The Road Ahead

By Kurt Rosentreter

Part One – My Thoughts

There is a lot of uncertainty in our lives this summer of 2020 as we continue to watch the COVID virus largely impact the world and life as we have known it.

We have all grown up experiencing "bad things" periodically. Until now, much of our mental conditioning was to experience a bad event in our lives followed by a recovery where we see the light at the end of the tunnel.

We are not emotionally used to an event that is bad on this scale of population, doesn't get better right away and affects so many aspects of our life. Careers, health, families, money, real estate and more – it is all being affected.

Positively though, the slowing of our lives has allowed us to reconnect with family (our 19 year daughter is not sure this is a good thing), save money by spending less, work from home, reduce air pollution, plan more Canadian vacations, reflect on the importance of all types of essential workers, appreciate our medical system and think about all kinds of things we had been putting off – from fixing that broken shelf to reading a book you had hoped to read someday.

Why "The Road Ahead"

With over 30 years of financial management experience, our team has experienced a wide variety of circumstances that can affect one's financial stability, stock market returns, career, cash flow and faith in capitalism.

I am writing today to provide my impressions of how your finances will be affected by the continuing COVID pandemic and how you should position for it. I admit, some of this is a guess – but an educated guess based on past experiences and results from different but similar global events. It's also a commentary based on an ear to the ground from a world full of financial experts providing their expert opinions. While some of the comments below may prove to be materially inaccurate in the months ahead, I would expect some of the comments will also ring true. Overall, I feel there is something here for everyone and I wanted to share my thoughts as we collectively sit around our homes during 2020.

The Virus

Nothing to date has shown that the virus will fade away on its own – quite the opposite: the current flare-ups worldwide have some countries reversing course in what they had allowed to "re-open" in a rush to normalize. While we hate the thought of another complete shut down like we saw in March, we fear dying more. People should be prepared to potentially hunker down again before this is done.

A Vaccine

An antidote to this sickness would be ideal, but even the experts say development of a vaccine will take time and may not provide a long-lasting fix. Then there is the issue of distribution to a world of billions of people and who will get it first. Still, this appears to be our best hope and the experts are saying it could be ready next year as the global medical community works together like never before.

For now, however, we will have to learn to live with the virus and take precautions in our everyday life. I will go with the assumption that a period of co-existence will occur at least for a year in making my remarks below. Clearly the implementation of an effective vaccine would be a game changer should it happen.

Canadian Federal Government Support Programs

The easiest months are behind us – we all stayed home in March and April while the government sent some Canadians money to pay their bills. Other bills were deferred until the fall. But now the hard part comes: when do you stop the support money? So far, the Federal Government seems willing to continue to extend the cheques to people and business through much of this year. I suspect payments will continue in some industries until there is a solid and long-lasting economic restart.

Small Business

I am most worried about small business on main street Canada in the months ahead. Specifically, I'm watching the period from October 2020 through January 2021. Businesses that re-open this summer and are dependent on large volumes of foot traffic (think restaurants) may struggle to pay high big city rents by October if Canadians don't resume normal buying volumes from restaurants. This could be trouble if Canadians still feel reluctant to go out in public worsened with forced social distancing through seating reduction in restaurants. I fear small business bankruptcies before the snow flies. The coffee shop near our office has already closed its doors for good.

Further, I am concerned about retail stores in malls. They load up on holiday season inventory in the fall waiting for holiday shoppers in November and December. Again, if the virus lingers or flares-up in December people will be reluctant to go into a mall where social distancing is difficult. Mall stores that have a terrible holiday season could be bankrupt by January.

Big Business

The Royal Bank of Canada, Microsoft and Nestle are not going to go bankrupt. Big companies have national and global strength to draw on, government support to rely on and deep financial pockets to weather downturns – even pandemics. This goes a long way to explain why the stock market has gone back up in mid-2020 while small business is still hurting.

Unemployment

Only six months ago in January 2020, politicians around the world bragged about reaching some of the lowest unemployment rates in their countries in the modern era. In the U.S. and Canada, unemployment was down to 3.6%* and 5.5%** respectively.

In the U.S., employment had been super-charged by a decade of economic strength topped off by the Trump tax cuts in 2018 to further stimulate the economy higher. It almost couldn't get better than this for working families.

Then, only two months into this year, employment plunged to record lows with millions of people suddenly unemployed. From a peak to a trough.

But we all know this shutdown was artificial – created by governments trying to stem a pandemic. The real question is this: when businesses re-open in the months ahead and we start to normalize what will the real unemployment rate be? There is no way we can return to the low unemployment rate from January – too many businesses will scale back or disappear doubting the demand will be there for their goods and services to support employment of as many people as before. So, a higher unemployment rate seems inevitable and we may need to wait until Spring 2021 to get a sense of how bad it will be.

I personally don't feel a potential high level of unemployment has yet been priced into the stock market. More on this below.

*Source: US Bureau of Labor
**Source: Statistics Canada

The Economy

Prior to the start of the pandemic we had reached the longest ever economic up-market without a slowdown / recession.

The 2020 pandemic threw us into a recession mathematically and it will be a question whether we pull out of it later this year or in 2021. The Federal government in Canada and other governments around the world launched a variety of stimulus programs starting in March 2020 designed to re-start the economy and pick up where we left off in January.

It is hard to see that happening anytime soon. While there is some pent-up demand that will be released as businesses re-open, I am skeptical that the level of business activity will return to January levels when people are still scared to leave their home. The people that are most concerned are older Canadians who have all the money.

I can see a recession lasting much or all of 2020 and 2021 as the virus subsides or is tackled by a vaccine. I feel this will happen – it is just a question of when.

Childcare

Let there be no doubt about it, we need a fix for childcare and schooling before the economy can significantly get moving again. Parents cannot be part time teachers, full time work-from-home employees and more than full time family managers. Children need to return to school or daycare in a safe setting, so parents are free to focus on getting back to work at maximum productivity. We now see how important schools and daycares and teachers are to our world – and how we won't resume a high level of capacity until this element of society is resumed.

The 2020 U.S. Election

In a "normal" year the upcoming U.S. election would have dominated the business news. Even last year in client meetings we were talking about how to get defensive after a decade long economic bull run if the Democrats win (in 2019 we talked about Sanders being the democratic rep) and reverse some of the pro-business initiatives that Trump provided.

While Biden could be considered a more centrist Democrat than Sanders, any reduction in profitability to big corporations through higher taxes, minimum wages or more regulation may be viewed negatively by the stock market. I would also suggest that if the polling numbers continue to sink for Trump that a Democratic White House (and more) could be baked in the stock market numbers well before the election – even now.

I will point out that the U.S. economy and stock market have gone up regularly under both red and blue parties in the U.S. in the past. No one should sell their stocks and sit in cash if Trump loses. Any market decline could be considered short term if it happens at all and a buying opportunity for long term gains.

The Debt

As an accountant I pay close attention to debt levels provincially and federally. It doesn't seem the politicians of any party do however – all sides swap more services for votes at any cost. And we roll on.

But will the cost of this pandemic be a back breaker? Months and months of every level of government handing out money while collecting less tax revenue is going to end up with a staggering cost. At some point we will hear about the total dollar amount. The question is what will the government do about it. Raise taxes? Maybe. Cut services – never – you don't get elected cutting services. Take on more debt – already happening. Throw it on the pile of debt we already have, and perhaps we face a global debt downgrading and a slide in our currency vs the USD as we kick the problem forward to future generations. All parties have taken this approach for years. What is new is the ever-increasing amount of interest cost that is creeping up the annual budgets of provinces, cities and federally to suck up money that otherwise would have gone into education, healthcare, transit, social services and much more. Canada has faced a slow creep of services erosion for years due to an interest cost on a massive debt pile that is not going in the right direction. And the COVID cost may add to this debt pile in a staggering way. We will likely find out in 2021.

The Arts

It is difficult to think of a harder hit area of our culture during COVID than the arts. Going to the theatre to see a musical, attend the opera or see a ballet may be off the table for months more. Actors and musicians are laid off. As they also look to re-open it will be difficult to attract a largely older population that attends many of these venues when our elders are the most reluctant age range to go back to a group setting anytime soon. And even then, how does the theatre make money to pay their bills with reduced seating?

If the opera and ballet were stocks to buy, I would be staying away for quite a while unfortunately.

Many organizations may start to ask for financial bailouts from Ottawa. Every city has big and small arts organizations that also support hotels and restaurants. It's a monumental task for any government to determine if these organizations should get money to help them survive and where to draw the line.

Real Estate

The price for real estate may be one of the most interesting areas to watch over the next year. Fifteen years of a roaring real estate market in Canada could come to an end suddenly and hurt a lot of people financially if we don't play our cards right. The biggest mortgages ever have been taken on over the last decade by Canadians

– mortgages that often require two spouses to pay them down. Job loss coupled with high unemployment nationally could finally work against the value of detached homes and condos in 2021.

Condos could be potentially worse off as they were also being propped up by the rental market, namely Airbnb. With tourism down for a while, these condo units may be converted to longer term rentals which should bring rents down.

Office towers could face increased vacancies if work-from-home becomes a permanent trend. Shopping malls were already feeling the Amazon-effect of reduced foot traffic and could now face store bankruptcies. Nursing homes and retirement homes are going to be less popular and I suspect people will try to stay in their homes longer in the future. Expect lawsuits to follow from families of COVID related deceased residents of nursing homes.

Interest Rates

Central banks of countries reduce interest rates during times of economic crisis as a means to stimulate spending by consumers to re-start the economy. If your interest rate on your mortgage, line of credit or credit card is suddenly lower, this may motivate you and millions of other people to upgrade a home, buy a new car, buy a new phone and so on. This puts people back to work producing goods and the next positive business cycles start.

Unfortunately, I am going to portray today's low interest rates as a bad news story here.

We have faced record low interest rates since 2008 when the sub-prime mortgage crisis saw a significant drop in interest rates to stimulate the economy. This worked but interest rates were left "too low, too long" and this led to countries around the world (and people) gorging themselves on too much debt. Canadian governments were no different – Ontario for example, tripled its provincial debt over the last ten years.

In March 2020, with the economy in trouble once again, the Bank of Canada dropped interest rates three times – 0.50% each time for a total of 1.50% from our already record low rates.

Hard to see how anyone has benefitted from this yet – it is difficult to spend money when you are trapped in your home.

But let's finally talk about who is hard hit with lower interest rates – seniors. Seniors who are trying to live off bond and GIC interest in retirement and do not want the stock market stress in their portfolio.

One year ago, a one year GIC paid 2.47%*
And last week, a one year GIC paid 0.98%. *
*Source: CBID on July 27,2020

It's great that mortgage rates are 2.5%. But you better add a bedroom for grandma who cannot afford to live on a GIC that pays 0.98% before tax and before inflation.

Worse – I don't see these rates going up for many, many years.

The Stock Market

The global stock markets reached their market low of the year on March 23rd and the Canadian TSX got down to -35%* year to date return that day. At this time the virus was just starting to grow and we were hunkering down at home.

Fast forward to July 27, 2020 and the Canadian TSX Index is now -4.4%* year to date. Global markets surged back before many people expected because of coordinated global government stimulus to prop up the economy, talk of vaccine development and early signs that the virus had peaked in parts of Asia.

*Source: National Bank July 27, 2020

A common question is: "why did the stock market go up when the virus is still growing and nothing really seems much better around me?". The answer is that the stock market is not main street small business. As I said earlier, the largest companies in the world make up a large part of the stock market and they have a greater ability to roll with the punches than mom and dad's restaurant down the street. Plus, the stock market acts more like a crystal ball – always looking forward to the next big event rather than getting pulled down into the bleakness of the current moment or recent past.

It is important to note that technology sector stocks like Google and Apple have roared back year to date and this has lifted the market in general. But much of the broader market (banks, industrials, energy companies, real estate and more) are still in double digit declines year to date. Your portfolio returns year to date will very much depend on whether you were in technology investments or not.

Canadian banks continue to be hard hit for the third time in twelve years. They fell hard on the market decline in March, a squeeze in profits margins due to the three interest rate reductions, the fear of large loan losses due to small business bankruptcies in the months ahead and exposure to loans to the resource sector. Long term the Canadian banks will be fine and there is not even an expectation they will cut their dividends paid out of annual profit.

Now let me speak to basic strategy in your finances if some or all of my predictions come true. We will follow a more personalized commentary in our calls, meetings and video discussions during the weeks and months ahead. Please feel welcome to contact the office now if you would like to book a discussion sooner.

Part Two – What to Do

Financial Strategies During A Never-Seen-Before Pandemic & Uncertain Times

In my opinion, the biggest three considerations for your finances in 2020 are your career, real estate values and interest rates.

Career – Job loss or even income reduction for a middle-aged professional could lead to inability to pay a mortgage. Young people who take longer to find their first job out of school delay their financial lives moving forward and often stay with parents longer. Older workers closing in on retirement could find themselves packaged out with less savings or pension than they had counted on. Career income is the engine of our cash flow and all financial strategies flow from here. Keep our team informed about any career impact so we can help you assess whether other changes are needed for your finances, your insurance and your goals.

Real Estate Values – For people renting, a steep real estate price decline could be your moment to buy in finally. Make sure you have your deposit ready and financing in place. I worry about people who are potentially over-exposed to rental real estate or vacation property carrying big mortgages and now renting to tenants who may have trouble paying. Retirees, or those close to retirement, who have most of their wealth tied up in real estate and planned to downsize to free up cash for travel and lifestyle may need to delay these plans if home values drop in the next year. Real estate and our own home specifically is often the most expensive asset we own in a lifetime. As we watch real estate values in the months ahead, we will talk to you about the impact on your financial plan and goals. Long term, many areas of Canadian real estate will continue to be solid investments and value.

Manulife Securities Incorporated
Suite 302, 3 Church Street, Toronto, ON M5E 1M2
T: 416-628-5761 • F: 416-225-8650 • TF: 1-866-275-5878
Visit our website: UpperCanadaCapital.com

Interest rates – Record low interest rates mean your maturing bonds and GICs, the safe part of your investment portfolio, now pay less than 1% in some cases. We will talk to you about what your options are but let's be frank – unless you are going to increase your risk tolerance to chase more return you don't have many options. GICs still pay more than most other government and corporate bonds. Bond funds and bond ETFs, international bonds, junkier corporate bonds and similar products offer higher returns but you can also lose money.

First and foremost, you need to respect your risk tolerance – that's the securities commission saying that. If you are comfortable in bonds and GICs for a portion of your portfolio then **stay there** and change other factors like your spending level or saving level. Dividend paying stocks sound great and can be an option but you need to accept that even blue-chip securities can drop -30% suddenly. The Canadian banks dropped -40% in approximately two weeks earlier this year! But they do offer great dividends of 5% /year and have paid them for decades. Annuities are cash flows resembling guaranteed pensions and can be another option for part of your portfolio. Rest assured we will show you all the options for your "safe money". With rates this low for what could be many years, sitting in cash earning even less is not an option for long. Decide if you are prepared to become a riskier investor at this stage of your life and if so we will talk about the best product options for the portfolio.

Why Did I Leave Out the Stock Market from Key Considerations Above?

The stock market is not doing anything special or different then it has in past crises. The stock market goes up and down all the time – this time for a virus. In all of these past cases you never know when or how long. But you do know to "buy low and sell high".

Stock market volatility has been around for 100 years. This is no different – if the market falls again in October 2020 due to a resurgence of the virus (guessing here) then buy more. If it goes even lower in November, buy even more. If you are 35 years old, even borrow money to buy in – these once-in-a-decade opportunities to buy at deep discounts are rare but they are what successful investing is all about.

Achieving Long Term Financial Goals

It is fair to ask if your long-term financial goals (e.g. retirement spending, children's savings) will be affected by what is happening in 2020 with the virus. The short answer is no – the time period is too short and the impact too shallow so far to impact decades long averages we have used in any financial modeling of goals we have prepared together. Of course, we will monitor this together with you and make recommendations as required.

Short Term Cash Flow Planning

It is generally not wise to start retirement and spend your savings in a year where the investment returns could be zero (or negative), forcing you to pull spending money from your capital right from the start. Similarly, if you can avoid buying new cars, doing expensive renovations, making large financial gifts to children or taking expensive vacations in a negative stock market year this will help to make your money last longer. There will be far more "up" stock market years in the future and all periodic large retirement costs should generally be paid for out of profits in good market years.

If you are a retired client, we will continue to work with you yearly to plan cash flows at least a year in advance to account for these market ups and downs, taxes and other factors to achieve your cash flow needs.

Maintain and Add to Life & Disability Insurance

Sadly, we have all seen many deaths from COVID so far in 2020. Many were working Canadians with mortgages and families to support. It's times like these that disability insurance and life insurance prove their worth and we should all pause to reflect on what coverage we have, how prices will change in the future and how long the coverage is necessary. Relying on employer provided policies is the absolute worst thing you can do. Private coverage is best. Frank on our team is our practice leader for insurance so lean on Frank and me if you have questions. At a minimum make sure we have copies of all of your policies so they can all be found in one place if needed by others should something bad happen to you.

Ensure Estate Documents are up to date

During the pandemic earlier this year there was a rush to get Wills and Powers of Attorney documents finalized as people watched the death toll mount. If you still haven't finalized your documents, get a copy of our "estate tips" checklist and lean on me for planning topics before you book time with the lawyer. I assist many clients each year to fine tune their estate planning thoughts for taxes and their broader financial plan and then often maintain a copy of the finalized Will that the family is aware of.

Income Taxes

It's not a stretch to think that governments will raise some income tax rates in order to help pay for the cost of the financial support provided during COVID. Talk to your accountant and us about strategies to possibly trigger more taxes now (at lower rates?) personally or in your corporation rather than deferring them into the future at potentially higher rates. Of course, this is a guess and there are tradeoffs to consider but it is at least a worthy conversation to have that will leave you better informed about tax rates and what you pay.

Living the High Life Dangers

There is lots of evidence to show that Canadians were living footloose and fancy free before the pandemic. Big incomes led to big cars and big vacations. Real estate that seemed to only ever go up in value. Debt (mortgages) that has been so cheap that we bought the biggest house the bank will lend us money for.

No one saw the pandemic coming and it sideswiped even the most stable financial situations. Know that no stock is blue chip anymore (hasn't been since 2008), too much debt is still bad if you lose your job and saving for a rainy day (plus having insurance and a Will) is still common sense planning for the future.

Final Thoughts

Friends, while the pandemic continues to work itself through the world your financial core will be resilient and will survive this event. The world will continue to endure "financial curve balls" every few years no matter what they are caused by. Get used to it if you are not already.

My biggest tip to you is not to fear these events. Instead, ask yourself if you have built the financial stability to weather them and more so, take advantage of them. Maintain three months savings for emergencies. Have proper insurance in place and estate documents finalized. Save aggressively for goals like retirement and children's education. Pay down debt even with low interest rates and never take on more than you can easily handle on one income. Put financial priorities annually ahead of vacation and leisure spending especially after age 45. Take time to understand your finances and revisit strategies and products as you age and change. Buy low and sell high. Be realistic in your expectations. And be confident you have a partner in us that will be there 24/7 hand in hand with you to shine the light forward.

Please take time to enjoy our summer! The girls and I are just back from hiking in Banff for a week (yes, we flew) and it was a lovely and needed break after a hectic half year. All of our team is well and looking forward to talking to and seeing you in the second half of the year!

Kurt Rosentreter

UPPER CANADA CAPITAL
PRIVATE WEALTH MANAGEMENT

Kurt Rosentreter, CPA, CA, CFP, CLU, FCSI, CIMA, CIM, FMA, TEP

Senior Financial Advisor & Portfolio Manager, Manulife Securities Incorporated
President, Upper Canada Capital Inc.
Life Insurance Advisor, Manulife Securities Insurance Inc.

http://www.kurtismycfo.com

Follow me on social media:

Kurt Rosentreter, CPA, CA, CFP, CLU, TEP, FMA CIMA, FCSI is a national best-selling author seven books on personal finance in Canada and the past co-founder of the national wealth management practice at one of Canada's "Big Four" public accounting firms. For the last fifteen years Kurt has been a core financial course instructor for the Ontario Chartered Public Accountant Association and also appears regularly in the national press as an expert on matters of money. Kurt is the owner of a national wealth management practice in Toronto working with professionals and business owners on all topics of personal finance. Learn more about Kurt at www.kurtismycfo.com.

Manulife Securities Incorporated
Suite 302, 3 Church Street, Toronto, ON M5E 1M2
T: 416-628-5761 • F: 416-225-8650 • TF: 1-866-275-5878
Visit our website: UpperCanadaCapital.com

Manulife Securities

Any opinion or advice expressed in a linked site should not be construed as the opinion or advice of Kurt Rosentreter or Manulife Securities. The information in this communication is subject to change without notice.

The opinions expressed are those of the author and may not necessarily reflect those of Manulife Securities Incorporated or Manulife Securities Insurance Inc.

Stocks, bonds, and mutual funds are offered through Manulife Securities Incorporated. Insurance products and services are sold through Manulife Securities Insurance Inc. Please confirm with your advisor which company you are dealing with for each of your products and services. This message is only to be read by the addressee and is not for public distribution. The sender is not responsible for distribution of this message beyond the addressee intended. All information in this message is confidential to the addressee and should be treated as such.