"Germane Thoughts"

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"I've fallen, and I can't get up!" Some of you may remember that catchphrase from the late 80's and early 90's commercial from LifeCall, a U.S. medical alarm company. It's the feeling I get that global equity markets are currently trying to tell us after another month of dreadful performance in September. Whether it be the normal seasonal effect, the Federal Reserve remaining on hold, the fact that this is the third longest bull market on record in the U.S., slightly above-average valuations or continued economic concerns with China or Europe, there is no shortage of reasons for the Bears to build their case.

After a weak August, which included the flash crash on August 24th when the Dow Jones Industrial Average dropped over 1,000 points intraday, September followed up with more weak performance from the markets. The S&P/TSX Composite Index declined another 4.0% while the S&P 500 Index dropped 2.6%, bringing the third quarter returns to -8.6% and -6.9% respectively, the worst quarterly returns since the third quarter 2011. Global equity markets were also pummeled across the board with the NIKKEI 225 (Japan) declining the most, down 8.0%, while the MSCI World Index was down 3.7%. The DAX 30 Index in Germany was also down 5.8% with the biggest decline coming from Volkswagen AG which declined 53% after it admitted to cheating on U.S. emissions tests for years. Five of the ten sectors in Canada treaded water in September with the Consumer Staples sector leading the way, up 2.6% followed by the Industrials and Telecommunication Services sectors which were each up 1.1%. After significantly outperforming in the first half of 2015, the Health Care sector in Canada continued to give back the outperformance by declining 21.8% in September as heavyweight Valeant Pharmaceuticals dropped 21.9% and Concordia Healthcare Corp. declined 44.1%. Meanwhile, south of the border, the defensive Utilities and Consumer Staples sectors were the only sectors to post positive returns in September, up 2.6% and 0.1% respectively. The resource sectors were the worst performing sectors in the U.S., with the Materials sector down 7.6% and the Energy sector down 6.8%.

The much anticipated U.S. FOMC meeting came and went with the Federal Reserve remaining on hold (again!) as Janet Yellen cited weakness in China and the potential impact on global growth as the latest concern. Yields on 10-year bonds declined on a global basis with yields in Europe declining over 20 basis points while 10-year treasury yields in the U.S. declined 14 basis points to 2.06%. The Canadian dollar continued its downtrend and minted a new cycle low declining 1.3% in September to end the month at $0.75 vs. the US$. Earnings estimates in both Canada and the U.S. continued to remain fairly weak with only a small percentage of all stocks having their 2015 estimates raised over the past three months. That being said, actual earnings results have come in stronger than expected, somewhat offsetting the weakness in revisions. Furthermore, valuations have contracted sharply over the past few months as the S&P 500 Index now trades at 15.8x 12-month forward earnings compared to 17.7x at the end of February. The S&P/TSX Composite Index trades at 15.5x 12-momth forward earnings estimates compared to 18.4x at the end of February.

Heightened volatility seen in late August carried over into September as the S&P 500 Index experienced 8 trading days of more than a +/- 2% daily price change, after posting only one such day previously this year. Although our Funds continue to be fairly defensively positioned with higher than normal cash balances and covered-calls written, we believe much of the negative news has already been priced into the market and wouldn't be surprised to see the market rally in the fourth quarter on better than expected third quarter earnings and fairly attractive valuations. We continue to monitor our investment model daily for signs that the market is turning and are ready to deploy cash back into the market to take advantage of a potential fourth quarter rally.

Forward Looking Information and Disclaimer

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