BREZER VOS WEALTH MANAGEMENT GROUP
BMO Nesbitt Burns

"The Song Remains the Same"

I have intentionally delayed writing this newsletter, as I was worried that I would sound redundant in discussing the same topics that we presented in our last newsletter and that have been endlessly written about in the media as of late. In our last newsletter we spoke about interest rates staying low for many years to come, the ongoing trade war between China and the US, and the slowing of the global economy.

Several months later and we are in exactly the same situation with the very same topics being discussed, though I must admit with a slight change. In the last week of July the US Federal Reserve finally caved into pressure and decided to lower interest rates by -0.25%. Whether or not this was actually warranted can be debated, but the US Federal Reserve believed that the slowing global trade and effects of the trade war was likely to weigh on the US economy going forward, and hence saw the need to reduce interest rates to give the US economy a boost. The stock market had debated the size of the rate cut endlessly and was hoping for -0.50% cut in rates, so the markets traded down on the day of the rate cuts, only to trade up the very next day. That was until about 11am, when President Trump announced a new round of tariffs on $300bn of Chinese goods. The net effect of the tariff announcement was to push the S&P500 down by -6% over the next 3 trading days, effectively undoing exactly what the US Fed was trying to stave off by cutting interest rates. All eyes are now back on the US Fed who will probably need to lower interest rates again in September and October in order to cushion the blow to the US consumer and ultimately to the US economy.

We know that the market does not like uncertainty and is much happier when there is stability and a clear path forward, so this tit-for-tat leads to increased volatility in the market and that is exactly what we are experiencing of late and are likely to experience for the remainder of the year.
The global economy is slowing and that is clearly evident in all of the economic indicators that we follow and has been evident since late last year. Yet in spite of this, the North American stock markets have been willing and wanting to move higher over this period. Once again, the market is climbing the endless **'Wall of Worry'** that we wrote about last year. What the market seems to believe is that the global economy is slowing down gradually and that as long as the Central Banks of this world are willing to lower interest rates and provide 'Quantitative Easing', it will be enough to push the global economy through this slowdown. What they point to is the 2008 recession, where the Central Banks all cut interest rates and provided liquidity to the markets, so much so that it led to a 10 year Bull Market. That is to say that the stock market is relying heavily on the Central Banks to rescue the day and so far they have not disappointed. The US cut interest rates, as has New Zealand, India, Australia, Thailand and the list goes on, as all of the Central Banks around the world step in to shore up their economies in order to stave off a looming recession. What the market is suggesting is that with the daily volatility aside, these Central Bank measures should be sufficient and that is why the market is willing to move higher and in all likelihood will move higher through the rest of the year. Given what we know today, that is.
This is how I think this thing pans out: The stock markets of this world move up slowly through this year, but as mentioned not without increased volatility. Basically we are facing a giant game of chicken between the markets and the Central Banks. Cut interest rates and markets move up, don't cut rates and things are likely to get volatile and the risk of a recession rises. Given this scenario, we are likely to

see interest rates move back closer to the zero mark.
In the last newsletter we spoke about a hypothetical 'New Normal' and about the Japanese experience of over 2 decades with interest rates at zero and I truly believe that the rest of the world is likely to follow this path. In over 20 countries, government bonds have negative interest rates. That means you pay the government interest to buy their bonds instead of the other way around. This is something that we saw coming out of the 2008 recession and something that never went away for many European countries. Bottom line here is that the US Federal Reserve will likely have to cut rates further and then at some point the Bank of Canada may have to cut rates and so on and so on. The good news is that mortgage rates are likely to follow suit, which should help prop up the housing market and as long as they keep on cutting rates, it is also likely to provide support to the global stock markets.

Bonds vs Stocks

We touched on this last time and explained how it was highly unusual to see both bonds and stocks moving up at the same time. This trend continued as the stock market rallied through most of July as did bond prices. The reason being is that the bond market believes, as explained above, that there are more interest rate cuts to come through the remainder of this year. The bond market always looks out much longer than the stock market and so the bond market remains convinced that interest rates will be lower still next year. What we have also seen is that 'Fear Trade' kick in where, as volatility increases, investors look to the bond market for stability and in turn drive up the price of bonds further.
One other factor that has helped the North American bond market is the fact that it still has a positive yield. So when faced with buying a European bond with a negative yield or a North American bond with a +3% yield, investors further flock into buying CDN and US $ bonds, increasing demand and hence bond prices. The problem is that bond prices are almost *too* high at this point and if the Central Banks do not cut interest rate as aggressively or as low as predicted, we could see some negative action in the bond markets. So it's definitely a difficult balancing act for us as Portfolio Managers of late in balancing out the amount of bonds vs stocks in your portfolio.

Our Strategy

As explained last time we took a fairly defensive position with all portfolios in the April time frame and increased our bond holdings across the board. We have for the most part maintained a higher weight in bonds through June and July, though we have scaled back a little, as bond prices rose quickly along the way. We have put some of the money taken out of bonds into more defensive names like Algonquin Power and Brookfield Infrastructure, both names with good dividend yields, and in sectors that are likely to provide stability and benefit from lower interest rates while providing steady returns in a volatile market. We continue to see opportunity in the most recent bout of volatility and will be looking to increase our investments in technology companies over the coming month.
You will also notice that we have eliminated our last financial position by selling our shares in Royal Bank last month. This was the last Canadian financial stock that we owned having previously sold CIBC and TD over the last 18 months. I know that as Canadians we have pride in our banks and a bias for owning and holding their shares, however as Portfolio Managers, we try and remove subjectivity from our decision making by taking a more objective approach. We are looking to use more and more data analysis and quantitative analysis in the management of your portfolios. When we run the data, the hard facts are that Royal Bank has underperformed for close to 2 years and actually has had a negative effect on the total returns in the portfolio and so we eliminated it. If in time we see the Canadian banks doing well and a likely place to drive growth and returns, we are happy to buy it back. However in a slowing

1800 - 885 W. Georgia Street, Vancouver BC V6C 3E8 · T: 604- 665-7500 (Greg Vos) 604-221-2853 (Jed Brezer) · F: 604 631 2658

economy with lower interest rates, we believe it will be harder and harder for any bank to drive profit and growth in the coming year, given what is currently playing out.
The term 'Tech', is a bit of a misnomer and something that we would like to explain. As technology has become so integrated into all aspects of business, these so called 'Tech' companies are hardly just 'Tech' companies as they mature. I would argue that PayPal is an online bank. Intel, Broadcom and all of the semiconductor companies are industrial manufacturing, Cisco is basically a telecommunications company, Netflix and Facebook are media companies, Uber and LYFT are transportation and the list goes on. This is where the future lies and where the ability to drive growth and profit is the most evident. In turn we will continue to look for opportunities in this space more so than in some of the more traditional names that you may be familiar with. Using our example above we believe the outlook is more favourable for companies like PayPal, Visa and MasterCard than it is for Royal Bank…

CDN $ Outlook

As you all know we favour the US markets and the US $ over the CDN $ and so when the CDN $ goes up like it did the last month it can weigh on our performance numbers in the short term. What happened in July was that the CDN $ rallied from $0.74 to $0.76. This is a 2.7% increase and for us is a -2.7% decrease of our US $ holdings, on paper that is. The reason for the increase was that the US Fed lowered interest rates and the Bank of Canada held interest rates steady, for now that is. Fast forward a week and the CDN $ is back down to $0.75 and looks likely headed back to $0.74 in the very near term. So yes there has also been volatility in the currency markets of late. The CDN $ is also on the back foot as oil prices slide closer to $50 a barrel for WTI and should oil break below the $50 mark, it is likely to push the CDN $ lower over the remainder of this year. Should the Bank of Canada also lower interest rates later this year, we may see further weakness in the currency.
Currency fluctuations aside, we still anticipate greater opportunity and returns in the US Equity market and remain committed to our US $ holdings.

We hope you are all enjoying your summer and please reach out to us if you have any questions or concerns. We would also like to congratulate Marion & Brian Reems on the birth of their son and look forward to having Marion back at work in the New Year.

Sincerely,

Greg, Jed, Dave, Marion and Lili

This third party publication is not prepared or approved by BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltee/Ltd. ("BMO Nesbitt Burns") and therefore does not meet Canadian research disclosure requirements applicable to BMO Nesbitt Burns.The opinions, estimates and projections contained in the publication are those of the author as of the date indicated and are subject to change without notice. BMO Nesbitt Burns makes no representation or warranty, express or implied, in respect thereof, takes no responsibility for any errors or omissions which may be contained therein and accepts no liability whatsoever for any loss arising from any use of or reliance on the report or its contents. The provision of this publication is not to be construed as an offer to sell or a solicitation for or an offer to buy any securities. BMO Nesbitt Burns or its affiliates may buy from or sell to customers the securities of issuers mentioned in this publication on a principal basis. BMO Nesbitt Burns, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities of issuers mentioned in the publication, related securities, or options, futures or other derivative instruments based thereon. BMO Nesbitt Burns may act as financial advisor and/or underwriter for certain of the issuers mentioned therein and may receive remuneration for same. BMO Nesbitt Burns is a wholly owned subsidiary of BMO Nesbitt Burns Corporation Limited, which is an indirect wholly-owned subsidiary of Bank of Montreal. Bank of Montreal or its affiliates may have lending arrangements with, or provide other remunerated services to, the issuers mentioned herein.The reader should assume that BMO Nesbitt Burns or its affiliates may have a conflict of interest and should not rely solely on this publication in evaluating whether or not to buy or sell securities of issuers discussed herein.

® "BMO (M-bar roundel symbol)" is a registered trade-mark of Bank of Montreal, used under licence. ® "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Corporation Limited, used under licence. BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltée are indirect subsidiaries of Bank of Montreal.

The opinions, estimates and projections contained herein are those of the author as of the date hereof and are subject to change without notice and may not reflect those of BMO Nesbitt Burns Inc. ("BMO NBI"). Every effort has been made to ensure that the contents have been compiled or derived from sources believed to be reliable and contain information and opinions that are accurate and complete. Information may be available to BMO Nesbitt Burns or its affiliates that is not reflected herein. However, neither the author nor BMO NBI makes any representation or warranty, express or implied, in respect thereof, takes any responsibility for any errors or omissions which may be contained herein or accepts any liability whatsoever for any loss arising from any use of or reliance on this report or its contents. This report is not to be construed as an offer to sell or a solicitation for or an offer to buy any securities. BMO NBI, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell

1800 - 885 W. Georgia Street, Vancouver BC V6C 3E8 · T: 604- 665-7500 (Greg Vos) 604-221-2853 (Jed Brezer) · F: 604 631 2658

BMO Wealth Management
BMO Nesbitt Burns

Brezer Vos
Wealth Management Group

securities mentioned herein as principal or agent. BMO Nesbitt Burns Inc. and BMO Nesbitt Burns Ltee/Ltd. ("BMO Nesbitt Burns") will buy from or sell to customers securities of issuers mentioned herein on a principal basis. BMO Nesbitt Burns, its affiliates, officers, directors or employees may have a long or short position in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. BMO Nesbitt Burns or its affiliates may act as financial advisor and/or underwriter for the issuers mentioned herein and may receive remuneration for same. A significant lending relationship may exist between Bank of Montreal, or its affiliates, and certain of the issuers mentioned herein. BMO NBI is a wholly owned subsidiary of BMO Nesbitt Burns Corporation Limited which is a majority-owned subsidiary of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Nesbitt Burns Corp. and/or BMO Nesbitt Burns Securities Ltd. Member-Canadian Investor Protection Fund.

Member-Canadian Investor Protection Fund

If you are already a client of BMO Nesbitt Burns, please contact your Investment Advisor for more information.

BMO Wealth Management is the brand name for a business group consisting of Bank of Montreal and certain of its affiliates, including BMO Nesbitt Burns Inc., in providing wealth management products and services.

BMO Nesbitt Burns is a member-Canadian investor protection fund and member of the Investment Industry Regulatory Organizations of Canada

1800 - 885 W. Georgia Street, Vancouver BC V6C 3E8 · T: 604- 665-7500 (Greg Vos) 604-221-2853 (Jed Brezer) · F: 604 631 2658