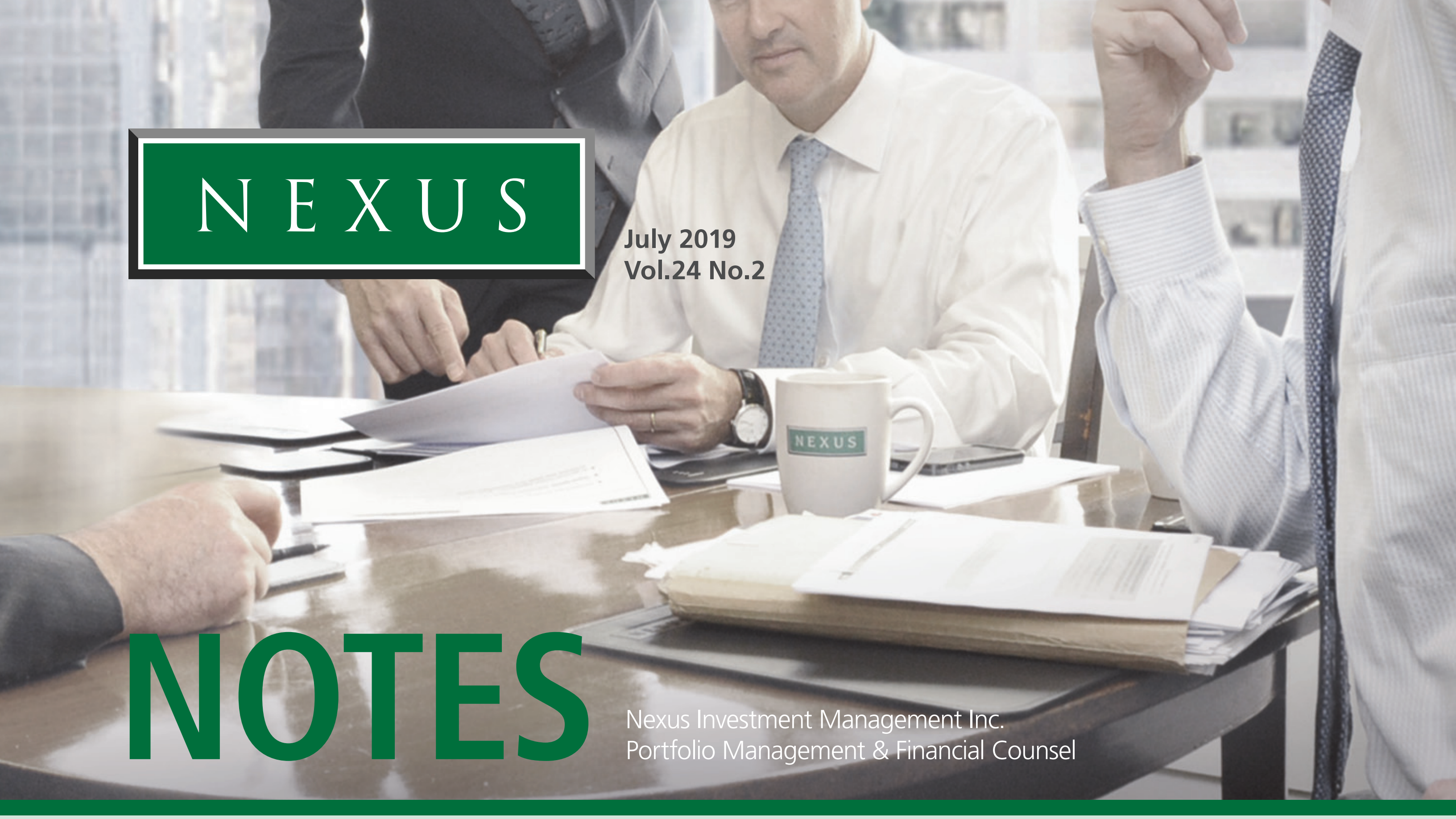

NEXUS

July 2019
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NOTES

Nexus Investment Management Inc.
Portfolio Management & Financial Counsel

Inside Articles

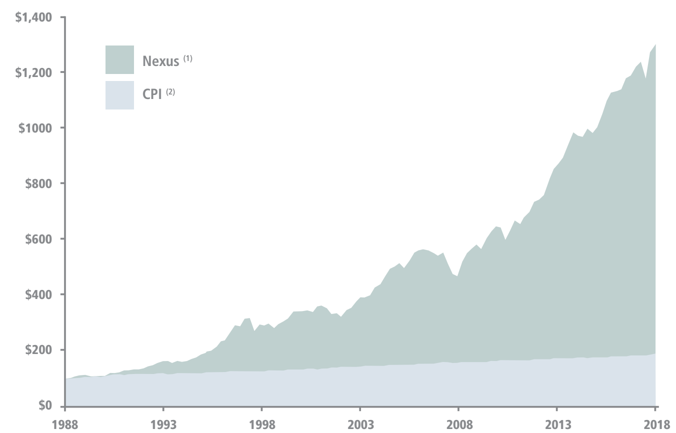
Building Value for Clients

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 $1,305 at June 30, 2019.

(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.

$100 Investment with Nexus in 1989



Longevity, Estate Plans and Low Growth – Oh My!

In June, I was busy attending two different conferences, one for financial planners and one for trust and estate

practitioners. Many subjects were presented, including economic forecasts, retirement planning issues, estate planning strategies, Canadian and U.S. tax updates and, my favourite, a session called "The Estate Freeze from Hell Redux" – there was a Part I *and* Part II! Despite the wide variety of topics, there were a few common themes throughout both conferences: aging and longevity, creating comprehensive estate plans, and the expectation for a low-growth investment environment going forward. I share with you a summary of ideas that developed from these recurring themes. Whether you are years away from retirement or well into it, these are important considerations for everyone.

It is not news that people are expected to live longer than previous generations. Scientific breakthroughs not only mean a longer life, but also longer periods of good health. Both have financial planning implications and thus aging and longevity were hot topics at the conferences. The longer you experience good health in retirement, the more likely that you will also be enjoying activities like travel and maintaining club memberships. While this is great news, they also cost money! The conclusion is that more emphasis should be placed on retirement planning, at least 10 years ahead of time, to ensure you have saved enough to cover these expenses. It might mean you decide to retire later, or work part-time in retirement. The downside of longer lifespans is that disease and disability tend to pile up toward the end of life. This gives rise to a whole host of other financial issues that need to be addressed to avoid clients and their families going into crisis mode. Issues include the complications and planning required around diminished competency, client end-of-life requests like DNR orders, and when to initiate palliative care.

Related to longevity and aging, the estate planning presentations went beyond the financial ramifications. It is still essential to be sure that documents such as wills, powers of attorney and a health directive are completed. However, just as important to being properly prepared, it is now generally agreed that an estate plan needs to include a conversation about personal preferences, such as how someone wants to be buried or organ donation. Once identified, these wishes need to be in writing. But it is even better for clients to discuss this with family members and others who will be part of the decision-making process.

There was also much discussion around what the future investment horizon looks like, given that we are in year 10 of a bull market. The conclusion: the economy is certainly different today compared to before the credit crisis – weak economic growth, the dramatic rise in e-commerce and, more recently, the rise in populist movements and the push towards de-globalization. This likely means a lower-inflation, lower-interest rate and lower-growth environment than we have been used to. It was no surprise to see that the guidelines for financial planning assumptions about future equity returns have been revised downwards by the FP Canada Standards Council. In this issue of Nexus Notes, there is an article about the Council's investment return guidelines and how Nexus's revised assumptions line up. Also in this issue, given the unknowable future and the current uncertainty in the markets, we feature an article about *time in* the market, not *timing* the market.

Finally, we have news about people movement at Nexus. First, Karrie Cheng joined us in May as a portfolio administrator to help with the day-to-day running of client portfolios. Second, and sadly, we are saying goodbye to a great colleague and friend, Mahmood Hassan, or "Mo" as he is affectionately called around here, at the end of July. Mo, his wife Zunera and daughter Minna are relocating to Pakistan to be closer to family. You can read more about Karrie's arrival and Mo's departure in our "Inside Nexus" feature. On that note, we hope you will be able to enjoy some downtime this summer relaxing… while reading *Nexus Notes*, of course.

DCW

Guidelines for Financial Planning Assumptions

Financial planning involves creating a variety of projections to model the future as accurately as possible. These projections

include, but are not limited to, cash flow, net worth, estate worth, retirement planning, retirement income, insurance needs, etc. The quality of any financial forecast depends on the quality of the inputs used. So, it is imperative to use assumptions that are realistic and objective.

Recently, the financial planning regulatory body of Canada, FP Canada Standards Council (FP Canada), published its financial assumptions guidelines for 2019. The guidelines recommend long-term (10+ years) rate of return assumptions for a variety of asset classes ranging from cash to emerging market equities. To eliminate potential bias by relying on a single source, the guidelines use data from numerous third parties. Historical experience drives much of the forecast. But in order to be realistic and objective, FP Canada takes into consideration special factors that reflect the changing nature of capital markets.

This table summarizes FP Canada's guidelines and compares them against our own assumptions for financial planning:

	FP Canada	Nexus Current Assumptions
Inflation	2.1%	2.0%
Cash / Money Market	3.0%	1.0%
Fixed Income (Bonds)	3.9%	2.0%
Canadian Equities	6.1%	6.5%
Foreign Developed Market Equities	6.4%	6.5%
Emerging Market Equities	7.2%	6.5%

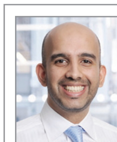
Note: the rate of return assumptions are nominal and before investment management fees.

As indicated in the table, Nexus's current financial planning assumptions for inflation and equities are largely in line with FP Canada's guideline, whereas our assumptions for short-term money market and fixed income asset classes noticeably differ.

In our view, FP Canada's short-term return assumption is generous. However, the difference is financially immaterial for most of our clients as the allocation to short-term instruments is typically small. What deserves more explanation is the significant differential (1.9%) between the fixed income return assumptions.

There are three reasons for the difference. First, Nexus is more conservative about fixed income returns over the long-term, given that interest rates are now at 50-year lows. Should interest rates creep up over time, this will exert downward pressure on bond prices, such that bond returns will suffer as a result. Second, bonds perform the important role of ensuring liquidity in our clients' portfolios. This is why we hold bonds that are higher in quality, resulting in slightly lower yields – we intentionally prefer lower credit risk. Third, in line with our expectation of higher interest rates to come, the average maturity of our bond portfolio is shorter than the benchmark, placing our holdings on the lower-yielding part of the yield curve. Another way of looking at this is that FP Canada's guideline may, in part, simply rely more on historical fixed income returns than our prospective view. In summary, when interest rates are this low in both nominal and real terms, we believe the role of bonds is mostly to add stability to the portfolio.

There is no way to predict when times will be good and when they will be challenging, so we prefer to be conservative when planning for the future. At Nexus, the investment team reviews our financial planning assumptions periodically. Recently, in light of slower potential global economic growth, we trimmed our assumed rate of return on equities from 7% to 6.5%. This reduction is minor and should not affect clients' existing financial plans. Other inputs, such as saving and spending rates, the length of your working life, and asset mix each have a far bigger impact on the robustness of long-term financial projections than minor adjustments to rate of return assumptions.



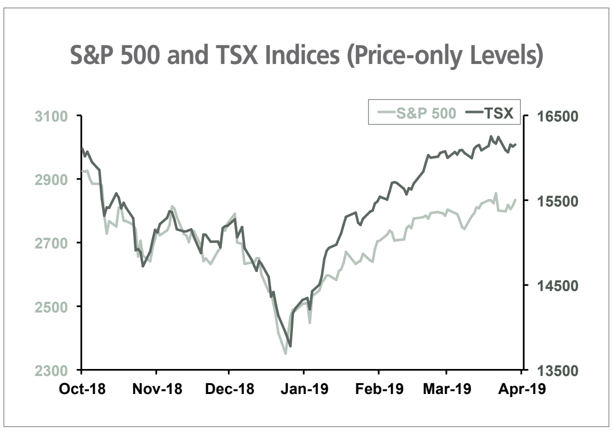
MH

TIME IN THE MARKET, NOT *TIMING* THE MARKET
Successful Strategies for Long-Term Wealth Creation

If you're a client of Nexus – or have ever sat through a presentation of ours – you will have inevitably heard our mantra: *The keys to long-term financial success are: keep it simple, control risk and avoid short-term distractions.*

Recently, we had a live example of a situation apropos this gospel, when one's ability to look past a myriad of short-term distractions was put to the test. In Q4 2018, in the face of geopolitical worries, economic concerns and many other unsettling developments, equity markets suffered an award-winning swoon that included the worst December since the Great Depression for the Dow Jones Industrial Index. Both the S&P 500 and the TSX Composite had similar experiences (see the chart below).

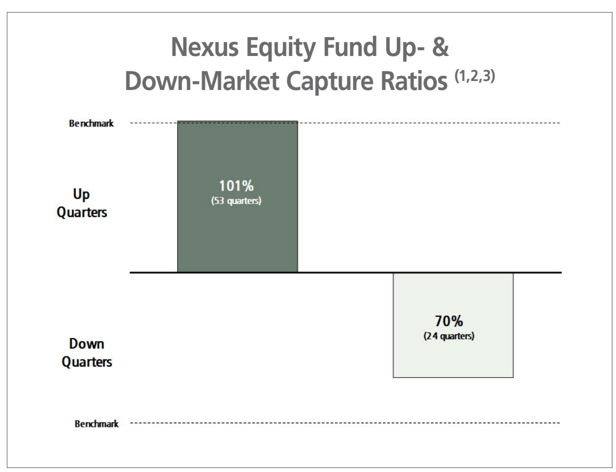
During bouts of volatility such as this, many investors find appealing the notion that they can get out when it's "risky", and then back in when it's "safe". This belief in timing markets runs counter to long-term success and has kept many investors underinvested during the market's subsequent recovery.



Consider an investor who happened to be sitting with cash on the sidelines in 2018. They likely breathed a sigh of relief as markets fell in the final weeks of the year. But unless they had powers of clairvoyance, it is highly improbable that such an investor jumped into the market in January. And why should they have? The concerns that troubled the market in December were no better in January and in fact remain worries today.

The problems with "timing the markets" are many. It is not just about trying to get out, but also about getting back in. Despite ample academic evidence that it is counter-productive to long-term financial success, some investors still see market timing as a viable means of managing money.

At Nexus, our belief is to stick to a philosophy and process that has been proven over more than 30 years to withstand the bumps and grinds of equity volatility. Using this approach we have produced solid absolute and relative returns, thereby creating actual wealth for our clients over time. We believe that the key is to identify quality companies with both growth and defensive characteristics. We don't always expect our portfolios to outperform the market, particularly when it's off on a speculative tear. We're indeed delighted that we have been able to match, on average, the market during periods of positive performance in the past (see the chart below). But we do expect our portfolios to weather the downturns better; i.e., fall less than the market in a decline, thereby providing a higher starting point for the inevitable subsequent correction. In this, we have delivered a very attractive up- and down-market capture profile. This "ratchet effect", if consistently produced, will result in better returns than the market over the long run, without the risk that comes from a market timing approach.



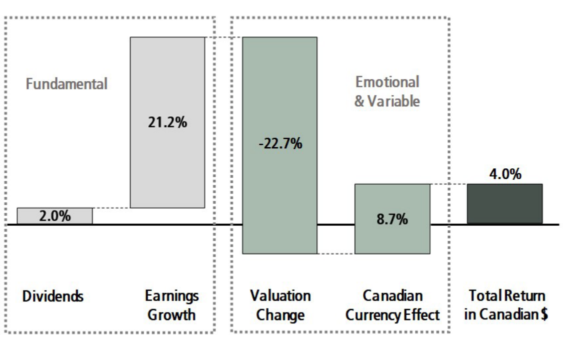
TIME IN THE MARKET, NOT *TIMING* THE MARKET *cont.'d*

Why do we believe this so fervently? It's actually quite straightforward. A stock's total return can be broken down as follows:

Dividends + Earnings Growth + Valuation Change + Currency Effect = Total Return

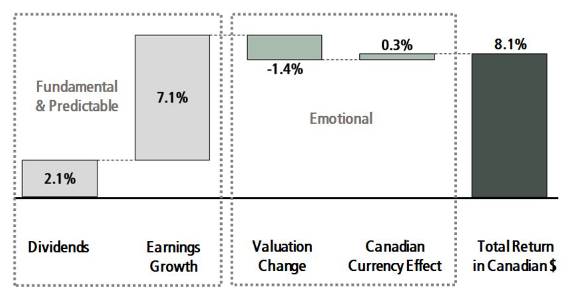
This is true for both short and long periods, but the *drivers* of the total return differ in magnitude between the short term and long term. As shown in the 1-Year Return chart below, over short periods, emotionally-driven factors, such as valuation changes and currency effects, have a large influence on return. Valuations change with the sentiment of the day – fear and greed. Similarly, currency effects are notoriously hard to predict as currency swings are heavily influenced by emotionally-driven investor flows. This is short-term market "noise".

S&P 500 1-Year Return as at December 31, 2018 [4]



Over the long term, however, it's a very different story! Long-term returns are driven by company fundamentals (see the S&P 500 15-Year Annual Return chart below). Dividends, which are generally predictable and consistent, contribute a significant and stable portion of the long-term return. But it is earnings growth that makes the largest contribution to returns. Over longer periods, valuation changes and currency effects matter very little as the short-term ups and downs tend to cancel out. To repeat, *long-term returns are driven almost entirely by dividends and earnings growth.* Not surprisingly, these are two factors that Nexus evaluates carefully when analyzing companies (along with making sure we are not overpaying on valuation, of course). Selecting securities using a disciplined investment approach incorporating these factors will produce tangible, long-term benefits.

S&P 500 15-Year Annual Return as at December 31, 2018 [4]



Summary

"In the short run, the market is a voting machine but in the long run it is a weighing machine."

– Ben Graham

As investors, we must accept that we cannot predict with any shred of certainty geopolitical events, currency fluctuations and short-term market movements. But, an investor *can* successfully identify well-run companies that have consistently proven that they can manage through economic, political and market gyrations, thus delivering value to the shareholder in the form of earnings growth and dividends. This is key: *the driver of long-term success – quality companies identified by a disciplined investment approach – is independent of short-term volatility.*

What else can an investor do? Realize that market fluctuations are normal and pay less attention to this short-term "noise". Avoiding short-term volatility is impossible. But, sticking to a long-term plan is doable. Accept the fact that over a 25-30 year horizon, you will experience *many* weak periods. It can be very tempting at certain points to move to the sidelines and wait for that next "buying opportunity". The solution to making that "leap" into the market, however, is not through any market timing "strategy". Rather, it is through establishing a program for getting invested and sticking to it. You don't need to get in all at once. But, in order to get the long-term benefit of stocks, you do need to get "in" – and stay "in".

AOJ

(1) To March 31, 2019. Each quarter since January 1, 2000 is defined as an "up" or "down" quarter based on whether the benchmark return for the quarter was positive or negative. For each of the up and down quarters, the capture ratio is the ratio of compound average rates of return for the Fund over its benchmark.

(2) Nexus returns are presented prior to the deduction of investment management fees. Past performance is not indicative of future results.

(3) Equity Fund benchmark is 5% FTSE TMX 91 Day TBill Index, 50% TSX, and 45% S&P 500 (in C$); rebalanced monthly.

(4) Percentage returns must be combined by multiplying, not adding, to get the total return.

Ch-Ch-Ch-Changes!

At Nexus, we pride ourselves on our internal work culture – one where we enjoy coming to work every day and are

surrounded by like-minded individuals who, together, put our responsibility to our clients' financial well-being first.

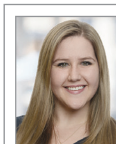
Many of our employees have worked together for decades. Recently, Heather Knight celebrated her 25th anniversary with Nexus. While there are several employees who have been here for most of our 30 years as a firm, we have continued to grow over time.

We are happy to welcome Karrie Cheng as the newest member of Nexus, joining our portfolio administrator team. Karrie will work closely with Dianne White and Jim Houston to support them and their clients. Karrie joins Nexus after previous experience with Beutel, Goodman & Company Ltd. and Gluskin Sheff + Associates. Outside the office, Karrie spends the majority of her time with her husband and young daughter. She loves watching movies, reading and travelling – her favourite place to visit is London, England.

Over the next few weeks, Karrie will introduce herself to the clients whom she will support. We welcome her to Nexus and look forward to her becoming a central part of our administrator team!

It is with mixed emotions that we will soon see a principal depart the firm. After 19 years in Canada, Mahmood Hassan and his family will be relocating back to Pakistan. Although we are sad to lose him at Nexus, we are happy for their opportunity to be closer to family.

Mo joined Nexus in October 2011 from Scotiabank and has been a tremendous contributor to our planning effort ever since. During his 8-year tenure, Mo earned his CFA designation, became a principal at the firm and has been a central part of our client service team. For clients, he lent his expertise to understanding their financial affairs and personal aspirations, helping each of them prepare a plan to achieve their goals. Internally, accompanied by his calm demeanour and his willingness to pitch-in on a range of projects, Mo has been a great assistance to the operation of the firm. On a personal level, Mo and his wife Zunera bought a house and settled in Etobicoke prior to the birth of their daughter, Minna, in the fall of 2016. Mo will be greatly missed by all of us here at Nexus. We wish him and his family the best of luck in their next chapter. In a short while, we will share some exciting news about our search for someone to take over Mo's role.



NMW

"Autonomous lawnmowers were a bad idea.
I see that now."

Image used with permission: Farley Katz, The Cartoon Bank/The New Yorker Collection

Pearls of Wisdom

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.

DMC

SOME THINGS JUST CAN'T BE TIMED

At Nexus, we often note the folly of trying to time the market. The only task more quixotic might be trying to time when you are born. And yet, that matters quite a bit for investment returns. According to numbers from Ritholtz Wealth Management, if you had invested from 1960-1980 and *beaten* the market by 5% each year, you would have made *less* money than if you had invested from 1980-2000 and *underperformed* the market by 5% a year. While this might be an example of "cherry-picking" the data, it does bring home the point that there are many factors that determine investment outcomes. As such, it's best to incorporate conservative assumptions into your financial plan just in case you weren't born when the investment stars were aligned.

("The Twenty Craziest Investing Facts Ever", *The Irrelevant Investor,* March 13, 2019.)

EMPTY HOMES (THAT AREN'T IN VANCOUVER)

Canadians have been inundated with tales of homes sitting empty in Vancouver. The reasons for this phenomenon are difficult to pin down. But the provincial government has seen enough to institute a "Speculation and Vacancy Tax", while the city has put in place a separate "Empty Homes Tax" to combat the problem. Yet, Vancouver is not alone in enduring this empty-home phenomenon. In Japan, approximately 14% of the housing stock is currently vacant. This represents a total of 8,460,000 homes across Japan, a record high. Stripping out homes that are available for sale, rental or are vacation homes lowers the Japanese vacancy rate to a still impressive 6%, or 3,470,000 homes. In contrast to Vancouver, the reasons for Japan's high vacancy rates are fairly easily explained: (1) a shrinking Japanese population and (2) the flight of youth from rural towns to cities in search of jobs.

("One in Seven Homes in Japan is Empty", *Bloomberg*, April 19, 2019.)

LOW-CARBON ECONOMIES

A recent research report from Raymond James delved into the rate of decarbonization of the U.S. economy. The conclusion was that U.S. CO_2 emissions have been gradually declining for more than a decade. Most of the emission reductions have come from the electric power sector, which accounts for 26% of U.S. emissions, where the retirement of coal-powered plants has been the driving factor. Change has been slower in other key sectors including Transportation (30% of emissions), Industry (22%), Commercial and Residential Buildings (11%) and Agriculture (9%). The U.S. economy may continue to reduce its emissions, spurred by technological advancements and regulatory mandates. However, the bigger question for the global climate is whether other major countries can follow suit and transition to low-carbon economies.

("Energy Stat: To What Extent Can the U.S. Become a Low-Carbon Economy?", *Raymond James*, April 22, 2019.)

Nexus Investment Management Inc. provides discretionary investment management and financial counselling services to private clients, trusts, estates and foundations.

- ☐ **Exceptional client service and objective advice:** tailored to the client's individual needs.
- ☐ **Superior investment performance [1]:** long-term record of superior after-tax returns and capital preservation.
- ☐ **Disciplined investment approach:** *"Growth at a Reasonable Price"* philosophy, using research and patience.
- ☐ **Alignment with clients' interests:** as the Firm is wholly owned by its principals, we are committed to your financial success.
- ☐ **Cost-effective management:** our services are accessible directly, without the costs of branding and distribution.

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[1] The Nexus North American Balanced Fund has earned 9.7% per annum, pre-fees for 10 years. The return from a notional investment in market indices in the following weighting was 8.6% over the same period: T-Bill (5%), Bonds (30%), TSX (40%) and S&P 500 (25%).