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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well informed of changes affecting local business decisions and our investment recommendations. We believe Knowledge Pays and we want our knowledge to help pay for you.

CLIENT SURVEY QUESTIONS EMERGENCY FUNDS – HOW BIG? ARE THEY NECESSARY?

The last few issues of Taking Stock detailed our thoughts on the COVID-19 incited market downturn and subsequent rally. Now that markets have calmed down a bit, we are able to dive back into our grab bag of client questions. This month we have:

How large should an easily accessible "emergency fund" be if there are no major expenditures in the near future?

Establishing an emergency fund of **3-12 months' salary and investing this fund very conservatively** has long been a golden rule of personal finance. We challenge this golden rule and below we show how keeping an emergency fund, rather than relying on lines of credit, will leave most investors with less financial flexibility over time.

Canada is not the US

Golden rules borne in the US tend find their way to Canada. However, Canada's more robust social and entitlement programs reduce the need for an emergency fund.

Unemployment Insurance. Canadians can expect up to ~$30,000 in unemployment benefits in the year following a layoff while Americans can expect up to $3,000-$24,000 in the 12-30 weeks following a layoff, depending on the state. The US average maximum is roughly to $12,000 over 26 weeks.

Child Benefits. Canadians can expect up to $6,639 and $5,602 for each child under six and age 7-17, respectively. Americans receive no such benefits.

Health Care. Canadians enjoy universal health care limiting annual non-discretionary health care spending. In the US, accessing health insurance is often through employment plans, so losing employment often means losing coverage.

Emergency Fund versus Lines of Credit

Let us assume one has **$50,000** either to *maintain as a true emergency fund, earning 1% on average* **or** to *invest long-term in a 60/40 portfolio, earning 5% on average*. A 60/40 portfolio ensures that the maximum potential drawdown is modest in case one needs to access these funds. We assume income is taxable annually at a tax rate 30%.

If one goes thirty years without unemployment and one does not touch these funds for another thirty years in retirement, **these amounts would grow to ~$76,000 and ~$394,000, respectively**. This difference shows the high cost of an emergency fund.

If you need to use a line of credit to get you by temporarily, the cost of doing so will likely be dwarfed by the gains on an almost fully invested portfolio over time. One caveat worth mentioning is that your financial institution can close your line of credit or change the terms at any time, therefore relying on lines of credit is not foolproof. If you do choose to rely on lines of credit to get you through hard times, it is best to attain a line of credit secured by your home, which reduces the odds of your financial institution calling your loan. Finally, **if you have known expenses coming up** in the next few years, **it still makes sense to hold cash or cash-like securities to offset those upcoming expenses**.

Current Rates & Data

Govt of Canada

90 day	0.25%
1 year	0.29%
2 year	0.25%
5 year	0.36%
10 year	0.54%
30 year	1.12%

U.S. Treasury

90 day	0.12%
1 year	0.14%
2 year	0.16%
5 year	0.31%
10 year	0.65%
30 year	1.34%

Canada Prime Rate

2.45%

U.S. Prime Rate

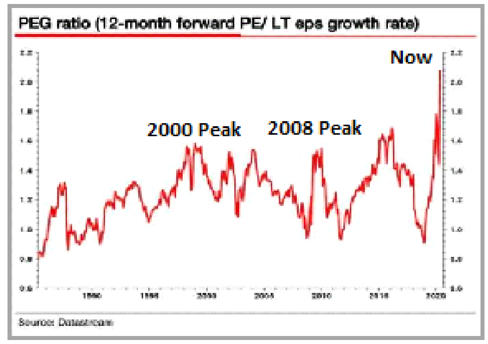
3.25%

Exchange Rates

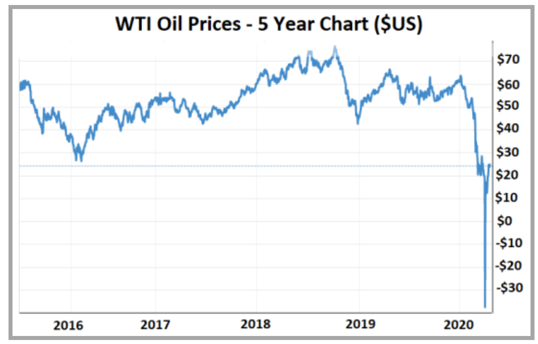
CAD/USD	0.710
USD/EUR	1.082
JPY/USD	107.0

ECONOMIC TIDBITS HIGH MARKET VALUATIONS VS. GROWTH & NORTH AMERICAN OIL PRICES GO NEGATIVE

• The PEG ratio (forward price-earnings ratio relative to long-term expected growth rate) for the S&P 500 hit an unprecedented level following the equity market rally. Equity market bulls have long touted this ratio as a way to justify the prices of high-flying, expensive-looking stocks, as high expected growth rates justified high valuations. This argument is weak now that the ratio is ~20% above previous highs.



• The May oil contracts for most US and Canadian oil price benchmarks went wildly negative on April 20 as oil traders dumped future contracts in order to avoid taking physical delivery of oil. Declining oil storage capacity and high transportation costs made the cost of accepting delivery of oil greater than the oil itself. Many amateur investors also got a shock, thinking that negative prices were impossible.



LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

The Shiny Stuff Starting to Look Good Due to Valuation Relative to Other Assets and Debt Jubilee

- Gold is highly correlated with US Treasuries, especially during market downturns and economic crises.
- US Treasury bonds maturing in ten years or under yield less than 0.7% and 30-year Treasuries yield only ~1.3%. US Treasury bonds no longer act as a useful ballast to equity exposure in a balanced portfolio (i.e. unless US Treasury yields go wildly negative, which is a choice not favoured by the US Federal Reserve, US Treasury bonds will not offset potential equity downside).
- Some fixed income portfolio managers have been adding gold to their fixed income portfolios because of the now diminished risk management capability of US Treasuries. Gold prices can theoretically rise much more than US Treasury prices in future market downturns and US Treasury yields are currently negligible.
- As portfolio managers, we have historically been hesitant to add gold to portfolios. We do believe gold could act as an effective replacement for or complement to government bonds. Following the historic equity market rally of the past six weeks, and with stocks now trading at their highest valuation ever based on various metrics, gold also looks reasonably valued relative to common equities as well. We still remain fairly cautious toward gold equities given they tend to be highly correlated with common equities in general during market downturns so we do not see the same risk management value in gold equities.
- Gold can be accessed through ETFs such as **Spdr Gold Trust (GLD-US)** or **iShares Gold Bullion ETF (CGL.B)**.

  Key risk points: Gold is volatile just like any other asset. Gold is priced in US dollar terms, which may add to volatility. Gold has no yield and has an associated cost to store so there is an ongoing cost to own gold.

JEANNINE'S TIP O' THE MONTH Raymond James Trust (Canada)

Raymond James Ltd. recently announced an acquisition enabling it to become the first non-bank-owned wealth management firm in Canada to offer nationwide trust services. Raymond James Trust (Canada) will soon be able to offer executor and power of attorney services as well as act as a "wills bank" to store sensitive documents for clients. This allows Raymond James Ltd. clients the ability to get more services under the same roof.

This newsletter has been brought to you by Steele Wealth Management

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