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Crypto Conundrum

Bitcoin presents a mystery, a technical challenge, and a threat, all combined into one messy assault on the status quo.

There were more than a few money managers who breathed a big sigh of relief back in 2018 when bitcoin crashed, losing a whopping 80% of its value in less than a year (Figure 1).

Bitcoin presents a mystery, a technical challenge, and a threat, all combined into one messy assault on the status quo. It may be a meaningful challenge to gold as a hedge against irresponsible central bankers, but Bitcoin is hard to understand, hard to trade, and quite volatile. So, when prices crashed, many, including this writer, were perhaps relieved they didn't have to think about it anymore.

But a few things have changed since 2018. First off, volatility has at least stabilized. (Figure 2). For an asset, making a claim to being a store of wealth, this could be key to its ascendency. It's still twice as volatile as gold and about as volatile as Tesla stock, but on an improving trend.

More importantly, Bitcoin has clearly become more mainstream. It's no longer just the plaything for hackers and libertarians. Bitcoin has gained, to varying degrees, some big-name adherents in recent months including the arch-skeptic Nouriel Roubini, Ray Dalio, Paul Tudor Jones and Stanley Druckenmiller. If these names are unfamiliar to you, rest assured their collective opinion could move billions of dollars in a heartbeat.

Figure 1: Bitcoin Prices in US Dollars

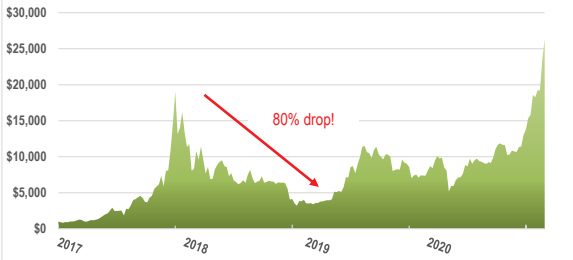

Figure 2: Bitcoin Volatility Steady in 2020

Bitcoin skeptics will retort, "But how do I spend bitcoins?" They have a point. Nerdy enthusiast may tell you that merchants such as Starbucks and Subway can take bitcoin, but just try it yourself. You won't get very far. The better defence is to grant that Bitcoin will never compete with paper and super-fast payment apps. So,while you might not ever be able to buy groceries with bitcoin, neither will anyone ever walk into a Sobeys with a gold coin and expect to get through checkout. Yet gold's place in our current financial system remains unimpeached.

		2020 Q4	12 Month Returns
S&P/TSX*	17433	8.1%	2.2%
S&P 500	3756	11.7%	16.3%
Dow Jones	30606	10.2%	7.2%
Nasdaq	12888	15.4%	43.6%
$CAD	$0.7853	4.6%	2.0%
Crude Oil	$48.52	18.6%	-33.1%
Gold	$1,898.4	0.7%	25.1%

**The S&P/TSX, the S&P500, the Dow Jones and Nasdaq indices are not investable indices, and as such are not a direct comparison to any investment product available at Foster & Associates Financial Services Inc, and therefore should therefore be considered hypothetical in nature and for illustrative purposes only.*

A more compelling concern is that Bitcoin, and cryptocurrencies generally, are the preferred means of exchange for money launderers, drug dealers and arms traffickers. How could our financial system ever be integrated with such a cesspool of criminality? This is a powerful criticism, especially for financial professionals like ourselves. We know first-hand that financial regulators will not rest if they see potential for the proceeds of crime making their way into the legitimate financial ecosystem.

However, the distributed ledger technology upon which Bitcoin transactions reside is not quite as opaque as once believed. In the past, criminals may have hidden behind Bitcoin to move their ill-gotten gains. But it now seems that criminals have been relying as much on the poor tech skills of authorities, as much as on the innate secrecy of the ledger itself, to cover their tracks.

Whatever ethical concerns remain, we may just have to live with them. In recent months PayPal (in the US, not Canada, sadly) has permitted conversions to bitcoin on their app, and Visa is now offering Bitcoin rewards points.

These behemoths may be simply copying the Airbnb and Uber ethos that it's better to ask for forgiveness than

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permission. But either way, they are giving Bitcoin an opportunity to start coursing more freely through our financial bloodstream. At some point it will be practically and politically impossible to be rid of it.

Directly buying digital currencies such as Bitcoin is a daunting task, requiring the consumer to familiarize themselves with cold wallets, hard wallets, paper wallets, crypto exchanges, forks, etc. Hard work, to be sure. This is one of the enduring ironies of Bitcoin. It may be a legitimate asset capable of offering investors protection against profligate central banks, but the very people who need it most (people with money, who are typically older) are the very ones who struggle the most with the technology.

Mercifully, there are some funds emerging now that allow investors to buy into pools of these cryptocurrencies, sparing them the worries of being hacked, losing their password, or burdening their estate with the unimaginable difficulty of getting bitcoins through probate.

This is still an emerging story and one that is still fraught with much risk. But now it's definitely a story that we can't ignore any longer – as much as we may want to.

Christopher Foster, CEO and Portfolio Manager

The 12-Month Market Outlook

Stocks (U.S.)	▲
Stocks (Canadian)	▲
Bonds (US)	▼
Bonds (Canadian)	▼
Canadian dollar	--
Crude Oil	--

This table represents the way the firm is leaning in particular market sectors over the next 12 months. It does not represent a trade recommendation, nor does it play a major role in our portfolio construction, which involves much more than having a view on a particular market index, currency or commodity.

Investing in Whole Life Insurance

According to Robert Kiyosaki, author of Rich Dad, Poor Dad, an asset is defined as something that puts money into your pocket, and a liability as something that takes money out of your pocket. This seems clear enough. But by this definition, is insurance an asset or a liability?

That depends. There are two types of Life insurance: Term and Permanent.

- Term insurance is definitely a liability. As long as you hold a term insurance policy, you pay premiums in exchange for a payout that you personally will not see.
- On the other hand, Whole Life insurance (one particular type of Permanent insurance) is definitely an asset. This is because such policies generate cash value, and over time the combination of the cash value and the death benefit grows. Key for investors, the growth in this value provides diversification and can powerfully complement traditional investment strategies.

Let me explain further:

Predictable rates of returns
A Whole Life insurance policy is a contract you have with an insurance underwriter, such as Manulife or Canada Life, where the expected returns of the policy are explained. Most importantly is that parts of this policy will have guaranteed returns, helping investors plan for their retirement or for their estate.

Stable
Behind each Whole Life insurance policy is an investment portfolio managed by the underwriter. But unlike a regular investment portfolio where returns can fluctuate dramatically, these portfolios have built-in stabilizers that ensure the risks are minimized. Additionally, by law, insurance underwriters must return a portion of their business profits to the policy holders.

Tax Free Growth
Canadians have very few tax-free or tax-deferred investment options available to them. Most investors know about RSPs, TFSAs and RESPs. Fewer investors are aware that money inside Whole Life policies also grows tax-free. Used properly, these policies can be structured as an additional source of tax-free retirement funds.

Simplified Wealth Transfer
In addition to tax-free growth, when the insured dies the entire value of the Whole Life contract is passed onto a named beneficiary totally tax-free. Even better, in very specific circumstances, the policy premiums can be paid by a corporation and the death benefits are paid to family members tax-free.

Whole Life insurance is not for everyone. Talk with your financial advisor to evaluate if this investment option is appropriate for you.

Howard Schwartz, MBA, CPA, CMA, Vice President, Wealth Management
Howard supports the Advisor Team at Foster & Associates to help customize insurance solutions for their clients.

Two Down, One to Go?

Briar Foster
is a retired Portfolio Manager and remains an active investor.

By most reckonings, 2020 created three major issues that required resolution.

The first was the need to navigate the US presidential election. While President Trump's campaign looked competitive for a couple weeks, the mail-in ballots of the urban voters finally gave Biden a substantial victory.

The second issue was conquering Covid-19. This also looks successful. The discovery and production of vaccines solves half of this problem. The other half is the distribution of vaccines and the inoculation of a sufficient number to enable a safe restart of the North American economy. This will require patience. We have heard much skepticism about how accepting Americans may be to a vaccine, but concern seems unwarranted. Being barred from travelling or attending school without proof of vaccination will surely be enough to get most Americans to roll up their sleeve.

The third issue is how Canada deals with the monstrous expansion of our federal and provincial debts. A federal budget deficit of $382 billion for the past year is uncharted territory for Canada, and it remains to be seen how many decades it will take for tax revenues to catch up to the ten months of Covid-19 expenditures. The post-Covid stimulation programs could easily worsen the situation.

Unfortunately, the Canadian dollar is not a world reserve currency, so Canada, unlike its neighbour to the south, must be more attuned to how much debt it carries. Will Canada suffer another credit rating reduction? Will the Conservative opposition be able to successfully paint Prime Minister Trudeau as a spendthrift who used the cover of Covid-19 to re-set Canada as a socialist paradise? If the answer is "Yes" to both questions, Canada could soon be facing a new government.

The great news for investors is that we probably have several years before the mounting deficits impede the running of government. The freshly minted Bank of Canada Governor, Tiff Macklem, has pledged "Interest rates will be very low for a long time." That apparently takes care of the possibility of rising short-term interest rates that would choke off the recovery and make the deficit-funding costs unsustainable. The problem of rising long-term interest rates has also been "solved" by the Bank of Canada in the form of weekly purchases of bonds, to the tune of about $4 billion per week.

Of course, this feels wrong. Having a central bank seemingly complicit in a prime minister's spending spree makes a farce of central bank independence. But these certainly are challenging times, so it just might work. Moreover, the job of investment professionals is not to adjudicate on what should occur, but to assess things clearly as they are.

Looking ahead for the next year or two, even as our nation staggers to the edge of fiscal ruin, Canadian investors are not without investment opportunities, especially in the financial services and resource sectors. Given that catastrophe has been averted, bank dividends will continue to increase. Communication utilities will benefit from 5G. Copper will remain in strong demand from China, the EV industry and heavy infrastructure program spending.

The price of gold may also start to rise again, from a revival of that old feeling that paper currencies are failing as a storehouse of value, especially when interest rates remain below the inflation rate.

And maybe, just maybe, aided by buoyant emerging economies, high levels of immigration, a robust recovery in the U.S. and a little bit of luck, Canada will grow its way out of this mess.

Our core beliefs

What defines the culture of a firm is what stays consistent no matter what's going on in markets. Politics, market trends, and the business cycle will cause us to think different about the way we invest our clients' money. However, there are a few things you can count on from us, through good markets and bad, through recessions and buoyant recoveries:

Asset Allocation is Key.

While some individual securities will do well, and some less well, most of what will make or break your portfolio over time is asset allocation. Of course, we all remember our great buys, and mourn our missteps, but the key to how well you do in the markets will come from how much you owned of various asset classes, and when you owned them.

We Love Canada.

But it's not where we want to put all your money. The Canadian stock market is heavy on banks and resource companies, making true diversification hard to achieve. Venturing abroad can improve returns and lower volatility. You'll also find companies where Canada isn't as strong, such as in consumer staples and biotechnology.

Alternatives aren't that Scary.

Sure, some hedge funds can be dangerous, but there's more to the Alternatives space than hedge funds. There's private debt, real estate, infrastructure and market-neutral funds, all of which can provide a place of refuge during periods of excessive market volatility.

Costs matter a Great Deal.

Over time, even small increases in costs can significantly lower returns. If you pay us to manage your money, we will pinch your pennies for you.

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