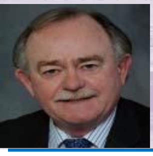
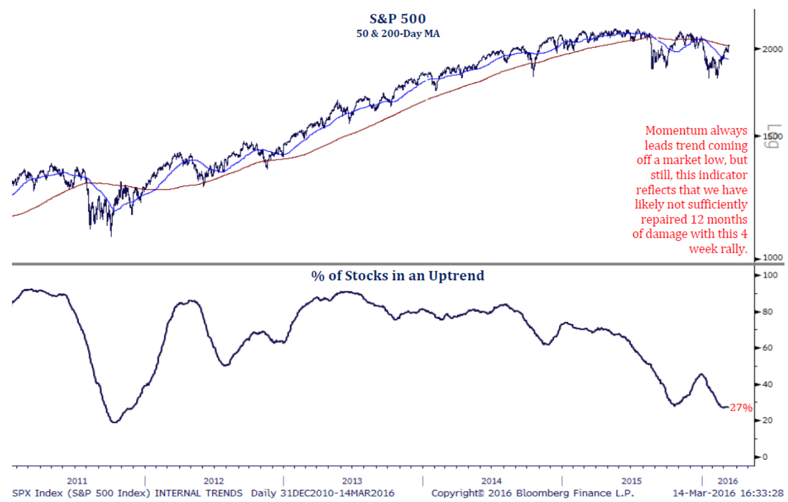


Jack Way
Vice President

Given the amount of volatility, commenting on current financial markets lends itself perfectly to social media. A tweet or blog can be created in the morning, and when proven wrong, can be replaced with a different outlook the same afternoon. Committing one’s opinions to a more permanent record may prove to be embarrassing, but here we go.

In my last letter I opined that, given the breakdowns in the price of individual stocks and market indices, the onus was on the bulls to prove that one should maintain a positive outlook. They have done so emphatically. The improvement in investor attitudes that has taken place in such a short space of time has been impressive. However, we now stand at something of a crossroads, as many world markets (in particular the most important, the S&P 500) find themselves back where the breakdowns mentioned above took place. What were once levels of support, are now resistance that must be overcome if this bull market is to continue. I have often referred to breadth as an important factor in assessing the internal strength of the market, and while the recent move off the February bottom has shown good follow-through, it has not been sufficient to proclaim the all-clear. We expect further consolidation.



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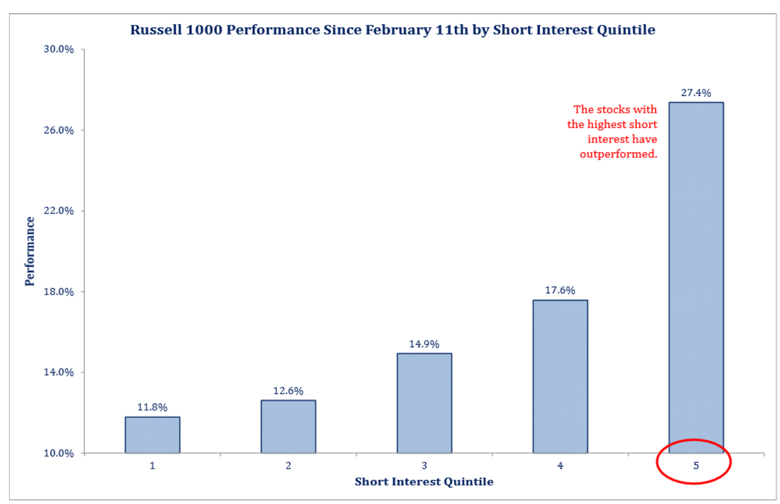
Ironically it is a totally different group of stocks taking the S&P higher in this rally. The best performing 20% of stocks from 2015 are down in aggregate 3% so far this year, while the last year’s bottom quintile is up 6%. A market led by former laggards, and also stocks with a high short interest must be viewed with concern and a jaundiced eye. It has now been 7 years since the March 2009 bottom, but the S&P is only up 0.5% in the last 18 months. That kind of lack of momentum makes it hard to be enthusiastic currently. In addition, Merrill Lynch points out, there have been 619 interest rate cuts around the world, and $10.4 trillion worth of central bank liquidity injections that have helped get us this far.



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Recently, many of the best performing stocks have been in the Materials sector, of particular note have been mining and gold companies. Several factors have been at work including; less worry about global growth, especially in China; a weaker U.S. dollar; and short covering. Whether this has been only a throwback rally or something more sustainable remain to be seen, but for now it has been a positive for the outlook for Canada, the loonie, and our financial markets. As I see it, gold is in the strongest position, and appears the most promising to go higher. Energy stocks have also rallied, but are more questionable given supply and demand issues which are still of concern. The volatility in the price of oil is staggering; almost 90% of trading days so far this year have seen a range in the price of over 5%.

The policies and actions of global central banks continue to have a marked and sometimes disproportionate impact on financial markets, that can't be ignored. For example, the Bank of Japan opted to institute a negative interest rate policy with the hope it would stimulate the economy, boost trade through a lower Yen, and promote a stronger stock market. It proved highly unsuccessful, probably in large part because investors who had borrowed Yen to buy stocks were made nervous and bought back the Yen and sold stocks to reverse that trade. Consequently the Yen rose and stocks fell, opposite to the Bank's intended outcome. Then last week the European Central Bank moved aggressively to lower rates and expand and increase its asset purchasing programs. Initially markets responded very positively, but it was short lived when the bank's president, Mr. Draghi, suggested this might be last of any stimulus, which immediately drove prices back from whence they came. I read two lessons here; bankers can't be sure of the effect of their words and actions, and investors are becoming more skeptical that such policies are appropriate or effective. As usual Yogi Berra had a thoughtful insight on such matters; "In theory there is no difference between theory and practice. In practice there is."

Of course, the elephant in the room remains the US Federal Reserve, which seems to be backing away from an earlier game plan to raise rates four times in 2016. We would concur with consensus that at least for the March meeting no action will be taken. While much economic data, particularly concerning employment, remains positive, others such as a tightening by bank loan officers and lowering of CFO's earnings expectations are worrisome. And that's not to mention anxiety about global growth. If the FED errs by being too restrictive, the damage to the economy and markets could be significant. As for Canada, higher US rates would likely take the US dollar higher and put pressure on commodity prices and thus hinder the nascent recovery.

Finally, while the November US election is a long way off, and US Presidents can't act unilaterally, I think it is safe to say a win by Mr. Trump or Mr. Sanders would be negative for financial assets

Forward Looking Information and Disclaimer

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