The Tinnerman Wealth Brief

Winter 2016

The month of December, the fourth quarter, and, indeed, the entire 2015 calendar year were times to forget for many investors as the red ink flowed in global equity markets. Looking back, the results were remarkably similar to what we saw in 2011 when the S&P 500 produced a flat result, but the U.S. was still "the winner" because the other key markets turned in significantly negative performances. Now, as then, Canadian equities suffered with the S&P/TSX Composite Index returning -8.32% for the 2015 year. Equities were not the only investments that had a tough year, and many bond investors discovered that there can be a nasty side effect associated with "reaching for yield" by buying junk debt and other low quality issues – big capital losses.

Against this challenging backdrop, we at the Tinnerman Wealth Group are pleased to be able to report our client families had another good year in 2015, but we must (as always) note that we do not provide summary performance results in our quarterly letters as our investment portfolios are unique to the goals and objectives of each of our client families – unlike mutual funds and pooled funds which employ a "one size fits all" approach. In this regard, we ask that you please take a moment to review your account statements (or give us a call) for your actual portfolio results.

Although we are pleased that clients of the Tinnerman Wealth Group had a good year, we actually put very little stock in such short-term investment results for either ourselves or anyone else. In this regard, five years is typically considered the minimum period required to evaluate portfolio managers and their performance track-record; but, in our view, ten years is probably a more appropriate yardstick for today. This is because the investment industry has benefitted from the direct support of central bankers who have used monetary policy – money printing and zero rates – to support the prices of financial assets since 2008. On numerous occasions, our quarterly letters have expressed our concern that these "crisis policies" could have unforeseen negative consequences, especially what might happen when portfolio managers (and individual investors alike) no longer have "the wind of monetary policy" at their backs. Given what has transpired in the past few months, it appears that we may soon find out.

After many years of co-ordination on economic policy, the global picture has now changed dramatically, as the world's two biggest economies – the U.S. and China – appear to be pursuing their own unique agendas. Probably the biggest development came in December when the U.S. broke ranks with other

Let's connect

Mark Tinnerman
Portfolio Manager,
Senior Vice President
mark.tinnerman@nbpcd.com

Jonathan Lin
Wealth Advisor,
Financial Planner
jonathan1.lin@nbpcd.com

Tamara Uptigrove
Investment Advisor,
Portfolio Manager
tamara.uptigrove@nbpcd.com

Natasha Rose
Sales Assistant
natasha.rose@nbpcd.com

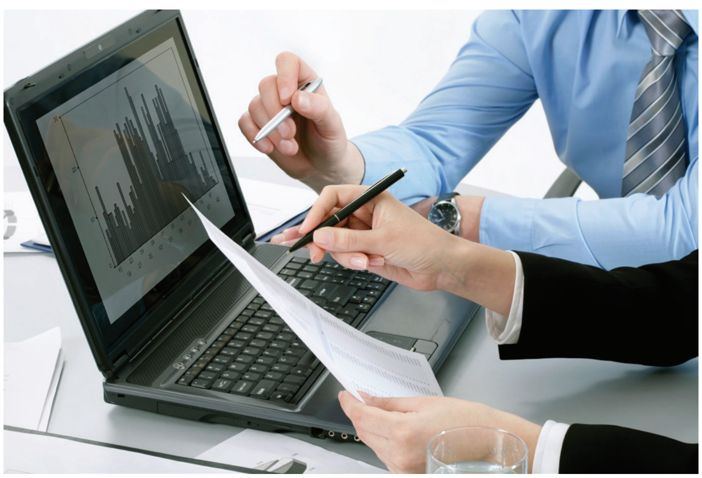
Tel: 416-359-4803
Toll Free: 1-866-210-5204
Fax: 416-359-6519
tinnermanwealthgroup.com

Continued

nations and the Federal Reserve increased its overnight lending rate, albeit after four years of warning that rates would rise. It may have only been a ¼ of one percent, but the rate increase reflects the American economy is on the mend. The U.S. dollar is strong, the country is close to full employment, wages are starting to rise, and household debt has fallen dramatically. The economic picture is much bleaker for most other countries in the world, including Canada.

The unfortunate reality is that the economic situation in Canada stands in stark contrast to that in the States.

Although our two economies are closely linked, the unfortunate reality is that the economic situation in Canada stands in stark contrast to that in the States. Employment looks weak in tandem with the rout in the energy sector, which has seen oil (WTI) fall below $28.00 USD per barrel. The Canadian dollar has continued to weaken such that it now takes $1.46 Canadian to buy one U.S. dollar before bank charges. Household debt levels have set a string of new records such that Canada is now the most indebted of the Group of Seven nations. Income taxes have been increased at both the Provincial and Federal levels, even as the Federal government is fast-tracking the roll out of its deficit funded spending programs. Not a pretty picture, but we have seen this movie before – in the 1980s.



There appears, however, to be something on the horizon that we have not seen before, which comes courtesy of the Bank of Canada and its Governor, Stephen Poloz. Poloz has mused publicly several times in the past two months that negative interest rates might be of benefit to the Canadian economy. When you have the Bank of Canada talking about the shocking possibility that they might "help the country" by expropriating cash from retirees and the fiscally prudent, you know that the financial world is a risky place!

But the world has always been a risky place, and what ultimately does transpire in Canada and the U.S. remains to be seen – economists are notoriously inaccurate in their predictions as evidenced by the fact that no-one saw the "financial crisis" coming. While we follow and often discuss macro-economic issues, we in the Tinnerman Wealth Group are agnostic about these types of issues. When it comes to portfolio management, our belief is that financial success comes with being very selective, having in depth knowledge about each individual investment, and from being careful about price. As we have discussed in our letters of the past four years, our primary focus is on finding and making informed investments in "better businesses". We pride ourselves on doing the hard work needed to find these companies which have: (i) simple and easy to understand business models; (ii) strong balance sheets; (iii) predictable, sustainable revenues and attractive dividends; (iv) proven abilities to generate above average returns over the long term; and (v) can be purchased at prices that provide margins of safety.

Our interest in doing our own research is not as widely shared in the investment industry as it once was, despite the fact that investors today have access to virtually unlimited amounts of financial information through the internet. Financial knowledge seems to be eroding primarily because the money printing and zero interest rate policies of central bankers pushed all asset prices higher regardless of asset class or investment quality. Investors have been "taught" a dangerous lesson, which is that there is no benefit to doing research and the trend today is towards buying pooled funds and ETFs which mimic indices, sectors, commodity baskets, etc. The fact that these pooled vehicles are popular is not a surprise to us because they are quick and easy to buy, they do not require much knowledge on the part of investors, the investments that these vehicles make are not selective (e.g. they buy the whole index), and they are not price aware (e.g. they are always fully invested). The combination makes for a compelling story when markets are rising, but the situation is different when market conditions become difficult or the rules change, as occurred when the U.S. Federal Reserve raised interest rates last month.

In response to the recent market turmoil, most commentators are advising that investors should not panic. We fully agree that staying invested and buying when asset prices correct is important for achieving long term financial success, but we have one critical caveat to following such advice. This caveat is that investors and/or industry professionals must be extremely knowledgeable about the investments they own. Knowledge is of the greatest importance when markets become difficult because investors with insufficient knowledge are at risk in two ways. The first risk is that they take a loss and miss out on some future recovery because they panic and sell good investments due to a lack of conviction which comes with a lack of knowledge. The second (and more damaging) risk is that they take a huge loss because they do not sell lousy investments due to strong convictions that are not based on knowledge. Over the

past few months, the markets have demonstrated these risks as the shares of good quality companies have held their value while those of lesser quality companies have plunged.

In thinking about the foregoing, the old expression knowledge is power came to mind. Everyone knows this saying, but we doubt that many people know either its roots or its full meaning. The saying is more than 1300 years old and has Islamic origins with the full text being as follows:

> *Knowledge is power and it can command obedience. A man of knowledge during his lifetime can make people obey and follow him and he is praised and venerated after his death. Remember that knowledge is a ruler and wealth is its subject.*

It is quite a profound saying and the final line really gives one pause for thought – Warren Buffett could not have better articulated the relationship between knowledge and wealth.

As we enter our 30th year in the investment industry, we can say with confidence and humility that our approach to wealth management has served our client families well. And while we do not expect that our efforts will produce the good results we saw in 2015 every year, we do expect that our focus on making knowledgeable and disciplined investments in better businesses will help our client families achieve their wealth management objectives. With this in mind, please do not hesitate to give this letter to anyone in your circle of family and friends that you think might benefit from our perspectives on investing and/or our wealth management services.

Sincerely,

Mark Tinnerman

Mark Tinnerman
Portfolio Manager

BMO Wealth Management
BMO Nesbitt Burns

Tinnerman Wealth Group

**Both Associate Portfolio Managers and Portfolio Managers can offer the BMO Nesbitt Burns Managed Portfolio Account to clients. For simplicity, we have used the term "Portfolio Manager". Bank of Montreal or its affiliates may act as a lender or provide other services to certain of the corporations mentioned herein and may receive remuneration for the same.*