CFA
Portfolio Manager

Technology has changed our lives. Our obsession with instant gratification has given rise to a society driven by short term impulses. No industry or company is immune to this evolution; online shopping offers same day delivery, ridesharing eliminates the need to wait for a taxi, streaming services offer full seasons of television shows commercial-free. The financial industry has also been impacted. Banks offer transfers with the click of a button, trades are executed in a matter of seconds, and robots are available to provide financial advice. As our need or desire to wait is slowly diminishing, so is our ability to exercise patience.

While immediate feedback and shorter wait times may improve some things in life, lack of patience can be detrimental to achieving financial goals. Investing is about delayed gratification; waiting to save, waiting for investments to demonstrate returns. However, exercising such patience and restraint is easier said than done. Whether it is those new shoes, a warm vacation, or a home renovation, almost every investor has given into spending today at the expense of tomorrow. In fact, the phenomenon is so common it has been identified as the “self-control bias”. The CFA Institute defines this as, “the failure to act in the pursuit of long-term, overarching goals because of a lack of self-discipline”. There is an inherent conflict between short-term satisfaction and the achievement of long-term goals, which may result in failure to realize one’s financial objectives. A short-term focus may impact investments by interrupting the compounding effect, triggering unnecessary taxable events, and increasing portfolio turnover resulting in greater transaction costs. But the most impactful consequence of the self-control bias is not saving enough for retirement and other future financial goals.

The good news? This dissonance between short-term desires and long-term goals is a bias that can be overcome with the proper tools. Working with a financial advisor to create a financial plan and budget can help to keep discretionary spending on track. Constant and regular review of one’s financial plan creates accountability and demonstrates the merits of adhering to long-range thinking. Additionally, working with investment professionals, such as the portfolio managers at BCV, can help investors remain focused on taking the necessary steps in achieving investment objectives while staying within the confines of the financial plan.

At BCV, we invest for the long-term as we believe it takes time to create wealth. Our blue-chip value investment philosophy, focused on companies growing their dividend, is a marathon not a sprint. It takes time for dividends to grow, for capital to appreciate, and for the snowball effect of compounding to materialize. Our approach is to invest in high quality companies that will remain competitive over the next 3 to 5 years. We focus on the long-term success of the business by evaluating its prospects and its fundamentals. The premise behind long-term investing is simple, but it is not easy. Over time, the stock market will rise, but it will be characterized by short-term fluctuations. Our strategy requires conviction and a strong belief in our original investment thesis. It demands patience and discipline, for which investors will be rewarded. The strength of the companies in which we invest creates the potential for long-term earnings and dividend growth, which in turn would be expected to drive long-term share price appreciation.

The USMCA (or NAFTA 2.0)

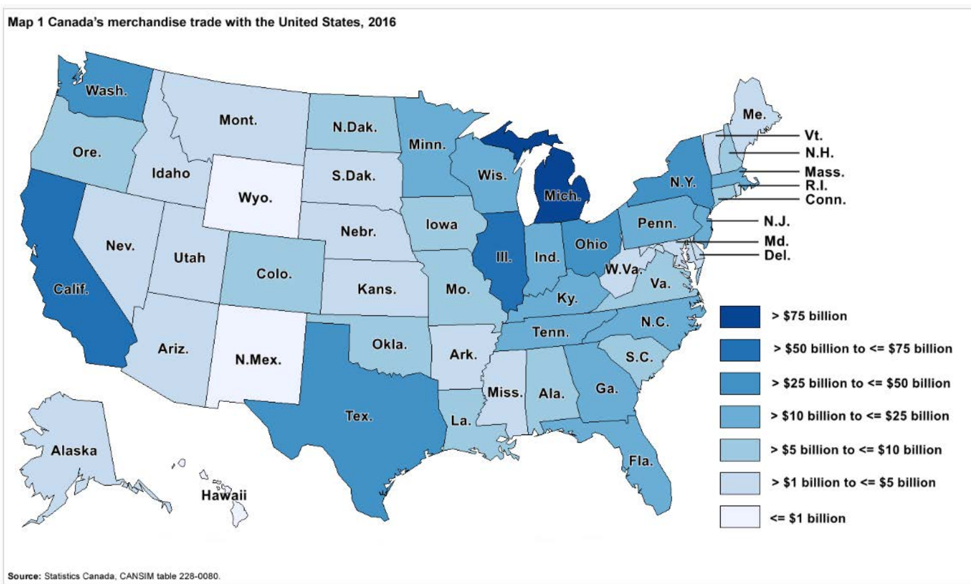
Chris Richard, CFA
Portfolio Manager

Over the past six months, we have observed the formal negotiations for a new trilateral agreement between Canada, the United States and Mexico. In effect, the renegotiation of the North American Free Trade Agreement began on the campaign trail and ended on the last Sunday in September with the new United States Mexico Canada Agreement (USMCA).

The 25-year-old NAFTA deal had been described as the ‘worst trade deal ever’ for the United States. In reality, this has not necessarily been the case. Trade between the three nations grew under the agreement and while it needed to be updated, a whole new agreement was sought to replace the old.

During the negotiations it was said that President Trump would sign a bi-lateral agreement with Mexico or cancel NAFTA all together. While the legality of making a unilateral change has been questioned, that hasn’t stopped the U.S. President from taking similar actions in the past. What is clear is that we have strong ties to the United States. In 2016, the value of Canada’s total merchandise trade (exports plus imports) with the United States on a customs basis reached $637 billion. That accounted for 64% of Canada’s total merchandise trade.

The map below illustrates the level of merchandise trade Canada has with each state. Canada trades extensively with the United States, but specifically with states that have become increasingly important in a very tight election cycle that start this coming year for the U.S. Presidency in 2020.



While the size is notable, so is the fact that Canada was the number 1 trading partner with 33 states in 2016.

Business Insider/Andy Kiersz, data from US Census Bureau

As cooler heads prevailed, we have the USMCA, or NAFTA 2.0. There were several changes but overall, this is viewed as an updating of NAFTA. Canada was able to secure the protection of the Canadian auto industry; however, this came at the expense of sacrificing a small portion of our dairy market. Copyright and patent laws also changed but not in a significant way.

The one issue that is of concern is the "non-market economy clause". This clause allows any of the three countries in the USMCA the right to review any trade agreement that another member country wants to sign with a non-market economy. Should any country in the USMCA object to the new trade deal, they can walk away from USMCA. Many commentators feel that this is a reduction in sovereignty for Canada and Mexico and a tool that the United States will use to put pressure on China. This new deal is not perfect, and the changes are still being reviewed. What is apparent is that having a deal with our largest trading partner is of the highest importance and the consequences of no deal would have been far more serious for the Canadian economy.

Recent Dividend Increases

Canada

First Quarter 2018:
Brookfield Asset Management Inc.: 15 cents (14 cents)*
Bank of Montreal: 93 cents (90 cents)
Brookfield Property Partners LP: 31.5 cents (29.5 cents)*
Canadian National Railway Company: 45.5 cents (41.25 cents)
Canadian Western Bank: 25 cents (24 cents)
Enbridge Inc.: 67.1 cents (61 cents)
Intact Financial Corporation: 70 cents (64 cents)
Magna International Inc.: 33 cents (27.5 cents)*
Manulife Financial Corporation: 22 cents (20.5 cents)
National Bank of Canada: 60 cents (58 cents)
Suncor Energy Inc.: 36 cents (32 cents)
TELUS Corporation: 50.5 cents (49.25 cents)

Second Quarter 2018:
BCE Inc.: 75.5 cents (71.75 cents)
Bank of Nova Scotia: 82 cents (79 cents)
Canadian Imperial Bank of Commerce: 133 cents (130 cents)
Canadian Natural Resources Ltd.: 33.5 cents (27.5 cents)
Power Financial Corporation: 43.3 cents (41.25 cents)
Royal Bank of Canada: 94 cents (91 cents)
Stantec Inc.: 13.75 cents (12.5 cents)
Sun Life Financial Inc.: 47.5 cents (45.5 cents)
Toronto-Dominion Bank: 67 cents (60 cents)
TransCanada Corporation: 69 cents (62.5 cents)

Third Quarter 2018:
Bank of Montreal: 96 cents (93 cents)
Canada Western Bank: 26 cents (25 cents)
Saputo Inc.: 17 cents (16 cents)
TELUS Corporation: 52.5 cents (50.5 cents)

Fourth Quarter 2018 (Pending):
Canadian Imperial Bank of Commerce: 136 cents (133 cents)

United States

First Quarter 2018:
AT&T Inc.: 50 cents (49 cents)
Analog Devices Inc.: 48 cents (45 cents)
Home Depot Inc.: 103 cents (89 cents)
Johnson Controls International PLC: 26 cents (25 cents)
VISA Inc.: 21 cents (19.5 cents)

Second Quarter 2018:
Apple Inc.: 73 cents (63 cents)
International Business Machines Corp.: 157 cents (150 cents)
Johnson & Johnson: 90 cents (84 cents)
Qualcom Inc.: 62 cents (57 cents)
United Health Group Inc.: 90 cents (75 cents)

Third Quarter 2018:
Bank of America: 15 cents (12 cents)
Bank of New York Mellon Corp.: 28 cents (24 cents)
FedEx Corporation: 65 cents (50 cents)
Medtronic PLC: 50 cents (46 cents)
Starbucks: 36 cents (30 cents)
Wells Fargo & Co.: 43 cents (39 cents)

Fourth Quarter 2018 (Pending):
U.S. Bancorp: 37 cents (30 cents)

Dividend Increases reported in domestic currency of common shares, except where noted.
* Dividend paid in USD.
Source: Bloomberg LP