Counsellor Quarterly

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Wealth Management
PH&N Investment Counsel

President's message

Global investment markets continued to struggle over the late summer and early fall, as investor sentiment see-sawed between hope and worry. Investors hoped that rate increases from key central banks would work to rein in moderating but still-persistently high inflation. However, worries that these rate increases would be too severe to avoid a recession in the coming months have left investors in a pessimistic mood.

The economy's ability to withstand increasingly restrictive monetary policy is becoming more problematic as asset prices – especially housing – decline and the rising cost of living bites into consumers' ability to spend. Cracks are starting to show, as job growth slows and businesses limit spending in light of increasing input costs and higher financing rates. This suggests challenging times lie ahead for business activity, which is likely to impinge on corporate profits. Despite stock and bond prices correcting downwards to more reasonable valuation levels over 2022, the strength of any slowdown or recession is still to be fully priced in, suggesting ongoing volatility for investors in the months ahead.

Despite today's negative economic news, consumers and businesses are responding in a positive way to rising interest rates by deferring or moderating their spending. With global energy prices falling, and evidence mounting that a few key components of inflation measures such as CPI have peaked, central banks may be able to ease off their tightening measures sooner than some have anticipated. This, in turn, should work to lessen the extent of any future economic downturn, and help markets to see a light at the end of the tunnel.

Regardless of which way the pendulum swings in the short term, we remain steadfast as the stewards of your wealth, and with our long-term perspective, seeing through and past today's challenging conditions to the opportunities of tomorrow. Our stewardship is aligned to your long-term goals and what matters to you, and includes not only your wealth, but also your health and well-being. We are honoured by the trust you put in us, and we look forward to continuing our journey together.

Regards,

Vijay Parmar

Vijay Parmar, CPA, CA
President
RBC PH&N Investment Counsel

Economic and capital markets forecast

Around the world in 80 seconds

Canada

Having raised interest rates at the fastest pace in 40 years, the Bank of Canada has squarely set its sights on quelling inflation – and quickly. Regardless of the economic impact, the Bank clearly sees inflation as enough of a threat that it warrants a strong response. This leaves the near-term future of the economy, and in particular the housing market, in question. While job growth has slowed dramatically over the summer months, job openings continue to suggest that there is strong latent demand from consumers. With the economy under pressure from rising living costs and interest rates, the equity market has declined, with even the energy sector beginning to give back its phenomenal 2022 returns.

United States

Employment and consumer spending remain bright spots for the world's largest economy. However, there are signs the U.S. Federal Reserve's (the Fed's) interest rate hikes are tamping down business activity, as intended, in order to fight inflation. The housing market is also showing signs of weakness, which is a key indicator that the current U.S. business cycle is nearing its end. Stocks have reflected the uncertainty around the tenacity of inflation, the Fed's end goal for interest rates, and the sustainability of corporate profits in the face of an increasingly likely economic decline. While the consensus view for economists is that the U.S. will suffer a recession in 2023, the degree of its severity remains in question, leading to ongoing market volatility for investors.

Europe

The sharp rise in inflation has hit consumers and businesses across the region hard. Global supply issues, a post-pandemic surge in local demand and the resurgence of tourism have combined with surging energy prices to drive up the cost of living. The embargoes against Russian oil, and the country's own refusal to supply natural gas to the region's markets that support Ukraine, is leading to an energy shock crisis for some of Europe's largest economies. While the European Central Bank is likely to continue to tighten monetary policy, it must tread a fine line between taming inflation and snuffing out economic activity in the months ahead. Investment markets have responded by moving sharply lower, and the economy is likely to give little support to equity values in the months ahead.

Emerging Markets

Emerging markets have been underperforming developed markets for more than a decade, with the most recent culprit being the juggernaut U.S. dollar. However, a number of the largest emerging-market economies are now in a stronger position to rebound than developed markets, as many of their central banks were ahead of the curve in tightening monetary policy last year. Asia's economic growth is likely to slow in the months ahead due to tighter financial conditions, and China continues to curtail its growth with COVID-19 lockdowns. Higher inflation is expected to trigger a quickening in monetary tightening across Asia, with governments offering increased financial assistance to households. Worries over slowing growth have also hit the region's markets, with most markets in bear or sharp correction territory.

ToMorrow's Insights

From Stuart Morrow, RBC PH&N Investment Counsel Chief Investment Strategist

Stuart Morrow, CFA

Vice-President, Head of Investments
RBC PH&N Investment Counsel

Strong foundations – Infrastructure investing 101

An overview of infrastructure investing, what it is, and how it works to provide a strong foundation for a portfolio.

Private infrastructure investments have long provided institutional investors with sources of portfolio diversification, income and protection against inflation. Infrastructure started as an asset class in the mid-1990s. Since then, it has continued to gain greater acceptance from institutional investors, and more recently from high-net-worth investors. Since 2008, the private infrastructure market has more than tripled in size, with alternative (i.e., non-public) investors now owning or operating a large proportion of the world's economic infrastructure. More than US$550 billion has been raised by unlisted infrastructure funds over the past 10 years – evidence of the sector's growing importance in institutional investor portfolios. The delivery of strong risk-adjusted returns within this industry, across varying market conditions and regions, has continued to appeal to investors.

What is infrastructure?

Infrastructure is defined as the basic physical and organizational structures needed for the operation of a society or enterprise. Traditional infrastructure subsectors include:

- social infrastructure (e.g., schools, hospitals, etc., typically built under public-private partnership frameworks)
- utilities (e.g., gas, water/waste and electricity networks)
- transportation (e.g., toll roads, airports and seaports)
- energy infrastructure (e.g., power generation and midstream assets, such as pipelines)

How does infrastructure investing fit into a portfolio?

Investments in long-lived infrastructure assets can generate steady cash flows, supported by either long-term contracts or regulated inflation-adjusted rates of return, and tend to demonstrate a greater degree of insulation against macro risks, such as economic recession or unexpected inflation. Such exposure can also bolster portfolio resilience to market downturns. Infrastructure is typically considered in a portfolio alongside other traditional asset classes like cash, bonds and stocks, as well as private equity and real estate.

What are the benefits to investing in infrastructure?

Infrastructure is widely regarded as a comparatively low-risk asset class, with a longer-term investment horizon than other alternative investments. Investment in this asset class is commonly seen as a longer-term yield play, rather than a short-term commitment focused on capital appreciation. Benefits include:

- Low volatility through stable and steady cash flows as the underlying assets have monopolistic characteristics and deliver essential services underpinned by regulation, concession arrangements or contractual agreements.
- Inflation protection, as some infrastructure assets have cost pass-through mechanisms built into

their contracts with customers. The means that as costs are rising with inflation, real investments returns are usually positive.

- Low correlation to other asset classes, including global bonds and global equities which lowers the overall risk in your portfolio without compromising your returns.

Are all infrastructure investments the same?

No, as there are various categories or classifications of infrastructure. Infrastructure investment strategies are categorized according to their risk and return characteristics. Generally speaking there are four such categories of infrastructure investment strategies – Core, Core-plus, Value-add and Opportunistic. These classifications are differentiated by various factors, including the asset's development stage, geography/physical location of the asset(s), holding periods and drivers of revenue and cash flows:

- **Core infrastructure** – Considered to be the most stable, with assets generally providing most returns as income with limited capital gains, and holding periods tend to be for the long term. These strategies target assets with little to no operational risks, and that are usually generating returns. These tend to be assets in developed economies with fairly transparent regulatory and political environments. Relative to the other three categories of risk, core infrastructure typically provides the lowest nominal return, with most of the return coming from income.

- **Core-plus infrastructure** – Similar to core infrastructure assets, but there is more variability with cash flows in core-plus, and a greater opportunity for capital gains. These assets tend to be located in developing markets, but with little-to-no construction risk. These are usually secondary stage or can be brownfield (i.e., vacant or underutilized properties where past industrial or commercial activities may have left contamination behind) if in a developed market. These assets may also have higher sensitivity to the economic cycle, and may be exposed to fluctuations in demand.

- **Value-add infrastructure** – These investments typically include less monopolistic assets, assets that have a material growth, expansion or repositioning orientation, and certain greenfield assets. Value-add infrastructure investments are usually a moderate-to-high-risk strategy targeting assets that require enhancements. The focus is adding value by growing demand for the asset. Assets are typically greenfield (i.e., land that has not been developed yet and is likely to be found in rural environments) or brownfield, potentially involving new or unproven technologies that do not have pricing power at time of investment.

- **Opportunistic infrastructure** – These assets have the highest degree of risk, but also return potential. Assets can include those in development, those located in emerging markets, those subject to a high degree of commodity price exposure, or those under financial distress and in need of significant repositioning. Projects targeted will be fairly risky and assets may need to be developed or constructed in their entirety. The focus is less on generating stable cash flows, and more on achieving capital growth in the value of the underlying asset. Opportunistic infrastructure closely resembles the return/risk characteristics of private equity investments.

Each category of infrastructure investments carry a varying degree of leverage, liquidity, political, and environmental risks to just name a few.

Please reach out to your RBC PH&N Investment Counsellor to learn more about what RBC has to offer around infrastructure investing, and how it might be suitable for your portfolio.

Grab your bear spray!

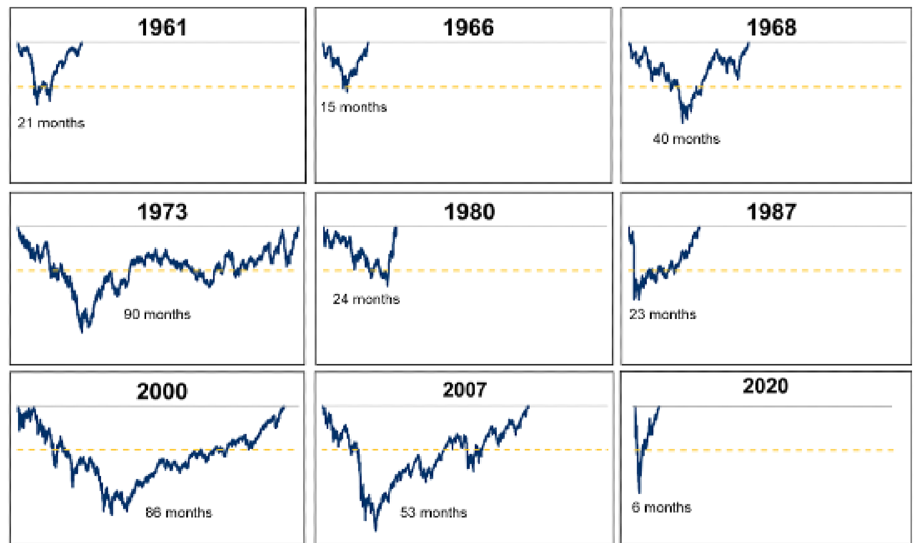
Three important reminders to help avoid a bear-market clawing

2022 has been a tough year for investors so far, with recession and inflation worries combining to push the financial markets – both bonds and equities – into sharply negative territory. The mighty S&P 500 Index, the leading barometer for equities, and the technology-laden NASDAQ, both reached official bear market territory this year, while the S&P/TSX Composite Index, Canada's leading equity index, has hit correction territory, meaning a downturn of 10% or more.

Ursas major and minor: The anatomy of bear markets

"Bear market" is an investment term used to describe the market's performance when it has fallen by 20% or more from its most recent high. While each bear market is different, here are some of their key features:

- Over the last 60 years, equities have experienced 10 distinct bear markets.
- On average, they tend to occur every seven years.
- More than 70% of bear markets have preceded an economic downturn.
- Over the last century, the average bear market has lasted just over two and half years, and the median peak-to-bottom decline over that period was just over 35%.
- The last bear market occurred in 2020 – the COVID Crash – and it was the quickest one on record, dropping 20% in one month, but recovering within six months.



Source: RBC GAM, Bloomberg. S&P 500 Index. Bear markets labelled based on year of index peak before decline. Charts scaled to depth of the deepest bear market (which occurred during the global financial crisis as markets fell over 56% from October 9, 2007 to March 9, 2009) and based on the longest bear market and recovery which spanned 1899 trading days from January 11, 1973 to July 17, 1980. Yellow line represents 20% decline threshold. You cannot invest directly into an index.

Grin and bear it: Important reminders to survive bear market "attacks"

Suffering through a bear market is no easy task for investors, and some make the mistake of veering off of their long-term investment plans when faced with the often powerful emotions provoked in times of market stress.

To help keep you on track, here are three important reminders about surviving through and sticking with your investment plan in bear markets:

- **Keep the bear repellent close** – the bear will eventually appear: History has shown us that bear markets are a fact of investing, and can be expected to arise every six to seven years. It's impossible to know when they will arise, or when they will end – each one will be different. As such, market timing is, as always, ill-advised.
- **Ignoring the bees for the honey** – bear markets can be positive for long-term investors: For investors with long-term investment horizons and appropriate risk profiles, the lower asset prices offered up by bear markets can pay off over the long term into stronger returns. Leveraging strategies like regular investing and dollar-cost averaging can even help you benefit from the opportunities that bear markets can create, allowing you to "buy low" and more when markets are behaving irrationally.
- **"Play dead"** – stick to your investment plan: In moments of fear and crisis, it's challenging to avoid falling prey to poor decision making. The old adage to "play dead" if confronted by a bear can be helpful: in short, don't run or make any rash moves. Having a well-constructed, personalized and risk appropriate plan is critical.

Your Investment Counsellor can help guide you through these challenging times – and help you to avoid the long-term scars of a bear market mauling by avoiding the common pitfalls that arise during times of extreme volatility.

Planning with care today for tomorrow's cost of care

Understanding and preparing for the costs of care in our elder years is a critically important element to one's wealth planning today.

Canadians are living longer, with the average lifespan today 82 years (84 for women and 80 for men).[1] Advances in health care and drug treatments, along with healthier lifestyle choices (e.g., exercise, eating better, not smoking) are mostly to thank for this phenomenon.[2] And our lifespans are expected to keep getting longer still, with living into one's nineties or beyond no longer an extreme outlier.[3]

A compelling reason to care about one's care

While an increasing number of Canadians will be blessed with longevity, the older we get the more risk there is that we will encounter illnesses and even incapacitation. More often than not, we require the most care in the last years of our lives. Unfortunately, this is likely to be the time when we are most vulnerable and dependent on others to deliver that care.

How we want to live in our elder years – and, in fact, can afford to live – is therefore an increasingly critical component of wealth and investment planning, as most of us will require our savings to meet those costs of care. With assisted living at an average home or at a private residential care facility costing as much as $100,000+ per year, and as much as $300,000+ per year at a higher-end luxury facilities, how one plans for these costs today is increasingly important.

"An ounce of prevention is worth a pound of cure."

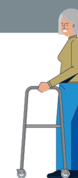
Preparing today for the eventuality of the challenges of aging and its associated costs of care can help you keep your options open as to how you would prefer to live in your elder years. Here are five things that can help:

Living at home

Personal support worker

For one year at $35/hour, eight hours a day (not including HST/GST & excluding overnight care and statutory holidays):
$102,200 /annum

Private residential care



Assisted living per month:
$2,500 - $9,000/month OR $30,000 - $108,000/year

Publicly funded long-term care facility

Co-payment for long stay private room at facility in Ontario (costs vary by province):
$32,420/year

Source: Ontario Ministry of Health and Long Term Care. As of July, 2019.

1. **Set your time horizon to 100:** As Canadians live longer, the need to fund one's retirement and especially elder years when the cost of care peaks, is getting longer, too. When it comes to thinking about an investment portfolio, it ideally should meet your needs for your entire life, not just to your retirement date.

2. **Leverage the power of equities:** A risk-appropriate and properly balanced portfolio that leverages the long-term historic power of equities to grow your wealth over time can help offset the corrosive effects of inflation, the drawdowns needed to fund your cash flow requirements, and unexpected costs in your later years.

3. **Generate cash flow:** The more a portfolio can generate cash flow from various sources – interest payments, dividends, distributions, return of capital – can help fund your care costs over time, without the need to draw down on your capital.

4. **Establish a Health Care Directive:** Letting your loved ones know how and where you wish to be cared for is important, and will remove unnecessary concern for them if you become incapacitated.

5. **Research your care options:** While most Canadians want to live in their home until they pass away[4], it is not the only option, nor necessarily the optimal one. Research care options before deciding on what's right for you, and realistically align your choice to your financial means.

Preparing today for tomorrow's costs of care is a critically important component of building and maintaining an effective and successful wealth plan. Whether for yourself, your family or other loved ones, knowing your care options can be an important part of that planning, while providing you key information about your options – and all in turn working to provide you with the peace of mind that comes with that knowledge. Talk to your Investment Counsellor about how we can help.

Sources

[1] Statistics Canada, "Life expectancy and other elements of the complete life table, three-year estimates, Canada, all provinces except Prince Edward Island" (January, 2022).

[2] Public Health Agency of Canada, "How healthy are Canadians?" (April, 2017).

[3] FP Canada – Standards Council, "Projection Assumption Guidelines" (April, 2021).

[4] National Institute of Ageing (NIA)/TELUS Health Survey (2020).

The Last Word

The 2,000 hour retirement challenge

Retirement can be a blessing but also a curse, as retirees navigate the end-of-work void.

Canadians are suddenly retiring in droves. After what appears to have been a sharp pandemic-related drop-off, over 300,000 workers 55-years-old and over left the workforce between August 2021 and August 2022. That's more than a 30% increase over the prior 12-month period, and a 13% increase over the last pre-COVID 12-month period. At the same time, more than 620,000 Canadians entered the 65+ age category, increasing the cohort's size by almost 10%. If this trend continues, it is estimated that over 25% of Canadians will be retirees by 2030 – an all-time high.*

This development is not entirely surprising as the heart of the enormous Baby Boomer population cohort – those born between 1946 and 1963 – hit retirement age, which averages around 63 in Canada. And the recent surge is likely to continue, especially as the world reopens, and travel and leisure activities become safer and more accessible, leading more pre-retirees to be drawn to finally opting out of the working world.

So … now what?

What are all of these new retirees facing? If you consider the number of hours that we spend working a full-time job over a year, it works out to over 2,000 hours (40 hours per week X 52 weeks). As a retiree, that is a tremendous amount of time to fill without the familiar cadence of employed life, and represents a real challenge for those entering the work-free period of their lives.

For many retirees, leaving behind their work means a loss of purpose, social engagement, mental stimulus and sense of accomplishment – and leaving them with a whole lot of hours to fill.

Enjoying the best days of your life – we can help

At RBC PH&N Investment Counsel, we recognize that wealth and investment success is a means to an end, not an end in itself, and that wealth is a tool to help us achieve our life goals. That is why we strongly encourage our clients to discuss their retirement lifestyle plans and goals with their Investment Counsellors. Retirement is very often where the confluence of wealth, health and well-being meet – and, as such, it is a place that we are focused on helping our clients navigate and enjoy successfully.

While achieving your retirement savings and investment goals is critically important, what you do with your time in your retirement years – which can span a longer period than your career/work stage of your life – highlights the importance of planning to and through your retirement years.

Unfortunately, for too many that only means building enough wealth to financially sustain yourself and your family through those years. But as much as your investments matter, it is equally critical to ensure one also plans around their health and well-being, to avoid the very real mental and physical challenges that can arise without a life filled with meaning, accomplishment and happiness. This is why we focus on a more holistic planning approach with our clients, moving beyond wealth to those other components that are also essential. In short, a healthy life

coupled with a strong sense of well-being, makes your wealth meaningful, and vice versa. Without one of those three components, something crucial is missing, and achieving a fulfilling and happy retirement will be very challenging.

For those who successfully planned out the post-work period of their life, those 2,000 hours of newfound time will hopefully provide lots of opportunities to enjoy fulfilling and fun-filled activities. Now "owning" their time and how they spend it, they can freely pursue their various goals, whether spending time with their family, travelling, playing golf, learning some new skill or finally getting through those projects they've always had in their sights. Some may even choose to continue working part-time, or to "un-retire" altogether. Whatever your vision and hope for the years ahead, working together with your Investment Counsellor can help you overcome the 2,000 hour conundrum, and enjoy what we hope will be the very best years of your life.

We are open, and excited to see you again whenever you are ready!

Our offices have now fully reopened, and we are delighted to welcome you back to our RBC PH&N Investment Counsel offices. As always, you are more than welcome to contact us by phone or email, and we remain available at your convenience to meet with you virtually, depending upon your preference. We look forward to seeing you again soon.

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