Monthly Portfolio Report – May 2016

In addition to our quarterly market commentary on the broader economy and how that affects our decisions on asset mix and foreign content, we will be providing you with a monthly report on the position changes that take place in our model portfolio as well. Because the composition of cash, fixed income and equities differs for each of you, this report will focus on the Canadian equity allocation with broader references to other components.

Both the Dividend Growth portfolio and the Growth portfolio have outpaced the benchmark year-over-year but have underperformed year-to-date because of our underweight allocation to the oil and gas sector and our exposure to global equities, which continue to lag the Canadian market so far this year. We have increased our cash allocation to Canadian equities across all of our portfolios at the end of the first quarter. These have risen in value since then and have contributed to positive performance in the portfolio. However, we did not add significantly to the energy sector which has been the leader in the broader market due to the rebound in oil prices.

During the last quarter, we sold Power Financial, Enbridge, Domtar, Shaw and Dorel in the Dividend Growth portfolio, and added Allied Properties, Canadian REIT, Transcanada, Enercare, Atco, and Chemtrade for their exceptional yield characteristics. All of these transactions contributed to the overall performance of the portfolio, although our timing on selling Dorel was probably a bit too early. We also saw the share price for Intact Financial drop due to insurance liability concerns from the Fort McMurray fires, but it has recovered nicely since then and continues to be a hold. All of the other names in the portfolio have contributed positively to the performance.

In the Growth portfolio, we sold DH, Rogers and Sunlife, and bought Bank of Montreal, Smart REIT, BCE, and Open Text. Just recently, we sold Brookfield Asset Management, Constellation Software and added Altagas, Suncor and Canadian Tire. We captured a strong profit on Brookfield but missed with our sell timing on Constellation which was triggered by our concerns on valuation. As noted above, we were late adding oil and gas positions back into the portfolio, but the names we did include have already increased in value with further upside expected. Although Stella Jones has been flat so far, we expect to see future growth resulting from increased capital spending by utilities and rail companies, and therefore we have kept this position in the Growth portfolio. All the other positions have contributed to performance except Intact Financial for the reasons noted above.

We are currently rebalancing our portfolios after the Q2 earnings season which reported relatively muted profits and revenues but slightly better results than analysts expected. Looking ahead, we will likely add to our bank positions in both portfolios, especially if we see any pullback in their share prices.

Market Thoughts

The U.S. Fed will be meeting again soon to announce its decision on interest rates. All bets are on a moderate increase at some point this year but, with the recent disappointing job numbers report, the big question now is when. When they finally do make their interest rates announcement, the market may react negatively at first but that will be short lived in our opinion, and it will not cause the economy to fall into a recession. In fact, we see rising rates as a sign of a strengthening economy that should reduce volatility further down the road.

There has also been some talk that we are due for a recession because we have been in an almost uninterrupted expansion phase since 2009. The likelihood of this happening will depend far more on what the economy is doing and what action the Fed Reserve takes with their monetary policy than the length of time since the last recession. If economic growth does face the slight risk of turning negative, we would expect the Fed to be cautious as it would be hard for them to correct course if rates are raised too quickly rather than too slowly. There is also a concern that just the fear of a recession can become self-fulling - resulting in people who are worried about losing their jobs saving more rather than spending, and businesses hoarding cash and becoming reluctant to hire workers.

We do not expect this to happen if the correct signals are provided from the Fed. The increase in oil prices and the strengthening US dollar is definitely a drag on the slow growing global economy but we do not expect this to interrupt that growth or contribute to recessionary pressures either.

In closing, we would like to reiterate our investment philosophy is to never extend our reach beyond what is reasonable for reaching your goals and expectations. Although we would not be surprised to see some elevated volatility over the next couple of months and the possibility of a short term pullback in the market as well, we are expecting positive performance in our portfolios at year end.

As always, please contact us if you have any questions or concerns you would like to share with us.