

# High Level Investment Report

*Trusted Advice & Peace of Mind*

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## What a Summer! -- Greece Debt Issues, Chinese Market Turmoil, Strong US Dollar, and Federal Reserve Interest Rate Expectations.

### Why this is all good for you?

Summer has been full of several volatile global events that should be considered a positive development. That may seem like an odd statement, but let me explain.

Investors are driven by emotions, and make decisions with their gut, more often than their head. We like to think that we don't, but without a lot of discipline, the gut takes over our investment decisions quite easily. The markets have had several years of good performance, at least in the non-resource related sectors. Positive sentiment in certain areas of the market have become stretched however, and earnings multiples on companies (which is the amount of money you are willing to pay per share for every dollar a company earns per share) in many sectors could be considered overvalued, such as Consumer Discretionary and Utilities. The longer a company or sector goes up, the better it feels for an investor to buy more. And the longer the share prices rise, the less we seem to pay attention to risk tolerance. We can become a danger to ourselves if we lack discipline and do not engage in ongoing self-evaluation of our tolerance for risk.

This is why I believe that the recent **Greece default potential**, the closure of Greek Banks for three weeks, more Austerity measures to be implemented in order to structure another bailout (although counter intuitive to the referendum vote results) is a good thing. **The Chinese stock market** rallying over 150% within a year, driving speculation in their market, to be followed by a sharp market decline that caused Government intervention and halting trading in many Chinese shares, is a good thing.

The reason I am calling this a "good thing" is that **it is making people pay attention to risk**. These are large enough events, happening elsewhere, but are still having impact on our investments and daily lives in Canada. Small shocks like this are good, so that each individual can consider how they feel about their money when they are watching or reading about these events in the news.

**It gives an opportunity to make an evaluation of your personal risk tolerance and decide if these events are cause for more concern than they would have before. If so, then a discussion about those feelings is needed, and I encourage you to speak with me about it. Some of you already have.**

By now Greece is old news to most people, so I won't spend more time on it here, other than to say there is still a lot to be worked out before the book can be closed on their financial situation, and I continually monitor this issue in case there is need for action.

The focus has shifted away from Greece and towards China, as their market has been in sharp decline. How does this impact our market if China is struggling? Bad news for China is bad news for commodities, yet a declining stock market doesn't necessarily mean a bad economy. After a huge market rally in China, ending with rampant speculation by a small percentage of their population, it should be considered possible for the market to fall back to reality. **I personally believe that the sentiment towards commodities has been so dismal the last couple of years that the recent Chinese concern has given one final blow to commodity sectors, that has turned the last remaining "commodity investors" negative.** This is a positive for a Canadian investor exposed to these sectors as I believe we are close to a rotation of sector outperformance, right at a time when almost everyone is fed up with the sector.

In my January edition of this newsletter, I discussed the likelihood that energy prices rebound, but to **exercise caution as oil will likely take another drop in 2015.** So far this summer we have seen Oil prices fall back to late 2014 lows, requiring investors to reassess risk, portfolio allocations, and repositioning investments to take advantage of the stronger positioned companies preparing for recovery from these lows. **The opportunity will soon come** to reposition and strengthen portfolios to prepare for the recovery in the resource sector.

Another item for investor attention this summer has been what Federal Reserve Chair, Janet Yellen, would say about **U.S. interest rate direction.** While Canada has recently lowered rates, the **Federal Reserve keeps guiding to a future rate increase.** Recent July comments by the Federal Reserve again opened the door to an eventual rate increase. I believe rates will eventually have to rise, and will have to play major catch-up at some point. **This will also have positive impact on my clients,** as the sector allocations and investment positioning have been for eventual rate increases ahead of the shift, as it may be too hard to position at just the correct time. **The million dollar question is when does this occur?**

Lastly, I mentioned the **unexpected U.S. dollar strength.** I am not saying that no one expected a weaker Canadian dollar one year ago when we were in the mid-90 cent range. However, I know there were very few expecting the Canadian dollar to fall below 80 cents, let alone almost down to 75 cents on the dollar! **I can admit I did not expect this sort of move lower.** The reason being, our economy isn't as bad as the Canadian Dollar would lead us to believe. We are just a small currency against a volatile global currency and commodity market.

**The significant rally in the U.S. Dollar against most other currencies** (by 30% in the last year for some currency relationships) has had a negative impact on parts of our Canadian market because of the commodity allocation our markets contain. Commodities are U.S. Dollar priced, which all else being equal, when the U.S. currency appreciates by 20%-30% in one year on a global basis, the commodity prices should fall in the opposite direction, which is exactly the case for 2015. Almost all commodities are down this year across the board. Some as much as 25%! This has had a very negative impact on several investment sectors, notably oil, base metals and some soft commodities like sugar and wheat. Yet, while this has been a negative to local resource investments, **any investment made in the U.S. market in the last 2.5 years will have likely resulted in a potential 20%-30% additional return on those investments** because of the currency appreciation of the US Dollar in that time.

**Why is the US dollar so strong?** Some believe it is the economy in the United States recovering, and while this might be part of the reason, **I believe it is because of the amount of money being printed in Europe, and also in Japan in the last 18 months.** The US Dollar rise began a year ago when Europe was becoming more certain about introducing their own version of Quantitative Easing – basically to print their currency to support the debt markets. This was between two rounds of monetary stimulus from Japan, who was preparing for their second round of money printing and market stimulation in less than 12 months. **Because the Euro and Yen are the two other largest currencies,** when they weaken dramatically based on eventual money printing, **it sends the US dollar soaring.**

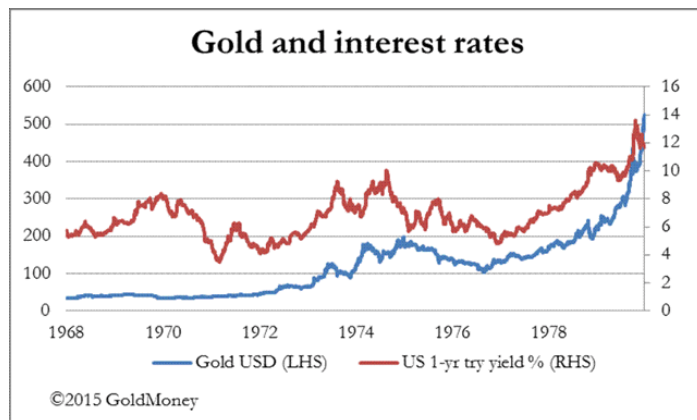
**My belief is that the US Dollar strength is not primarily one of economic reflection, but merely a shift of assets and currency into US dollars for the past year to avoid uncertainty with what is going on in those other countries.** As the US dollar reverses the sharp uptrend and returns to a more sustainable value, many of the sectors that have been hurt by the rise of U.S. Dollars' value will start to catch an uptick in sentiment.

The following charts and illustrations support my views on how many of the developments currently occurring are potentially positive for my client base.

The first chart was created by Cornerstone Macro on July 9th, wherein they illustrate the sector performance three months after a Federal Reserve rate hike. As you can see, Energy and Materials are two of the top four sectors, along with technology and telecom. Also notice that the worst performers are Consumer Discretionary & Utilities. As mentioned earlier, the last few years have been dominated by investor sentiment being strong towards the Consumer and Utilities sectors, and absolutely negative towards energy, materials and parts of the technology sector. This study shows that what "feels good" now is likely to hurt investors the moment the first Federal Reserve rate hike is implemented or at least expected to become a certainty.

This illustration is to show that patience will be rewarded for those holding resource and materials stocks and now isn't the time to be selling. It is the other sectors of the market that should be reviewed to be positioned in sectors that aren't hurt by rate increases, or are simply now trading at extreme valuations.

History never repeats, but it is a good guide to follow for the future. This illustration is also supportive of why I believe current market scenarios and expectations are going to be a positive for my clients in the years to come. Interest rates are artificially low, inflation will end up being a result of money printing, which is currently being used to fight deflationary forces in the debt market, which our central bankers are destined to not let occur.



Sector Performance After 1st Fed Rate Hike (Historical)



CORNERSTONE MACRO  
Economics, Policy, Strategy & Technicals

This next chart was posted to jsminset.com on July 27th, 2015 and is sourced from GoldMoney. It interestingly points out the decline in gold bullion from 1974 to 1976 (a 50% decline in Gold from \$200 to \$100 per ounce) and interest rates declining from 10 percent to 5 percent. In late 1976 gold bullion began to turn up and ended a 3 year bear market. Gold bullion led the interest rate increase that followed 6 months later. Within 4 years interest rates had doubled and gold had gone up 5 times in value.

The graph on the next page was published July 7th on King World News, and sources to the article posted that day were Incrementum AG, and Goldprice.org. The chart illustrates the calendar year performance of Gold in each of the 9 main global currencies. It is an interesting chart as Gold should be considered as money and a store of value during difficult times. It should also maintain purchasing power over time as currencies devalue themselves.

With gold being priced in U.S. dollars, we have seen positive performance in the value of bullion owned in the last two years, when priced in Canadian dollars on our statements. While positive returns are the reality for bullion investments it has not been recognized by most investors in Canada. The metals shares, on the other hand, haven't been able to avoid a sell-off nor have any other commodity companies in the last 12 months. While almost all commodities are down, gold has been one of the strongest commodities this year, which is why my advice continues to be to hold the gold and gold equities as the primary "resource" allocation for now. Pessimism is extreme, and I believe it was Warren Buffet who said "be greedy when people are fearful, and fearful when people are greedy". With that said, I am still reluctant to recommend adding much energy and other metal commodity companies while uncertainty and US Dollar strength is persistent.





	EUR	USD	GBP	AUD	CAD	CNY	JPY	CHF	INR
2001	8.10%	2.50%	5.40%	11.30%	8.80%	2.50%	17.40%	5.00%	5.80%
2002	5.90%	24.70%	12.70%	13.50%	23.70%	24.80%	13.00%	3.90%	24.00%
2003	-0.50%	19.60%	7.90%	-10.50%	-2.20%	19.50%	7.90%	7.00%	13.50%
2004	-2.10%	5.20%	-2.00%	1.40%	-2.00%	5.20%	0.90%	-3.00%	0.90%
2005	35.10%	18.20%	31.80%	25.60%	14.50%	15.20%	35.70%	36.20%	22.80%
2006	10.20%	22.80%	7.80%	14.40%	22.80%	18.80%	24.00%	13.90%	20.58%
2007	18.80%	31.40%	29.70%	18.10%	11.50%	22.90%	23.40%	22.10%	17.40%
2008	11.00%	5.80%	43.70%	33.00%	31.10%	-1.00%	-14.00%	-0.30%	30.50%
2009	20.50%	23.90%	12.10%	-3.60%	5.90%	24.00%	27.10%	20.30%	18.40%
2010	39.20%	29.80%	36.30%	15.10%	24.30%	25.30%	13.90%	17.40%	25.30%
2011	12.70%	10.20%	9.20%	8.80%	11.90%	3.30%	3.90%	10.20%	30.40%
2012	6.80%	7.00%	2.20%	5.40%	4.30%	6.20%	20.70%	4.20%	10.30%
2013	-31.20%	-23.20%	-28.80%	-18.50%	-23.30%	-30.30%	-12.80%	-30.20%	-19.00%
2014	12.10%	-1.50%	5.00%	7.70%	7.90%	1.20%	12.30%	9.90%	0.80%
2015 YTD	8.2%	-0.9%	-1.10%	7.70%	8.10%	-0.80%	1.30%	-6.10%	-0.60%

Sources: Incrementum AG, Goldprice.org

The chart above shows price performance of gold in nine currencies. Looking at this chart you can see that in the last 15 years, gold has risen for all but 3 or 4 years in every currency. Other than in 2013 (when gold had its largest yearly decline in the shortest amount of time), most often the negative performance year in each currency occurs in different years. This illustrates that currencies continue to devalue over time against Gold (hence the store of value characteristics) and that currencies take turns being the strong currency for the year. Gold in U.S. dollars was strong in all years from 2001 to 2013, while they devalued their currency. Since 2013, Europe and Japan have devalued their currency, and you are seeing the strongest performance for gold in EUR and JPY (Japanese Yen). The Canadian Dollar and Aussie Dollar are also seeing strength in gold because of the fact that commodities are U.S. dollar priced, the U.S. dollar is strong, commodities fall in that scenario, and Canada and Australia are heavily resource and commodity focused.

I use this chart less for a Gold illustration, but more for a review of something that is occurring in the world, that is hard to illustrate – currency devaluation -- which leads to inflation over time. Inflation is what we measure returns against, and is why we allocate money to stocks, real estate or commodities in general. If there wasn't inflation over time, we would not need to stretch for returns to keep pace with our cost of living. Potential for future inflation and cost of living increases requires us to invest outside of GIC's & bonds to achieve those returns.

**Understanding why you invest in something other than a GIC investment is important. And using times like these to evaluate how much risk you are comfortable with to achieve those returns is essential.**

**My hope is that these quarterly reports help address some of the educational points and theories behind my portfolio decisions and strategy.** The goal is to help communicate some of the things I am considering when making investment decisions for you and on behalf of my clients. You should understand and know how I view the world when implementing a strategy for your wealth.

**I have a great feeling about how my clients are positioned in their portfolio, and I am spending a lot of time right now reviewing every client portfolio** to make sure they are allocated properly for changes occurring in the market.

The portfolio trend so far is to make sure some of the U.S. equity gains and currency appreciation is captured and rotated to international equity markets. I am allocating to global bond and stock strategies that are more active in their management and are **capable of moving to cash or fixed income if conditions move rapidly in the market and reduced exposure to stocks is desirable.** Lastly, I am making adjustments in the weakest part of the portfolio (resources) and finding the strongest companies within the sector, and making switches to move money to the leaders in preparation for recovery.

I hope you have all had a wonderful summer so far, and I look forward to when we see each other next.

Take care,  
**Ryan Cockburn**