The David Miner

Communiqué

Summer 2017

"If you don't know where you are going, you might wind up someplace else."
-Yogi Berra

SUMMER IS HERE!

Summertime – it seemed to take a long time to arrive this year. We have no complaint about the warmer weather – even if it means having to mow the lawn.

As always, we took our annual ski vacation in the month of March. After many years, we went back to Québec city and skied at Mont Saint Anne and Le Massif.

Three generations at our Mont St. Anne Ski Holiday.

Québec city offers some of the finest restaurants and shopping in Canada – not just great skiing.

This holiday was particularly special. The entire family was there, including David's daughters Victoria and Amelia. Even granddaughter, Nalina enjoyed her first ski holiday though her days were spent in daycare and not on the ski slopes.

Dorinda and Dave also escaped for a few days in the Mayan Riviera in Mexico in April. That holiday goes under the category of: "Total Relaxation".

"Games are won by players who focus on the playing field -- not by those whose eyes are glued to the scoreboard."
-Warren Buffett

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Economic and Market Commentary

In the month of May, many of us became a little poorer. Of course, I am not speaking of financial markets, but of the real estate market. The average price of all types of home sales in the Greater Toronto Area dropped 6.2% in May versus the previous month of April according to the Toronto Real State Board. For the average Toronto homeowner, that amounted to tens of thousands of dollars in reduced net worth. Nevertheless, home prices are still up year over year.

Real estate is often the biggest single investment a family will make. Of course, a principal residence is more than an investment. Our homes provide not only a roof over our heads, but some emotional anchoring. Home is where the heart is.

David and Dorinda in the Mexican Riviera Maya with Dorinda's sister Lisa and her husband Bob.

Ownership of a principal residence is a big part of personal net worth for many of us. But I doubt many of us felt much of anything as real estate prices pulled back in May. As we have often said, one of the calming factors about real estate is that we cannot look at our computer screens to see what the closing value of our principal residence. We do not receive quarterly statements showing our house or condominium was worth. We do, on the other hand, get good information about our investment portfolios. To win and be successful, wise investors avoid emotional response to normal market fluctuations.

Just like real estate, investments in stock and bond markets will sometimes decline in value. History tells us, however, that values go up over time. To that end, wise investors are no more emotionally engaged in their investment portfolios than they are emotionally engaged in the fluctuations in their house.

In 2017, those of us with global stock and bond exposure in our investment portfolios have done particularly well. Of note, the Dow Jones Industrial Average in the United States is up over 1000 points since the U. S. election. Year to date, the Canadian equity market is substantially underperforming U.S. and global equity markets. As always, we do recommend holding both domestic and global investments in portfolios.

The Canada Pension Plan, a portfolio of over $300 billion, has significant exposure to global equity. As of the latest CPP report, the Canadian equity component of overall equity in the CPP portfolio is less than 10%.

Active versus Passive Management

Nalina Naidoo plans for another big day on the slopes at Mont St. Anne.

Growing in popularity over the last few years are Exchange Traded Funds (ETFs). Most ETFs are linked to an index like the S&P/TSX. Most ETFs have lower management fees than mutual funds. Advocates of ETFs focus on the virtue of ostensibly lower-cost than most active solutions (e.g.; Mutual funds). There are a few hidden costs with ETFs of which investors should be aware:

1. ETFs do have management fees which should be understood before investing.
2. Dealing with cash inflows and outflows in ETFs often creates a high level of trading activity. Many ETFs have much larger TERs (Trading Expense Ratios) than typical mutual funds because of the high level of ETF trading expenses. TERs are not part of a mutual fund or ETF Management Expense Ratio (MER).
3. ETFs involve the activity and influence of "market makers" whose main purpose is to ensure the continued liquidity on the ETF. As such, most ETFs trade with a "bid – ask" spread, which means the price paid by a buyer to purchase an ETF may be higher than the price received by a seller.
4. ETFs are not especially tax efficient in taxable accounts.
5. Aside from all of the above, ETF investors incur commission costs to purchase and sell ETFs.

"BULL MARKET -- A random market movement causing an investor to mistake himself for a financial genius." - unknown

Notwithstanding the fact that ETF strategies may not be quite as cost-effective as many ETF advocates claim, there are a number of other reasons why ETF investing is unwise as a core strategy. Here are just a few:

1. Indices reflect “average”. Can you imagine a parent sending their child off to school with the pep talk “just try to be average today”? Parents never encourage their children to be “average”. Why would investors strive for “average”?

2. With passively managed ETFs, there is no active risk management. In volatile markets, ETFs capture the full drops of their underlying indices. Good active managers typically demonstrate much lower “downside capture”, meaning active management generally helps reduce portfolio volatility in falling markets. See the table below which illustrates index versus active fund management performance in bear markets.

S&P/TSX Composite Index versus Canadian equity funds | Bear markets 1980 – 2009

Peak Month	Trough Month	TSX Performance	Average Fund* Performance	Difference
November 1980	June 1982	-38.8%	-27.2%	+11.6%
July 1987	November 1987	-25.4%	-23.0%	+2.4%
December 1989	October 1990	-20.1%	-15.5%	+4.6%
April 1998	August 1998	-27.5%	-24.3%	+3.2%
August 2000	September 2002	-43.2%	-26.9%	+16.3%
May 2008	February 2009	-43.3%	-42.8%	+0.6%
Average		**-33.1%**	**-26.6%**	**+6.5%**

**Source: Globe HySales. Based on the average of 569 funds (558 actively managed mutual funds and 11 index funds); calculations are made using month-end figures.*

David with a hitchhiker in Playa del Carmen, Mexico.

We are not against ETFs but we always recommend active management over passive with regard to core investment strategies. Many good active managers may include some use of ETF’s to implement quick tactical manoeuvres. Good active managers never use ETFs at the core of their strategy. Good active management wins over the long term.