"Germane Thoughts"

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In-flec-tion point "a time of significant change in a situation; a turning point". After a weak and volatile 3rd quarter of 2015, the 4th quarter started off with a bang as global equity markets shed their concerns (for the time being at least) regarding slowing global growth, a potential hike in interest rates by the U.S. Federal Reserve and the continued economic weakness in China. With the strength in October pushing many indices back into positive territory for the year, it seems we may be at a bit of a fork in the road regarding future performance. Does the slowdown in global growth triggered by weakness in emerging markets along with the continued rise in the U.S. dollar manifest itself into a greater correction for global equity markets? Or are we just about to end a mid-cycle slowdown, pulled out by better growth in the developed world along with central banks in both Europe and China willing and ready to do whatever it takes. We shall soon find out, but our belief is that markets will continue to climb the proverbial "wall of worry" and rally into the end of the year.

After a weak August and September, historically two of the weaker months for equities, October roared back with a vengeance as the S&P 500 Index rose 8.3%, its largest monthly rise since October, 2011. Meanwhile, the TSX Composite lagged, up only 1.74% due to the "Valeant effect" as Valeant Pharmaceuticals Int'l Inc., which had the distinct unfortunate pleasure (see Nortel, RIM, Potash, etc.) of having the largest market capitalization in Canada as recently as July 28th, dropped 48.8% during the month, with most of the decline on October 21st after it was accused by a short-seller on a blog that the company was using an Enron-like strategy of recording fake sales.

Global equity markets also bounced back across the board with the DAX 30 Index in Germany rallying 12.3%, the Shanghai SE A Share market (China) rising 10.8%, the CAC 40 (France) up 9.9% and the NIKKEI 225 (Japan) up 9.7%. Seven out of the 10 sectors in Canada rose with Energy and Materials, the two weakest performing sectors up to the end of September, bouncing the most up 7.6% and 7.0% respectively. For the second month in a row, Health Care was the weakest performing sector in the TSX, down 45.7%, mostly due to the Valeant reasons stated above. All ten sectors within the S&P 500 Index posted positive performance in October with the 3 top sectors, Energy, Materials and Technology each generating double digit returns of 13.5%, 11.3% and 10.7% respectively.

After disappointing the market in September by remaining on hold with respect to the overnight rate, the October FOMC meeting came and went with the Federal Reserve standing pat. Some believe that Yellen and the FED continue to risk losing credibility by suggesting a rate hike is still likely in 2015 with only the December meeting left to do anything. The market took this as a sign that the December meeting is still on the table as US 2-year Treasury yields jumped 8 basis points on October 28th, though liquidity could be an issue as we head into Christmas holidays and year-end. Commodities were a mixed bag in October as Gold Bullion rose 2.4% to US$1,141 per troy ounce while Silver jumped 6.8% to US$15.64 per troy ounce. Crude Oil continued to remain in the US$40 to US$50/bbl range closing October at $US46.60, up 3.4% for the month. Meanwhile Natural Gas prices plunged 21.5% to close below US$2 per mcf, the first time since April 2012 as Henry-Hub prices ended October at $1.94 per/mmbtu. The Canadian dollar followed crude oil for the month and was up 1.85% to close at $76.5 cents.

Although earnings revisions continued to remain weak and in decline in October, there were some notable earnings releases with strong price reactions in the month such as Alphabet (formerly Google), Microsoft and Amazon, each reported better than expected earnings and forward guidance. With the strong move in October, valuations in the U.S. rose over a full multiple point for the S&P 500 to trade at 16.9x forward earnings vs. 15.8x at the end of September. Meanwhile, the S&P/TSX Composite Index P/E multiple stayed flat in October at 15.6x forward earnings estimates, still down from the high of 18.4x at the end of February. Heightened volatility in late August and September declined for most of October and moved back to the mid-teen range it had been trading in for most of in 2015.

As I stated in the September letter, "Although the Funds continue to be fairly defensively positioned with higher than normal cash balances and covered-calls written….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". And that is precisely what has happened. We started to redeploy cash and reduce our call positions in early to mid-October which has helped lift the Net Asset Values for most of our Funds

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