DM Portfolio Commentary
2nd QUARTER 2016

If you've followed my forecasts, you've probably lost a lot of money

- James Bullard, St. Louis Federal Reserve President

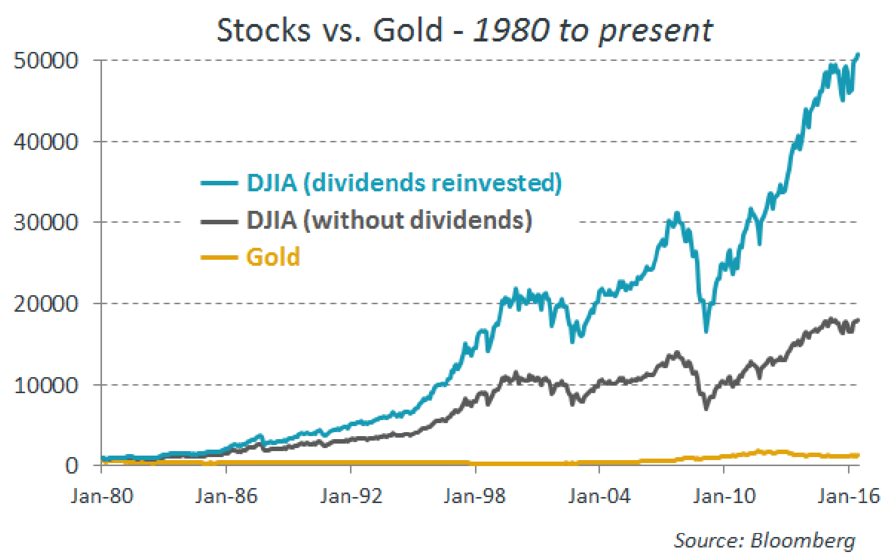
Last month, pro hockey's annual selection of junior and collegiate players was held and, by all accounts, this particular draft was a deep one. As such, the 2016 class of hopefuls had been analyzed, interviewed, poked and prodded to such a degree that there was little disagreement left amongst experts as to how the picks would fall into order once the process began. Certainly the first three choices were touted as a lock and there was only slightly more doubt as to how things would go from there. With Vancouver picking fifth, Canuck fans were already well advanced in envisioning how their prodigious new centre-to-be would fit into the lineup.

As it turned out, though, Columbus management evidently didn't get the script and made a third slot selection that no one saw coming. From there, the rest of the preordained sequence fell to pieces and, by the end of the day, the Oilers accepted an unexpected gift, Calgarians were beside themselves with their unforeseen good fortune, and the Canucks? Well, they laid yet another brick upon their already formidable monument to draft day disappointment.

While this important business was being conducted, another decision was being made an ocean away, as Britons voted to either re-embrace or cast off their 43 year membership in the European Union. We could write that the world waited on tenterhooks for the result to be known but, much like the NHL draft, the outcome of this plebiscite had been all but guaranteed by the chattering classes and they assured us that once those outside the City of London had enjoyed their chance to be heard, the world would settle back into its established order. That this set of punditry had also widely miscalculated, though, was soon writ large across equity, bond, and currency markets and the sanguine backdrop they had foreseen was anything but in the days to follow.

So what can we take from these two episodes? First, forecasting is very difficult, regardless of the subject matter. Second, it's human nature to crave certainty and to be drawn to those who appear to provide it, even when our rational selves know that the definitiveness on offer is rarely possible. Of course, sports predictions are fun and can add another layer to our overall entertainment; economic and market prognostications, on the other hand, often influence important decisions and can prove hazardous to one's financial health if afforded too much weight (a truism that is proved out time and again when individuals sabotage their long term investment plans in reaction to near term events).

Oddly, there seems to be little correlation between a forecaster's past success rate (or lack thereof) and his or her willingness to double down with yet more predictions. Even before the final vote had been counted in the UK, the same experts who were exactly wrong on the referendum result were rushing forth with their diagnoses as to how the outcome would play out in legislatures, investment markets, and the world economy. If making bold assertions immediately following such an unexpected and complex turn of events seemed foolhardy at the time, it was confirmed to be so in the days that followed when several key players in the British executive (including the Prime Minister himself) suddenly resigned their posts, a petition to set aside the referendum result swelled to more than four million signatures, and policy makers grappled with how exactly the "leave" vote would be ratified under the rather narrow exit guidelines provided by the EU constitution. And, just as commentators were telling investors that early market losses would surely compound in the weeks to follow, stocks promptly defied this call and reclaimed almost all of their lost ground (in fact, the rebound was so swift, we missed our chance at a few beaten down names that had been in our sights!).



When we take in events such as Brexit and consider them in the context of your portfolio, our first task is to pull back from the short term noise to gain proper perspective on what, if anything, the developments might mean over a proper investment time horizon. For example, one of the most frequently offered investment comments in recent weeks has been that gold will benefit from this latest wave of economic and political uncertainty and, to be sure, the yellow metal has enjoyed an enviable run in recent weeks. That said, commentators rarely indicate whether their advice is directed at those working on a long term plan to build wealth, or toward individuals with a trading mentality looking to capitalize on the latest hot-money move in a particular asset class. The chart above provides some historical context as to how we'd categorize this latest popular recommendation.

We started the graph at the beginning of 1980 because, for a brief moment in January of that year, the price of gold and the level of the Dow Jones Industrial Average were about the same. Since then, gold has increased by about half, despite countless "Brexit-like" crises over the past 36 years, while the Dow has leapt more than 20 fold; if you like dividends and happened to have reinvested them back into the equity index, growth of capital would have come in at nearly 60x original investment. So, while gold or some other alternative asset might enjoy a star turn in the year to come, we believe we're far better off favouring long term probabilities within your portfolio than joining the forecasting game to leap from one short term idea to another. On this basis, the choice to stick with stocks and bonds in the investment plans we manage couldn't be much easier, even in the face of a possibly turbulent period to come.

Enjoy the balance of the summer!