2016 First Quarter Summary

The purpose of this summary is to provide you with a brief overview of the markets globally as well as highlight activities within our portfolios during the first quarter of 2016.

Economy and Market Overview

The best description of the first quarter of 2016 is volatile, and this applies to almost all asset classes globally. At this time last year, Oil and the Canadian dollar had suffered precipitous losses, while this year Brent crude and the Canadian dollar both have rallied more than 6 % .As well, gold staged a solid rally of more than 16%.Many commodities have experienced decent rallies resulting in commodity sensitive economies including Canada, Russia, and Brazil producing positive year to date stock market performance of 4%, 11%, and 7% respectively (excluding dividends).

Despite this positive performance, it has been anything but a straight upwards line. In fact, during the first quarter, the TSX/S&P Index, the S&P 500, and the Nasdaq Composite all temporarily declined at least 9% each.

While the U.S raised interest rates for the first time in 8 years in December 2015, other central banks including European Central Bank and The Bank of Japan continue their version of Quantitative Easing (Q.E). QE is the open market purchase of longer maturity bonds to artificially keep interest rates low, thus encouraging borrowers to borrow and invest**.** To further promote investment, many central banks have introduced “negative” interest rates whereby depositors must pay the central bank interest to keep their funds on deposit. These actions have resulted in negative bond yields in a number of countries including Germany, Sweden and Switzerland. The Governor of the Bank of Canada, Stephen Poloz, has stated that negative interest rates would only be implemented in Canada in “an emergency”. Clearly, the negative interest rate strategy illustrates the concern many global Central Banks have for minor GDP growth, and a fear of deflation.

Currently, Canadian Gross Domestic Product (GDP) growth is near zero, while U.S GDP is approximately 1%. In addition, reported corporate pre-tax earnings in the U.S. have contracted by approximately 5% in each of the past two quarters, so it is not surprising that stock prices have struggled during the past year, and in the last quarter.

Portfolio Overview

The TSX/S&P index and the S&P have both rallied approximately13% since their lows in the first quarter. In fact the S&P 500 is now only off about 4% from its all-time highs. With the recent strength, we are asked regularly if the recent downturn was a short term correction, or the beginning of a more serious bear market. A bear market is defined as a correction of 20% or more from the previous peak. With the S&P 500 off slightly more than 3% from its high, it is easy to conclude the most recent declines last fall and this year are simply “corrections” and not a bear market. However, almost half of all common stocks in the U.S are already down 20% or more. The strength in the large companies of the S&P 500 index is masking the broad weakness of stocks overall in the U.S.

Our portfolios remain in the most defensive position possible, and have been since August 2015. With lower interest rates, globally and in Canada, we have seen improved demand in certain sectors including Real Estate Investment Trusts (REITS) and utilities. As a result we anticipate modestly increasing our exposure to the REIT sector in the near future.

The first quarter in Canada has brought a very significant change in leadership in our stock portfolios. Just three months ago, the Canadian market was being led by defensive companies such as Sunlife Financial and Rogers Communications. Today, the leadership is almost completely mining, minerals and gold stocks. The last time we saw similar activity was at the beginning of the 2009 bull market. Whether this activity indicates the worst is behind us for the Canadian market is unknowable, but this recent activity is encouraging.

In the U.S we are seeing a substantial, but less noticeable shift in leadership. At the end of 2015, the FANG (Facebook, Amazon, Netflix, Google) stocks were making headlines almost daily. Since then, demand for high growth stocks has waned somewhat, while slower growth value oriented companies such as Mattel and Raytheon have prevailed. These shifts are a reflection of institutional investors repositioning their portfolios to a much more defensive stance and away from many of the previous market leading high growth companies.

These changes in leadership are also reflected in the portfolio turnover. When leadership in the markets change, the portfolios experience an above average number of buys and sells. This has certainly been the case in the portfolios during the first quarter.

The markets are a discounting machine, meaning the markets generally anticipate changes in the economy 6 to 9 months in advance of the actual reported changes in economic growth. Many of the global stock markets including Canada peaked in April of 2015, yet it has only been in the last quarter or two that slowing economic growth has become evident. How long this contraction lasts can’t be known. However, the markets will also anticipate the next economic expansion. Stocks will begin to rise, with strong demand, despite the poor economic news. For most individual investors this strength is most often met with extreme scepticism, yet this is often the greatest opportunity for significant growth.

With an abundance of bonds and cash, we continue to be positioned defensively (see chart).However, we are also well positioned to take advantage of the next inevitable change in sustainable demand which we believe will arrive sometime in 2016.

As always, please call us if you have any specific questions regarding this summary or your portfolio.

Sincerely,

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1. XIC ETF total return, SPY ETF total return in $U.S

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