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The CM Group Quarterly

March 20 is the first day of Spring and for many people in this part of the country, it cannot come soon enough. It has been a very cold and a very snowy winter here in Calgary and our typically reliable Chinooks have been few and far between. A far cry from the milder winter we had last year and a little colder than what we are used to, even on the prairies.

Yet, from year-to-year we all prepare for winter the same way, knowing there will be unbearable cold spells and some “nicer” days. We tend not to assume that forecasts made in October of nice weather in February will come to fruition, we brace for a bad winter and take advantage of the better ones. Snow tires go on the car, shovels and snow blowers are purchased and we make sure we are ready. Forecasts are often wrong and can quickly change, hence why we keep gloves in our pockets and winter boots by the door.

It sounds much like how we view investment portfolios and markets. We prepare for volatility and corrections, but we take advantage of gains that come with the markets. A forecast of mild weather doesn't mean we pack up our toques and mittens, just as a forecast of huge growth in one sector or asset class doesn't mean we run away from the conservative portions of the portfolio. No one wants to get caught in a sudden snow storm without the proper attire. We make sure we are prepared. In a portfolio that means we are well diversified, invested and disciplined. Bad weather and bad markets should be an inconvenience, it should not dictate our plans.

Whether it is a nice spring or an extended winter (In Calgary that could be in the same day), we make sure we are prepared, as we know how quickly the weather and markets can change.

“Predicting rain doesn't count. Building arks does” - Warren Buffett

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Nine Experts, Four Surprises, and One Million Dollar Bet

In 2017, we were again reminded of the importance of following an investment approach based on discipline and diversification vs. prediction and timing. As we gear up for the new year, we can look at several examples during 2017 that provide perspective on what guidance investors may want to follow, or not follow, in order to achieve the long-term return the capital markets offer.

NINE EXPERTS

Each January, a well-known financial publication invites a group of experienced investment professionals to New York for a lengthy roundtable discussion of the investment outlook for the year ahead. The nine panelists have spent their careers studying companies and poring over economic statistics to find the most rewarding investment opportunities around the globe.

Ahead of 2017, the authors of the publication's report were struck by the "remarkably cohesive consensus" among the members of the group, who often find much to disagree about. Not one pro expressed strong enthusiasm for US stocks in the year ahead, two expected returns to be negative for the year, and the most optimistic forecast was for a total return of 7%. They also found little to like in global markets, citing "gigantic geopolitical issues," including a Chinese "debt bubble" and a "crisis" in the Italian banking system.

The excerpts below summarizing the panel's outlook presented a less than optimistic view of the year ahead in January 2017.

"This could be the year when the movie runs backwards: Inflation awakens. Bond yields reboot. Stocks stumble. Active management rules. And we haven't even touched on the coming regime change in Washington."¹ The outcome of these predictions: Zero-for-four, although some might point out that at least they got the direction right regarding the inflation rate.

- Inflation barely budged, moving to 2.17% for the January-November 2017 period, up from 2.07% for the year in 2016.²
- The yield on the 10-year US Treasury note did not move up but instead slipped from 2.45% to 2.40%.
- Stocks moved broadly higher around the world, in some cases dramatically. Twenty out of 47 countries tracked by MSCI achieved total returns in excess of 30%.³
- According to Morningstar, the average large blend mutual fund underperformed the S&P 500 Index by 1.39 percentage points, and the average small company fund underperformed the S&P 600 Index by 1.35 percentage points.

The above-mentioned panel was no aberration. Among 15 prominent investment strategists polled by *USA TODAY*, the average prediction for US stocks for 2017 was 4.4%, while the most optimistic was 10.4%.⁴ Expert or not, there is little evidence that accurate predictions about future events, as well as how the market will react to those events, can be achieved on a consistent basis.

FOUR SURPRISES

- What do you get when you combine a tumultuous year for a new US president and divisive political trends in many global markets? Answer: a new record. For the first time since 1897, the total return for the US stock market (the CRSP 1-10 Index and, prior to 1926, the Dow Jones Industrial Average) was positive in every single month of the year. During the year, a great deal of media coverage was focused on markets at all-time highs, and some investors braced themselves for a sharp drop in stock prices. Not only did the much anticipated "correction" never occur, financial markets remained remarkably calm. Out of 254 trading days in 2017, the total return of the S&P 500 Index rose or fell over 1% only eight times. By comparison, in a more rambunctious year such as 1999, it did so 92 times.⁵
- North Korea issued threats of a nuclear missile strike throughout the year and boasted that even mainland US cities were vulnerable to its newest warheads. Next-door neighbor South Korea would seem to have the most to lose if such a catastrophe occurred, but Korean stocks were among the top performers in 2017, with a total return of 29.5% in local currency and 46.0% in US dollar terms.⁶

- To many experienced researchers, Chinese stocks appeared alarmingly vulnerable. A gloomy November 2016 article⁷ warned that “China’s debt addiction could lead to a financial crisis.” In the article, a prominent Wall Street strategist observed: “It’s scary that China seems to be continuing its debt binge to achieve its unrealistic growth targets.” And a global fund manager noted: “We are the most overweight China we have been since launching the fund five years ago.” The outcome: China was the third best-performing stock market in 2017 with a total return of 51.6% in local currency and 50.7% in US dollar terms.⁸
- The seven-year string of increasing US auto sales finally ended in 2017. Domestic sales fell 1.0% at Ford Motor, 1.3% at General Motors, and 10.7% at Fiat Chrysler.⁹ Anticipating the sales slump, a *Wall Street Journal* columnist warned investors in January 2017 to avoid the stocks.¹⁰ Good advice? Ford Motor had a total return of 8.7%, which was in fact below the 21.8% return of the S&P 500 Index. However, General Motors returned 22.5%, and Fiat Chrysler’s total return came in at an impressive 96.3%, even with more than a 10% drop in sales.¹¹

While some of these examples may seem counterintuitive, the above “surprises” from 2017 reinforce the challenge of drawing a direct link between positive or negative events in the world and positive or negative returns in the stock market.

THE MILLION DOLLAR BET

Last year saw the conclusion of a 10-year wager between Warren Buffett, chairman of Berkshire Hathaway Inc., and Ted Seides, a New York hedge fund consultant. Seides responded to a public challenge issued by Buffett in 2007 regarding the merits of hedge funds relative to low-cost passive vehicles. The two men agreed to bet \$1 million on the outcome of their respective investment strategies over the 10-year period from January 1, 2008, through December 31, 2017. Buffett selected the S&P 500 Index, Seides selected five hedge funds, and the stakes were earmarked for the winner’s preferred charity. The terms were revised midway through the period by converting the sum invested in bonds to Berkshire Hathaway shares, so the final amount is reported to be in excess of \$2.2 million.

The 10-year period included years of dramatic decline for the S&P 500 Index (-37.0% in 2008) as well as above-average gains (+32.4% in 2013), so there was ample opportunity for clever managers to attempt to outperform a buy-and-hold strategy through a successful timing strategy. For fans of hedge funds, however, the results were not encouraging. For the nine-year period from January 1, 2008, through December 31, 2016, the average of the five funds achieved a total return of 22.0% compared to 85.5% for the S&P 500 Index.¹² (Results for 2017 have not yet been reported.)

Having fallen far behind after nine years, Seides graciously conceded defeat in mid-2017. But he pointed out in a May 2017 *Bloomberg* article that in the first 14 months of the bet, the S&P 500 Index declined roughly 50% while his basket of hedge funds declined less than half as much. He suggested that many investors bailed out of their S&P 500-type strategies in 2008 and never participated in the recovery. Hedge fund participants, he argued, “stood a much better chance of staying the course.”

Seides makes a valid point—long run returns don’t matter if the strategy is abandoned along the way. And there is ample evidence that some mutual fund investors sold in late 2008 and missed out on substantial subsequent gains. But do hedge funds offer the best solution to this problem? We think educating investors about the unpredictability of capital market returns and the importance of appropriate asset allocation will likely prove more fruitful than paying fees to guess where markets are headed next. A hypothetical global diversified allocation of 60% equities and 40% fixed income¹³ still outperformed the hedge fund basket over the same nine years (56.6% vs. 22.0% in total returns).

Over any time period, some managers will outperform index-type strategies, although most research studies find that the number is no greater than we would expect by chance. Advocates of active management often claim that this evidence does not concern them, since superior managers can be identified in advance by conducting a thorough assessment of manager skills. But this 10-year challenge offers additional evidence that investors will most likely find such efforts fail to improve their investment experience.

EXPECT THE UNEXPECTED

Financial markets surprised many investors in 2017, but then again they have a long history of surprising investors. For example, from 1926-2017, the annualized return for the S&P 500 Index was 10.2%. But returns in any single year were seldom close to this figure. They fell in a range between 8% and 12% only six times in the last 92 years but experienced gains or losses greater than 20% 40 times (34 gains, six losses). Investors should appreciate that many times realized returns may be far different from expected returns. For a number of investors, 2017 was a paradox. The harder they

tried to enhance their results by paying close attention to current events, the more likely they failed to capture the rate of return the capital markets offered. New Year's resolution: Keep informed on current events as a responsible citizen. Let the capital markets decide where returns will be generated.

APPENDIX

Dimensional 60/40 Balanced Strategy Index

Rebalanced monthly. For illustrative purposes only. The balanced strategy index is not a recommendation for an actual allocation. All performance results are based on performance of indices with model/backtested asset allocations; the performance was achieved with the benefit of hindsight; it does not represent actual investment strategies, nor does it reflect fees associated with investing. Actual results may vary significantly. The underlying Dimensional indices of the balanced strategy index have been retrospectively calculated by Dimensional Fund Advisors LP and did not exist prior to their inception dates. Other periods selected may have different results, including losses. Backtested index performance is hypothetical, is not actual performance and is provided for informational purposes only. Backtested performance results assume the reinvestment of dividends and capital gains. Additional information is available upon request.

1. Lauren R. Rublin, "Stocks Could Post Limited Gains in 2017 as Yields Rise," *Barron's*, January 14, 2017.
2. Inflation data © 2018 and earlier, Morningstar. All rights reserved. Underlying data provided by Ibbotson Associates via Morningstar Direct.
3. As measured by the MSCI All Country World IMI Index (net dividends).
4. Adam Shell, "How Will Stocks Make Out in 2017?" *USA TODAY*, December 24, 2016.
5. S&P data © 2018 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.
6. As measured by the MSCI Korea IMI Index (net dividends). MSCI data © MSCI 2018, all rights reserved.
7. Jonathan R. Laing, "China's Debt Addiction Could Lead to Financial Crisis," *Barron's*, November 5, 2016.
8. As measured by the MSCI China IMI Index (net dividends). MSCI data © MSCI 2018, all rights reserved.
9. Neal E. Boudette, "Car Sales End a 7 Year Upswing, With More Challenges Ahead," *New York Times*, January 3, 2018.
10. Steven Russolillo, "Yellow Flag Waves Over Auto Stocks," *Wall Street Journal*, January 4, 2017.
11. Ford Motor, General Motors, and Fiat Chrysler returns provided by Bloomberg Finance LP.
12. Hedge fund data from Chairman's Letter, Berkshire Hathaway Inc. 2016 annual report.
13. Global diversified allocation is the Dimensional 60/40 Balanced Strategy Index. Indices cannot be invested into directly. See Appendix for index description. Past performance is no guarantee of future investment results

In USD.

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Past performance is no guarantee of future investment results. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Diversification does not eliminate the risk of market loss. There is no guarantee an investment strategy will be successful. Any specific stock reference is provided for illustrative purposes only and is not a recommendation of any specific security. All expressions of opinion are subject to change. These materials have been prepared by Dimensional Fund Advisors Canada ULC ("Dimensional Canada"). This information is provided for educational purposes only and should not be construed as investment advice or an offer of any security for sale. The information provided in this presentation has been compiled from sources believed to be reliable and current, but accuracy should be placed in the context of the underlying assumptions. Commissions, trailing commissions, management fees, and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. The annualized returns include reinvestment of all dividends or other distributions and do not take into account sales, redemption, distribution or optional charges or possible taxes payable by a security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated. To obtain further information regarding the Dimensional funds, please visit ca.dimensional.com. Dimensional Fund Advisors LP, an investment advisor registered with the US Securities and Exchange Commission, is the sub-advisor to the mutual funds managed by Dimensional Canada.

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The Benefits of Staying Invested

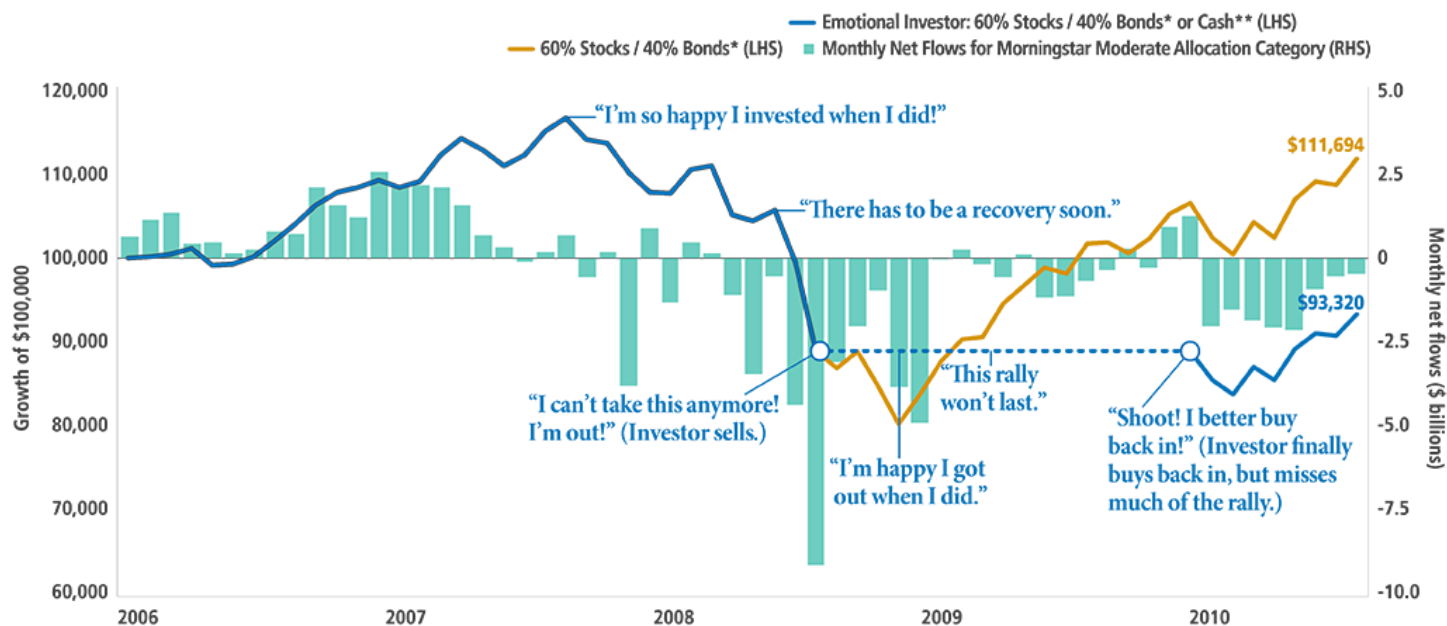
Investors are more likely to reach their long-term goals if they remain invested and avoid short-term decisions that may take them off course.

WHAT THIS CHART SHOWS

As this hypothetical example shows, investors may make suboptimal decisions when emotions take over, tending to buy out of excitement when the market is going up and sell out of fear when the market is falling. Markets do ultimately normalize, and when they do, those who stay invested may benefit more than those who don't.

WHAT IT MEANS FOR INVESTORS

To help reason prevail, first make sure you're comfortable with your allocation to riskier assets and that it makes sense in light of your time horizon. You also need a logical framework for financial decisions and a plan that anticipates periods of market turbulence. A systematic approach for reviewing portfolio results, with pre-established guidelines for selling, may help as well.



January 2006 to December 2010. Source: Morningstar, Bloomberg, PIMCO

Hypothetical example for illustrative purposes only. Not indicative of the past or future performance of any PIMCO product.

* Stocks are represented by S&P 500 Index. Bonds are represented by Barclays U.S. Aggregate Index. It is not possible to invest in an unmanaged index.

** These results are based on hypothetical modeling and are intended for illustrative purposes only. Emotional Investor is assumed to move to cash on 10/31/2008 and back to 60% Stocks / 40% Bonds on 04/30/2010.

Hypothetical and simulated examples have many inherent limitations and are generally prepared with the benefit of hindsight. There are frequently sharp differences between simulated results and the actual results. There are numerous factors related to the markets in general or the implementation of any specific investment strategy, which cannot be fully accounted for in the preparation of simulated results and all of which can adversely affect actual results. No guarantee is being made that the stated results will be achieved.

PIMCO

Five Essential Lifestyle Ingredients

To help you live a longer, healthier life.

by Pankaj Vij MD, Pankaj Vij, MD, FACP Internist, Medical Director, Medical Weight Management Program, Pleasanton, CA

Lights flashing and sirens blaring, the ambulance races toward the hospital. Inside the ambulance, Mary, a middle-aged woman, lies on a gurney, struggling with chest tightness, sweating, and dizziness.

Within an hour of her arrival at the hospital, Mary undergoes an angioplasty procedure: A wire is inserted into her occluded coronary artery, and then the artery is opened by inflating a small balloon inside. Finally, a “stent,” which resembles the small spring inside a ballpoint pen, is inserted in the proximal, left anterior descending (LAD) artery (one of the heart’s main arteries, a.k.a. the “widow-maker”), to prop it open permanently. Blood flow is restored to her heart. Several days later, she walks out of the hospital. The marvels of modern medicine have saved her life.

Though many catastrophic emergencies can now be treated with modern medical techniques, millions of people every year are still diagnosed with chronic diseases, such as diabetes, high blood pressure, heart disease, cancer, and stroke. And these diseases seem to be striking people at a younger and younger age. What is the cause of this epidemic? Do we simply need to have more ambulances and high-tech life-saving procedures? Or is there a deeper reason for this widespread problem? Why is it that the United States spends more money than any other nation on health care, yet it has the fattest, sickest population of any country in the world? Are we ignoring the root causes of chronic disease and simply trying to fix the problem by throwing money at it?

As I have pondered these questions, I have realized that many of my own relatives are in the same predicament as Mary. Even though most of them appear lean, with skinny faces, arms, and legs, they have visible belly fat – prominent bulges in their midsections – fitting the proverbial definition of “thin outside, fat inside” or TOFI, as it is commonly known.

At the same time, in my practice, I have observed that with just a little weight loss – as little as 7 percent of one’s starting weight, or only ten, twenty, or thirty pounds for many people – my patients’ need for blood pressure or diabetes medication can be drastically reduced. Even their heart-related symptoms can improve. As this occurs, they have a lot more fun and freedom. They can say yes to life’s wonderful adventures more often and participate and engage in activities with their children and grandchildren.

I have often thought: Instead of treating a dangerous condition resulting from chronic disease, what if we implemented proven lifestyle changes before the disease reached the critical stage?

When I first started to scour the research, I found mentors in Dr. Joel Fuhrman and Dr. Neal Barnard, who were already working with thousands of people and helping them reverse chronic diseases and regain their vitality. Other really smart colleagues like Dr. Michael Roizen and Dr. Mladen Golubic were getting amazing results, while pushing for change at a policy level. I am immensely grateful to all of them for guiding the way and influencing my thinking about the reversibility of most chronic disease.

Thus, I started to experiment in using lifestyle optimization as the primary treatment for chronic disease. The results have been astounding. When we shift the focus to correcting the lifestyle factors that lead to disease, we are essentially treating the root cause. At that point, we can start thinking about prescription medications and procedures as a supplement to the first priority, which is treating the causes.

What are the five essential lifestyle ingredients that can reverse disease and add years and years to your life?

1. Impeccable nutrition: Eat enough highly nutritious foods that are not calorie dense. This maximizes nutritional content while minimizing empty calories. The food that we need provides fuel as well as information and intelligence from the environment, and it needs to be as nutritionally complete as possible. It needs to be satisfying and delicious because it is our most primal need. We need to be mindful of the toxins from the environment and to choose foods that minimize these toxins.

2. Optimal hormone balance: Eat the right foods and avoid hormonally dangerous ones (like dairy and alcohol). At the same time, make good lifestyle choices in terms of physical activity, stress management, meditation, and sleep habits to maintain optimal hormone balance.

3. Regular exercise: Move your body with joy and abandon as it is meant to be moved. Find enjoyable physical activities. Exercise also has benefits in terms of brain health – memory and mood – as well as heart health, metabolic, bone, and muscle health. Do you want to know the secret to Turbo Metabolism in three words? Activate big muscles.

4. Stress management and quality sleep: This combination is the foundation of a healthy lifestyle and the most critical emotional-resilience component of this book’s strategy. Toxic load can also be caused by unmanaged repeated and prolonged psychosocial stress and lack of sleep. We need to be mindful of the importance of avoiding toxicity in our physical, psychological, and social environment as well.

5. Social connections: Loving, supportive relationships; meaning and purpose in life; and involvement in family and community can make a huge difference in health and longevity. Meaningful social connections help build *emotional resilience*, which is a foundation for healthy eating and active living.

When you start to master these five factors – of which nutritional excellence is the most important, lean muscle mass is the key, and emotional resilience is the foundation – you can improve your quality of life, reverse disease, and enhance your health.

*Source: Pankaj, Vij MD, Pankaj Vij, MD, FACP Internist, Medical Director, Medical Weight Management Program, Pleasanton, CA. Excerpted from the book Turbo Metabolism. Copyright ©2018 by Pankaj Vij, MD.
<https://www.thriveglobal.com/stories/22684-five-essential-lifestyle-ingredients>*

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