2015 Fourth Quarter Summary

Welcome to our first summary of 2016. To begin, we would like to wish you all a Happy New Year and thank you for the opportunity to assist you in realizing your financial goals and dreams. We are especially grateful for the trust you have placed with our team and hope that 2016 will provide you with health, happiness and financial success.

This summary will be broken into four segments including an overview of our process and the markets, as well as a portfolio overview and our 2016 Forecast.

Process Overview

As a brief review, it has been almost 30 years since I began my career with Burns Fry Ltd., which was subsequently purchased by the Bank of Montreal. For the first 20 years of my career our team employed the traditional investment approach of owning a diversified portfolio of stocks, bonds and mutual funds. We held these investments through bull and bear markets alike. It is a successful strategy, but only if an investor can handle the significant swings in the annual value of their portfolio.

The last two bear markets of 2000-03 and 2007-09 each saw peak to trough (top to bottom) declines of more than 50%. Studies in investor behavior illustrate that this sort of volatility often causes investors to alter their behavior regardless of any financial plan, and as a result, make very poor decisions that permanently hinder their financial success. While ongoing education can help reduce the impact of this destructive behavior, human emotional behavior is nearly impossible to change in periods of stress and uncertainty.

Ten years ago we began to develop a process that would help minimize emotional investor behavior. Our portfolio goals were to provide our investors with an investment process that was systematic and tactical, but also helped reduce a portfolio's downside volatility. While we initially employed a strategy using exclusively Exchange Trades Funds (ETFs), we have made a number of enhancements over the past 5 years using individual securities in Canada and the USA.

Most investors have a definite domestic bias in their investor behavior. This means that investors tend to invest domestically because they know and are comfortable investing in names of companies they use or see daily. Our secondary goal was to build global portfolios that minimized the damage of a bias towards domestic investing. Canada represents just 3% of the total global stock market capitalization, and this type of investor behavior can severely handicap an investor's returns. Proof of this is best illustrated by comparing the previous 5 year returns of the major Canadian stock market (TSX/S&P) compared to the major U.S. stock market (S&P 500). The returns were 2.2% vs 12.4% respectively per year. (1)

Many individual investors continue to invest primarily in two asset classes – stocks and bonds. When examining leading pension funds, these institutions often invest in a variety of asset classes beyond stocks and bonds. Doing so provides greater diversification, reduces downside volatility, and enhances returns over time. To provide our clients with these benefits, we expanded our stable of available investment assets to include Canadian, U.S and International stocks, bonds and preferred shares, cash, commodities, currencies, and real estate.

The price of any asset (i.e. stocks, bonds, oil, orange juice, etc.) is determined by the universal law of supply and demand. If demand exceeds supply, prices will rise and vice versa. We determine our portfolio constituents using this straightforward law. Assets displaying the greatest demand garner the greatest weighting within the portfolio, while the weakest garner little to no exposure. Over time, demand and supply will shift for each asset class, and when it does, we adjust the portfolios accordingly.

Market Overview

The collapse of commodity prices has had a significant impact globally, especially in Canada. Brent crude oil prices declined 35%, which helped send the Canadian economy into a recession, and the Canadian dollar into a tailspin declining 16% in 2015. The TSX/S&P total return index (including dividends) had negative returns for the first time since 2011, declining almost 9%. Other commodity heavy stock markets including Brazil and Russia, suffered as well declining 13% and 4% respectively. Many of the world's economically sensitive commodities saw significant declines. Standouts include natural gas, nickel and zinc which declined 33%, 42% and 27% respectively.

The European Central Bank (ECB) reiterated their stance of "doing whatever it takes" to try to stimulate the economies of European Union. Quantitative easing (i.e. purchasing long dated bonds) continues, resulting in favourable returns of 10% and 3% for the German Dax and the main European stock (DJ Euro Stoxx) Index.

In Asia, the Japanese central bank is following a similar easing playbook, which resulted in a modest loss of 3% for the Nikkei Index. Growth in China has continued to slow. As a result, the Peoples Bank of China (PBoC) cut interest rates numerous times and devalued their currency, the Yuan. The Shanghai Composite Index experienced significant volatility in 2015, dropping from its peak by 36%, yet finishing the year with a gain of 6%. To bring stability to their market, the PBoC embarked on their version of 'quantitative easing' by purchasing shares in the open market.

In the U.S., markets were generally flat, with the exception of the NASDAQ market which gained 6%. Federal Reserve Chair Janet Yellen finally raised interest rates by 0.25%, the first interest rate increase since 2006. However, interest rates globally continued to be under pressure, with many countries including Canada, South Korea and Russia cutting interest rates.

Portfolio Overview

We utilize a variety of asset classes in our Global Growth, Balanced and Income portfolios. The actual percentage of the portfolio allocated to each asset class changes throughout the year depending on the relative demand and supply of each asset class. As you would expect, not all asset classes produced positive returns for the year.

Asset Class	Growth Portfolio Weight %	Balanced Portfolio Weight %	Income Portfolio Weight %	2015 Result (Before fees)
US Stock Portfolio (US$)	20%	15%	10%	6.9%
Canadian Stock Portfolio	20%	15%	10%	-2.2%
Rotation Portfolio	30%	30%	14%	4.8%
Bond and Preferred Shares ETFs	22%	32%	62%	-3.4%
Managed Futures ETF (US$)	4%	4%	2%	-0.7%
Commodity ETF	4%	4%	2%	-3.2%
Total	100%	100%	100%	

We are pleased with the stock performance of our portfolios in 2015. In Canada, the TSX/S&P total return index declined almost 9%, while our Canadian stock component significantly outperformed declining by 2%. In the U.S, the benchmark S&P 500 total return index advanced 1% (US$), while our portfolio's U.S. stock component also outperformed, advancing almost 7% (US$).

The rotation component of the portfolio also performed well advancing almost 5%. This is due to having minimal exposure to stocks globally throughout the last half of the year.

The 'alternative' asset class which included Managed Futures and Commodities produced positive returns thanks primarily to the advance of the U.S. dollar. In Canadian dollar terms, Managed Futures and commodities both declined.

The fixed income component includes bonds and preferred shares. This asset class performed relatively poorly due to our investments in preferred shares. After the surprise rate cut by the Bank of Canada in early 2015, the preferred market in Canada sold off significantly. With ongoing weakness in the Canadian economy, and the possibility of further rate cuts in Canada, we have exited the preferred market and will reconsider if demand significantly improves.

2016 Forecast

In 2015, few predicted another further 35% decline in Brent Crude, and even fewer predicted the 16% decline Canadian dollar, so we place little value in year end forecasts. We would rather look at the current market conditions and offer our perspective of what we currently see.

A number of countries including Germany and Japan experienced relatively good performance with positive returns in 2015. However, many others produced negative returns.

The definition of a bear market is when a market has fallen by more than 20% from its annual peak. While the U.S. markets are barely off their 2015 peaks, many markets including China, Brazil and Russia are currently in bear markets. Many others are approaching bear markets, including Canada which has declined 16% from its 2015 high.

The U.S. market represents approximately 40% of the world’s stock market capitalization, so it is an important component. In 2015, both the S&P 500 and the Dow Jones Industrial Average declined 1% and 2% respectively, while the Nasdaq gained 6%. On the surface, these results are not newsworthy. However, below the surface, a noteworthy story is being told.

In mid-December, the following update was sent to our clients;

The Nasdaq, S&P, and the NYSE indices are made up of mostly very large American companies. However, there are thousands of small and medium sized companies in the US that don’t garner the attention of the media when reporting stock market results. Currently, small and medium sized companies are seeing weakening demand, and increased supply. In fact, more than half of all small companies are already down more than 20% from their peak, while more than a third of medium sized companies are down by more than 20%. Big companies, which have carried the popular indices higher, only have approximately 20% of their constituents down more than 20%, but this figure has been steadily increasing over the last 6 months.

The weakness in the broad U.S. market has persisted through year end. A large portion of U.S. and Canadian stocks are already in a bear market. We see two possible scenarios in the year ahead. First, the damage in the markets has been done, and we begin to see increased and significant improvement in demand for all stocks – small medium and large alike. Without significant new demand, scenario two is likely.

Scenario two involves increased selling across all stock market sectors especially amongst the remaining leaders. Recall typical top to bottom moves for stock indices in bears markets is often 30%, while the last two bear markets experienced declines of 50%. The TSX is 16% off its peak, while the S&P 500 and the Nasdaq markets are off just 6% and 4% respectively. If the future is similar to the past bear markets, increased and potentially significant downside volatility should not be ruled out.

Our multi asset portfolios currently own the minimum allowable percentage of stocks. We significantly reduced our stock exposure in August 2015 as demand for stocks relative to other choice began to significantly weaken. We plan to maintain this defensive stance until we see a broad based improvement in demand. When this occurs, and it eventually will, we will increase our exposure to stocks once again. Until then, we will wait patiently with the knowledge that our portfolios have substantially reduced exposure to stocks.

We look forward to helping you achieve your goals and dreams in 2016. If you have any questions regarding this summary, or your investment portfolio, please call us.

Sincerely,

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