

# MARKET UPDATE

Q2 | January 1 to June 30, 2022

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It's been over 40 years since we've had a whiff of inflation in our economy. Almost two generations of investors have never experienced inflation's impact on their daily spending and their investments. In the following pages, we'll discuss what's happening, why it's happening, what we expect could occur and what we're doing about it.

- 2. In Q2 2022, Emerging Markets and Europe dropped less than their peers. That's because, on a Price/Earnings (P/E) level, their valuations were cheaper than the other major markets.

Pundits warned that the bond market was "dead money" in 2022. Instead, in Q2, bonds fell less than

From the numbers at right, observe that:

- 1. The worst second-quarter performances came from the U.S. Nasdaq Index and Canada's TSX 300 Composite Index. For the Nasdaq, higher interest rates and a slowing economy hurt its fortunes, while the TSX went lower because commodity prices tumbled due to the possibility of a recession and a subsequent drop in demand.

### Total Quarterly Equity Index Returns For First Half 2022 (in Canadian dollars with dividends re-invested)

QUARTERLY RETURNS	Q1 2022	Q2 2022	YEAR-TO-DATE
STOCK INDEXES	TOTAL RETURN	TOTAL RETURN	TOTAL RETURN
TSX 300 Composite Index (Canada)	3.84%	-13.69%	-9.85%
MXEF Index (Emerging Markets)	-8.18%	-8.29%	-16.47%
MSCI Global Index (World)	-6.29%	-11.60%	-17.89%
S&P 500 Index (United States)	-5.86%	-12.70%	-18.56%
Stoxx600 Index (Europe)	-9.59%	-10.23%	-19.82%
Russell 2000 Index (U.S. Small-Caps)	-8.75%	-13.35%	-22.10%
Nasdaq Index (U.S. Technology)	-10.24%	-17.73%	-27.97%

Data Courtesy of Bloomberg L.P.

## Total Quarterly Returns for Various Bond Indexes (in Canadian dollars with interest re-invested)

QUARTERLY RETURNS	Q1 2022	Q2 2022	YEAR-TO-DATE
BOND INDEXES	TOTAL RETURN	TOTAL RETURN	TOTAL RETURN
Canadian 10-30 Year Bond Index (ZCM)	-7.32%	-4.66%	-11.98%
Canadian 30+ Year Bond Index (ZLC)	-10.44%	-10.36%	-20.80%
U.S. 30+ Year Bond Index (VCLT)	-12.20%	-8.65%	-20.85%
Canadian Real Return Bond Index (ZRR)	-9.64%	-8.28%	-17.92%
<b>PREFERRED SHARE INDEXES</b>			
Canadian Rate Reset Index (ZPR)	-2.25%	-6.55%	-8.80%
U.S. Perpetual Index (ZUP)	-6.66%	-3.43%	-10.09%

Data Courtesy of Bloomberg L.P.

the stock market (see the table above), proving it's not wise to read / listen to market commentators.

A continued rise in interest rates suggests there could be more pain in store for the bond market. That's because when rates go up, bond prices decline. However, if economies slip into recession, interest rate increases may be put on hold as inflation eases or rates may be cut to try and accelerate demand. Either action would be good news for bonds.

### Why we currently favour bonds over stocks

As a result, we're currently more bullish on bonds than stocks. Our rationale is this:

Our bond duration is 5 years, meaning for every 1% increase in interest rates, our bonds should fall 5%. If central banks raise interest rates another 2% in the coming year to ease inflation worries, the bonds might drop another 10% in value. However, we hold our bonds to maturity so no money is actually lost.

The table below illustrates a sample of current bond prices and their yields (Liberty owns all of them). What's important is that the average yield-to-maturity is 5.62%, much higher than when corporate bond yields were around 2% in 2020. The real return (yield minus inflation) has narrowed considerably.

A bond ladder (successive annual maturity dates) has been built only for the next 3-9 years because yields haven't risen dramatically at either the short or long end of the yield curve and, therefore, aren't appealing.

BOND LISTINGS AT JUNE 27, 2022	COUPON	MATURITY DATE	PRICE	YIELD TO MATURITY	CREDIT RATING
Cascades Inc.	5.13%	Jan. 15, 2025	\$98.25	5.87%	BB-Low
Videotron Ltee.	5.75%	Jan. 15, 2026	\$98.50	6.23%	BB-High
CT REIT	3.47%	Jun. 16, 2027	\$92.77	5.13%	BBB-Mid
Allied Properties REIT	3.13%	May 15, 2028	\$88.29	5.49%	BBB-Mid
Rogers Communications	3.75%	Apr. 15, 2029	\$92.43	5.08%	BBB-High
CO-OPERATORS GROUP	3.33%	May 13, 2030	\$85.80	5.58%	BBB-Mid
Fairfax Financial Holdings	3.95%	Mar. 3, 2031	\$86.51	5.96%	BBB-Low
<b>Average Coupon &amp; Yield</b>	<b>4.07%</b>			<b>5.62%</b>	

Courtesy of RBC Capital Markets

While few issuers have come to market in 2022, eventually they will. When they do, the average coupons of those issuers should be higher.

### Why we're currently not stock market bulls

For stocks, the big worry is two-fold: First, the stock market has fallen around 20% because of a P/E multiple contraction. From a peak around 25-30 times earnings, the S&P 500 Index currently trades around 19 times profits.

Interest rates began their climb from 0% at the beginning of the year. With a lot of available cash in the system (people could borrow or buy on margin for next to nothing), investors were willing to pay \$30 for \$1 of earnings. Now that rates are higher, investors will only pay \$19 for a similar \$1 of profit.

Second, corporate profit growth is in doubt. Higher interest rates and a slowing economy have pressured corporate income statements. We could see further declines in the P/E multiple if the denominator (Earnings) heads lower.

On the company income statement, revenue growth is slowing, costs are up because of inflation and interest expenses have risen. This should lead to lower profits and higher P/E/ multiples. A further contraction of the P/E multiple because of lower earnings could result in another drop in stock indexes by 10% to 30%.

A recent CNBC article noted that “If the past 150 years of financial-market history are any guide, the S&P 500 Index may have another 24% to fall by year-end. That’s according to Societe Generale, which calculates the benchmark gauge may need to tumble as much as 40% from its January peak in the next six months to hit bottom. That comes out to 2,900. The upper end of the range the firm gave is for the index to slump by roughly 34% from its top, to 3,150.”

Therefore, if bonds could potentially drop 10% but stocks could fall up to 30%, then bonds are the better place to be invested. And because bonds are half as risky as stocks, the risk-adjusted returns also favour bonds.

### **The impact of inflation and higher interest rates on the consumer**

High gas and food prices and higher home expenses may stretch thin consumer balance sheets. Since two-thirds of economies are supported by consumer spending, a drop in consumer discretionary spending could put us into a longer-than expected recession and further extend this bear market.

Consider the impact of higher mortgage rates on consumers who purchased a home in the last five years. In the table below, Mortgage #1 was a rate available in 2020. Mortgage #2 is where things stand today.

<b>How Interest Rates Impact Monthly Payments</b>		
	<b>MORTGAGE #1</b>	<b>MORTGAGE #2</b>
<b>Amount</b>	\$500,000	\$500,000
<b>Term (Years)</b>	5	5
<b>Rate</b>	2%	5%
<b>Amortization (Years)</b>	20	20
<b>Compounding</b>	Daily	Daily
<b>Monthly Payment</b>	\$2,530	\$3,303

*Data Courtesy of Bloomberg L.P.*

An extra \$800 in monthly mortgage payments adds a lot of stress to family expenses. Heaven forbid if we fall into recession and one (or both spouses) loses their job.

The long-term secular concern I have is that if the Bank of Mom & Dad helped secure the home purchase by providing the down payment initially, what will happen if Mom & Dad have to provide more of their retirement savings to keep the kids in the home?

In the 1970s, workers would retire at age 65 and die by age 75 or 80. Their retirement savings only had to last 10 or 15 years. Today, people are retiring at 55 and living to age 95. The money now has to last up to 40 years. The retirees shouldn’t be giving money to their kids because they’ll need it themselves.

Will this cause Mom & Dad to pre-empt or change their retirement plans, or, in the worst scenario, force the parents to sell their home and move in with the kids, causing even more stress to households?

### **What’s a bear market look like?**

The chart below illustrates the last real bear market (2000 to 2003). It included the tech bubble burst, 9/11 and then a recession. We may end up enduring a similar situation with a tech bubble burst / Ukraine War / recession.



Data Courtesy of Bloomberg L.P.

From the table above, It may take a strong stomach to get investors through the next two or three years. The initial Nasdaq index drop was only 15% (March to September 2000), while the S&P 500 Index didn't move at all. Note that back in 2000, mega-cap tech stocks didn't make up 20% to 30% of the S&P 500.

The real pain came during the next six months (September 2000 to April 2001) as investor capitulation hit tech investors hard. If you were fully invested in tech stocks, it was definitely unnerving to watch 61% of your portfolio value disappear. The S&P 500 Index fell 27% during that time, meaning no sector was immune to the destruction of personal net worth.

The moral of this story is that active, short-term trading like selling tech stocks and diving into commodities doesn't protect investors. During 2000 to 2003, the tech sector fell 78% but the S&P 500 Index wasn't far behind, down 49%. In a bear market, there's nowhere to hide.

## Market Summary

- If interest rates rise another 2% before the end of 2022, corporate bond yields could be in the 6.5% to 8.5% range, an attractive buying opportunity.
- Higher rates cause downward pressure on stocks. Leveraged corporations should see higher interest payments and lower profits.
- If companies can't raise prices, their higher operating expenses will also reduce profits. This double whammy (lower margins and lower profits) could cause more P/E multiple contraction.
- If we fall into recession (two straight quarters of negative growth), the stock market could drop another 10% to 20%. If stagflation persists, the drop could be more toward 30%.

## How is Liberty positioned?

- We are holding between 7% and 12% cash and letting the interest and dividends increase the cash balances.
- For each 10% drop in the stock market, we'll pick away at some of the cheaper valuations. Currently about half of our holdings trade at normal historical valuations.
- Inflation is covered by about 75% to 80% of portfolio investments in instruments such as stocks (the average dividend growth rate for 2022 has been 12%), inflation-protected bonds and, to a lesser degree, rate-reset preferred shares.
- We always do our heaviest buying in late October / early November. We'll see where the market is then to decide if the timing is right.

# FUN WITH MATH: DIVIDENDS – USING THE POWER OF TIME AND COMPOUNDING TO BECOME A MILLIONAIRE

By David Driscoll

During my 43-year career, talking about dividends and the power of time and compounding with clients is like watching paint dry. It's boring. Telling them that their average pay raise or dividend increase in 2022 is 12% causes much eye-rolling and wide-mouthed yawns.

I liken the value of dividends to the lyrics of the song "Money for Nothing" by Dire Straits, released in 1985: "That ain't working. That's the way you do it. Get your money for nothing. Get your chicks for free." Substitute the word "**chicks**" with "**dividends**" and that's how you become a millionaire: Get paid a rising annual dividend while you wait and let time and compounding grow your fortune.

In 2020 and 2021, investors thought they could become rock stars like Dire Straits through day trading. Unfortunately, they learned a harsh lesson how to lose money, not make it.

A dividend is simply a percentage of the annual profits paid to shareholders in the form of cash or stock. As investors save for their retirement, that money is important. During an investor's early years, that income can be used to buy more shares in either new stock names or for more shares of the same company.

In retirement, the income is necessary to cover living expenses without having to eat into the capital. If an investor can offset their income and expenses in retirement, the capital becomes an estate planning issue for future generations.

Consider the example of owning a stock for the past 22 years like Paychex Inc. (PAYX US), a long-term Liberty holding. In 2000, the company paid a USD \$0.27 dividend per share. If you owned 1,000 shares at the time, your dividend income was \$270.

Over the next 22 years, the annual payout grew to \$3.16 a share, or \$3,160, a compound annual growth rate (CAGR) of 11.3%, faster than the inflation rate and the 7% CAGR of the average publicly-listed stock. During that time, the dividend growth supported a tripling of the stock price. As the dividend grew each year, so did the share price. It had to.

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The best part of investing in businesses and letting the dividends grow over time is that you let time and compounding be your ally.

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That's because if the shares were still priced at \$26.67, the dividend yield would be 11.8%, a number too high for a growth stock whose diluted GAAP (Generally Accepted Accounting Principles) earnings per share (EPS) jumped from \$0.51 in 2000 to \$3.84 in 2021, an annual CAGR of 9%.

- Buying more shares along the way helps increase the compound factor as incomes and unrealized gains grow faster.
- Without having to eat into the capital in retirement, money could be gifted before death

Paychex Historical Price and Dividend Growth							
YEAR	SHARES PURCHASED	DEC. 31 PRICE	ANNUAL DIVIDEND	DIVIDEND INCOME	COST	MARKET VALUE	UNREALIZED GAIN/LOSS
1999	1,000	\$26.67	\$0.27	\$270	\$26,670	\$26,670	\$0
2004	0	\$34.08	\$0.48	\$480	\$26,670	\$34,080	\$7,410
2009	0	\$30.64	\$1.24	\$1,240	\$26,670	\$30,640	\$3,970
2014	0	\$46.17	\$1.40	\$1,400	\$26,670	\$46,170	\$19,500
2019	0	\$85.06	\$2.24	\$2,240	\$26,670	\$85,060	\$58,390
2022	0	\$113.18	\$3.16	\$3,160	\$26,670	\$113,180	\$86,510

Data Courtesy of Bloomberg L.P.

Here are the important benefits of dividends plus time and compounding:

- If an investor started with a \$1 million portfolio of 30 stocks with better-than-average dividend growth like Paychex, the portfolio could generate about \$37,000 in income in 10 years. In 20 years, it could be close to \$70,000. Combined with pension and/or other income, the investor should be able to retire comfortably.
- Starting early has its advantages. The above example is just dividend growth over 22 years. If the investor is between the ages of 25 and 40, they have an even longer growth runway. As the income grows over a longer time period, the investor can amass higher capital and income amounts and potentially retire before age 65.

or left for the heirs through an investor's estate. Therefore, more money would be available for the second and third generations.

- Trading actively doesn't work – buying and selling or rotating sectors

essentially cancels out time and compounding. Every time they trade, investors reset their growth rate to zero.

The best part of investing in businesses and letting the dividends grow over time is that you let time and compounding be your ally. Perhaps you could “maybe get a blister on your little finger, maybe get a blister on your thumb” along the way but you don't have to write a song and become a famous rock star. This is a far easier way to make millions.

# SOME RETIREMENTS AREN'T COMFORTABLE: GOVERNMENT ACTION IS NEEDED

By Scott Kerkhof CPA, CA, CIM

Imagine yourself in your 70s in retirement, living off a lifetime of hard work, savings, and government programs. This is how the Canadian Federal government designed the retirement benefits system.

However, for a large majority of Canadians, this isn't the case. Many people are living into their 90s and thus need to work longer to save enough for retirement. And this doesn't even take into consideration other possible life-changes. What if you or your spouse becomes ill and requires around-the-clock care?

After an individual reaches the age of 70, they are required to collect CPP and OAS. In the year they turn 71, they must convert their RRSPs into a RRIF, (which have a minimum withdrawal requirement per year) and are no longer eligible to make RRSP contributions to defer their taxes.

At this age, most other pensions begin their payouts as well, and further contributions are not allowed. So, what happens when you reach this age, but your retirement savings are not enough to cover your expenses? Let's compare a few scenarios:

	SCENARIO 1	SCENARIO 2	SCENARIO 3	SCENARIO 4
Spouse#1 RRSP Balance	\$ 750,000	\$ 500,000	\$ 500,000	\$ 500,000
Estimated RRIF Income	\$ 40,500	\$ 27,000	\$ 27,000	\$ -
CPP	\$ 9,352	\$ 9,352	\$ 9,352	\$ -
OAS	\$ 7,700	\$ 7,700	\$ 7,700	\$ -
Pension	\$ 12,000	\$ 12,000	\$ 12,000	\$ -
Employment Income	\$ -	\$ -	\$ 110,000	\$ 110,000
RRSP Deduction	\$ -	\$ -	\$ -	\$ (19,800)
Pension Splitting	\$ (12,750)	\$ (19,500)	\$ (19,500)	\$ -
<b>Income before possible Claw back</b>	<b>\$ 56,802</b>	<b>\$ 36,552</b>	<b>\$ 146,552</b>	<b>\$ 90,200</b>
OAS Claw back	\$ -	\$ -	\$ (9,719)	\$ -
<b>Taxable Income</b>	<b>\$ 56,802</b>	<b>\$ 36,552</b>	<b>\$ 136,833</b>	<b>\$ 90,200</b>
Taxes	\$ (9,463)	\$ (4,606)	\$ (38,926)	\$ (19,527)
<b>After Tax Income</b>	<b>\$ 47,339</b>	<b>\$ 31,946</b>	<b>\$ 97,907</b>	<b>\$ 70,673</b>
Spouse #2 RRSP Balance	\$ 500,000	\$ 100,000	\$ 100,000	\$ 100,000
Estimated RRIF Income	\$ 27,000	\$ 5,400	\$ 5,400	\$ 5,400
CPP	\$ 9,352	\$ 9,352	\$ 9,352	\$ 9,352
OAS	\$ 7,700	\$ 7,700	\$ 7,700	\$ 7,700
Pension Splitting	\$ 12,750	\$ 19,500	\$ 19,500	\$ -
<b>Taxable Income</b>	<b>\$ 56,802</b>	<b>\$ 41,952</b>	<b>\$ 41,952</b>	<b>\$ 22,452</b>
Taxes	\$ (9,463)	\$ (5,689)	\$ (5,689)	\$ (1,779)
<b>After Tax Income</b>	<b>\$ 47,339</b>	<b>\$ 36,263</b>	<b>\$ 36,263</b>	<b>\$ 20,673</b>
<b>Total Taxes</b>	<b>\$ (18,926)</b>	<b>\$ (10,295)</b>	<b>\$ (44,615)</b>	<b>\$ (21,306)</b>
<b>Combined After Tax Income</b>	<b>\$ 94,678</b>	<b>\$ 68,209</b>	<b>\$ 134,170</b>	<b>\$ 91,346</b>
Average Annual Expenses	\$ 60,000	\$ 60,000	\$ 60,000	\$ 60,000
Average Annual In-Home Care	\$ 30,000	\$ 30,000	\$ 30,000	\$ 30,000
<b>Total Expenses</b>	<b>\$ 90,000</b>	<b>\$ 90,000</b>	<b>\$ 90,000</b>	<b>\$ 90,000</b>
<b>Surplus/Shortfall</b>	<b>\$ 4,678</b>	<b>\$ (21,791)</b>	<b>\$ 44,170</b>	<b>\$ 1,346</b>

**Scenario 1:** A couple has a total of \$1,250,000 in their RRSPs, one spouse has a pension, and they're both eligible for the average amounts of CPP and OAS. They have annual regular expenses of \$60,000 and additional home care expenses of \$30,000. Based on these factors alone, they will have enough in retirement to cover their expenses and will have taxes owing of \$18,926.

**Scenario 2:** A couple has a total of \$600,000 in their RRSPs, one spouse has a pension, and they're both eligible for the average amounts of CPP and OAS. They have annual regular expenses of \$60,000 and additional home care expenses of \$30,000. Based on these factors alone, they will have a shortfall as their savings will not cover their expenses and will have taxes owing of \$10,295.

**Scenario 3:** A couple has a total of \$600,000 in their RRSPs, one spouse has a pension, and they're both eligible for the average amounts of CPP and OAS. One spouse continues to work to pay for the shortfall. They have annual regular expenses of \$60,000 and additional home care expenses of \$30,000. Based on these factors alone, they will have a large surplus after expenses, but will have taxes of \$44,615.

**Scenario 4:** This scenario is based on an ideal situation that does not currently exist. The first spouse continues to work to pay for the in-home care, they can defer collecting their CPP and OAS and pension, are not forced to begin to withdraw from their RRIF and they are able to continue to contribute to their RRSPs (a deduction for tax purposes).

**In Scenario 2,** if a couple hasn't had the means available to save for unexpected expenses, their RRIFs, pensions, OAS and CPP are not enough to cover their expenses. Thus, they are forced to continue working as shown in **Scenario 3.**

However, if the working spouse is over age 71, they must still collect their RRIF, pension, CPP and OAS,

without having any deductions available to them. This causes their income amount to be higher than they require, while they pay a higher amount of taxes.

The government needs to understand this is happening to many Canadians and it needs to make the appropriate changes now.

Currently, the main tax savings available for seniors are the pension credit and pension income splitting with their spouse. However, the pension credit is only \$2,000 and if a spouse continues to work, that employment income isn't eligible to be split and provides no benefit to seniors who are single or widowed.

Scenario 4 is the ideal situation which we would like to see be implemented by the government. Seniors who are forced to continue to work should be allowed to defer collecting their RRIF income for as long as they like, while continuing to be eligible to contribute to their RRSPs and claiming the deduction.

First, this would better help them save for their retirement. Second, CPP and OAS should also be eligible for further deferral, as the OAS claw back would unfairly penalize seniors who are forced to continue to work. Finally, an increase in the pension credit for lower income seniors would also help to reduce their tax burdens.

These are just some possible solutions that the government should implement to help seniors in struggling situations.



By Sharang Arora

For Millennial investors just starting out, their investment journey is fraught with obstacles that are hard to navigate.

Let's consider this example:

Since he graduated from a carpentry program at a community college, Elliot, now 30, has worked hard for the last 10 years. He's lived frugally and saved \$100,000 to invest. Not knowing where to begin, he takes the most natural step: A visit to his local bank branch.

The teller is quick to set him up with an advisor to discuss investment options. The rigorous process of getting to know Elliot's full financial situation and goals is hurriedly completed, and within minutes, the computer spits out a couple of bank-run mutual fund recommendations.

Unfortunately, Elliot doesn't know any better; he trusts the information given to him by the so-called "experts". He invests the money into one of their funds and leaves a very happy customer.

One year later, Elliot visits the branch again. His portfolio has dropped since he started and the fees charged were higher than he expected. He wants to review his options.

To his surprise, the advisor he met the previous year is no longer there. Instead, he is ushered into an office to meet another advisor, who has no knowledge of Elliot's previous discussions. Elliot must explain his situation again. This new advisor suggests that he change his holdings to a more low-risk mutual fund.

There are tens of thousands of new immigrants coming to Canada each year in a similar situation. One of the first things they may do upon arrival is go to a major bank and open an account. If they fall prey

to the pushy tactics discussed above, they start their investment journey in Canada at a disadvantage.

## **Notice the problems?**

- The average millennial is not aware of their options as a new investor.
- Retail branch advisors may employ pushy tactics to sell a mutual fund that pays them a higher commission rather than what may be best for the investor.
- Mutual funds carry high fees with little to no customization tailored to the investor's goals or needs.

To solve that quandary, here are some questions to consider when you meet an advisor:

- Is my money in the right place?
- Am I getting the attention I deserve?
- Is my advisor always objective when making recommendations?
- What am I really being charged, and is it eating into my returns?

It can be a challenge to find an advisor that's right for you. But there are tangible clues that can help you evaluate how responsive and accountable an advisor may be. Below are six key benefits of independent, non-bank, financial advisors:

### **1. A Customized Financial Plan**

Independent advisors are not tied to any particular family of mutual funds, ETFs or other products. This helps them have the freedom to choose what's best for the client and be more efficient with personal tax planning.

## **2. A relationship that's responsive, attentive, and personal**

Listening closely to the goals that a client is trying to achieve goes a long way to keep the relationship strong. That means being available at any time, especially if conditions change in a client's life.

## **3. A fee structure that is simple and transparent**

Independent advisors charge a fee based on a percentage of assets managed. This fee structure is simple, transparent, and easy to understand. It also gives your advisor an incentive to help grow your assets. When you succeed, your advisor succeeds.

## **4. A high level of expertise to support your complex financial needs**

Some advisors are specialists in certain investment strategies such as stocks, bonds, preferred shares, commodities, private equity, etc. Others may assist you with comprehensive services, such as estate planning, tax planning, borrowing, the sale of a business, or an intergenerational wealth transfer.

## **5. Your money is held at an independent custodian, not the advisor firm**

Independent advisors use independent custodians, such as Liberty's use of National Bank Independent Network (NBIN), to hold and safeguard client assets. This provides a reassuring system of checks and balances – your money is not held by the same person who advises you.

## **6. Standard of Care and The Prudent Man Rule**

Independent advisors are obligated to exercise their duties honestly, in good faith and in the best interest of each client (Standard of Care) and invest as if the money was their own (The Prudent Man Rule).

Liberty is one such example of an independent advisor. The firm was named Liberty to create freedom for clients from the banks' stranglehold on most Canadians' money and provide a better way to invest.

### *I understand that hindsight is 20/20 but, since the market was poised to fall, why didn't you do SOMETHING?*

We did. We maintained our discipline while understanding that long-term market growth comes from rising dividends and the re-investment of those dividends, not stock prices (see the above Fun With Math article).

The problem with many investors is that they treat the stock market like a casino, thinking that buying and selling creates the road to riches. That emotional thinking couldn't be further from the truth.

In the past year, despite rising values, do-it-yourself investors jumped into the wrong investments for the wrong reasons.

A Dalbar Inc. study from March 2022, pointed out that, "In 2021, the average equity investor earned 10% less than the S&P 500 (18.39% vs. 28.71%)." Since 1985, that's the third-largest underperformance ever observed by its QAIB study.

Here's just a sample of investor mistakes made in 2021:

- They piled into growth stocks, namely US mega-cap tech growth and ignored the cheaper emerging markets.
- They assumed that the Covid lock-down stocks that performed well in 2020 would continue to do so in the future. Stocks like Zoom, DocuSign and Amazon that were priced to perfection

### *What are inflation-protected bonds and why are they down so much in 2022?*

In Canada, Real Return Bonds (RRBs) are issued by the Government of Canada that provide protection from inflation. In the United States, they are known as Treasury Inflation-Protected Securities (TIPs).

The buying power of the cash flow remains constant over time, no matter what the interest rate or inflationary environment may be.

faltered as soon as people returned to the office.

- They invested heavily in private equity and venture capital without understanding the risks. In a recent *Bloomberg* article by Dawn Lim and Allison McNeely, "The private equity industry faces one of the most challenging fundraising environments in years, creating a new test for a rising generation of buyout leaders. Pension fund and endowment coffers have shrunk in the stock selloff, making them reluctant about locking up more money in funds that are hard to sell and value."
- They believed that 30% returns could be made every year when the average annual equity return since 1871 (after inflation), is just 6.9%. Meta Platforms (the old Facebook) is a perfect example of a stock that traded as high as \$384.33 and, at the time of this writing, had fallen 52% to \$160 a share.
- They were suckered by brokers / banks / robo-advisors / trading applications like Robinhood into believing that active trading is good for the average investor. Actually, it's good for the firms who make money from each trade, not the investor.

The bond pays a semi-annual coupon rate, also known as the interest rate, that is then adjusted for inflation as measured by the Consumer Price Index (CPI). The principal amount is also indexed to protect the holder from measured price erosion.

RRBs may be attractive to people who want to keep up with inflation to help them meet future post-

secondary education and retirement costs in today's dollars. They may also appeal to those who wish to save part of the value of their estate for the benefit of their heirs.

As shown above in the bond returns, the Real Return Bond ETF was down 17.92% through June 30. It's not as bad as long-term bonds (down 20.80%) because of the inflation adjustment but they suffered because they

### What's influencing the S&P 500 Index in 2022?

So, what is bear meat made of, exactly? *Bloomberg's* John Authers mapped out the most painful losses thus far — Alphabet, Tesla, NVIDIA, Meta, Amazon, Microsoft and Apple — which jointly account for 42.5% of S&P 500 losses since January:

The lesson is to beware stock index funds that are market cap weighted (shares x price) as a percentage of the overall index. In the chart on the right, just 7 companies of 500 have weighed down the S&P 500 Index return.

### What's your opinion on cryptocurrencies?

A June 29, 2022 *CNBC* report filed by Arjun Kharpal noted that, "Things are looking pretty shaky in the Cryptoverse as a continuous flow of damaging headlines continues to rock the sector. The staunch believers are calling it a "crypto winter" before things heat up again, while the naysayers are pointing to the final demise of "tulip mania" they have been warning about for years."

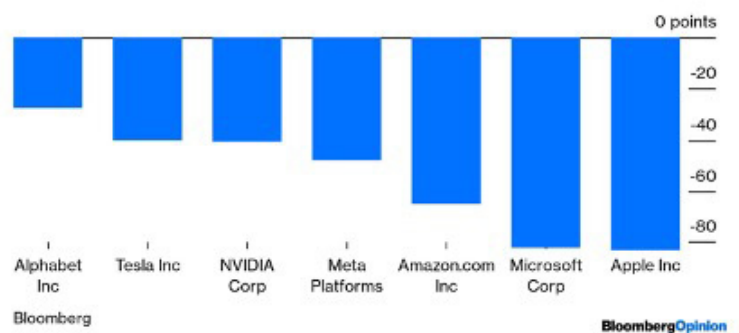
"Those in between are acknowledging that a shakeout is underway but feel that only the strongest players will survive in a similar fashion to the aftermath of the dot-com crash. Bitcoin (BTC-USD) is trading under \$20,000 again on the developments, and only time will tell which camp prevails."

are long-dated bonds that are more price sensitive to rising interest rates.

We don't trade these bonds. We buy them and put them away with the intention that clients hold them for the rest of their lives. The price will move around in any one year so it's not a cause for concern. In 2021, these bonds had positive returns while the rest of the bond market's returns were negative.

The Stocks That Made The Bear

Seven companies lost more than 25 S&P 500 index points since the high



Data Courtesy of Bloomberg L.P.

"The failure of the TerraUSD "stablecoin" project in May sent shockwaves through the crypto market, while the Celsius Network froze accounts and now is preparing for a possible bankruptcy. Popular crypto-focused hedge fund Three Arrows Capital was ordered to liquidate and crypto exchange CoinFLEX issued new "Recovery Value USD" tokens in an attempt to resume withdrawals."

"Meanwhile, Coinbase (NASDAQ:COIN) and BlockFi have said they would slash their workforces by a fifth, though others remain undeterred, like MicroStrategy's (NASDAQ:MSTR) Michael Saylor, who scooped up another 480 Bitcoins for \$10M despite undergoing massive unrealized losses."

Liberty has never invested in any type of cryptocurrency for the following reasons:

- There is no rule of law to protect owners of Bitcoin. If an owner is hacked and has their Bitcoin stolen, there's no legal recourse to recover them.
- The ETF exchanges and others like them that sold Bitcoin and other tokens lack any credible size and liquidity. As the crypto price drops further, margin calls, over-leverage and lack of liquidity should continue to put downside pressure on these investment platforms and their prices.
- Fiat currencies, a government-issued currency that is not backed by a commodity such as gold, has a lot more liquidity and much less

volatility. The U.S. dollar doesn't change by much on global currency markets each day, but cryptocurrency sure does.

- For example, say you buy a loaf of bread for \$1 USD. Tomorrow, using fiat currency, it should cost roughly the same amount, inflation notwithstanding. Buy that loaf of bread with Bitcoin and it could cost \$1 today but \$2 tomorrow.
- Any sale of Bitcoin triggers a capital gain, meaning CRA in Canada or the IRS in the U.S. will want their share of the profits.

Our ownership in Visa Inc. (V-US) gives us ancillary exposure to cryptocurrencies without taking on crypto-like risk.

### ***With some stocks down 30 or 40 per cent, won't that take a long time to make back the unrealized losses?***

Holding some cash during market revaluations or economic recessions gives an investor the option to "dollar-cost average". If a stock that was purchased at \$50 drops 40% to \$30 and the company still generates free cash flows, has pricing power and market share, there's nothing wrong with buying more shares.

For example, if you bought 100 shares at \$50 for \$5,000 and then buy another 100 shares at \$30 for \$3,000, the average cost of your \$8,000 total investment is \$40.

If you do nothing and keep just the original 100 shares, you'll need a 67% return to get back to break-even.

Given the rarity that stock markets rise 20% in any given year, it could take about 5 years to make your money back.

If you dollar-cost average, you only need to make 25% to reach break-even. That may only take 1-2 years to do so.

Additionally, if the company pays a dividend, the dividend yield will be higher when you buy more shares at a lower price, thereby providing greater income for future compounding (see the Fun With Math discussion above).

## **IN OTHER NEWS:**

Congratulations to Farai Murove, a bilingual portfolio manager assistant at Liberty. While on maternity leave, as if she wasn't busy enough, she passed the CSC Level 2 exam. Well done, Farai.

If you have any questions, let us know.

**David Driscoll CIM**  
President & CEO

**Brett Girard CPA, CA, CFA**  
Portfolio Manager & CFO

**Annie Bertrand CIM**  
Portfolio Manager

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