ODLUM BROWN REPORT

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ODLUM BROWN
Investing for Generations®

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The Perils of Forecasting

Mark Twain is credited with saying, "It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so." It's wisdom worthy of reflection.

Investors naturally believe that forecasting matters because the media bombards us with predictions and advice: *A recession is coming – sell stocks; buy bonds. Global conflicts are intensifying – own gold. Interest rates are rising – sell dividend-paying stocks.* Unfortunately, forecasting is fraught with peril. Predictions are often wrong, and even when they are right, markets often don't behave as expected.

Bestselling author Michael Lewis shared a great example of a costly, though correct, forecast in his latest book, *Going Infinite,* about the disgraced crypto king, Sam Bankman-Fried (SBF). It began like so:

> "In the weeks leading up to the [2016 U.S. presidential] election, there had been a pattern: stock markets everywhere tanked on good news for Trump and rose on good news for Clinton."

It was a pattern SBF and his colleagues at Jane Street Capital wanted to exploit. Jane Street is a high-frequency trading business that uses powerful computers and complex algorithms to transact large numbers of orders in fractions of a second to generate profits on information advantages. It is where SBF worked after studying at the Massachusetts Institute of Technology (MIT) and before co-founding Alameda Research and FTX Trading Limited, the now bankrupt cryptocurrency businesses at the center of his high-profile fraud trial.

As chronicled by Lewis, SBF and his fellow traders at Jane Street studied how to get evolving election odds directly from individual states faster than CNN could report them to the nation, and they used the information to make profitable trades on election night:

> "Around one in the morning, after twenty-four thrilling hours without a break, Sam left the trading desk to get some sleep. The markets seemed to have fully digested the news of Trump's victory. Jane Street was sitting on maybe the single most profitable trade it had ever done."

Three hours later, Sam returned to the office and learned that investors had changed their minds about the influence Donald Trump would have on the economy and stock markets:

> "'What had been a three-hundred-million-dollar profit for Jane Street was now a three-hundred-million-dollar loss,' said Sam. 'It went from the single most profitable to the single worst trade in Jane Street history.'"

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The traders at Jane Street believed getting more timely information on the election outcome was the hard part of their endeavour; making profitable trades was supposed to be the easy part because they were confident that stocks would rise on a Clinton victory and drop if Trump won. They were wrong.

Jane Street traders weren't the only ones who got the 2016 election call wrong. The fact is, we and almost everyone thought Hillary Clinton would be the next President of the United States. There was also a fairly universal belief that Trump would be bad for business and the markets. Not only did stocks unexpectedly rise on election night, but the broadly based U.S. S&P 500 Total Return Index rose roughly 24% in Trump's first year in office and 70% over his four-year term.

Predictions about the recent pandemic's impact were similarly dismal. In March 2020, when the world locked down and people started working from home en masse, we, and most others, thought we were in for a long and grueling recession that would be hard on stocks. It ended up being the shortest recession on record – two months. Canadian stocks returned 42% in a year and 66% over a two-year period. Thankfully, we didn't advise investors to liquidate equity portfolios.

The latest drumbeat on the business news networks is that interest rates will stay higher for longer. It's a fear that has been fuelled, in part, by recent remarks by Jerome Powell, the Chair of the U.S. Federal Reserve (Fed) and other members of the institution's Federal Open Market Committee (FOMC).

Because the Fed's policy has a huge influence on both domestic and international interest rates, it's understandable that everyone listens when Mr. Powell and other FOMC members speak.

Still, one might want to consider the Fed's record on forecasting. Two years ago, U.S. consumer price inflation had already taken flight and was rising at more than a 5% annual rate, and yet the Fed kept the bottom end of its federal funds rate (FFR) anchored at zero, where it had been since the early days of the pandemic. Mr. Powell told investors that inflation was a transitory phenomenon, and investors believed him. The futures markets were discounting an expectation that the FFR would be no higher than 1.0% by the end of 2023.

In March 2022, with annual CPI inflation nearing 8%, the Fed finally increased the FFR by 0.25 percentage points and signaled that inflation wasn't merely temporary. At that point, the market for fed funds futures suggested the battle against inflation would be won without having to take administered interest rates beyond 3.0%. That proved to be wishful thinking.

With the economy more resilient and inflation more persistent than expected, the Fed has had to increase interest rates at the fastest and most aggressive pace since the early 1980s. The FFR is currently 5.5%, and investors worry that interest rates will rise further.

Shares of companies paying good dividends have sold off sharply in the face of higher interest rates and the fear that they could go higher. That's understandable, as dividends are less attractive when bond yields are higher. Yet it's a little perplexing that growth stocks, like Apple and Microsoft, have held up so well. In theory, companies that have more of their potential profits weighted further into the future should be more sensitive to changes in interest rates.

The explanation for this inconsistency is that lots of other factors affect stock prices. Higher interest rates weighed on growth stock valuations in 2022, while excitement around artificial intelligence has had an overwhelmingly positive influence on many of them in 2023.

We follow numerous intelligent forecasters. Some argue that interest rates will rise further, while others believe they will decline as the economy softens and inflationary pressures abate. We think the latter scenario is more likely, and that could be good news for depressed, dividend-paying stocks. But we also know that anything is possible in the near term.

The Odlum Brown Research Department spends a lot of time thinking about the big picture, and we believe we are pretty good at anticipating the influence of interest rates and the economic cycle. That said, even if an investor is right about market timing calls 90% of the time, it's the 10% of the time they are wrong that can dramatically undermine their long-term performance. Say, based on a forecast, an investor chooses to sit on the sidelines – and then the market goes up 20%. Not only does the investor forgo the 20% upside, but that is money they don't have to grow and compound every year in the future.

Successful investing is a marathon, not a sprint. It's an endeavour where the odds are stacked in an investor's favour. Unlike gambling, one person's winnings aren't offset by another's losses. Over the long run, stocks tend to rise because the size of the investment pie grows as the economy and corporate profits expand.

It would be wonderful if we could correctly and consistently predict the timing of economic and market setbacks all of the time, but we can't. Forecasts are regularly wrong, and when they are right, the market often behaves differently than expected.

The odds of the economy being bigger and companies being more valuable in the long run are a lot better than the probability that a short-term prediction will be right and profitable. Those who commit to owning shares of great companies through good times and bad invariably do better than those who try to time their participation in the market. Don't let forecasts spoil a sound long-term commitment to stocks.

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We are thrilled to share that Odlum Brown is the recipient of the 2024 Rix Award for Engaged Corporate Citizenship, presented by the Greater Vancouver Board of Trade.

We are very proud of this achievement, which honours our ongoing commitment to making a meaningful and lasting difference in the communities where our clients and team members live and work. The award will be presented at the 36th annual Governors' Gala and Rix Awards on Monday, April 22, 2024.

"Odlum Brown has been honoured with the prestigious Rix Award for Engaged Corporate Citizenship for their unwavering commitment to exemplary stewardship in all aspects of their operations. Odlum Brown showcases outstanding leadership and community impact in various sectors, including healthcare, the arts, sports, and education."

– Greater Vancouver Board of Trade, October 23, 2023

What Are Pension Buybacks?

A purchase of past service in a pension, or "pension buyback" as it is commonly called, allows individuals who are part of a defined benefit pension plan to increase their pensionable service and thus their future income benefits. For example, past service for a maternity leave or for a period prior to joining the pension plan may be offered for purchase.

Paying for a buyback

Buyback costs are calculated by a pension actuary. The exact cost depends on facts including your age, salary, which years of service you will purchase, and on actuarial assumptions for future uncertainties, such as future pension indexing (if applicable), future investment rates of return and average mortality of the plan members. Generally, the cost increases over time since the pension will have less time to invest before providing benefits to you.

When it comes to paying for a buyback, you may have up to three options:

YOU CAN COMBINE THESE SOURCES.

Source of Funds	Method of Payment	Is Your RRSP Room Impacted?	Considerations	Documents to Complete
Registered Retirement Savings Plan (RRSP) or **Registered Retirement Income Fund (RRIF)**	Qualifying Transfer: Direct transfer from your RRSPs/RRIFs to your current pension.	No.	Avoids risk of exceeding RRSP limit.	Provide a signed transfer form (T2033) to your RRSP/RRIF provider. Provide the signed buyback paperwork to pension plan.
Pension plan	Qualifying Transfer: Direct transfer from your former pension to your current pension.	No.	Avoids risk of exceeding RRSP limit. Your service and benefits in your new pension may differ from what you give up in your older pension plan.	Provide the signed paperwork, including a signed transfer form, to the pension plan in which you're buying the extra service.
Cash (non-registered funds)	Cheque, payroll deduction or similar payment methods.	**Yes,** your RRSP room is **reduced** by a PSPA[1] in the calendar year you make your buyback. If there is insufficient RRSP room to absorb a PSPA, consider reducing your buyback amount, paying with a Qualifying Transfer or making a Qualifying Withdrawal.	Risk of exceeding RRSP limit. Can enable a larger buyback than using just RRSP or pension transfers. Up to negative $8,000 RRSP room is permitted as a result of certifying a PSPA.[2]	First, contact CRA to have your PSPA "certified."[1] Once CRA's approval has been received, provide your buyback payment and paperwork to your pension plan.

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> There are other potential factors to weigh when deciding whether to purchase past service. These are more fully described in our article "Pension Buyback Considerations," available from your Odlum Brown Investment Advisor or Portfolio Manager.

Other considerations

There are other potential factors to weigh when deciding whether to purchase past service. These are more fully described in our article "Pension Buyback Considerations," available from your Odlum Brown Investment Advisor or Portfolio Manager. Here is a list of key factors to consider:

- **Future employment –** E.g., will your salary and service increase after a buyback?
- **Cost-sharing –** Is your employer sharing the buyback cost?
- **Estate planning and decision-making flexibility –** Are you aware of the different estate planning options between defined benefit pensions and registered accounts (i.e., RRSPs and RRIFs)?
- **Life expectancy –** The longer you and/or your spouse[3] expect to live, the more you could collect as future pension benefits.
- **Timing –** A buyback opportunity is time-sensitive: when does the opportunity expire?
- **Income flexibility –** Is the pension income's structure too rigid for your future needs?
- **Inflation –** Does the plan offer any guaranteed or ad-hoc cost-of-living increases over time?
- **Solvency –** How healthy is this pension?

Tax considerations

Review tax and RRSP planning considerations associated with a buyback. For example:

Past service pension adjustment (PSPA) – Since your buyback generates a PSPA, which reduces your RRSP room in the same calendar year as the buyback occurs, review your RRSP contributions before committing to a buyback. You may need to pause further contributions until you have completed the buyback and received a new post-buyback RRSP Limit Statement from the Canada Revenue Agency (CRA), to help avoid overcontributing.[1,2]

Tax deductions – While "cash" used for pension buybacks can generally be claimed as a tax deduction, you cannot carry-forward any undeducted pension contributions to deduct them in future years as you can with RRSP contributions. In some cases, it may be better to contribute to your RRSP before transferring RRSPs to your pension for a buyback. Your advisor and tax professional can help review your payment options and personal circumstances, particularly for large buyback amounts.

For more detailed information about pensions and pension buybacks, consult your pension plan, a pension actuary and/or tax professional. For further information about investing for retirement and the products and services offered by Odlum Brown Financial Services Limited, please contact your Odlum Brown Investment Advisor or Portfolio Manager.

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Manager, Financial Planning and Education
Odlum Brown Financial Services Limited

[1] A past service pension adjustment, or PSPA, is calculated when buying back past pension service. If you don't ask the CRA to "certify" your PSPA before paying with non-registered funds, you risk incurring penalties and interest for excess RRSP contributions, risk having your buyback cancelled or having to request RRSP or RRIF Qualifying Withdrawals.

[2] When the CRA certifies your PSPA, it will permit you to have up to $8,000 of negative RRSP room resulting from the buyback, without requiring RRSP withdrawals. In such situations, you cannot make additional RRSP contributions until your RRSP room becomes positive.

[3] If you select a joint-life income option, some or all of the pension would continue to be paid to your spouse after your death.

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