Ferrie Petruccelli Wealth Management Group

BMO Nesbitt Burns

2017 Fourth Quarter and Year End Summary

Happy New Year. We wish you continued health and prosperity throughout 2018.

This summary will be broken down into three segments including a review of our investment process, an overview of the markets globally and our portfolios during 2017.

Process Overview

2017 was one of the least volatile stock markets results in history. In fact, during the past year the S&P 500 did not experience a correction of 3% even once. With the US market moving steadily upwards, it is easy for investors to forget that markets are normally volatile, and sometimes violently so.

The great financial crisis of 2008 is now a distant memory for most investors as the global stock markets have now enjoyed one of the longest bull markets since 1900. The current bull market which began in March 2009 is now 104 months in duration, while the average since 1900 is approximately 41 months. Given this extended bull market it is easy to forget the peak to trough 50% market declines during 2000-2003 and 2007-2009. The average bear market decline is approximately 30%.

Can we expect another nine years of this current bull market? Probably not. One key to successful long term investing is to minimize portfolio losses during bear markets, which also helps to reduce anxiety and poor investment behavior.

To help minimize this behavior we created a number of global portfolios that adapt to changing market conditions, as well as utilize a variety of assets classes beyond traditional stocks and bonds. Global exposure is important as it provides opportunities beyond Canada's borders. Canada represents just 3% of the world stock markets market capitalization, and has produced approximately 1/3 of the returns of the S&P 500 in Canadian dollars during the past five years.

Our process focuses on the universal law of supply and demand. Assets with demand exceeding supply will rise in value, and will fall when supply exceeds demand. As demand and supply is constantly changing our process measures these changes and adjusts the portfolios accordingly.

The process works exceptionally well over time. It works best when there are long term trends occurring within the various markets. However, it is less effective when the markets rotate from one asset to another, or during choppy or trendless markets.

The goal of the process is to minimize the portfolios downside volatility, while aiming to capture most of the upside returns.

Market Overview

It was a quiet end to the year for North American stocks, as the Santa Claus Rally failed to pad investors' portfolios following the Christmas holiday. However, a soft end to 2017 wasn't enough to dent an otherwise stellar year for securities and speculators more generally.

Canadian stocks underperformed their Wall Street and global counterparts for 2017. Although the outlook remains somewhat mixed, the bottoming of the oil-price collapse combined with a stronger economy could provide a catalyst for the slow-moving TSX.

The major U.S. stock averages returned between 18% and 25% over the course of 2017. That included 71 record highs for the Dow Jones Industrial Average.[1] It was also the first time ever that the Dow reached four 1,000-point milestones in a year.[2]

The so-called Trump reflation trade largely sustained the equities surge, with investors rallying behind a cocktail of pro-growth policies designed to revamp the domestic economy. Along the way, markets benefitted from strong corporate earnings and signs of a rebounding global economy.

Domestically, the economy produced its fastest six-month expansion in three years. This included back-to-back quarters of at least 3% growth.[3] The growth, which was largely guided by stronger business investment, defied weather-related disruptions in the Gulf of Mexico and Florida peninsula during late summer.

Despite a slow end to 2017, the bulls have regained control at the start of January, with the Dow, S&P 500 and Nasdaq hitting multiple record highs through the first week of the year.

After a difficult first year in office, U.S. President Donald Trump scored his first major legislative victory in December after both houses of Congress approved a $1.5 trillion tax reform bill. The president officially signed the new piece of legislation Dec. 22 after the House and Senate gave their blessings.

"All of this, everything in here, is really tremendous things for business, for people, for the middle class, for workers," Trump said as he signed the bill in Washington. "I consider this very much a bill for the middle class and a bill for jobs."

The new legislation, which came into effect this month, slashed corporate taxes to 21% from 35% and made sweeping changes to how income taxes are bracketed. Analysts say the vast majority of taxpayers will see relief through 2025, when certain measures are set to expire. [4]

Canadian Stocks

Canadian stocks had a disappointing year by comparison, and it was only until September that the TSX returned to growth. The benchmark index returned roughly 6% for 2017, including a 1% gain for the December. Since the start of the month, the TSX has registered new all-time highs, a sign that the equities euphoria was finally spreading north.

The TSX's large energy component was one of the biggest drags on growth during 2017, as oil producers in Alberta slowly recovered from a multi-year downturn that had earlier pulled the region into a minor recession. Canadian stocks with heavy exposure to U.S. markets were also adversely affected by a stronger loonie, which rose more than 7% against the greenback throughout 2017.[5]

Portfolio Overview

We utilize a variety of asset classes and stock portfolios within 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, some of the asset classes produced positive returns while others produced negative.

Asset Class	Equity Portfolio Weight %	Growth Portfolio Weight %	Balanced Portfolio Weight %	Income Portfolio Weight %	2017 Results (Before fees)
US Stock Portfolio (CDN$)	30%	20%	15%	10%	28.0%
Canadian Preferred Shares	0%	21%	21%	32%	6.4%
Rotation Portfolio	40%	39%	39%	19%	5.6%
Bond Portfolio	0%	0%	10%	29%	2.4%
Canadian Focused Growth	30%	20%	15%	10%	0.6%
Total	100%	100%	100%	100%	

In each of our Global portfolios we maintain a number of core positions including Canadian stocks, U.S. stocks, bonds and preferred shares. As well, the portfolios have a “rotation” portion that is dependent on the supply and demand relationship of the various asset classes we monitor. The top three asset classes globally garner additional weightings, and change over time when the demand changes.

During 2017, the US stock market was ranked the #1 asset class for the majority of the year, while international markets such as the emerging markets was ranked #2 most of the year. Canadian equity or Canadian real estate garnered the third position. Interestingly, with the anticipation of rising interest rates in Canada, Canadian bonds as an asset class never ranked in the top three beyond January 2017.

In anticipation of higher interest rates, in February we reduced our exposure to Canadian bonds in favour of owning more preferred shares through individual holdings as well as through the iShares Preferred Exchange Traded Fund. This transaction provided higher fixed income returns, as well as a more favourable tax treatment when outside of registered accounts.

Our Global portfolios maintain a core position in Canadian and U.S. stocks. We use the same process for selecting stocks in each market. The results of each portfolio illustrate the tale of two markets and identifies the strengths and the weaknesses of the process. The process is designed to capture strong trends in stocks and sectors. In the US market, very strong ongoing trends occurred in semiconductor and technology stocks leading to very strong returns. In our universe of large cap Canadian stocks, the markets did not experience significant sector or stock leadership. Rather, many of our stocks experienced short burst of strength only to be followed by bursts of weakness resulting in weak performance for the Canadian stock portfolio. As in the past, new leadership will eventually be established and we expect to participate in strong ongoing trends when they do appear.

You can view the results of all our Global Multi Asset Portfolios and individual stock portfolios here.

2018 Looking Ahead

Market momentum is strong heading into the first week of 2018. This will likely continue for the foreseeable future, at least until the spring/early summer when seasonality begins to favour the bears. Over that period, market movement could become range bound with periodic spikes like the one we saw at the start of the year.

In the United States, valuations remain on the higher side of the historical norms, and it remains to be seen whether the Trump administration can deliver on a range of other policies tied to infrastructure, healthcare and deregulation.

Domestically, speculators are gearing up for the cannabis boom as the federal government gets set to legalize recreational marijuana on Canada Day. Appetite for speculation is high, as demonstrated by the meteoric rise of bitcoin and the broader cryptocurrency market. By the first week of January, the total value of all cryptocurrencies in circulation crossed $750 billion, with lesser known 'altcoins' making their presence known. This is definitely one market to keep an eye on throughout the course of 2018.

We look forward to helping you achieve your goals and dreams in 2018. If you have any questions regarding this summary, or your investment portfolio, please call us.

Sincerely,

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5 Fergal Smith (Dec. 29, 2017). "Canadian dollar strengthens, climbs more than 7 per cent in 2017." The Globe and Mail.