Provisus Wealth Management

JUNE 2015

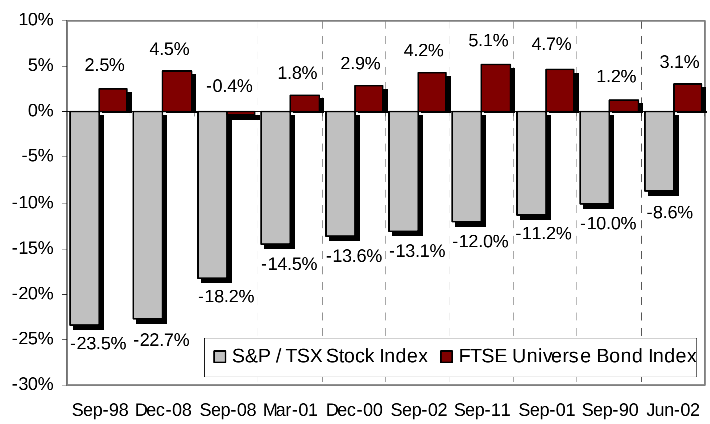
MONTHLY INSIGHT

SOME MARKETS ZIG, OTHERS ZAG

Investors have long divided their assets between stocks and bonds in the belief that those asset classes counterbalance each other. One “zigs” when the other “zags”. The theory of complementary asset classes is the cornerstone of investment management. However, the correlation between stocks and bonds is constantly changing and currently bond returns are less volatile than stock returns. The only certainty is that no one can predict the future and that most of the time returns for either asset class are generated randomly of each other, except during extreme events and then history is a clear guide.

Investors place money in stocks and bonds depending upon their desired return and risk trade-off. Stocks outperform bonds over the long term, although there are periods when bonds excel, usually the result of severe economic events: the 1930s Depression; World War II or the 2008 Great Recession. On the other hand, stocks are riskier and more volatile than bonds as bonds principally protect investors against inflation. Varying the weighting of stocks and bonds will attain the right blend of risk exposure at a given time, but in bad times it is the direction of the movement between stocks and bonds that is key.

Recently stocks and bonds have been moving together, much more so than in the past as both markets are being flooded with financial liquidity and distorting the traditional relationship. Stock and bond returns have normally been positively correlated as shown by the quarterly return correlation of 0.07 for the period from 1970 to 2011. Over the past 40 years there have been a number of very different stories over various sub-periods as correlations ranged anywhere from +0.60 to -0.60. Historically stock prices have gone up when bond prices were falling, as stronger economic activity drove investors to stocks and away from bonds. Dramatic economic weakness can trigger the reverse.



This chart shows the worst calendar quarterly returns for the S&P/TSX Stock Index (grey column) since 1990 and the corresponding return for the FTSE Universe Bond Index (maroon column). The complementary role of bonds in a balanced portfolio is to provide portfolio protection during falling equity markets.

While equities have normally been the primary driver of performance for balanced portfolios, the chart above and the data to the right clearly illustrate how bonds have performed during the 10 worst calendar quarters for stocks going back to 1990. In these cases bonds have done extremely well, returning 3.0% per quarter which is 79% better than the average quarterly bond return. Stocks declined an average of 14.8% during these 10 worst quarters. At the other extreme, the 10 worst quarters for bonds since 1990 generated average losses of 2.0% while stocks gained 3.3%, which was 36% greater than normal. This is exactly what investors should expect. So while the current concern about weak bond returns may be troubling, it is important to keep these numbers in perspective when it comes to understanding why bonds are used in the first place. They are there for protection.

Investors need to keep in mind that the relative movement between stocks and bonds can have signification impact on their portfolios. Achieving excess returns means more than tracking the news about future risks to stock specific holdings such as the impact of the European financial crisis, disappointing economic reports, or the energy sector crash. It means protecting against the extremes because that is where the game is truly won or lost.

“...while the current concern about weak bond returns may be troubling, it is important to keep these numbers in perspective...”

Average Quarterly Returns

	FTSE Universe Bond Index	TSX Stock Index
1990 to 2015	1.7%	2.4%
10 Worst Stock Quarters	3.0%	-14.8%
10 Worst Bond Quarters	-2.0%	3.3%

This table shows the average quarterly return between 1990 and 2015 for the Canadian bond and equity markets. The worst quarterly returns are also shown for these markets and confirms that bonds have gained in value during falling equity markets and haven’t declined nearly as much when bond prices do fall.

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MARKET DATA

31 MAY 2015

Index Total Returns (%) (C$)

	1 Month	1 Year	5 Years
S&P TSX	-1.2	5.8	8.1
S&P TSX High Dividend	-4.7	-3.4	10.7
S&P TSX Small Cap	0.3	-7.2	3.5
S&P TSX Preferred Shares	-0.5	-3.1	3.8
S&P 500	4.3	29.1	21.5
Russell 2000 (US Small Cap)	5.2	26.9	18.6
MSCI EAFE	2.6	15.5	15.4
MSCI World	3.4	22.8	18.5
MSCI Europe	1.6	7.3	12.4
MSCI Asia	2.6	25.9	9.9
MSCI Emerging Markets	-1.2	13.2	6.4

Bond Total Returns (%) - DEX Indices

	1 Month	1 Year	5 Years	Yield
Universe	0.2	7.1	5.6	1.90
Short Bonds	0.4	3.2	3.2	1.10
Mid Bonds	0.3	7.3	6.4	1.89
Long Bonds	-0.1	12.7	8.7	2.92
Federal Bonds	0.2	5.6	4.2	1.21
Provincial Bonds	0.2	10.1	7.0	2.25
Corporate Bonds	0.2	5.8	6.1	2.39
Real Return Bonds	-1.7	7.0	6.1	0.28
91 Day T-Bills	0.1	0.8	0.9	0.63
Barclays Aggregate Bond (US$)	-0.2	3.0	3.9	

Currencies: (%) (C$)

	1 Month	1 Year	5 Years
US$	-3.0	-14.9	-3.5
EURO	0.8	-7.7	1.2
GBP	2.3	4.5	4.5
YEN	-0.6	-6.1	-2.8

Commodities: (%) (US$)

	1 Month	1 Year	5 Years
Index	-2.0	-35.4	-4.2
Oil	1.1	-41.3	-6.9
Gold	1.0	-4.5	-0.4
Wheat	-4.7	-34.1	2.1

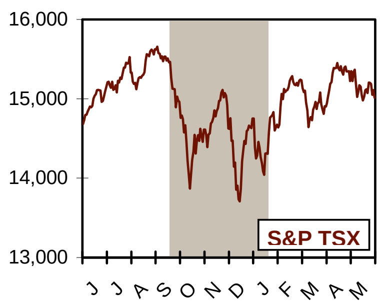
Sector Returns (%)

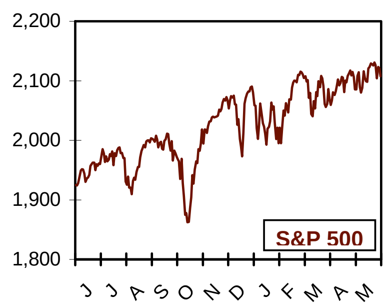
	S&P TSX (C$)				S&P 500 (US$)				MSCI EAFE (US$)			
	1 Month	1 Year	5 Years	Weight	1 Month	1 Year	5 Years	Weight	1 Month	1 Year	5 Years	Weight
Consumer Discretionary	4.9	27.1	15.5	6.3	1.2	16.2	18.9	12.3	-0.2	4.3	12.3	13.2
Consumer Staples	1.4	39.2	21.2	2.4	0.7	8.3	13.1	9.2	-0.9	-3.1	10.0	11.0
Energy	-7.1	-29.8	-5.1	21.6	-5.2	-17.6	7.6	7.9	-5.5	-27.2	-1.0	5.6
Financial Services	-1.7	3.2	7.0	36.1	1.6	10.3	10.9	15.8	-1.4	-3.4	5.9	25.7
Health Care	3.3	47.0	29.6	6.0	4.3	25.3	21.0	15.9	-1.3	5.7	14.0	11.7
Industrials	-2.4	6.0	13.9	8.3	0.0	3.1	13.3	10.5	-0.5	-2.9	7.3	12.6
Information Technology	-0.2	39.6	11.6	2.3	2.0	17.0	15.5	20.1	1.9	9.3	5.7	4.9
Materials	-0.8	-4.2	-7.7	10.5	0.3	2.5	11.3	2.6	-0.7	-9.4	0.9	7.5
Telecommunication	2.7	4.2	9.1	4.5	-1.9	-2.0	8.9	2.5	-2.0	-1.8	7.9	4.5
Utilities	-3.2	4.2	3.7	2.0	0.0	4.1	9.2	3.2	1.2	-8.4	-1.3	3.3
Growth Index	0.1	24.9	8.2		1.6	12.7	15.9		-0.4	0.1	8.3	
Value Index	-2.4	-2.9	4.5		0.4	6.2	12.3		-1.6	-6.0	5.3	

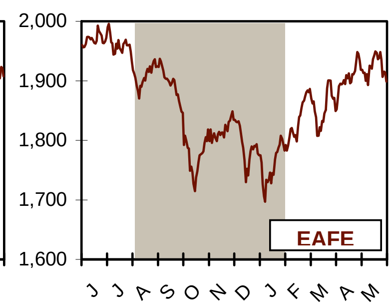
Index Charts

12 Months ending May 2015

Grey shaded areas indicate periods of stock index decline.







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