FALL 2020

Info SIGMA

Risk Management

A question that came up often in our survey earlier this year takes on additional importance given the current circumstances. Several of you have asked us how we manage risk in these situations? The answer, in our experience, is that a well-designed portfolio should already be able to protect the investor before periods of volatility arise. In other words, risk management must always be present, and the right portfolio structure must be in place before a correction occurs. So what are the risk management measures of Sigma portfolios?

Diversification

Sigma Balanced and Income portfolios are made up of a wide variety of asset classes that are not sensitive to the same factors. This ensures that a single event will not lower all positions simultaneously. In general, the same event will be positive for one portion of the portfolio and negative for another. A well-known saying goes that if all the positions in your portfolio go up at the same time, beware, because they will all go down at the same time too!

Rebalancing

Lower risk and lower volatility are not the only benefits of diversification. When some asset classes go down while others go up, it allows us to rebalance those positions. Adding to positions that have become underweight allows us most of the time to buy them at a discount. Selling some of our overweight positions allows us to take profits. Over time, this dynamic generates additional returns while reducing risk. We wouldn't go so far as to say we wish each for volatility, but these downturns do represent real opportunities to rebalance.

The Asset Class Rotation basket.

The Asset Class Rotation (ACR) basket is more tactical in its approach than the balanced and income baskets. Invested at all times in just five asset classes, its objective is to participate in strong medium-term trends among all asset classes that make up the balanced basket. Unlike the balanced and income baskets, ACR buys on strength and sells on weakness. Its time horizon is on the other hand different than the two other baskets; a short-term overweighting is rebalanced downward in a diversified portfolio but could indicate the start of an uptrend in the medium term and therefore a purchase in the rotating basket. Also, a short-term underweight will be rebalanced upward, but could indicate the start of a medium-term downtrend, therefore an asset class that will not be present in the rotation basket. There is no such thing as a strategy that is foolproof all the time. It is for this reason that there is little or no persistence of returns among managers. Diversification and rebalancing offer the greatest reliability given time. But the diversified portfolio is not foolproof. Sometimes an asset class goes through a sustained period of decline, during which we constantly rebalance upward to maintain our weighting. Eventually, we are rewarded when it resumes an uptrend because the average cost of ownership has dropped significantly as a result. Since it follows trends, it is likely that the asset class rotating basket would simply not be invested in that asset class during its downturn. The rotation, on the other hand, needs a sustained period of several months to spot a trend, so it never buys on the bottom and never sells on the top. Used together, the two approaches complement each other; the weakness of one is the strength of the other.

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Review of the markets

There is no denying it, we are living in historic times. It is hard to remember a time when we were faced with such important issues. We are obviously referring to the COVID 19 pandemic as well as the US elections that will take place in a few days.

Despite the polls putting Mr. Biden ahead of Donald Trump, the memory of the surprise results of the 2016 election and the 2000 Gore / Bush contest are still fresh our collective memory, despite the fact that there are several differences in the dynamics of the three campaigns. All that can really be said is that this campaign is very polarizing. The post-campaign is also seeped in uncertainty given Donald Trump's declaration that it should be mandatory to determine the outcome by midnight on November 3rd … unless he's not winning of course. The Supreme Court is also joining in. The court ruled on Tuesday on the state of Wisconsin's right to give itself a few days to count advance votes sent by mail. The state's highest court upheld this right but was challenged in the Supreme Court by the Republican Party. The Supreme Court ruled against the state's right to continue counting votes beyond November 3, which risks wasting hundreds of thousands of mailed-in votes. The majority of these votes are presumed to be Democrats because they were far more likely to take advantage of the right to vote in advance than the Republicans. The same scenario is likely to recur in other hotly contested states by next Tuesday. The results of the presidential and senate elections (one-third of the 100 senate seats are at stake) are uncertain, and moreover, the reaction of the markets to the various scenarios is just as impossible to predict. For example, would a «blue wave» sweeping over the White House and the Senate necessarily be well received by the stock market? Historically, markets perform somewhat worse on average in those years when the same party controls the executive and the legislature, fearing too abrupt changes.

For now, Mr. Biden maintains about a 12 point lead over his opponent. By this point in 2016, Ms. Clinton's lead had dropped to 2%. It looks like the Democrats should win despite the disadvantage of the Electoral College playing against them. Mr. Biden skillfully pursues his strategy of framing the election as a referendum on the deep character contrasts between himself and Donald Trump. In 2016, Ms. Clinton was not popular with the electorate, and Donald Trump was not yet known enough yet.

The American election at least has the advantage of distracting us somewhat from COVID19! Market behavior so far in 2020 can easily be summed up; there is before COVID and three is after COVID. Before the onset of the Pandemic, we were in the tenth year of the economic recovery following the 2008 financial crisis. Stock market indices were reaching new heights, but there were questions about the sustainability of the recovery after so many years. . The arrival of the virus put an end to the questions. There was obviously the initial shock which saw the stock indexes drop very suddenly. Fortunately, the US currency, gold, and bonds held in portfolios at all times cushioned the impact.

The recovery in late March was as sudden as it was unexpected. The impact of the massive flooding of markets with liquidity and fiscal measures was greatly underestimated. But the recovery is very uneven, and stock index performances, inflated by the performance of large tech companies conceal weakness in the real economy. In fact, the size of the US market capitalization relative to annual GDP is reaching new heights. In other words, the valuation of companies is high relative to the actual size of the economy. We also see a marked underperformance of dividend-paying stocks such as financials and non-cyclical stocks compared to growth stocks. Several managers who have relied on dividend-paying stocks for years to manage risk have stumbled badly due to this.

We are in the second wave of the pandemic. As health experts anticipated, this second wave is shaping up to be even bigger than the first for several countries. Governments have to negotiate a difficult balance between the health of the economy and the limits of care systems. Such stressful times represent a moment of truth of sorts for any portfolio. If the structure is not adequate, or if there is a risk management weakness lurking in the makeup of the portfolio, the results can be impactful. Discipline can also be tested. It is not always easy to maintain discipline when emotions and anticipation take over. Even the best strategies lose their value if they are not executed with discipline. We are also witnessing a huge dispersion between the returns among managers. Some balanced portfolios ended the third quarter slightly higher and others lower by more than 10%. Some were too focused on certain types of stocks, others had too few bonds given the low rates, others were under-diversified going into this current crisis.

Rebalancing during the pandemic

During the first three months of the year, rebalancing mainly consisted of buying the stock indexes lower and selling the bond indexes, US dollar and gold.

On February 28, March 3, 12, 17 and 20, we rebalanced the Canadian and US dividend equity, Canadian and US real estate, preferred shares and US large-cap growth indices upward. From the end of March, when the US Federal Reserve has opened the monetary valves full throttle, the dynamics of rebalancing reversed. Almost all of the sales (downward rebalances) were made on equity, real estate and gold indices while purchases were made on bond indexes. Bounces like we experienced in March are ideal for rebalancing our baskets. The stock market downturn allowed us to rebalance several positions at a bargain price just in time to take advantage of the rally that followed. Obviously, these declines are not pleasant to go through, but the rebalances allow us to take advantage of the eventual recovery.

The rotation of asset classes

The Asset class rotation basket entered the crisis with a relatively defensive positioning, invested 40% in bonds, 20% in gold, 20% in the S&P 500 and 20% in Canadian real estate. Despite the strong rally in the S&P 500, the majority of stock indexes have not been able to regain all the ground lost in the correction. Aside from the technology sector (FAANG-M) and emerging countries (thanks to the recovery in Asia), stock markets are not in a leadership position in the medium term. In terms of trends, fixed income and gold still have the advantage.

The impact of COVID19 on insurability

Insurance companies are adjusting to the new reality of a post- COVID world. Insurability will be more difficult, and premiums higher. Read the full article of July 10th 2020 by Juliette Baxter on the financial post

> *The coronavirus pandemic has been a wakeup call for many Canadians, triggering a stampede to pick up life insurance to protect their families.*
>
> *“We’re seeing a new dialogue emerge around mortality, illness and job security like we’ve never seen before,” says Andrew Ostro, co-founder and CEO of PolicyMe, an online insurance brokerage.*
>
> *“COVID-19 has opened our eyes to the threats that we face and the need to safeguard against them. In the past few months, we’ve seen a doubling of the number of life insurance applications.”*
>
> *But even amid this tidal wave of new business, some insurance companies are raising prices. In April, Sun Life hiked premiums for some policies by up to 27 per cent for new applicants.*
>
> *Here’s what’s happening — and how you can still find policies you can afford.*
>
> *Why is life insurance getting more expensive?*
>
> *The answer lies in today’s incredibly low interest rates. Canadian law requires insurance companies to only make investments that a “reasonable and prudent person” would make in order to “avoid undue risk of loss.” It also limits their ability to invest in real estate and stocks.*
>
> *As a result, insurance companies invest the bulk of the money they take in from your premiums in conservative investments that depend on interest rates, like bonds.*
>
> *But the Bank of Canada has dropped interest rates dramatically to spur the rest of the economy during the pandemic.*
>
> *“Globally, life insurers manage more than $20 trillion in assets and as much as half of this is estimated to be in government bonds. But the yields from these have fallen dramatically,” Laura J Hay, global head of insurance for accounting giant KPMG International, wrote in March as the COVID-19 crisis got underway.*
>
> *“In addition to this ... central banks have been slashing interest rates. We were already in a low interest-rate environment, which is always difficult for insurers in general, but especially for life insurers. Now rates are heading down even further (possibly below zero in some countries).”*
>
> *In short: When interest rates are low, insurers see less profit from their investments, so they need to increase their premiums to make up the difference.*
>
> *How can I save money on life insurance?*
>
> *Ostro points out that Sun Life is only hiking forms of permanent insurance — expensive lifelong policies that often act as investment vehicles and tax shelters.*
>
> *For the extra money, policyholders are guaranteed a payout (you will die at some point) and can stash surplus cash, earn dividends and borrow against their cash value.*
>
> *Meanwhile, “term” life insurance remains a much more affordable option. These policies are budget-friendly because they only do one job: to pay your family if you die during the duration of the policy, which can range from 10 to 30 years.*

A 20-year term policy for a healthy 30-year-old man can cost as little as $30 per month, whereas a permanent policy can start at $300 per month.

Ostro adds that term premiums may also rise during the COVID-19 crisis, perhaps as much as 20%, so you may want to lock in a low rate sooner rather than later.

Even if you can afford a permanent policy, it's worth looking at your investment options. You may find it more lucrative to buy a term policy and then invest your remaining budget in an RRSP or TFSA.

How to buy life insurance during COVID19?

The life insurance industry is trying to meet the increased demand for their services with safety and social distancing in mind. Online brokers like PolicyMe make it easy to compare quotes and buy a policy without the need for physical documents or face-to-face visits.

Medical exams, a typical requirement for new applicants, remain on hold, and many companies are increasing the amount of coverage you can get without one. Ostros adds they were already on a downward trend before COVID-19 to help streamline processes and cut costs.

If you're under 50 years old, you can now find policies offering up to $2 million in coverage without a medical exam. If you're over 50 years old, you can get up to $1 million.

When applying, you might be asked whether you're experiencing any symptoms consistent with COVID-19. If the company doesn't like your answers, you may have to wait 14 days to ensure you're OK before you can proceed.

With prices poised to increase, now is the time to lock in a policy that can protect your family today and for many years to come.

Bulletin board

We are very pleased to welcome a new member to the Sigma family! Andrée Anne Boulay joined us at the very beginning of the pandemic. Andrée Anne has already proven to be an important asset to us. Thank you Andrée Anne and welcome to the team!

Do you know of anyone that could benefit from our services?
Don't hesitate to contact a member of our team!

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