Net Worth Boom & Inflation

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Keith: Welcome to The Empowered Investor. My name is Keith Matthews, and I'm joined by my co-host Marcelo Taboada. Marcelo, how are you today?

Marcelo: Keith, I'm great. How are you?

Keith: I'm good, thank you. How's the start of the month of July going for you? Summer is upon us.

Marcelo: I'm doing lots of projects around the house. Enjoying the Habs making it to the Stanley Cup even though they're having a very tough time. But yeah, things are opening up and it feels good to see a lot of people and have gatherings. What about yourself? Have you been to any restaurants yet?

Keith: We've done one outdoor restaurant, and then I'm gearing up to do my annual summer canoe trip. We're driving about seven hours north of Montreal and we will be canoeing down 140 kilometers of whitewater. It will be spectacular.

Marcelo: That is an epic trip and like I told you last time, I'm trying to get on that trip so I'll just put it in the air here so we're on the record that you have to invite me at least once.

Keith: All right, that's a deal, that's a deal. My brother-in-law's organized this with a group of great guys for almost 25 years now and I've participated maybe seven or eight. This will be a great trip.

Marcelo: Yeah, it's amazing. So I'm sure you'll have a great time. So let's get into the meat here. I'm super pumped by this episode, by the way. I think it's two great subjects we had today, but let's get on with the Net Worth Report that came out a few weeks ago. Very interesting stuff.

Keith: Yeah, so today's show we're really going to talk about the expanding net worth of Canadians. What was driving that expansion in net worth? We'll report a couple of numbers with regards to how Canadians are doing relative to other global counterparts. And then in the second part of the show, we're going to switch gears a bit and discuss inflation. There's a lot of media coverage of inflation and let's provide a few comments on that. So Marcelo, let's start with net worth. We do client meetings. Now we're a year and a half past that started January 2020. How did the conversations go around net worth of clients? What are you seeing when we talk about net worth?

Marcelo: I think if I could boil it down in one word, it would be surprising. Obviously, we've lived through a pandemic and it's been a shock to the economy, but on the other hand, we've had a booming stock market and we had a booming real estate market in Canada. So I'm going into these meetings, obviously very happy that I can show these numbers to clients, but a lot of them are surprised to see how well they've done in both areas—in their investments and their homes. So it's definitely been an interesting time, especially when you think about where we were in March of 2020. Doing the annual reviews back then, like you forward to April of 2020, May 2020, people were worried and you fast forward to today and it's definitely been surprising for a lot of people, including us.

Keith: Absolutely. So what sort of net worth increases are you showing clients when you tally up the net worth and you sit down and you say, "Okay, about a year and a half ago you were here, and today you're here"? What does that look like?

Marcelo: Yeah. So anywhere between 15 and 20%, obviously that includes depending on how the person is invested. So we were looking at a 70/30 portfolio, 70% stocks and 30% bonds. And we were looking at an increase of about 14% from January of 2020 till June 30th of 2021. Now you add the real estate component there, that could be anywhere between 25 and 35% depending on what area they live in. And it ends up being around those numbers, a 15 to 20% increase.

Keith: Yeah. And I got to be honest, I've never seen that in my career going back, and you look at challenging economic times and then you fast forward 12 months and you see these spectacular growth numbers.

Marcelo: I mean, I think it's one of the few economic times where we've had an economic shock and this magnitude of an increase in the net worth of people. But I want to segue into the report that we both read that we read it. It was like, "Okay, let's do a show on it." Give me an update on the global numbers that we've seen.

Keith: Yeah. So the report was done by Credit Suisse. It was the 2021 Global Wealth Report and it's 12 years in the running now. So what they did was essentially go through all the countries and report the growth of wealth in 2020. And so the average net worth per adult in the world last year grew by 7.4%. So that's 2020, not 2021, 7.4%. And the average Canadian net worth per adult grew by 9.6%. So Canadians on average, their net worths grew more than their counterparts around the world.

Marcelo: That is incredible.

Keith: Yeah, it is. When you net out the US dollar, the growths are closer to 4.5 and 6.5. Again, incredible for a recessionary year. Now, as we'll discover, not everybody's net worth grows. Or grew last year. But what were the three main factors that the report spoke to that enabled this growth of wealth to occur?

Marcelo: I think the first one, everybody knows how much the governments have spent in this pandemic. So large amounts of government stimulus is the number one. Number two, you have falling interest rates. They're even lower than they were a few years ago, which they were already at a very low level. And then the surging in savings have pushed a lot of the assets level higher. So if you're a person who has a portfolio or has been able to save money during the pandemic because you were able to work from home, you've greatly benefited from this event.

Keith: Absolutely. To me, that's the area that people underestimated going into last year's pandemic was the surprising ability of technology to keep people working. Incredible. That's completely unexpected how well technology would be able to keep people working from home, keep people working from remote areas, keep companies going. And that, in addition to the other three areas that you spoke about, I think was really the underpinning of why we saw all this massive net worth growth.

Marcelo: I was listening to a podcast the other day, and I can't remember which one, but I'm not going to take credit for this, but they were interviewing an expert in working from home. And he was saying, "You have the pandemic happening in, let's say, the 1990s, and this wouldn't look completely different because you have a fully developed economy who doesn't have the infrastructure to operate from home as opposed to 2020 like we had just now." Which a lot of work, I experienced it myself, our jobs we can do 100% from home. I spent less on gas, less on restaurants. So you have all that salary still coming in and it's just accumulating. And we've seen, I can't even tell you, like a lot of the meetings I have with clients, it's "Okay, I have this amount in cash and like this amount in cash." And it's so common to see like this huge amounts of cash just being accumulated from not having this day-to-day activities.

Keith: Absolutely. One of the stats in this Credit Suisse report that I thought was very intriguing was they measured the growth of wealth of a country versus the decline of your economy.

Marcelo: Nice.

Keith: And Canada, whether we like it or not, ended up at the top along with Belgium and Singapore for a gap of 15%. It basically shows that we did extremely well even though our economy was doing extremely poorly. There's a bit of a disconnect there for many.

Marcelo: Canada, we know it's because of the real estate and also the stock market went higher. But did they say why Belgium and Singapore? I'm curious there.

Keith: No, you don't remember. Canadian stock market didn't do that well in 2020. It was the housing market that exploded. So it leads us into the question, like who in general benefited? Marcelo, we've got some stats here, mostly in the United States, but I think we can use that as a bit of a guide because I think we see similar things here in Canada. Whose net worth really benefited the most?

Marcelo: So the largest increase in net worth was in the top 20% of people who hold wealth in the United States. So again, it's who holds the capital and who holds the assets that have increased that ended up benefiting the most. You look at the bottom 20% and the increases, it's absolutely flat. It's like they didn't see a net worth increase at all.

Keith: Correct. And yeah, the top 20% in the US saw 65% of the gains. And essentially the top 40% saw virtually everything.

Marcelo: Which is normal, right? You look at the people who have the ability to have investments in the stock market and it's typically people in the top 20%. We've seen in the inequality numbers that a lot of people in the middle class, they barely can afford a home now, let alone a portfolio of stocks and this type of assets. So I think the numbers are very skewed, but I can't say I'm not surprised.

Keith: Absolutely. Yeah, you're right. And so let's focus on the two types of assets that really push these numbers. Let's focus on stocks and let's focus on real estate for a little bit. So Marcelo, stocks went up last year. Is that a normal thing in that kind of a year? We've got a chart that obviously shows the last five recessions and what was going on in the last five recessions, right?

Marcelo: So we don't always have a connection or movement in the same direction in the stock market and the economy. It can happen that the economy is doing amazing and the stock market could go down and vice versa. But it is fair to say that when we hit a recession and it's bad, we could see like a big downturn in stocks that we saw in the 2007-2009. So if you look at the last five, it's either a decline or a very small increase. Like in the 1990s, we had a small increase in stocks. The early 2000s, we saw the dot-com bubble that obviously stocks did really bad. Then 2007-2009 recession, stocks lost almost 40% when you look at the S&P 500. And now the COVID-19 crisis, the S&P 500 almost went up close to 30%.

Keith: Yeah, you're referring to a chart that we're looking at here, which essentially looks at the stock market, the S&P 500, one year after the recession. And what's striking is one year after the recession, the COVID-19 numbers are absolutely huge versus all the other recessions, which are either moderately up, down, or down a lot. And so this is one of the conversations we have with clients on a continual basis right now, which is what we're seeing in either stocks or homes is unprecedented given the environment that we lived through. There are reasons why now in hindsight it explains things, but this is an extraordinary time. There are some things that can happen which we'll speak to at the second part of today's episode. But moving into real estate now, Marcelo, Canadian real estate. We did a couple of shows three weeks ago, four weeks ago, where we had three different guests and we reviewed this lack of supply price increases. But we're looking at a chart right now called the bubble indicator and it was produced by Bloomberg. What does a bubble indicator say?

Marcelo: So it looks at the average price of the Canadian market or the real estate market and it looks at the prices of today's market and it looks at how inflated it is compared to that average median price for the previous year. So for example, if you had a price of 10 and that's your average price for the last few years and now you have a price of 30, just to throw an example, that's going to put you in a very high position in the chart. So they grouped all these countries together and they ranked them into which prices have increased the most compared to the average price. It's historical. So obviously Canada is number two in the list and New Zealand is number one, which I'm not surprised.

Keith: Yeah, that's amazing. What essentially it does is it shows relative values where we are today relative to the last 10 or 15 years. And it puts Canada at the second most expensive relative nation in the world. And it's not by a little, it's by a lot. Like New Zealand, Canada, and Sweden are way at the top of this list. And that speaks to the affordability issue, but it also speaks to what we're talking about today, which is the net worth. So you can see now why homes have gone up at the pace that they've gone up at. And even if we look at most recently the Teranet prices, which I did this morning, and our year-to-date numbers. So Jan 1st to June 30th of this year, year-to-date numbers on average are up about 8 or 9%.

Marcelo: Wow.

Keith: A 70/30 portfolio is up year-to-date about 11%. So a Canadian that owns real estate and a sort of a 70/30 mixed portfolio, net worth is up another 10% year-to-date. And these are extraordinarily high numbers. Now, in future episodes, we'll talk about expected returns because unfortunately, when you usually get some really strong numbers, you see all the positive baked into your current numbers. It typically means that lower returns are coming in the future.

Marcelo: It's funny. We have an asset projection financial planning software. It projects real estate prices growth at 2%. So it happens a lot during meetings that we're pulling up the numbers from the previous year and then projecting them to this year. It's "No, wait a second. That's not the value of my home," right? Like it's not worth 600. It's not worth like 750. You get a nice gauge of also not necessarily the hard numbers, but you get a nice gauge of even people are tracking the prices of their homes more closely because it's everywhere in the news.

Keith: One of the things that Canadians like to do is compare themselves to our neighbors south of the border. So we've got all the stats here for median house prices in the United States as well as Canada. So I'll ask you first, Marcelo, what's the median house price? So remember folks, median means that half are cheaper than this or lower than this number and the other half are higher than this number. So what's the median price of a home in the United States?

Marcelo: So the median price in the United States is $350,000.

Keith: So $350,000 US. What's the median price? Now we've got three numbers. He's in Canada. We've got a standard two-story home, we have a bungalow, and we have a condominium. What is the median price of a standard two-story home in Canada?

Marcelo: It's $894,000. So you can see the difference.

Keith: It is huge. It is huge.

Marcelo: Wow.

Keith: So that's, I just did the calculator, that's 2.55 times the average median price of a home in the United States. Actually, to be fair though, that also might include bungalows. So what's the average price of a bungalow in Canada, Marcelo?

Marcelo: It's $628,000 and a condo is $509,000.

Keith: We see it in our clients. All Canadians see this if they own real estate. These numbers have skyrocketed in the last 24 months. And there's lots of discussion as to is it sustainable? How do we make this more affordable for the next generation? Suffice it to say, let's different shows. We'll talk about that. In today's show, we really want to report on net worths and what impacted net worths and real estate is a huge component along with stocks.

Marcelo: Yeah. I think that's the main drivers, right? It's the stocks and the real estate.

Keith: As we transition into the second part of the show, Marcelo, one of the things that individuals speak to that possibly could derail some of this price appreciation or asset price appreciation is in the world of investing a four-letter word. And that word is inflation. So why are we now talking about this as we segue into the second part of today's episode?

Marcelo: First of all, it's been on the news a lot. To me, inflation is something that when I did economics in university, it's something that you talk about a lot. But I think for a recent generation, it hasn't been a topic that is important in their money lives because it hasn't been a problem or it hasn't been an issue. But now there's talk about having higher inflation for the first time in a long time. And you know, we were talking off mic about the inflation levels of the 1980s and even the early 2000s. And I think it's been the norm in the last 10-15 years that inflation is well below the 3% target that the Bank of Canada has. So now that it's threatening to go up to this level, I think a lot of people are realizing, you know what, maybe this has an impact. And it does because this is what affects the purchasing power of the goods you buy on a day-to-day basis. It's the food you buy, it's the gas you use, it's the prices you pay to travel, it's the materials you buy to renovate your home. And you look at the buzz now and a lot of people have felt it in their day-to-day lives. One of the things that I've asked my friends now going into restaurants is that they've realized that there's a huge price increase in everything. Whether it's a burger or a drink at a bar, everybody's telling me that the prices have increased. I've experienced it myself. I don't know about you, but pretty much that's the inflation story.

Keith: And the inflation story for sort of the individual 55 and over, who has a memory of either how they lived as a young adult or alternatively what their parents might've gone through in the seventies, that stirs emotions. Everybody's got an inflation story. When I was 16, 17, I owned a 67 Firebird, Marcelo. That was a hot rod back then in the day. And I remember gasoline was so expensive in the late seventies and I only had enough money to think about this. I would put $3 of gas in my car and that's all I could afford. And $3, I think $3 back then would get me like an eighth of a tank. So I was constantly running my car at less than a quarter of a tank just because I couldn't afford it. You're going week by week, throwing in a few bucks of gas. But that was a time of inflation in the eight, nine, 10%, and you had even 11%. You had short-term interest rates at 18, 19, 20%. So this is what is so incredibly, it stirs emotions. Now, we haven't seen those levels for 30, 40 years now, and no one is suggesting that's coming back. I think what the marketplace is talking about is if we've seen inflation at 2% for the last 20 years or last decade, two and a half percent, will it go to three and a half or 4%? And if it does, that's going to disrupt interest rates, it's going to disrupt asset prices, it's going to disrupt valuations on all sorts of different things. What do the experts think, Marcelo? You can't pick up a newspaper without reading an article about inflation. What are the experts thinking right now?

Marcelo: So I think there's two camps right now, Keith, but I think the consensus is running more towards the idea that this is temporary. And we're just experiencing like what we call quote-unquote bottlenecks in some areas. And what that means is that there's too much demand chasing very few supplies. In other words, there's way more demand in the market than there is supply. So I think if you look at the US, for example, the US, the inflation rate year to year went up 5% in May of 2021. Those are the latest numbers that we have. Now, if you look at the things that have been going up, it's gasoline. So that went up about 56.2%. Then used cars and trucks went up 29.7%. Utility gas service 13.5, transportation services 11.2, and apparel 5.6. So it seems like the things that have been going up are the things that tend to point out to a recovered economy and the economy opening up again. And what this causes in terms of a bottleneck is that you have all these people now going out into the economy and chasing all these goods. And if you don't have enough supply to meet this demand, you have a bottleneck in increasing prices. So this is one side of the theory that it's temporary. There's no reason to panic. Once the market figures out this dynamic between supply and demand and everything goes back to normal, quote-unquote, things will just go back to the way they were before. The other camp is on a more alarmist side saying that central banks are just setting up the table for higher inflation to come and staying here for longer. So I think those are the two camps that we're seeing now.

Keith: I think that's very well laid out, Marcelo. What about the inflation rate in Canada that came out higher than normal too? What did that do?

Marcelo: In Canada, Keith, the inflation rate as of May of 2021 for the one-year period was 3.6%. So again, you look at what went up and yeah, it's very similar to the US. So we got a lot of inflationary pressure in transportation costs. Gasoline prices saw an increase of 43.4%. And also we saw prices increasing the construction costs, as homeowners will tell you now. The price of wood and anything that's renovations and construction has been going up. So again, what we've seen go up is directly tied to the economy opening up again and people getting out of their houses and spending money and getting on with their day-to-day activities.

Keith: But incidentally, what has happened since those inflation numbers were released is the 10-year US Treasury, which is a gauge of the US bond market, has rallied from 170 basis points, so 1.7%, down to 1.45. And the rotation has moved away from value stocks towards growth stocks in the last month or two. And all this is primarily on the fact that people think that the Fed will raise rates and that will actually keep inflation in check. And that we will not see the level of inflation that people are worried about. And so that created investors to rush back and buy US Treasuries, which is exactly the opposite of what most people would think if they're worried about inflation. If they're worried about inflation, they say, "Oh my God, interest rates are going to move up." But the opposite occurred. And that's so telling because at this particular juncture, it seems like those that feel that inflation is temporary and that it will reduce back to much more reasonable levels are winning the battle, if you will.

Marcelo: Yeah. And we both read this article on the Globe and Mail on June 22nd based on the speech by Jerome Powell and where he indicated that interest rates may now go up in 2023 as opposed to 2024. But he also said that he is in the camp that inflation will be temporary. And he was just referring to if he had to raise interest rates, he would do it, but it's not a guarantee. And I think what I took from that article, and I think you would agree with me, Keith, is that if the smartest and brightest of economists at the Federal Reserve can't even agree on what the outlook is for inflation, I think it's safe to say that neither can we.

Keith: Yeah. No part of our investment approach is one that isn't trying to predict major movements of asset prices and the global trends because it's very hard to predict.

Marcelo: You think too, is that if one thing we've learned in the last 20 years in the field of economics is that the classical economic models were very static. They assumed that people were 100% rational. If behavioral economics has taught us something, it's that the psychology of people plays a bigger role.

Bigger role, that's a big word, but it plays a huge role into these dynamics as well. So yes, you have all these things that the central bank can do, but people's expectations and ideas of how the economy is going to do also play a bigger role into how the economy functions. So it's really hard to think how things will play out in the long term because you have all these factors moving in different directions.

Keith: Yeah. And you're absolutely right. And if I think of clients, contacts, friends, people that I know who might have an opinion on inflation, a lot of it is going to be based on their personal biases and what they're experiencing in their lives. So if they're a business owner that are dealing with certain types of materials and they're seeing massive spikes in prices because of supply chain disruption, their natural inclination is to expand that across the entire universe of how things will work with inflation and vice versa. I think inflation is one of these economic numbers that, although it's a stat, although it's a number, it is quite personal because people feel it in home prices, food, education, clothing, medical costs. And so it is a fascinating topic. And you're so right. When the US Federal Reserve has a series of well-renowned economists setting interest rate structure, that group cannot agree on whether they see inflation or not. So what are the implications, Marcelo, for portfolios?

Marcelo: That's a great question. And I think on bonds, obviously if you have high inflation and then that leads into higher interest rates, that is bad for the fixed income market because they're inversely related. So as interest rates go up, fixed income prices tend to go down. And when it comes to equities, I think there's no consensus. I think you can have good and you can have bad situations. I think we can agree that over the long term, the best inflation hedge or the one asset class that will do better than inflation is equities. But also you can have, for example, if you have a commodity or a consumer-based company that is able to transfer the price increases to the consumers, that could be good for that company. But on the other hand, if you have companies that are not able to do this and are facing other external factors like high import costs and the prices of goods that they need to produce the things that they sell, some of these companies may get hurt. So I think it's not a clear-cut implication for stocks, even though in the long term.

Keith: So short term is a bit nuanced and long term, I think it's safe to say that stocks are a good hedge for inflation. I don't know if you agree with me.

Marcelo: Yeah, I think the general consensus would be stocks, real estate, commodities tend to do well with inflation. Mind you, there's some great articles right now that speak to this idea of the biggest threat to the Canadian real estate market is interest rate. And if we see spikes of inflation, that will have an impact. Again, the jury's out, as we mentioned, in terms of most people still feel that it's short term in nature and that we will migrate back to more reasonable levels. Time will tell. So what are the general takeaways, Marcelo, general portfolio takeaways that you want to share with our listeners?

Marcelo: So I think the number one is, and I think the biggest one for me in this scenario is because you know that things are very hard to predict, the best thing to do is to diversify. You want to be exposed to a situation where you can benefit from both scenarios. So you know what, if inflation goes up and stays longer, your portfolio will have exposure to areas where your portfolio will do well. And if inflation does just, it's temporary and goes down to their normal state, you want to be also exposed in things that will help you in this scenario. So the thing with diversification is, and we've said this before in the past, is that you're going to have things in your portfolio that you love and you're going to have things that you hate at the moment, but over the long term it will help you. And it'll make sense.

Keith: Yeah, that's outstanding. I think that's fantastic suggestions and ways to think about portfolio. The only thing I would add to this conversation is that we've seen some pretty massive price increases in real estate and equities. And typically when that happens, we have to prepare ourselves for lower returns in the future. So to me, the message is always keep your expectations reasonable. Understand that we've been well rewarded if you own those assets and that you can't be extremely well rewarded all the time. And so we have ups and downs. Stay disciplined, stay the course, and continue to do the right things. So with that, Marcelo, thanks so much for all your comments on net worth appreciation, levels of homes, real estate, and our end discussion on inflation.

Marcelo: Yep. This is a great show. I think people will appreciate it because it's relevant to their lives and to what's going on now. And yeah, we'll see you next show.

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