

The Gruchala Wojtal Group Newsletter



1st Quarter 2017

As the first quarter came to an end, North American equity markets gained modestly. With current valuations and other parameters of implied future volatility (VIX) looking sedated, we feel that the current market backdrop is quite complacent. Another cause for concern in the equity world is a falling US 10 year treasury yield, which is back to where it was last fall. This is historically a leading indicator.

The message to the markets is mixed. Equity markets rallied following the election on expectations the Republican controlled White House and Congress would pass numerous pro-business bills, including reversing many financial regulations and major elements of the tax code. With the divisions in the Republican party and the scale of political hurdles (health care bill not passing), it appears that the markets have run ahead of the political process. The prospects for tax and regulatory reform aren't looking quite as good as they were.

The calendar for reform has been pushed back and the likelihood of speedy corporate and personal tax relief is looking glim. With reality now setting in, it is quite possible that these reforms will not take place before year end, or may not even happen at all.

With worst-case scenarios unlikely to unfold, we have been more cautious over the last quarter. That being said, there are still sectors where we are continuing to put money to work. Health Care has taken a hit over the last year due to the proposed changes by the administration. Valuations in this space and free cash flow yield are too compelling to ignore. Energy is another sector where we see opportunity due to the fear of the potential border tax the administration may charge. Some specific good quality companies are down in excess of 20% this year.

We expect volatility to pick up in the second quarter of the year. We will use this volatility to take advantage of names we feel are being unfairly discounted. Disciplined asset allocation across favourable sectors and well run businesses therein will weather bouts of market volatility.

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