Nexus Notes

March 2020
Vol. 25, No. 1

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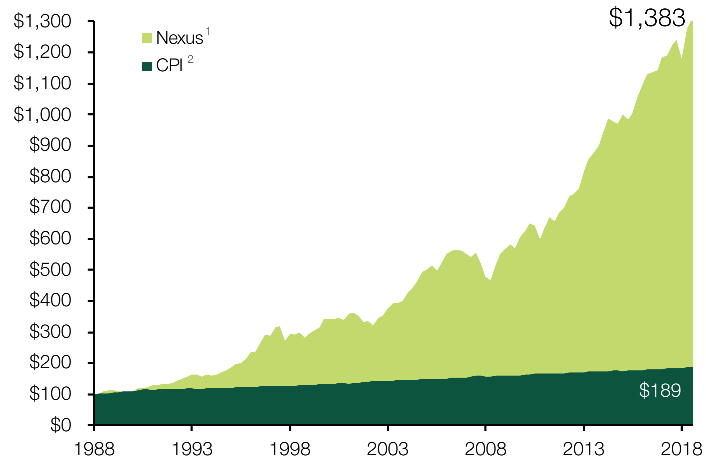
Building Value for Clients

Since its establishment in 1988, Nexus has pursued an investment approach which concentrates on real growth in client wealth over the long term.

The chart illustrates the impact of this long-term investment thinking – a $100 investment in a balanced portfolio in 1989 has grown to $1,383 at December 31, 2019.

$100 Investment with Nexus in 1989



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1 “Nexus” reflects the performance of a composite of Nexus accounts managed to a balanced mandate (until September 30,1997) and the Nexus North American Balanced Fund (thereafter). Returns shown prior to the deduction of investment management fees.

2 CPI is the “all-items” Consumer Price Index for Canada, not seasonally adjusted.

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FROM THE EDITOR

The End Game

Dianne White, CPA, CA, CFP, TEP

Drastic times call for drastic measures, as we currently try to flatten the curve of COVID-19 cases in hopes of alleviating the future strain on hospitals. So here we are, in a two-week suspension of all non-essential services, with governments across the country urging everyone to stay home, avoid contact with others and only go out if absolutely necessary.

There has already been a marked, unprecedented impact on economic activity. Canada and the U.S. will surely slide into a steep recession this year. We continue to monitor the long-term, fundamental outlook for all of our holdings. We are following the news and learning about the virus, government responses and the economic implications. At this point, it is unclear how this will play out over the next few months. There is a lot of uncertainty about our society's health and the economy. However, we do know the end game and that is: this too shall pass.

In the meantime, it is important to focus on what we can control. As investment managers we focus on our investment philosophy and process. We continue to assess our holdings, and look for opportunities to make additional investments when the time is right. As individuals, we can cut back on our spending (not hard with so many businesses closed) and heed the advice of governments and doctors to stay home and distance ourselves socially. We can also make sure we support those most vulnerable in our society. Many of us have aging parents and know people with health issues. Give them a call, arrange for groceries to be delivered and, most importantly, encourage them to stay home and stay healthy.

For those that do not receive our email blasts, we want to reassure you that Nexus and our custodian, RBC Investor Services, are considered essential businesses. We will continue to operate as we have been. While most of our team is working from home, we do have a few people physically in the office in order to send and receive mail and otherwise deal with the physical documents that remain part of our business.

You should also be aware that the Federal Government has announced several tax-related changes to help Canadians manage through the disruption of COVID-19. The CRA has extended the tax filing deadline from April 30th to June 1st this year for salaried employees. For self-employed individuals, the filing deadline remains the same at June 15th. The deadline to pay any tax owing for the 2019 tax year has been extended from April 30th to Sept 1st, 2020. For trusts, the filing deadline has been extended from March 31st to May 1st this year. Tax filing deadlines for corporations and partnerships remain unchanged.

The Government will also allow those with Registered Retirement Income Funds ("RRIFs") and similar vehicles to take out 25% less than the normal required minimum withdrawal for 2020. Reducing your RRIF withdrawal isn't for everyone, and will depend on your own financial circumstances. We are working out implementation details with RBC and will be in touch with clients. This may be attractive for those clients who want to reduce their 2020 taxable income, or simply lower withdrawals from their portfolio.

In this issue of Nexus Notes you will find an article on what it means to be an equity investor during times of market disruption, and why its important to take the long view. We also have an article about why the tax planning portion of your financial plan should map out tax strategies well in advance of the crush of tax time. Finally, to you and your families, try and make the most of your stay-at-home time and stay healthy!

Dianne White

INVESTMENTS

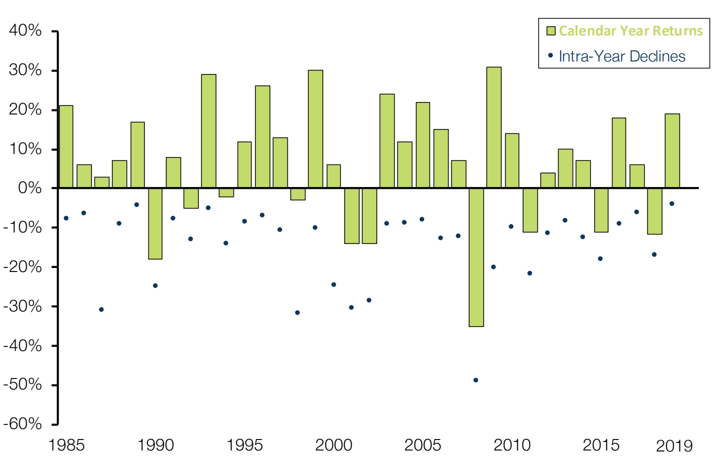
Fergus Gould, CFA

Take the Long View: Coronavirus – The Investor's Perspective

The novel Coronavirus has swept through China and spread to other countries.[1] How this will all play out is unclear. What is the mortality rate? Will there be a vaccine? How long will this last? We don't know the answers. Still, a recession is inevitable and investors are panicky. It is possible that "it's different this time", but investors tend to think it's different every time. In the face of this, investors have a strong natural instinct to do something... most typically, sell! But, is that the right answer? Here are a few things to keep in mind at a time like this.

The equity market is naturally volatile, and that's good

At an abstract level, remember that we have to endure short-term volatility in order to enjoy the attractive long-term returns that the equity market offers. There are periods that feel like sickening roller coaster rides. Currently, it's as bad as it gets. But if this weren't the case, equity investors wouldn't be well compensated. The chart below illustrates this. There is a sizeable market decline every year (the circular dots represent the worst intra-year decline for the Canadian TSX Composite each year since 1985). On the other hand, each actual calendar year return (shown as the vertical bars) is, by definition, better than the worst decline for the year, and most of the bars are positive.



S&P/TSX Composite Intra-Year Declines vs. Calendar Year Returns.

For the full 35 years, the average worst intra-year decline has been 15%, with the single worst close to -50%. But the calendar year return has been positive in 25 of the 35 years. And for the entire period the return has been 8.6% per year.[2] Not bad compensation!

Stay in the market

We know that the markets are "efficient", but we also know that we (the markets are collectively all of us) can get things wrong – sometimes badly overreacting in either direction. "Efficiency" just means that you can't use existing price patterns to predict anything useful about where the market may go in the short-term. This, along with natural volatility, proves that the markets are inherently unpredictable over shorter time periods.

If we know that the market goes up over the long term, and acknowledge that we can't predict the path, then it's better to be "in the markets, all the time" to fully capture the compensation. The big problem is that the story doesn't end here. Humans, it turns out, have foibles. Whether by divine design or earthly evolution, we have some, uhm, programming flaws.[3] To wit, an investor's emotions of fear and greed can overcome his/her rational mind. We *want* to capture the market's longer-term compensation. Unfortunately, we have a tendency to capitulate when fear or greed peaks – effectively, a tendency to do the wrong thing at the wrong time. The best way to combat this is to pick and stick to a strategic asset allocation that suits you. Then, realising that there will inevitably be bad times, hold a diversified portfolio of quality, reasonably-valued stocks. These will grow in good times and survive the bad.

Avoid overconfidence

Even successfully staying in the market isn't enough. Another behavioural foible is that we overestimate our ability. This occurs because, when we look back in hindsight, we tend to actually believe we suspected the outcome all along. So we *think* we can do this looking ahead. For instance, people believe that surely, they are smart enough to tailor their portfolios to the current outlook – say, hold more cyclical stocks in good times and more gold stocks in

bad times? Unfortunately, this is just another version of trying to repeatedly predict unpredictable market moves. A short-term trading orientation means that you need to get both trades (the buy and the sell) right and at the right time. In turn, this means that you are making a prediction about where the company is going *and* how the markets will respond.

> "I know that I know nothing."
>
> – Attributed to Socrates

The "wise" investor's version of Socrates' view is this plea, "May I have enough wisdom to know that I'm not very smart". Try as one might, we can't predict the unpredictable. A long-term investing approach is challenging enough, but more feasible than a trading orientation. "All" one needs to do is identify companies that have sustainable competitive advantages, are well run, and are priced at a reasonable valuation. These tend to do well over longer periods by virtue of dividends and earnings growth, not market moves.

Don't look back at the peak

A final human behavioural foible is that we tend to look back at the most recent market peak to measure our regret (which is how humans "feel" losses). Given inherent market volatility, there are almost always higher market peaks behind us, as is indeed the case today. Most Canadian investors are diversified beyond Canada, and a portfolio with equities from multiple countries tends to even out the peaks and troughs relative to the Canadian equity index. Finally, any fixed income and cash further dampen volatility.

* * *

The current investment environment is unsettling and all the more emotionally draining due to concerns about the health of one's family and the extent of the unknowns. However, the coronavirus crisis will inevitably pass. As an investor, remain aware of your natural behavioural foibles and always endeavour to take the long view.

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1 Putting aside the very real human consequences, this article looks at the investor's perspective.

2 For the technically-minded, this is the compound average annual growth rate for the TSX Composite total return index (i.e. including reinvestment of dividends).

3 These behavioural investor biases are well documented, so we won't explain them in any detail.

WEALTH PLANNING

A Tax Plan For All Seasons

Brad Weber, CPA, CA, CFP

As we move further into 2020, you'll notice your annual T-slips have been arriving in the mail, RRSP contribution advertisements have been everywhere and the tax deadline is just emerging on the horizon, albeit later than normal this year due to the announced temporary delay. All signs that point to the arrival of tax season.

This time of year comes with a flurry of activities as many people think about their taxes. While anytime is the right time to start planning, it's not ideal to be concentrating your activities around particular deadlines. At Nexus we believe a well developed financial plan that focuses on your goals considers a long-term time horizon. The tax planning portion of your plan should map out your strategies well in advance. Put simply, you should never be in a last minute rush to meet any tax deadlines as your plan will have anticipated your needs well in advance.

The RRSP Contribution Deadline

RRSP season is in February. It's the time when many people decide how much they should contribute to generate a deduction to their previous year's taxes. While the RRSP is a great tax strategy, the beginning of the year should be when you're deciding on your RRSP contributions for the coming year. A financial plan will ensure your RRSP contribution strategy will be laid out beforehand, without a need for rushing to meet deadlines.

Spousal RRSPs and Using Contribution Room After 71

The year after you've turned 71, you can no longer contribute to your own RRSP. But if you still have outstanding RRSP contribution room that you want to use, all is not lost if your spouse is younger than you. You can still contribute to a Spousal RRSP if your spouse is 71 or younger on December 31 of that year, and that contribution will be deductible on your own tax return. While this can be an opportunity to ensure the RRSP room isn't lost, you may likely have benefited from making that RRSP contribution earlier, and a financial plan would have helped in determining that.

Turning 71 this Year and Deciding How Much to Withdraw

If you are turning 71 this year, you'll finally have to convert your RRSP into a RRIF and begin making withdrawals. But you might not know how much you should be taking out of your RRIF. Should it be just the minimum? Or should you choose something more? A financial plan analyzes your cash flow and determines what amount is best for you to withdraw. Even more, with a financial plan in place you would already know if waiting until 71 was the right time to start your RRIF or if there were benefits to you in starting your withdrawals earlier.

Keeping an eye on the taxes you pay is important; but you should make sure that is combined with the right financial plan. At Nexus we work with you to build your financial plan which ensures your decisions are proactive and not reactive.

Nexus 2020… and Beyond!

Nicole Weiss

Late last year, we unveiled a preview of our new logo as a "teaser" for what's to come in 2020.

Behind the scenes, we're preparing a new look for our client materials, website (launching soon), our publications – and you'll notice that this edition of our Nexus Notes print publication is showcasing our new branding!

A year ago, we set out to update our brand to better reflect our current and future profile, while staying true to our founding principles of personalized client service, long-term results and trust, delivered in a thoughtful and straightforward way. We believe our new brand fuses our values with a modern aesthetic.

Our new logo is not a big departure from the look clients have been accustomed to for 24 years, and this reflects the importance of remaining steady, dependable and true to our values and clients. The modernized Nexus logo is intended to convey that we are open, consistent and collaborative, and work in unison with our clients to help them reach their financial goals, just as we have from the outset in 1988.

This edition of Nexus Notes signals an evolution of our quarterly printed publication, not just in the visual look, but also in content. Since the first issue in 1996, Nexus Notes has been where we have shared the firm's news and our views on investing and planning, as well as a topical editorial cartoon! Our blog started out small, but has grown so that there is now a greater overlap with Nexus Notes articles. We take great care in producing thoughtful, quality and relevant content for our clients. We will continue to use Nexus Notes to showcase these online pieces in a quarterly newsletter format.

While the core of our newsletter will continue to be centered on investing, informative updates on financial planning strategies (including estate and tax planning), and Nexus's internal happenings ("Inside Nexus"), you will see more of our materials morph into our new branded look. The online Nexus Notes will soon match the printed version as we undertake a refresh on our website. You will also see the evolution of our branding at our events, in the reporting materials you receive, and many other places. We're excited about this fresh, new look, and welcome your feedback.

Worth 1,000 Words…

"Hey, Dad, ever heard of The Wall Street Journal?"

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Hank Blaustein, Grant's Financial Publishing, Inc.

Pearls of Wisdom

Devin Crago, CFA

Reading is one of the principal occupations in our profession. As we digest a wide range of material, interesting ideas and surprising facts – some serious and some light-hearted – rise to the surface. We attempt to share a few of those with you in each of our issues of Nexus Notes.

China's larger role in the world

Seldom has the world's attention been so focused on China. Between trade wars and the coronavirus outbreak, there is a lot happening in the world's most populous country. While there are plenty of metrics available to measure the ascent of China, we found this one particularly intriguing: Chinese shoppers now account for approximately 35% of global luxury sales. That number is not only large in its own right, but also represents tremendous growth from only a 2% share during the SARS epidemic in 2003. Many of the high-end brands that have benefited from the rise of Chinese shoppers (Gucci, Cartier, Louis Vuitton) are likely in for a difficult period ahead until the coronavirus outbreak recedes. To make matters worse for those brands, many of the products are manufactured in Italy – another country that has been hit hard by the virus. *("Luxury Brands Fear Sales Hit as Chinese Shoppers Stay Home", The Wall Street Journal, January 30, 2020.)*

Immortality in a test tube

The healthcare industry is among the most dynamic and innovative sectors of the modern economy. From robotic surgery[1] to breakthrough pharmaceutical therapies[2], the extent of progress in this industry over the past century is stunning. However, Mother Nature often is the source of the best innovations. Recent lab research into how the brain works has focused on the hydra, a half-inch long relative of the jellyfish. The organism - which dates back some 750 million years - is sometimes considered immortal, due to its uncanny ability to repair itself. According to Columbia University neuroscientists "The hydra's regenerative powers are so incredible that if you break it up into individual cells and collect the cells in a test tube, they will reconfigure themselves into a proper animal within a few days." *("What Can this Ancient Creature Tell Us about the Human Brain?", Columbia Magazine, Winter 2019-20.)*

1 https://www.technologyreview.com/f/615179/robot-assisted-high-precision-surgery-has-passed-its-first-test-in-humans/

2 https://www.nytimes.com/2020/03/09/health/hiv-aids-london-patient-castillejo.html

Invest
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At Nexus, we offer thoughtful wealth planning and investment management with unparalleled personalized service to private clients and foundations.

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