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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.

WHAT IS THE SAFE WITHDRAWAL RATE? A HARD LOOK AT THE "4% RULE"

Since research published in 1994 by *Bengen et al* suggested that an initial safe withdrawal rate from a balanced portfolio is 4% of the initial asset value assuming a 30 year time horizon and withdrawals adjusted for inflation, investors and advisors have almost ubiquitously accepted this figure as fact. Now that bond returns, and likely equity returns, are expected to be notably lower than in the years leading up to 1994, and expected longevity has improved by approximately two years since 1994, **it is very likely that the 4% rule is no longer the rule**.

In January 2017, researchers at Morningstar published a paper that challenged the 4% rule and attempted to determine the new safe withdrawal rate.

The three primary findings of the paper were:

- Historical performance of Canadian securities is similar to global securities and **future expected returns in Canada are likely to be considerably lower going forward**
- Given lower future expected returns, **safe withdrawal rates are low and may decrease further considering improvements in mortality**
- Given the low future expected returns of fixed income at the current time, Canadian retirees can no longer rely solely on fixed income to provide income and **a mostly equity or balanced portfolio is likely the best asset allocation for Canadian retirees**

The Morningstar paper suggests that the new safe withdrawal rate, at an 80% confidence level, ranges from 2.7% for a purely fixed income portfolio to 3.6% for a purely equity portfolio. A portfolio consisting of 50% equity and 50% fixed income is expected to provide a safe withdrawal rate of 3.4%. That said, this 3.4% withdrawal rate is only at an 80% confidence level. If we wish to provide say 95% confidence, a confidence level that is comparable to the original 4% rule, **the safe withdrawal rate drops to 2.8%**. This is only for a 30-year period, which may be too short for some.

Assuming a balanced $1,000,000 portfolio value and using the 4% rule, an investor could theoretically **withdraw $40,000 in today's dollars for 30 years**. If the new rule is the 2.8% rule, the **annual income from a $1,000,000 portfolio falls to $28,000, a 30% decline in income relative to the mid-1990s**.

While we are not advocates of using a rule of thumb to determine one's retirement income, we believe it is important for investors to recognize the significant change return expectations since the 1990s and how this affects one's retirement income. The retirement projections we provide our clients pins down retirement income more effectively and incorporates fairly conservative return expectations.

Current Rates & Data

Govt of Canada

90 day	0.48%
1 year	0.62%
2 year	0.81%
5 year	1.22%
10 year	1.77%
30 year	2.47%

U.S. Treasury

90 day	0.72%
1 year	1.02%
2 year	1.35%
5 year	2.09%
10 year	2.57%
30 year	3.16%

Canada Prime Rate

2.70%

U.S. Prime Rate

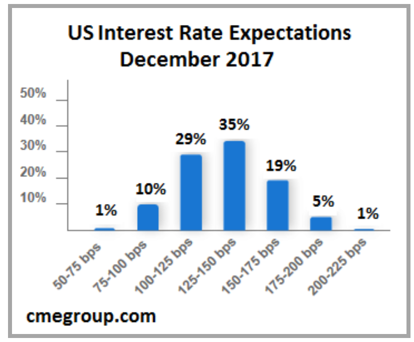
3.75%

Exchange Rates

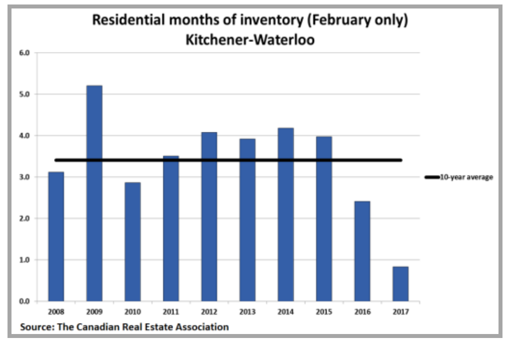
CAD/USD	0.740
USD/EUR	1.059
JPY/USD	114.9

ECONOMIC TIDBITS MARCH ODDS FOR U.S. RATE HIKE SURPASS 90% & GOLDEN HORSESHOE SHINES ON

• As a result of solid economic data and encouraging words from the U.S. Federal Reserve, investors have attributed over 90% odds to a 0.25% U.S. rate hike in March. Further, investors have once again priced in three U.S. rate hikes in 2017. While a U.S. rate hike in March would make three U.S. rate hikes in 2017 possible, a lot would have to go right economically to support three rate hikes.



• The southern Ontario housing market is experiencing its most pronounced active listing shortage in at least thirty years. As of February, residential months of inventory in Toronto, the GTA and most surrounding communities sits below one month meaning the market depends on new listings to maintain current sales activity. Affordability is no longer a metro Toronto problem.



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

After Kraft Heinz's Unsuccessful Bid for Unilever, Several Consumer Staples May Be Targeted Next

- **General Mills (GIS-US)** and **Kimberly Clark (KMB-US)** are two ideas related to this theme.
- **General Mills** appears inexpensive trading at ~19x trailing normalized earnings versus prepared food peers at 21x and higher. General Mills is down over 15% from its 2016 high as a result of higher interest rate expectations and investors fleeing defensive stocks for cyclical stocks. Having priced in three U.S. interest rate hikes in 2017, the market's interest rate expectations may be too high. General Mills could be a good fit for Kraft Heinz if the company is adamant on buying a consumer staple with a large food business. If interest rate expectations continue to climb, GIS would likely resume its decline.
- **Kimberly Clark** current trades at a valuation of ~22x trailing normalized earnings, roughly in line with global consumer staples peers. Kimberly Clark is by far the most similar company to Unilever and makes it Heinz's most likely potential acquisition target after the failed Unilever bid. Like General Mills, Kimberly Clark could benefit from a decline in interest rate expectations and an investor shift from cyclicals to defensives. Additionally, Kimberly Clark is underleveraged relative to peers and could boost its earnings should it bring its financial structure more in line with peers. If interest rate expectations continue to climb or if Kraft Heinz states it will not make an acquisition, KMB shares could come under pressure.
- Feel free to ask a member of our team for more information on these securities.

JEANNINE'S TIP O' THE MONTH Return of Capital on Tax Statements

Please note that return of capital data will be processed through client accounts on April 4, 2017. If you require updated gain/loss information with these reflected – the information can be generated directly through your online access. Select the specific account under *'My Portfolio'*, then using the *'Gain/Loss'* tab you can select the date range. This information is exportable to Excel.

This newsletter has been brought to you by Steele Wealth Management

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