INFORMED INVESTOR NEWSLETTER

March 2020

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WHY WE DON'T NEED A CRYSTAL BALL TO PREPARE US FOR RETIREMENT

Written by Mike Preto, CFP®

We can all agree that market downturns are not enjoyable for anyone. They can be stressful and worrisome. At Hillside Wealth, we believe that having plans in place to manage them, both psychologically and financially, helps keeps these periods in perspective.

Stock markets spend more time moving up than they do going down but it's the downturns that get all the attention. This is understandable; after all, fear is a strong motivator. The market volatility experienced in the latter half of February was significant and so it begs the question:

> *What kind of impact would a prolonged market downturn have on* ***your*** *retirement lifestyle?*

Before we get into the details of a potential impact, we need to understand the assumptions.

When I first entered the business in 2003, we were encouraged to use an 8% return with a 3% inflation, so a 5% real rate of return. Another colleague was told to use a real rate north of 10% when she started in the late 90s. Needless to say, the market's performance over the last 20 years has had a sobering effect on the retirement planning discipline.

When it comes to retirement planning, we must be prepared for challenging conditions which is why we use a 4% rate of return with a 2% inflation rate as our assumed long-term targets. This means that we're assuming a 2% real rate of return going forward.

Let's look at a recent plan we were working on for clients using the assumed rates of return and inflation discussed above. We planned for a 35-year retirement where this couple could draw $160,000/yr of after tax income in today's dollars until the last of them died at age 95. They had no pension income other than their CPP and OAS and no rental income from real estate; the bulk of their retirement resources were invested in the markets. *What would happen if their portfolio dropped 20% the year before they retired?*

First of all, it's important to note that our downside protection plan is designed to minimize the chances of a 20% drop, but exploring what one would look like can't hurt so buckle up.

In this scenario, what this couple could safely afford to spend in retirement went down to $139,000/yr; a meaningful reduction to say the least. Beyond our downside protection plan, how can we structure their retirement plan to better navigate challenging conditions? The answer lies in their **target retirement lifestyle** (the lifestyle that the retirement plan is designed to fulfill) and **Dream Pool** (the amount of money, if any, that is invested over and above what is required to reach the target retirement lifestyle) figures.

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Their target retirement lifestyle is in fact $90,000/yr which means that they have meaningfully more invested than they need to hit their target, which in turn means they have a large Dream Pool in place.

The power of separating the two, albeit notional, not only helps financially (i.e.: thinking *'we aren't going to spend money on dreams if we don't have the money')*, but also psychologically (thinking "*we're ok with money that we don't 'need' fluctuating in value")* and increasing the likelihood to leave this money alone - which is generally the very best course of action.

Why is it best to leave money alone during these market downturns? The answer is because when we see an above average drop in the markets, we typically see an above average increase, known as a rally or rebound, in the months or years to come following the drop. We don't want to bank on it, as that wouldn't be planning for the worst, but it's something that wouldn't be surprising to say the least.

While it's true - we don't know what is going to happen in the future; the crystal ball broke a while back. But what is also true is that we have plans in place to deal with whatever might be coming down the road. We're excited to show you how our 3 systems the **Hillside Factor(y), Hillside Navigator and Hillside Dreamscape** are designed to work together to help ***realize big, meaningful dreams***. Stay tuned to future issues of our ***Informed Investor*** newsletter for more about those systems.

Hillside Wealth is taking on new clients. If you want to know more about the **HILLSIDE EXPERIENCE**, let us know and we'll schedule some time to chat. We're passionate about helping people realize their Big, meaningful dreams.

PORTFOLIO UPDATE: "HOPE" IS NOT AN INVESTMENT STRATEGY

Written by Jason Del Vicario, CFA

February was a volatile month for the financial markets: up during the first three weeks and down sharply in the last. All three of our portfolios were down sharply for the month. The last week of the month saw the markets drop 10% - the quickest on record. While our hedges such as USD exposure, government bonds and precious metals all managed to zig while the markets zagged, we still experienced a drop in value over the month.

Where to from here? As per our message to clients during the last week of February, it's very difficult to say. At Hillside Wealth, we don't rely on guesswork to manage our clients' wealth but rather we believe that **data drives decisions**. **We recognize and honour our responsibilities and lead with informed opinions**. There are many Investment Advisors out there right now who are busy telling their clients things like: not to worry, you can't time the market and it will most certainly be higher in 'x' amount of time. This are the boilerplate initial responses that are trotted out when we experience a market wobble. Statistically this assertion will be correct 90% of the time because historically we only experience a prolonged bear market (greater than 20% drop) approximately once a decade. Market wobbles far outnumber bear markets; we won't argue that point. However, what if this is the start of another prolonged and deep bear market? What then?

> ***The important takeaway for clients and any investor is as follows: we do not believe central banks and unlimited amounts of nearly free money have cured the business cycle. We are likely closer to the next recession and bear market that we are removed from the last one. To completely ignore this possibility is short sighted in our view. We have a plan no matter the outcome and are committed to helping our clients navigate these murky waters.***

The plan referred to above is our **downside protection plan**. This has been an integral component ever since we started managing money this way in 2014. From where we sit, there is a discernable pattern in how our financial system has operated the last few decades. Let's not mince words: debt has exploded over the past 30 years. Debt allows us to bring forward consumption that otherwise would happen in the future and by extension as debt grows, future growth is crimped. As the table below demonstrates, countries are having to issue more debt to generate the same amount of income (GDP) than before. For example, in China $1 of debt generated $0.65 of GDP in 2008 whereas this is has now dropped to $0.34. Central banks and governments are proverbially 'pushing on a string.'

Latest Evidence of Diminishing Returns: GDP Generating Capacity of Global Debt: All Major Economies

		(2007-2009 avg.) Ratio of GDP to Debt	(2017-Q1 2019 avg.) Ratio of GDP to Debt	% change
		A	B	C
1.	Euro Area	0.44	0.38	-13.5%
2.	United Kingdom	0.42	0.36	-14.3%
3.	Japan	0.32	0.27	-14.8%
4.	United States	0.43	0.40	-5.6%
5.	China	0.65	0.34*	-38.2%*
6.	All reporting countries (aggregate)	0.47	0.42	-11.1%

Source: Bank of International Settlements. * China adjusted based upon "A forensic examination of China's national accounts," Brookings Institute on March 7, 2019, by Wei Chen, Xilu Chen, Chang-Tai Hsieh (University of Chicago), and Zheng (Michael) Song (Chinese University of Hong Kong). "China's economy is about 12 per cent smaller than official figures indicate and its real growth has been overstated by about 2 percentage points annually in recent years".

We have two competing factors at play: bulging debt levels crimp economic growth as funds are being used to pay interest on debt rather than directed towards productive efforts. The serves to depress risk asset prices which at the same time we have historically low interest rates which serves to buoy risk assets. There is a tug of war of sorts between these competing forces

TFSA CONTRIBUTIONS

While there is no deadline for TFSA contributions, the sooner you make them the sooner they can start earning tax-free!

If you wish to make contributions or have any questions, please contact Heidi at 1-800-665-6424 or heidi@hillsidewealth.ca.

SHIFTING FROM AN RRSP TO A RRIF

This article, What happens to your savings when you retire, provides a useful overview of what happens when RRSP accounts are converted to RRIFs to fund your retirement (source: iaclarington.com).

and frankly we don't know which force will overwhelm the other. We have seen twice in the past 20 years instances where markets have fallen over 50%; both times have coincided with a recession (2001 & 2008). It is for this reason that we have a strict stop loss process as part of our overall strategy. We have two prices for every security we own; if the first price is breached we'll sell half the position and if the second level is breached we'll sell the rest. No system is perfect and ours is no exception. We have been stopped out of stocks only to turn around weeks or months later to buy them back usually at a higher price. We have no doubt that one of these bouts of volatility will be the beginning of a prolonged bear market. While we won't be able to insulate our clients from 100% of losses, it is our objective to help protect against large capital drawdowns. Looking forward, there will be a time when this plan works out very well for us and we will be in the enviable position of having excess cash and bond reserves to be able to re-deploy into companies we know and love at lower prices.

The bulk of our clients trust Hillside Wealth with almost all of their investable assets. Many of our clients are either already retired or within 10 years of relying on income from their investments to supplement their retirement lifestyle. We strongly believe that the fixed income portion of our client holdings must, at the very least, hold their value in the event of an equity market fall or ideally rise to help soften the blow. In this low interest rate environment, it's crucial to keep fixed income investments conservative in nature and not be tempted by higher risk/high yielding alternatives.

We've seen this movie before. In the lead up to 2008, the investing public was being sold wrapped subprime debt which was rated 'AAA' by the rating agencies. We all know how this ended and if you'd like to freshen up, I highly recommend watching or re-watching 'The Big Short' (I know this has been recently added to Netflix for all of you Netflix subscribers). This is a long-winded way for me to suggest that your friends, family and co-workers that aren't clients of Hillside Wealth would do very well to at least be asking the right questions of their advisors at this juncture. Questions to ask:

1. What is my asset allocation and is this appropriate for my situation?
2. What exactly do I own in my fixed income allocation and how will this behave in a bear market?
3. What is your plan for if/when we experience a recession or bear market?
4. If the plan is to 'not worry and ride it out' how will this impact my financial plans and retirement income picture?

We are taking on new clients at Hillside and almost all are coming via way of referral from existing clients. We are happy to sit down with friends, family or co-workers to help them understand their current situation and how Hillside can help them navigate this environment. We thank you for your continued trust and support.

FEBRUARY 2020 PERFORMANCE RESULTS

An overview of our three portfolios to date.

Performance to February 29th, 2020	YTD	1 Mo	6 Mo	1 Yr	3 Yr**	5 Yr**	Inception **	Added Value vs. Benchmark**
Hillside Balanced Growth*	**-0.86%**	**-3.71%**	**-1.3%**	**9.25%**	**8.82%**	**7.7%**	**9.79%**	**+ 4.95%**
HBG Benchmark[1]	*-1.8%*	*-3.3%*	*1.99%*	*6.77%*	*5.19%*	*4.25%*	*4.84%*	
Hillside Focused Growth*	**-7.81%**	**-9.26%**	**-8.3%**	**-0.78%**	**4.37%**	**4.57%**	**7.07%**	**+1.45%**
HFG Benchmark[2]	*-6.74%*	*-7.95%*	*2.39%*	*3.94%*	*5.62%*	*5.12%*	*5.62%*	
Hillside Conservative Growth*	**0.67%**	**-1.57%**	**-0.38%**	**11.03%**	**8.07%**	**6.58%**	**7.82%**	**+3.27%**
HCG Benchmark[3]	*0.76%*	*-2.34%*	*1.94%*	*7.12%*	*4.92%*	*3.85%*	*4.55%*	

Past performance is not an indication of future returns.

* Performance is presented gross of fees. **Inception: Sept 2, 2014. Results beyond 1 year are annualized.
[1] Hillside Balanced Growth Benchmark: 100% Vanguard Balanced ETF
[2] Hillside Focused Growth Benchmark: 100% Vanguard All-Equity ETF
[3] Hillside Conservative Growth Benchmark: 100% Vanguard Conservative ETF

Source: SIACharts.com

Performance is calculated using month-end market values of the model portfolio. Since we use a model portfolio to calculate performance there are no client-initiated cash flows (deposits/withdrawals) to account for. Performance is calculated by dividing the change in the model portfolio's market value by the model portfolio's market value at the beginning of the performance period. Also, all income generated by the portfolio's holdings are held within the model portfolio in cash and is accounted for in the portfolio's month-end market value - this results in a total return measure of the model's performance.
Returns for periods less than 1 year are shown as periodic returns while returns for periods greater than 1 year are annualized. Returns do not include fees and actual returns experienced by an investor may differ from those shown. Past performance is not a guarantee of future results.

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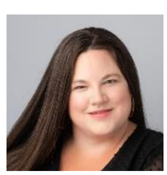

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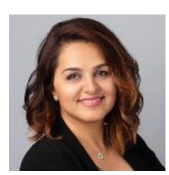

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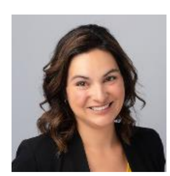

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