Family Wealth Counsel Advisory Group | RAYMOND JAMES®

Investment Commentary – Summer 2019

Summary

In the last couple of months, and particularly the last couple of weeks, we have witnessed increased volatility and more recently, some large negative market drops as well. The first source of this volatility was primarily the result of Trump escalating the trade war with China by raising tariffs once again. An escalation in the trade war with China will affect annual GDP growth and may ultimately result in an economic slowdown. Very recently, the inversion of the yield curve grabbed investor's attention and for good reason. Inverted yield curves have a good track record of calling US recessions. Yield curve inversions have preceded all US recessions in the past, but not every inversion has resulted in a recession. In fact, the timing between the inversion and the end of an economic cycle vary significantly. Since the 1960s the timing between the initial inversion of the yield curve and a recession is between 6 and 24 months, with an average period of just under a year. More interesting is that in most cases, the performance of the stock market between inversion and recession has shown positive gains.

While many of our recession indicators are neutral or trending negative, the jobs market and US consumer remain bright spots. At the time of writing this commentary, markets are back up, Trump has backed off some of the trade threats and has given a potential reprieve to Chinese telecom giant Huawei, and the yield curve has "un-inverted".

Model performance

Our Canadian Dividend Equity Model portfolio underperformed the S&P/TSX index for the seven month ending July 31, 2019 with a total return of approx. 11% vs. the benchmark of 14.5%. The portfolio far outperformed the market on the year over year return which was 3.71% vs, the benchmark of -0.2%.

The Balanced Growth portfolio which consists of 5% cash, 25% fixed income, and 70% equity was up approximately 10.5% for the seven months ending July 31, 2019, and up just under 3% for year over year period ending July 31, 2019, outperforming the benchmark for both time periods considering its asset mix. The outperformance was due to the global exposure and the overweight in defensive stocks.

During the last quarter, the portfolio benefited from the holding in Franco-Nevada which experienced a large out performance vs. the market as investors' appetite for gold significantly increased. Brookfield Asset management (BAM'A) continues to provide increasing and consistent performance to the portfolio and is trading at its 52 week high. All the utility stocks have also contributed positive capital performance as well as dividend yield and have outperformed the Canadian stock market over the last 12 months. In the second quarter, we added to Pembina Pipeline (PPL) Waste Connections (WCN), Parkland Fuel (PKI) and Algonquin Power (AQN) which all proved to be very constructive. Enbridge (ENB) has been weak and struggles to provide capital appreciation due to various issues with pipelines including environmental impacts and delayed projects. It does however provide an excellent yield of over 6% and therefore provides good cash flow. The oil stocks continue to detract from performance as there is no appetite these days for Canadian oil stocks among institutional investors. Our overall pure play oil weighting is very low at under 3%. Having said that however, we are evaluating our oil sector holdings which are currently Suncor (SU) and Vermillion Energy (VET).

Trades

We replaced Sun Life (SLF) with Manulife (MFC) as we expected Manulife to provide better capital performance. This has not proven to be the case so far due to reserve concerns and lower interest rates which drag down the insurer's earnings. We sold our position in the Horizon Preferred Share ETF (HPR) at a loss, as the environment for preferred shares very quickly became negative and due to current market forces, we don't believe this investment will recoup its loss. We sold Aecon (ARE) at a break even due to technical deterioration. Although from a capital stand point it was a flat trade, there was some return that came from the dividend. We trimmed Waste Connections (WCN) and CP Rail (CP) due to extreme outperformance vs. the benchmark and added the proceeds to Brookfield Asset Management (BAM'A) to improve the defensiveness of the overall portfolio. We also sold Interrent Reit (IIP.UN) due to its very strong capital appreciation and deployed the proceeds in the First Asset REIT Index (RIT) to increase overall yield and to reduce the risk of the portfolio. We switched the Dynamic Power Global Growth fund to the Dynamic Power American Fund as we believe that the later fund will provide better long term performance.

<u>Dividend Increases</u>

During the last quarter the following companies increased their dividends: Algonquin Power (AQN), Bank of Nova Scotia (BNS), CP Rail (CP), Franco Nevada (FNV), Loblaw (L), Pembina Pipeline (PPL), Royal Bank (RY) and Telus (T).

<u>What's next?</u>

While there are concerns weighing on the financial markets such as yield inversion, waning global economic momentum, trade war, Brexit, Middle East tensions, weak business investment and a slowdown in manufacturing, there is also support that we are not heading into an immediate recession. These include global central banks easing monetary conditions, low inflation and inflation expectations, job wage gains, robust US consumer spending and supportive US technicals on the S&P 500, Dow and Nasdaq. We also point out that the US market valuation is not at peak levels,

We believe that we will continue to experience the "dog days of summer" well into September. The origin of the phrase traces back to Greek astronomy when the Greeks discovered a 40 day period in which Sirius, the Dog Star, was the brightest star in the constellation. They believed the additional glow was responsible for the scorching summer days, drought, sudden thunder storms, weather volatility and even bad luck. We have witnessed even more volatility towards the end of the summer and we believe that the dog days of summer may extend into the fall. We have positioned the portfolio to be more defensive and have increased the overall yield.

We wish you a happy enjoyable end of summer! As always please contact any one of us at any time with any questions or concerns.

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