Angas Shick Group
PRIVATE WEALTH COUNSEL

Investment Commentary Fall 2017

Summary

It continues to be a difficult year for Canadian investors with the S&P/TSX only recently turning positive. The index's underperformance relative to its developed country peers is surprising considering the Canadian economy has recorded the best GDP growth among the G7 countries and commodities are ranking among the best performing asset class during the quarter.

The S&P 500 and the MSCI World Index have gained 12.5% and 14.5% year to date respectively. While the Canadian dollar has appreciated against the US dollar, Canadian investors with strong exposure to US and global stocks were better rewarded than those who held predominately Canadian equities.

After oil slipped back into bear market territory late in Q2, the commodity bounced back in Q3 which was driven by recent geopolitical events, supply disruptions, and high seasonal refinery demand. Historically, when the price of oil, measure by the WTI, breaks through the key technical level of US$50.00/bbl., it provides good support for oil stocks leading to higher annualized returns.

The third quarter may have marked the bottom for the S&P/TSX this year with the financials, energy and materials now all participating with tailwinds to support further gains. These sectors, which make up 2/3 of the index weight, advanced 3.7%, 5.7% and 3.0% respectively during the quarter. The Bank of Canada also appears to be on hold for further rate hikes which will help support the interest rate sensitive sectors like utilities and real estate.

US economic activity remains positive, clearing the way for the US Federal Reserve to continue its path to reduce monetary stimulus. This reduction has occurred at a measured pace which has not been a deterrent to positive market performance. The Fed hiked the Fed funds rate for a second time ahead of Q2/17. The increase occurred despite inflation data running stubbornly below the Fed preferred level, although August did mark the first CPI print that came in above economists' forecasts. The Fed did not hike rates in October but has signaled that one more rate hike may remain on the table for 2017 and three more potential hikes in 2018. US employment trends continue to point to an economy that is approaching full capacity.

Outside the US, the global economy hit its stride as purchasing manager indices (PMIs) continue to point to an acceleration in economic activity. PMIs remained securely above their long term average indicating manufacturing growth is firmly above trend. Global equity markets achieved fresh record highs during the third quarter despite the numerous headline risks that ranged from North Korea to the potential failure of US tax reform.

Model performance

Our Canadian Dividend Equity model matches the S&P/TSX Total Return Index of 4.4% year-to-date and the Balanced Growth portfolio which consists of 5% cash, 25% fixed income, 40% Canadian equity and 30% foreign equity is up approximately 5.5% year-to-date compared to an approximate 6.5% for the benchmark.

The four sectors that made a positive contribution relative to the portfolio benchmark were energy on the back of strong oil prices with WTI up 9.4% during September, real estate, utilities and telecom. The three weakest performing sectors were materials, consumer staples and financials.

Among the detractors, Franco-Nevada (FNV-T) dropped 5.1%, as gold prices headed for their worst monthly return so far in 2017, falling 2.8% in September. North West Company (NWC-T) declined 4.6% in September following the company missing its earnings and revenue estimates during the second quarter. The company also was impacted by Hurricane Irma, which affected 12 of its stores, representing approximately 10% of its total earnings. Exchange Income Fund (EIF), while still down year to date, was up for the month of September.

The portfolio continues to benefit from our increased exposure to the global markets with Black Creek Global Leaders Fund, the newly added Fiera Capital, and the other global funds and ETFs which have all outperformed their peers. We remind clients that we select funds and ETFs based on adherence to investment philosophy, geographical allocation, investment style and performance. Each fund is put through a rigorous quarterly review process (and earlier if there is a management change) to determine if it continues to meet our expectations and to determine if should be maintained in the portfolio.
We have included a report from the Black Creek management team at the end of this investment commentary for your interest.

Trades

During the quarter, we trimmed our positions in Emera (EMA) and Pure Industrial REIT (AAR.UN) to take some profits. We also sold half our position in Corus Entertainment (CJR.B) which was flat for the quarter, but because of its 9% dividend, it still contributed positively to the overall portfolio performance. We have the remaining position under watch due to its weak quarterly earnings and increased competition,
We added to CI Financial (CIX), which ended flat for the quarter on an analyst's downgrade, but has recovered since. We also added to our Sun Life (SLF) holding with the expectation that both of these positions will benefit from the current economic cycle.

With our mutual fund holdings, we felt it was time to take some profits and trimmed half our position in the Dynamic Power Growth Fund which has done very well lately due to its overweight position in technology stocks. We also sold the Fidelity NorthStar® Fund whose overweight position in cash continued to be a drag on performance. With the proceeds from these two fund redemptions, we added Fiera Global Equity to the portfolio due to its investment process and it has top quartile performance YTD and over one, three and five years. We also increased our position in the CI Black Creek Global Leaders Fund.

Dividend Increases

There were five dividend payout increases announced during the last quarter; Emera Inc. (EMA), Fortis Inc. (FTS), Loblaw (L), Royal Bank (RY) and Telus Inc. (T).

What's next?

While there were plenty of headline risks including geopolitical events, natural disasters and political drama, the quarter was characterized by an improvement in overall risk appetite underpinned by strong corporate earnings, synchronized global growth, and more importantly for the Canadian economy a pick-up in commodity prices.

We believe these factors will continue to provide support for all markets. The fourth quarter, historically the best performing quarter of the year is also the second least volatile quarter.

This does not eliminate the possibility of pullback on the U.S. market from either stretched share price valuations or some political event but since it would not be triggered by any economic crisis we see surfacing including recessionary pressures, it would be very short lived in our opinion.

Black Creek Global Leader's Fund

Management Commentary

Sometimes, it pays to take stock (pun intended) of where we are now in terms of equity markets. It's been eight years since the market lows of the last global recession and financial crisis. Ten-year performance numbers for the fund and for the markets generally do, in fact, reflect that crisis period. But performance numbers in the last five years have been stellar. In this time, the S&P 500 Index has nearly doubled, with Nasdaq stocks (more heavily technology-weighted) up by 124% (as of June 30, 2017). This is in spite of 10-year U.S. Treasury yields rising from 1.5% to 2.3% during the same period. The U.S. equity market has outperformed global equities in the last five years, with the MSCI World Index up 74% and the MSCI ACWI Index (ex U.S.) up 45%. Emerging markets have lagged, up only 23%. We need to be clear about one thing: the returns of the past five years are not sustainable and are well above normal long-term equity returns.

Perhaps some, or a good part, of equity returns have been caused by the move to passive investing – the use of exchange traded funds or index funds to invest in equities. Arguably, passive investing is self-reinforcing. Prices rise simply because of the demand for equities and no thought or judgment is given to individual stock prices. Perhaps this is why measures of stock price volatility are near all-time lows, which is opposite to what we thought would happen in a world of low interest rates. Judgment and selectivity remain core aspects of our discipline, and these traits may be more valuable over the next five years.

From this point, a normalization of equity returns may entail negative returns for the market for a period. Whether or not this is precipitated by an abrupt end to passive investing remains to be seen. It is worth noting that our portfolios have low exposure to stocks in the various indexes, and we have relatively high active share (a measure of how much the portfolio is different from an index). Of course, this is no guarantee for performance, but we will not be in the eye of any coming storm.

The “worry list” is long: central bank tightening, Russia’s apparent cyber warfare, the actions of North Korea, Brexit terms, lack of progress in U.S. reforms and rising isolationism, and ISIS. But the “happy list” is also worth noting: the massive consumer benefit from Internet price transparency and “free” Internet content, the rapid dissemination of information and knowledge worldwide that enables the development of emerging markets, relative peace and health in the world today, and the rapid advance of many technologies that will give rise to the jobs of the future.

Portfolio Allocations

Asset class (%)
International Equity 70.9
US Equity 23.7
Cash and Equivalents 5.4

Sector (%)
Industrial Goods 19.7
Consumer Services 12.6
Technology 12.2
Healthcare 11.4
Industrial Services 9.8
Consumer Goods 9.7
Financial Services 7.0
Energy 6.2
Cash and Cash Equivalent 5.4
Other 6.1

Geographic (%)
United States 23.7
Japan 11.3
France 10.7
Switzerland 6.8
United Kingdom 6.7
Mexico 5.6
Canada 5.4
Germany 4.8
Netherlands 4.5
Other 20.6

Top Holdings	**Sector (%)**
OC Oerlikon Corp AG Pfaeffikon	Dversified Industrial Goods 4.92
Heidelbergcement AG	Construction 4.77
Nielsen Holdings PLC	Professional Services 4.65
Koninklijke DSM NV	Diversified Healthcare 4.47
Oracle Corp	Information Technology 4.45
Schneider Electric SE	Diversified Utilities 4.35
Daikin Industries Ltd	Construction 4.32
Accor SA	Leisure 4.01
Santen Pharmaceutical Co Ltd	Drugs 3.89
Galp Energia SGPS SA	Oil and Gas 3.72
Santander Mexico Financial Group SAB de CV - ADR	Diversified Financial Services 3.51
ICICI Bank Ltd - ADR	Banking 3.46
Booz Allen Hamilton Holding Corp	Information Technology 3.45
BorgWarner Inc	Automotive 3.29
Makita Corp	Manufacturing 3.11