Family Wealth Counsel
Advisory Group

RAYMOND JAMES®

Investment Commentary – Fall 2019

Summary

The S&P/TSX spent most of the third quarter trading in a narrow range but managed to break to new all-time highs in September as a swift rotation into value and safe-haven stocks bid up the undervalued Canadian market. With the S&P/TSX trading at a discount to its 10-year historical forward price-to-earnings ratio for the past year, there were plenty of value names for investors to choose. The deeply depressed energy sector experienced the most notable bounce, gaining 8.2% from its August lows. The initial move was attributed to the value rotation, while the second leg resulted from rising Middle East tensions. An attack on Saudi Arabia's main oil processing and storage facility, Abqaiq, removed more than 5 mln/bpd of capacity, making it the most significant disruption to global oil supply in modern history, representing about 5% of global production.

Canadian financials also participated, particularly the banks and insurers, which traded higher in September. This was attributed to the value rotation but also due to signs that the Canadian housing market was stabilizing, with Canadian housing prices picking up for the first time in 9 months in August, thanks to a drop in mortgage rates. The average promotional five-year fixed rate fell by more than 80 bps since last December.

While the broader market benefited from investors moving into more cyclical pockets of the market, it also received a boost from a safe-haven trade, as investors sought the safety of precious metals stocks. Trade uncertainties, Middle East tensions, easing monetary policy and global growth concerns were the primary drivers for investors bidding up bullion prices.

The US expansion achieved a notable milestone during the quarter, marking its 10th anniversary and becoming the longest post-war business cycle expansion. The current expansion that started in 2009 has lasted over 124 months and exceeds the 1991-2001 expansion. Interestingly, while the current expansion is a record in terms of duration, it pales in comparison to the 1991-2001 expansion in terms of magnitude of GDP growth as it is notably smaller. This is a fascinating point considering the depth of the 2008-09 recession and the amount of monetary and fiscal stimulus used to right the economy.

While expansions do not die of old age, the current cycle continued to show its age. Bond markets rallied through much of Q3 amid greater global economic uncertainty, pushing global bond yields in major economies to their lowest level in history.

The steep decline in long-term yields pushed the closely watched US 2 and 10 year maturities to invert for the first time since 2007. As long bonds signaled slower economic growth ahead, in August, the US Federal Reserve delivered an 'insurance' rate cut, the first in a decade, and followed through with an additional cut in September. However, shortly after the insurance rate cut, President Trump ratcheted up the trade war with China by announcing intentions to levy a further 10% tariff on $300 bln of Chinese goods on September 1st. The result was that on August 5th, the S&P 500 posted its worst single trading day of the year. Fortunately, tensions eased toward the end of the quarter, which helped fuel the recovery and sent the S&P 500 near its current year high, while the S&P/TSX jumped to a record high

Model Portfolio Performance

Due to the underweight position in energy and precious metals, our Canadian Dividend Equity Model Portfolio moderately underperformed the S&P/TSX Index for the 9 months ended September 30, 2019 with a total return of approx. 14.8% vs. the benchmark of 16.3%. The portfolio has far outperformed the market on the year over year basis though posting a 5.6% return versus the benchmark of 3.6%.

The Balanced Growth portfolio which consists of 5% cash, 25% fixed income, and 70% equity was up approx. 13.5% for the 9 months ending September 30, 2019 and up just under 4.8% for the year over year.

During the last quarter, the portfolio benefited from the holding in **Franco-Nevada**, which outperformed the market as investors' appetites for gold significantly increased. **Brookfield Asset Management** (BAM'A) traded higher and continues to provide increasing and consistent performance to the portfolio. We also saw strong performance from **Enbridge**, **Manulife Financial**, **Dream Reit** and **Royal Bank** which contributed to the overall returns as well.

Trades

We took profits from **Interrent REIT** which was trading at its all-time high and invested the proceeds in **First Asset REIT ETF** to provide more diversification and return potential with less risk. We trimmed **Waste Connections** and **CP Rail,** and invested the proceeds into **Brookfield Asset Management**. We sold **Vermillion Energy** and bought **Open Text** to add a technology name to the portfolio. All these trades were initiated to de-risk the portfolio and increase the global exposure as all these names have international revenue exposure. We also added **the BMO Ultra Short Bond Index ETF** to increase yield on our cash holdings and provide a low risk way to access short duration bonds.

Dividend Increases

During the last quarter, **Nutrien** was the only company to announce a dividend increase. It is part of our Canadian Dividend Model Portfolio which is now yielding 3.5%.

What's next?

While both the Canadian and US market have experienced strong performance year to date, there are continuing concerns about the health of the global economy and the duration of the ongoing trade war has also caused growing uncertainty for many businesses as well. We can see this in the most recent Conference Board CEO Confidence index which sank to its lowest level since Q1/09 as pessimism spread about both current conditions and the economic outlook. While there are concerns weighing on the financial markets such as yield inversion, we also face the prospects of higher tariffs this year which will further exacerbate the 2020 growth outlook. The weakness in manufacturing is being felt globally and is now spilling over to the service side of the economy as well.

On the bright side, consumer spending which represents 70% of the economy (US) has been largely immune to the manufacturing slowdown and trade war uncertainty, at least so far. Global banks and fiscal policies remain accommodative which will also help support a slowing economy, and there is still much debate about whether a recession is imminent at all. Although the bond market is indicating that this is still a possibility, we believe that if we do experience one, it will be short lived and considered more of a soft landing.

We are entering into earnings season now which will provide some indication of the health of corporate profits and trigger any adjustments to our asset mix, country, sector and securities selections where necessary.

We wish you an enjoyable fall! As always, please contact any one of us at any time if you have questions or concerns.

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