The Gruchala Wojtal Group Newsletter

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2nd Quarter 2014

As we head into the summer months, equity markets continue to move higher, but our macro views have not changed. We believe equities will struggle once the Federal Reserve stops buying bonds. As a result of this, it will be difficult for earnings multiples to expand from current levels and profit margins should face pressure. Furthermore, a fall in US corporate profits would hardly be surprising given that they have been close to their post-war record high (as a proportion of GDP)

Higher profits are needed to justify current equity valuations. The cyclically adjusted price-earnings ratio (CAPE) is 25.6 which is well above the historic average of 16.5 according to Robert Shiller of Yale University. Though none of this may dent investors resolve, as long as they believe central banks will remain supportive.

We still believe that good quality companies who generate consistent positive cash flow, and have a history of dividend increases remain a viable option. We are still under our equity allocation and have earmarked cash equivalent reserves for when companies come back into a range we are comfortable purchasing into.

Our view on interest rates and the bond market also remains unchanged. We still firmly believe that we are in the midst of a 10 year global deleveraging cycle. As a result, global bond yields will stay lower for longer.

The recent strengthening of the Canadian Dollar has allowed us to convert Canadian Dollars into US Dollars (in registered and non-registered accounts) We are not currency strategists, however we do believe that any strengthening of the Canadian dollar will be short lived and should be taken advantage of accordingly.

US GDP Growth is still below 3% (recently revised), renewed east-west tensions over Ukraine and recent turmoil in Iraq has pushed oil prices over the $100 psychological threshold. There are also signs that the pace of European recovery is slowing. The Eurozone Purchasing Managers index fell by more than expected and German business confidence dropped to a six month low. We continue to believe that this will continue to weigh on Global Growth.

The main dilemma remains, either Central Banks are right to be worried about growth and likely to keep rates low, or the Central Banks are wrong and will be forced to raise rates quicker than markets expect. Both outcomes are likely to bring uncertainty and volatility in equity prices. If you have any questions, please do not hesitate to contact us.

Daniel J. Gruchala B.Comm, CIM, DMS, FCSI
Investment Advisor

Radek Wojtal B.Comm, CIM
Investment Advisor

Kathryn Carver
Client Service Assistant

James Goldberg
Business Development