ELAINE'S NEWS & VIEWS

MAR 2016

Usually I don't send a March newsletter, just a mid Apr one. I am sending this for 2 reasons. First, markets have been negative and jittery and I want to pass on some info about why I am not worried. Secondly I want to give you more time to book an appointment before my vacation, if you want an appointment before late May.

Vacation Alert: It has been a lot of years since I have taken more than a week off work at a time. However, now that Brendan Enright works with me and can handle any client needs while I am off, I am taking a few weeks in a row: Apr 26 to May 22. So, if you know you have an upcoming financial or planning need, please be sure to call for an appointment in Mar or Apr. Otherwise, you can just call Brendan in my absence.

Contrarianism: January and February this year were pretty busy for me – not because it was RRSP season or because people were worrying about the market drops over most of the last 2 months, but because so many clients were trying to take advantage of the drop in the stock market to buy in at lower prices. I take this as an indication that many of you are disciplined and market-savvy enough to buy low and not panic by trying to move to cash. It is important to stick to your long-term plan and not let bouts of volatility derail you. This strategy should serve you well over time.

Random Words of Wisdom and Perspectives on the Market

Our underweighting in Canada should provide us with better long term growth, just as it really protected our equity holdings last year. But the Canadian dollar just went from under $0.69 to over $0.74 and this hurt our foreign holdings. I think this will only be a short-term headwind and it is small potatoes compared to global market growth potential compared to Canadian market potential.

The man widely accepted as the most successful investor in the world, Warren Buffett, restated this old advice again in 2014: "Games are won by players who focus on the playing field – not by those whose eyes are glued to the scoreboard. If you can enjoy Saturdays and Sundays without looking at stock prices, give it a try on weekdays." And in 2015 he advised us not to bet against the U.S. economy: "Who has ever benefited during the past 238 years by betting against America? If you compare our country's present condition to that existing in 1776, you have to rub your eyes in wonder … We will regularly grumble about our government. But, most assuredly, America's best days lie ahead." Globe and Mail Feb 25, 2016 He reiterated this in his famous annual shareholder letter this year and he revealed that he has been buying stocks since the end of 2015 while prices are down. If it is good enough for a man who has achieved double the returns of the U.S. stock market since the mid-1960s, it is surely a good idea for us too.

The Canadian stock market, like so many in the world, fell in to bear territory dropping over 20% from its high in Sept 2014. The U.S. markets did not drop enough to fall into bear market territory. Globe and Mail Jan 8 2016 But bear markets that happen in the middle of secular bull markets like we are considered to be in now, typically are short run (lasting about 14 months on average) and then the upward trend resumes. If we have an average length bear market, we are over half way through the downturn.

The German stock exchange was down nearly 30 per cent from Apr 2015. Globe and Mail Feb 13, 2016

The historical average of the price of US stocks (as measured by the S&P 500) is 16.6. At the market high last Apr, the price earnings ratio hit 18. It fell in early Feb 2016 to 15.2, the lowest ratio (cheapest price) in 2 years. In the first 5 weeks alone of 2016 it fell 13%. Feb 15, 2016 Globe and Mail So the U.S. market has gone from being slightly overpriced to being slightly underpriced based on historical norms.

"Our finances would be better off if we started treating houses as what they are –consumer goods that a growing number of people cannot afford and shouldn't buy because they're too pricey. Instead, we regard home ownership as living the dream and treat rising prices as a validation of this view" Rob Carrick in the Feb 22, 2016 Globe and Mail

Vancouver real estate is now trading at almost 11 times income. First Asset believes that "Vancouver-area real estate is a disaster waiting to happen. … when, not if, the Chinese government is successful in stemming the flow of capital out of China and into markets such as Vancouver. When this happens, the house of cards is likely to fall. Demand for high priced real estate will dry up, speculators will leave the market, leaving only locals, who can't afford the prices, to fill the void left by wealthy Chinese investors. Prices will fall and the realtors and flippers who made a killing as prices have risen will be nowhere in sight. … This could lead to owners with underwater mortgages, again reminiscent of the late 2000's US housing bubble … and Toronto could be next." First Asset Feb 2016 Manager Commentary Mortgage foreclosures, and energy company bankruptcies with their attendant loan defaults won't help banks that have a lot of exposure to energy company debt.

Canadians are at financial risk. A poll done in Jan 2016 found that 31% of Canadians felt that any increase in interest rates could push them towards bankruptcy and that one quarter of Canadians already cannot pay their debts and bills. Scary!!!! Feb 16, 2016 Hamilton Spectator

Why Retire? In 2005 the British Medical Journal published a study which found that people who retired at age 55 were 89% more likely to die within 10 years than people who retired at 65. Each extra year a person works lowers their risk of dementia by 3.2%. Mar 15, 2015 Financial Post

As poor as Canadian markets have been in the last year, and on and off since 2000 they have been horrid some years, $1 invested in Dec 1975 would have grown to over $41 by Dec 2015. Lots of bad things have happened in the last 40 years, but that didn't stop stock market growth of 4041%. (Mackenzie and Bloomberg) If you let current political or economic woes scare you away from markets, you may never invest and would lose out on the relentless long-term growth of the stock market.

“On average, value investing beats growth investing. To me, the evidence is overwhelming. Using Canadian data for the period 1986 – 2014, my research show that value beat growth on average, by about 11 per cent. Figures are comparable for the United States as well as Europe, Austalasia and Far East (EAFE) markets.” George Athanassakos in the Feb 18, 2016 Globe and Mail

Emerging markets have underperformed for the last 3 years, with notable exceptions like India last year. And according to valuations based on cyclically adjusted price to earnings ratios, valuations have only been as low as this six times in the last 25 years, and after each of those times emerging markets rallied 188 % on average in the following five years. Perhaps that is why firms like Franklin Templeton, Goldman Sachs Asset Management and Blackrock (the largest asset manager in the world) have been bullish on emerging markets recently. The chief investment officer of Research Affiliates (an advisor to Pimco) says “The exodus from emerging markets is a wonderful opportunity – and quite possibly the trade of a decade – for the long-term investor.” Globe and Mail Feb 26, 2016 Russia and Brazil are in recession and China is experiencing its lowest growth rate in 25 years. And if the U.S. raises interest rates as expected, this could draw investments out of emerging markets into the U.S. In a 19 month period investors withdrew $900 Billion from the 19 largest emerging economies’ markets, which is double the amount that pulled out at the bottom of the 2008 financial crisis. Emerging market currencies have dropped, some to levels not seen for almost 20 years. On the other hand, emerging market debt is also lower than it has been in the past. The Philippines, Myanmar (formerly Burma) and Ethiopia have been growing at 6, 8 and 8 % respectively. “The long-term story hasn’t changed. The middle class in the U.S. and Europe will continue to be a pillar of the global economy, but the world’s new consumers –new growth engines – will be found in developing, not developed, countries. Even if the Chinese leadership fails to shift from investment-dependent to consumption-led growth, consumer spending in China will grow 60 percent over the next decade … HSBC researchers prognosticated that almost 3 billion people will enter the ranks of the middle classes by 2050 – nearly all in emerging markets. … Consumption in emerging countries could account for almost two-thirds of the global total in 2050, a significant increase from only about one-third today. Where stock markets, currencies, and growth rates will head in coming months may be unclear. That the meek will eventually inherit the earth is not.” Bloomberg Businessweek Sept 13, 2015

So, emerging markets might be a great opportunity now, or it might be a few years too early to be a great investment. Don’t we wish we knew! That’s why we always diversify.

Sentiment about Canadian energy stocks seems similar to that for emerging markets. Some feel the prices have fallen so much that they must be a bargain. Fidelity is even saying that they expect a very quick and steep recovery of energy stocks. On the other hand, Macquarie Financial, a huge firm out of Australia, doesn’t expect oil prices to rebound for 10 years. Most people think oil prices will be pretty low for about 2 years. A view I support is that markets throw out the babies with the bathwater. So while most companies deserve to have fallen drastically, there are some companies that have dropped to ridiculous prices compared to their worth. A very skilled value manager can unearth such selective bargains with enough research and analysis. But I don’t expect a quick general recovery because I don’t expect oil to rise any time soon to a price that Canadian oil companies can make money at. So I don’t think it is time to overweight Canadian energy companies holus bolus, but it doesn't worry me to see some of my best managers selectively add a few resource companies to their portfolios.

"People who invested in Jan 1985 and held on through August 2015 – through the Black Friday market crash (September – December 1987), the tech meltdown (Apr 2000 – October 2005) and the financial crisis (November 2007 March 2009) – made a robust nine per cent average annualize return on their investment. That takes into account three bear market declines of as much as 51.7 per cent." Globe and Mail Feb 11, 2016 So, the key to investing is not timing your investments or jumping in and out of the market, but in investing long-term. Don't let your emotions take over and change your long-term strategy.

The Canadian dollar was at 61.76 U.S. cents in Jan 2002. The range of predictions for it in the medium term are anywhere from the mid 60's to the low 80's. The top tax rate for those earning $200,000 or more is now 53.5 %. France, Sweden and Denmark have higher tax rates. Globe and Mail Jan 5, 2016

The fund managers of CI Mutual Funds in the January Review made the following points:

- The low Canadian dollar is working to restore Canada's competitiveness
- The U.S.' strong employment, higher wages and housing recovery are strong enough that the economy is in a stable recovery despite the headwind of the strong U.S. dollar
- Lower energy prices should provide stimulus to the American economy
- China is transitioning from a manufacturing to a consumption driven economy

Just as the Great Depression of the 1930s left many people too scared to invest in stock markets for the next 70 years and the fear can even be seen today in many of the next generation too, the Great Recession of 2007 to 2009 has left many, many investors still sitting out the market. Canadians alone have $75 Billion more cash sitting on the sidelines than would normally be there. The current amount of cash being held by Canadians, even adjusted for inflation and demographic, is at all-time record highs. While this cash really helps protect against market volatility, over the long-term it holds down investor returns. Although the Oct 1987 stock market crash only lasted 2 months, investors kept their cash positions high for 18 months after the crash. During that period those with cash lost out on 20% gains in the market. And as much of a drag as it is on a person's wealth to have large amounts of cash, the worst part is that investors move into cash at exactly the wrong time. When market volatility spikes, investors move into cash and are essentially buying high and selling low. CIBC's "In Focus" Jan 26, 2016

My favourite and most trusted economist makes these points:

- Oil supply is exceeding oil demand by about 1.5 Million barrels a day
- Low prices may not be a phase but a permanent reality, given the new supplies, especially from fracking
- The more volatility in oil prices, the more flexible producers will benefit and high fixed cost producers, like those in our oil sands, will be at a disadvantage
- Oil and China (lower growth and currency devaluation) are the two factors most impacting markets today
- China could return to 7-9% growth rates if it went back to concentrating on manufacturing, but it is trying to switch towards being a consumer economy so it won't likely alter its course

- Higher employment and wages in the U.S. translated first into higher savings and has not yet translated into higher spending, but that transition is expected in 2016 and 2017. This will be partly fuelled by how much richer the American homeowner feels after the housing recovery
- The cheap dollar should help Canadian exports but because we export intermediate goods instead of finished products, it could be beyond 2016 before exports rise materially
- A status quo budget would have been a drag on economic recovery but the deficit budget of the federal government will not be enough to stimulate the Canadian economy out of recession
- There isn't much light at the end of Canada's tunnel in 2016, but perhaps in 2017

Ben Tal's 2016 Global Economic Outlook Jan 15, 2016 and The Renaissance Advisor Dec 31, 2015

Women Power and Employment: Women hold more than one job more frequently than men. Women change jobs more frequently than men. Proportionately more women than men are employed, and in the last economic downturn, fewer women than men lost their jobs. Female entrepreneurship has tripled in the last 20 yrs leaving more female than male entrepreneurs. Women-owned businesses provide more jobs in Canada than the top 100 companies in the country did. The average woman spends 15% of her career out of the paid workforce caring for children and parents. For every year a woman is out of the work force caring for children, she has to work an extra 5 years to make up for lost income, lower pensions and missed career promotions. Women only get about half the average pension that men get in retirement ($4,200/yr compared to men at $7,800. Neither is a pretty number, largely because most Canadians don't have any retirement benefits.) Mackenzie Investments Jan 2016

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