Provisus Wealth Managemet

Volume 11, Issue 4

Q4 2016

Investment Review

Market Comment

INSIDE THIS ISSUE:

Canadian Equities	2
Fixed Income	2
U.S. Equities	3
International Equities	4

Dramatic twists and turns in politics, economics and finance have turned 2016 on its head. Extreme events have bombarded investors virtually every day of late but thankfully they appear to be isolated occurrences. Still, the potential blight on the global economic and financial markets (i.e. political uncertainty; the steep increases in bond yields; a potential hard landing in China; and trade wars) could be looked upon with trepidation during the next year. This would be a very wrong outlook as a bevy of market stimulating activities are just over the horizon.

Trump's election as U.S. president sent shock waves through global markets. This surprising turn has introduced a great deal of uncertainty in U.S. fiscal and monetary policy and it is impossible to tell which of Trump's often wild promises will actually be put into effect. Whether it is the slashing of corporate and personal income taxes, or massive infrastructure spending, or overseas cash repatriation or jobs stimulus, there is considerable uncertainty about the timing, size and composition of any policy initiatives; so as always the future is uncertain. But in all likelihood it will give stocks, another shot in the arm for now anyway.

Take heart, Canada. Despite the U.S. projections for a miserable next four years under a new U.S. president, Trump's victory could be a big win for Canada which could see its economy stimulated as an offshoot of U.S. activity. Furthermore a Trump presidency could lead to more political openness and less myopic thinking, which will actually allow the U.S. to clean up some of their outstanding problems. These are all good things.

International economies have stabilized and started to rise above the recent multi-year stagnation, however they are now playing a waiting game while the key political players shift seats. Trade tariffs and job repatriation threaten many countries, not just China and Mexico. Europe and the U.K. both do a lot of business with the U.S. and are just starting to see real job growth. Japan has seen a significant downturn in its currency and has been forced to ratchet up measures to combat this pressure. Emerging markets are experiencing massive capital outflows as protectionist trade policies loom.

The consensus is that the 35 year bull market in bonds is over and a bottom in bond yields has been reached. Bonds around the world suffered their biggest two week loss in at least 26 years as the election of Trump sent inflation expectations surging. As well, quantitative easing with massive bond buying by central banks appears to be over which suggests higher yields. However, bond weakness could also partly reflect a strengthening world economy, as the overall global environment has been healing rapidly. Canada has remained relatively immune to the global bond malaise eking out a 1.7% gain for the year on the back of corporate bonds which gained 3.7% for the year, as yields narrowed.

North American stocks surged last year, led by Canada as commodities made a big comeback, advancing 12% after sinking to a quarter century low in January. Canadian stocks appreciated 21.1% for the year, while U.S. stocks gained almost 9% (all figures in Canadian dollar terms). Investors have been rushing into inflation favoured sectors like insurance companies and banks while dumping utilities and real estate investment trusts (REITs). On the other hand higher interest rates and collapsing local currencies have caused capital flows out of Asia which was down 1.9% and Europe which was down 6.6%. Emerging markets were able to break the international weakness by gaining 5.4% for the year.

It is likely that a low growth, low interest rate world is here to stay driven by secular forces. The important thing is to hang in there as jumping to conclusions can be dangerous. Let events play out. However favourable or unfavourable the key market players may be, perhaps the prospect of future prosperity will make the journey more palatable.

Christopher Ambridge, CFA

PROVISUS™
WEALTH MANAGEMENT

PROVISUS™
WEALTH MANAGEMENT

Canadian Equities

Canadian markets, like other global markets around the world, have easily absorbed the unexpected outcomes of major events during 2016 including the fall of energy and commodities in early 2016, Brexit, as well as the pending change of the political regime in the U.S. Globally these events were initially presumed to be negative and should have put a halt to the 8 year bull market. Although some sell-off activity did occur for a short period, especially in the Brexit case, the trend quickly reversed and global markets have since surged higher.

The Canadian stock market in particular faced an extra hurdle in the Alberta wildfire, but nonetheless as the TSX index closed 2016 at 15,287 points; levels which had not been seen in months. The unanticipated rebound led the Canadian index to a strong 21.1% total return for the year thanks to a strong revival in the Energy and Materials sectors, making it the developed world's biggest advancer in 2016.

As global economic conditions have strengthened, the Canadian economy has followed suit, although there have been periods of sluggishness such as in the second quarter where GDP unexpectedly dropped 1.3%. Despite the strong 3.5% GDP rebound in the third quarter, GDP for the full year is expected to be moderate, which implies that the adjustment to a full recovery has yet to fully materialize.

The job market continues to remain relatively strong as 214,000 jobs were gained over the past one year period. That represents a 1.2% increase, versus 0.9% a year earlier, putting Canada in line with its long-term average. Unless the rebound in Energy and Materials is maintained there is a risk to a full economic recovery in the upcoming years. However, the world-renowned Canadian banking system, as well as recent government intervention to tighten mortgage rules, should mitigate that risk and prevent a major fallout in the credit market like the one that occurred south of the border a decade ago.

Ari Abokou, MBA, CIM, FCSI

Fixed Income

The Canadian FTSE TMX Universe Bond Index lost 3.4% in the fourth quarter of 2016 but was up 1.7% for the year. Over the course of 2016 the Bank of Canada maintained its overnight interest rate at an ultralow 1/2 of one percent, which is where it has been since July of 2015.

The Bank of Canada noted that global economic conditions are improving but at the same time they cut their forecast for the economy. Their December interest rate press release cited, "uncertainty, which has been undermining business confidence and dampening investment in Canada's major trading partners, remains undiminished. Following the election in the United States, there has been a rapid back-up in global bond yields, partly reflecting market anticipation of fiscal expansion in a U.S. economy that is near full capacity. Canadian yields have risen significantly in this context."

The prospect of an eventual rise in interest rates is heavily dependent on the U.S. With the outlook for an improving U.S. economy there is a significant chance that we have reached a top in bond prices after 30 years of falling interest rates. It is likely that President-elect Trump will pursue stimulative policies by cutting taxes for both corporations and the wealthy, slashing regulations and reducing the country's dependence on imports. The flip side, according to the Committee for a Responsible Federal Budget, is that Trump's plans would raise the national debt by $5.3 trillion over 10 years.

(continued on next page)

Fixed Income

(continued from previous page)

This would be on top of the $9 trillion that the national debt is already projected to rise as determined by the Congressional Budget Office. The increase in debt risks making it more expensive for the United States to borrow. Relatively strong U.S. growth could cause problems for plans to stimulate employment by U.S. manufacturers. Those that export products and services may find themselves priced out of foreign markets.

In this low rate environment, yield hungry investors have been ditching the safety of bonds in a search for returns in risker real estate investment trusts and high dividend yielding stocks. This can be dangerous as these investments don't have the defensive characteristics of high quality bonds. Investors should note that while the bull market in bonds may be over, it does not mean that a bear market in bonds is beginning.

Peter Webster, CFA

U.S. Equities

The Standard & Poor's 500 index climbed 3.8% in U.S. dollar terms over the fourth quarter, which was matched in Canadian dollar terms. For 2016 as a whole, the U.S. equity benchmark gained 12.0% in U.S. dollar terms and was up 9.0% in Canadian dollars as the Loonie rebounded over the course of 2016, largely due to an improvement in energy prices.

The surprise win of the White House by Donald Trump was easily the primary driver of the U.S. equity market in the fourth quarter. There are significant implications for the stock market over the next few years but it will take time to determine what the outcomes will be.

The main sources of concern for the U.S. equity market as a result of the new policies longer term are a stronger U.S. dollar and higher government borrowing costs. A strong dollar could undermine the new administration's efforts to revive export based manufacturing. The president-elect has also promised to spur growth with corporate and personal tax cuts, as well as to use tax credits to fund infrastructure projects. These initiatives could help the economy but would increase the fiscal deficit and likely lead to increasing bond yields. There are already concerns about high debt levels so increasing both the amount of debt and interest rates could push the cost of servicing government debt to challenging levels in the long term.

A big driver for the U.S. stock market for 2017 would be the implementation of a proposed reduction in the corporate tax rate from 26% to 20%. Lower taxes would boost corporate profitability which would improve the chances of keeping the long lasting economic expansion on track to rival the 10 year U.S. record. U.S. based companies with international operations could use the lower tax rates to repatriate cash held overseas and that could be used to fund expansion and for the payment of dividends.

The initial assessment of the stock market seems to be that the developments are broadly positive. The administration is being stocked with individuals who have good understanding of how the economy works and who are able to make reasonable calculations concerning the implications of their shifts. We should expect some big bumps resulting from these big changes but there is a good chance that irrationality will play less of a role than many had feared.

Peter Webster, CFA

PROVISUS™
WEALTH MANAGEMENT

Provisus Wealth Management Limited

Suite 303, 18 King Street East
Toronto, ON M5C 1C4

Phone: 416-933-1111
Toll Free: 1-87PROVISUS (877-768-4787)
Fax: 416-933-2222
E-mail: salesandservice@provisus.ca

We are on the Web!
www.provisus.ca

Follow Us On

Go beyond the ordinary

PROVISUS™
WEALTH MANAGEMENT

International Equities

The global outlook has become slightly more fragile of late, due to the results of the U.S. presidential election and heightened risks in China, Europe and some Emerging Markets. It is yet to be seen whether Trump's election will change the world, but it has turned the investment landscape on its head. Many parts of the world will be in a "wait and see" mode for some time to come, weighing potential rising inflation against faltering business confidence and general nervousness about the future.

In Europe, growth rebounded at the end of the year based upon domestic demand after a slow summer. Growth may have been artificially inflated by record low interest rates and the European Central Bank's asset purchase program. However, going forward it appears the key themes will be: higher fiscal spending, extended quantitative easing and regional elections. The potential for political upheaval on both sides of the Atlantic is raising financial stability risk and could trigger sudden capital flows and market volatility. Unemployment has been consistently falling for more than a year while manufacturing output has accelerated to its best pace since the start of 2014, benefiting from a weaker currency and stronger demand. In the U.K. a slowdown in growth remained likely in the near term. Interest rates remain at record lows, despite warnings of higher inflation and slower wage growth.

The outlook for Japan remains cautious as a potential rebound in exports after thirteen straight monthly declines could lead to domestic growth. However, twenty-two consecutive months of decreasing imports threatens Japan's stilted recover and exacerbates the risks associated with increasing U.S. trade barriers. The Yen skidded to an eight month low which could delay additional reforms which are much needed.

Emerging markets are in better shape than they have been in five years, continuing an upward climb as currencies recover and economic growth accelerates. However, U.S. policy uncertainty and imbalances in the Chinese economy are becoming major sources of risk. China expanded at a steady 6.7%, fueled by stronger government spending as they have clearly chosen to do everything they can to rebalance the economy from an over reliance on government led growth. The rest of Asia is looking at good growth rates going forward as well. Latin America has been dragged down by Brazil over the past two years but they appear to have finally turned the corner.

The topsy-turvy non-North American equity markets continue to struggle this year; particularly after the world's attention was diverted to analyze the potential implications of a Trump-led fiscal stimulus package and higher U.S. interest rates. That activity was compounded with the U.S. dollar surging to a near 14 year high and the stage was set for currencies to be clobbered and for a massive stock rotation out of defensive stocks into interest rate sensitive stocks, energy (OPEC's production cutting agreement contributed mightily here) and manufacturing stocks.

Clearly the global outlook had improved, but this partial optimism needs to be counterbalanced by an elevated level of risk. Certainly a note of caution is warranted, however it should be underpinned by slightly greater momentum in the global economy as evident in a range of data since the earlier part of last year.

Christopher Ambridge, CFA

These reviews may contain forward looking statements. Forward looking statements are not guarantees of future performance as actual events and results could differ materially from those expressed or implied. The information in this review does not constitute investment advice by Provisus Wealth Management Limited and is provided for informational purposes only and therefore is not an offer to buy or sell securities. Past performance may not be indicative of future results.

This is a publication of Provisus Wealth Management Limited. The contents of this publication are not to be reproduced, transferred or distributed in any form without prior written permission from Provisus Wealth Management Limited. The Transcend and Provisus logos are trademarks of Provisus Wealth Management Limited. All rights reserved.