The Gruchala Wojtal Group Newsletter

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As stated in previous quarterly letters, we feel that overall equity market predictions are currently extremely unpredictable. The main reason for this is that central banks globally have embarked on an unprecedented liquidity injection. This form of quantitative easing has never been previously attempted. This has for the most part driven equity markets (globally) higher despite moderate economic growth.

Given that we are still well underweight our equity mandate for the majority of clients, we were not surprised to see the TSX pull back (-4.26%) in September. The majority of this pullback has been a result of the energy, materials, and the precious metals sectors selling off. Many large names in the energy sector have sold off in the range of 10%-15%.

We have very little exposure to the commodities sector (coal, nickel, zinc etc.) and on average a 2%-3% position in precious metals. We believe there are some serious structural risks pertaining to China. Primarily, the size and scope of their shadow banking system, as well the vague and inconsistent mark to market practices involved with their commercial real estate prices.

We have stated in previous commentaries that we were concerned with investor complacency, especially going into the summer months. Equities never move in a linear fashion. We view the activity in the last month as a healthy pull-back. We have begun to moderately increase our equity allocations. Sectors where we are moderately increasing allocations are US industrials, selective consumer discretionary names, and high quality Canadian energy companies.

Our energy exposure was limited. As a result of the selloff, we have been strategically adding to positions in the energy space; names which we have a high degree of best quality visibility on, and ones which have retraced accordingly to our valuation theses.

We continue to have little to no exposure to Europe. In September, the European Central Bank reduced its 2014 prediction for Eurozone growth to 0.9%, and its 2016 target to 1.6%. This is the fourth time growth estimates have been cut in 2014. Double-digit unemployment, overall sovereign debt and austerity programs designed to bring down budget deficits continue to be the main reasons for growth revisions. The European debt crisis, encompassing banks and sovereigns, has by no means been fixed or solved. We felt it is important to reiterate our outlook on this part of the world.

We continue to look at the main longer-term themes that we have confidence in. We still believe the deleveraging trend has another 4-5years to run its course. Current levels of US corporate profits in relation to GDP growth continue to accelerate. Over time, these two numbers have to revert to the mean (higher US GDP growth, lower corporate profits, or a combination of the two). We believe that US corporate profit growth will be minimal and there is a risk of contractions.

To summarize, we continue to believe that emphasizing quality equities and bonds with strong balance sheets, dividend growth and predictable profitability will continue to provide consistent rates of returns in our portfolios.

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