Investing Essentials:

Investment Lessons from a tumultuous year

that will stand the test of time

One thing that 2020 taught us is that no one knows what is going to happen. Although we cannot predict the future, we can certainly learn from the past. While nothing about 2020 was conventional, the lessons learned felt very familiar and will serve as an investment playbook for years to come.

The year 2020 was challenging for policy makers and investors globally. Markets across the globe went through multiple inflection points with a series of record-setting lows and highs. What started as a "Pneumonia of unknown cause"[1] in late 2019 in Wuhan, China morphed into a full-scale global pandemic within the first quarter of 2020. By the end of year, the novel coronavirus had taken a heavy toll on human lives, livelihoods and the global economy. The International Monetary Fund reports an economic contraction of 3.2% globally, and 4.6% in advanced economies, for 2020.

LESSON 1: Patience is a virtue

> **The stock market is a device for transferring money from the impatient to the patient.**
>
> – Warren Buffett

The rapid onset of the pandemic jolted investments globally. In the U.S., the S&P 500 noted its fastest downfall and recovery in its history after starting the year at an all-time high. By March 23rd, the S&P 500 was down by 37.7% on a year-to-date basis along with most major indices in the red across the world. Even more surprising was the swiftness of the recovery as global stock markets sprung back to life with double-digit gains.

If you look closely at Figure 1, it's clear that sharp recoveries are not a new phenomenon. In the U.S. market, not only did many of the best days fall near the worst, but all of them occurred during a crisis: Black Monday in 1987, the financial crisis in 2008 and the global pandemic in 2020 included.

Figure 1 S&P 500 Top 5 Best and Worst Days

Date	Return	Date	Return
October 13, 2008	11.6%	October 19, 1987	-20.5%
October 28, 2008	10.8%	March 16, 2020	-12.0%
March 24, 2020	9.4%	March 12, 2020	-9.5%
March 13, 2020	9.3%	October 15, 2008	-9.0%
October 21, 1987	9.1%	December 1, 2008	-8.9%

Source: Bloomberg, January 1980 – December 2020, Total Return US dollars

Lesson learned:

Staying invested during turbulent markets usually pays off for the patient investor, and 2020 was no exception. Being disciplined through volatile markets is not always easy for many investors but staying diversified can be. **Scotia Portfolio Solutions** have a long history of successfully navigating changing and challenging market dynamics. Lead Portfolio Manager, Judith Chan, and her team continually seek new ways to enhance diversification, manage volatility and improve the risk-adjusted returns so investors don't have to.

[1] World Health Organization, Pneumonia of unknown cause – China, December 31, 2019

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LESSON 2: The best offense is a good defence

As with any other crisis, businesses and asset classes weathered the onset of COVID-19 in different ways.

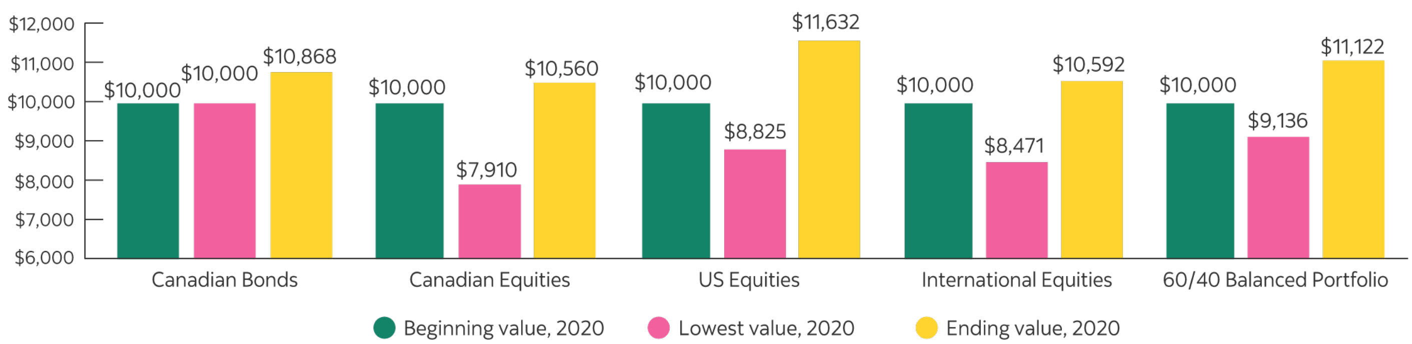
Fixed income is often considered a boring or even an unnecessary asset class; however, it was a bastion for balanced investors in 2020. High-quality bonds, a key ingredient in thoughtful asset allocation, dulled the impact of the dramatic equity market sell-off early in the year. This helped many investors avoid the costly mistake of selling their investments at the worst possible time, as our first lesson illustrates.

Figure 2 shows how a diversified portfolio of 40% fixed income and 60% equities ensured participation in the stock market's swift recovery without the steep declines of an all-equity approach.

Lesson learned:

Your portfolio's strategic asset mix of stocks and bonds is a key determinant of meeting your long-term investment goals. Think of fixed income as a shock absorber for your portfolio during stock market downturns. By contrast, equities are the growth engine of your portfolio, with a higher allocation offering a greater long-term return potential, but with a corresponding increase in risk. **Scotia Portfolio Solutions** are available in a range of strategic asset allocations that are regularly rebalanced to maintain a level of risk you're comfortable with. A Scotiabank advisor can recommend a portfolio that's best suited to meet your unique needs.

Figure 2 Market Value of $10,000 Investment, January 1 - December 31, 2020



Source: Morningstar. US Equities as measured using S&P 500 Index, Canadian Equities as measured using S&P/TSX Composite Index, Canadian Bonds as measured using FTSE Canada Universe Bond Index and International Equities using MSCI EAFE Index. Total Monthly Net Returns in Canadian dollars. 60/40 Balanced Portfolio: 45% MSCI World, 40% FTSE Canada Universe Bond Index and 15% S&P/TSX Composite Index. Assumes reinvestment of all income and no transaction costs, fees or taxes. This information is for illustrative purposes only. It is not possible to invest directly in an index.

LESSON 3: The market isn't the economy

Markets don't always move in tandem with the economy, and in 2020 we saw this firsthand.

Many investors were left scratching their heads as markets soared, while economic activity, employment levels and company earnings tumbled. The disconnect between investment returns and the economic data for much of 2020 reflects the forward-looking nature of equity markets. Unlike GDP and unemployment data, which are lagging economic indicators, equity markets clearly looked ahead to companies' future earnings potential in 2021 and beyond. Investors would do well to do the same.

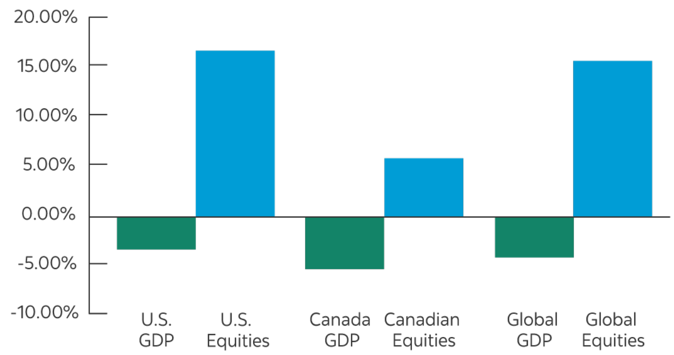
Real GDP is Gross Domestic Product adjusted for inflation. GDP is comprised of four economic components: personal consumption, business investment, government spending and net exports.

Lesson learned:

While it can be easy to get distracted by the headlines, long-term company fundamentals usually win out in the long run. Successful companies adjust, adapt and reinvigorate their business models to meet their ever-changing economic environment. It is tempting to react to the prevailing economic sentiment; however, it is often unprofitable to do so.

An axiom of disciplined investing is to maintain a long-term perspective. The experienced members of the **Scotia Portfolio Solutions** team continually examine economic developments and are prudent in distinguishing economic signals from noise.

Figure 3 GDP vs. Market Return, January 1 - December 31, 2020



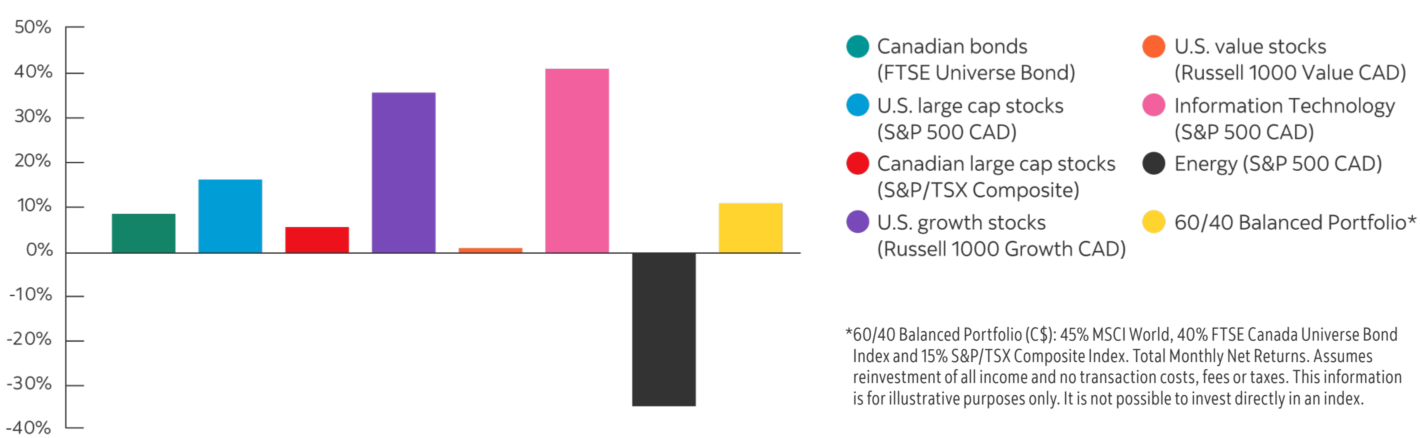
Source: Morningstar, Bloomberg and World Bank. US Equities as measured using S&P 500 Index, Canadian Equities as measured using S&P/TSX Composite Index and Global Equities using MSCI ACWI. Total Monthly Net Returns in Canadian dollars. Assumes reinvestment of all income and no transaction costs, fees or taxes. This information is for illustrative purposes only. It is not possible to invest directly in an index.

LESSON 4: Diversify, diversify, diversify

While preaching portfolio diversification might seem like a cliché, investors experienced the clear benefits of this approach in 2020.

There really is no way to know when certain sectors, styles, or factors are going to outperform and for how long. There were winners and losers in 2020 within global geography, market sectors and individual securities as Figure 4 highlights. Growth stocks vastly outperformed value stocks, while large cap stocks outpaced the more vulnerable smaller cap stocks. At the margins, extraordinary gains in technology and other stay-at-home industries outpaced the lackluster returns of the Energy and Financials sectors. In the absence of a crystal ball, diversification is the best approach to reducing the impact of underperforming segments of the markets while participating in the top performers.

Figure 4 Asset Class Performance, January 1 - December 31, 2020

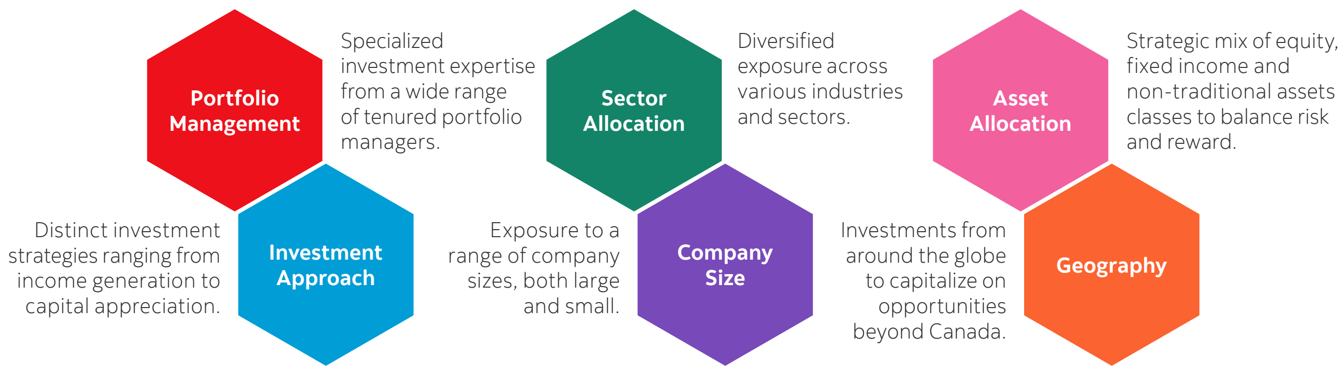


*60/40 Balanced Portfolio (C$): 45% MSCI World, 40% FTSE Canada Universe Bond Index and 15% S&P/TSX Composite Index. Total Monthly Net Returns. Assumes reinvestment of all income and no transaction costs, fees or taxes. This information is for illustrative purposes only. It is not possible to invest directly in an index.

Lesson learned:

The variability of performance between asset classes, industries and individual securities is often high and uneven, particularly in a moment of crisis. The impact of the pandemic of 2020 could cast a long shadow and the growth profiles of some stocks might be indelibly changed. With a wide range in the expected performance and prospects for different countries, sectors and companies, stock selection will play an even greater role in determining investor outcomes going forward. An actively managed portfolio solution with a broad set of diversification tools can be selective in its investment choices. Further, through active management, a portfolio manager can strategically reposition a portfolio to capitalize on the asset classes that are expected to respond positively to evolving market conditions.

Figure 5 Diversification Tools



LESSON 5: Advice is essential

The best advice starts with a conversation

Short-term market ups and downs like we experienced in 2020 can cause even the most experienced of investors to lose sight of the big picture. With the help of your advisor, understanding your initial reactions to market ups and downs can help you make better investment choices, view your portfolio more objectively, and ultimately reach your goals. Research on the value of advice has shown that investors find they have better savings and investment habits and almost four times the wealth of those who don't have an advisor.

Lesson learned:

If an advisor is a coach, a financial plan is your game plan. Downturns come and go – a financial plan can provide the discipline to ride out short-term uncertainty while focusing on the things you can control, such as maintaining a long-term view, staying diversified and investing regularly.

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Advice @ a glance

82%

Canadian investors say that they have better saving and investing habits because of their advisor.[2]

90%

Canadian investors feel confident in their ability to fund their retirement after meeting with an advisor in the past 6 months.[3]

[2] Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry, Pollara 2020. IFIC Investor Survey (2019).
[3] Scotia Global Asset Management Investor Sentiment Survey (November 2020).

From the global pandemic and ensuing economic and health crisis to social unrest and political uncertainty, 2020 was one of the most challenging years on record. Yet, in a year that was like no other, it also reinforced time-tested investment lessons like the importance of staying calm in the face of market volatility, maintaining a well-diversified portfolio, and perhaps most importantly, seeking guidance from a trusted advisor.

A Scotiabank advisor can develop a financial plan to help you stay disciplined and focused on your long-term goals.

Contact your Scotiabank advisor today to get started.

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