Jack Way
Vice President

"By The Way"

May 2017

Things that make you go "hmmm". It is the nature of us all to embrace news and facts that support our own views. In our case, most specifically, our positive market outlook. One tends to applaud research that is bullish, and seek reasons to dismiss negative forecasts. In the investment business, this is often described as "talking your own book". There is a real danger one's portfolio determines how you think, instead of the more appropriate other way around. We find ourselves at a point in time when the bearish arguments are particularly compelling, and worthy of analysis and reflection. However, this is not a call to rush for the exits, but rather a recognition that much of the easy money has been made over the past eight years, and the need for prudence has risen.

The concerns being expressed by the bearish camp can be loosely organized into four areas:

1. U.S. economic and earnings growth;
2. Washington gridlock and Trump's agenda;
3. Rest of the world geopolitics and growth expectations; and
4. Market valuations in the face of the above.

In our last letter, we noted the adage "growth solves all problems." The debate is will we get that growth. Some of the more useful early warning economic indicators are "rolling over" and thus flashing amber. For example, the U.S. Purchasing Managers Index is currently at 54.4 - down from 57.7 in February, but still above the 50 level that indicates growth. The ECRI (Economic Cycle Research Institute) U.S. Leading Index is at 143.69, down from the February high of 145.67, but up from one year ago when it read 137.37. And the Citigroup Economic Surprise Index (U.S.) has been particularly disappointing having declined from (+) 56.1 in March to a recent (-) 43.4. The question is, are these reports indicative of a new trend or merely a "reversion to the mean" and a base for new growth going forward? As of now there is not a definitive answer, but particularly the PMI should be watched closely.

A crucial element, and likely a deciding factor, in the ability of the economy and corporate earnings to produce good growth depends on the passage of at least some parts of President Trump's program of lower taxes, less regulation and increased fiscal spending. None of it will come easy, with the biggest roadblock being the conservative members of his own party. There's something of a silver lining in that it seems expectations have been lowered to a point where any success would be a positive for markets. The debt ceiling, which allows the government to borrow the necessary funds to continue to operate, will come to a vote as early as

August. Those negotiations should go a long way to determining whether any productive legislation will be passed this year or rather that gridlock will prevail. The rhetoric is bound to be intense, so it will be important to concentrate on what they do, not what they say.

The market has continued to climb the proverbial "wall of worry" despite geopolitical calamities of all shapes and sizes. Nevertheless, there are important events in Europe that could impact markets; the election in the U.K. and its implications for Brexit negotiations; European Central Bank policies; and an impending Italian election just to name a few. As for the European economy, the composite PMI was at a 6-year high in May, so there is no immediate concern there. The biggest economic concern is in China, where the world's second largest economy is experiencing a government induced slowdown, which is having a negative effect on other economies around the world. The ability of the Chinese to successfully navigate a slowdown without losing control will have a major impact on global growth. The Chinese PMI peaked in December and the May report was at 51.2%, dangerously close to 50%, the level below which the economy would move into contraction. Again, this needs to be watched closely.

Finally, on the subject of market health and valuation, I know of no one who argues the S&P 500 is cheap. That doesn't mean it must get cheap, or that it can't get more expensive, but it does get one's attention. Some valuation measures such as Warren Buffett's favorite indicator, which compares the market value of all stocks to GDP is near the high level of the late 1990's (but he is still buying stocks). The more common measure, the P/E Ratio of the S&P 500 is currently around 21.5x, which is above the historic average, but will be 18.5x and below the average if earnings estimates prove correct. As for the current position of the market there is concern that we are seeing a decrease in the breadth of the market, since as many pundits point out the indices are making new highs, but fewer stocks are participating in that rise. Other strategists are anxious that small cap stocks are underperforming, and still others worry about the fact that margin debt is at an all-time high.

Despite all of the above, a bull market is a bull market until proven otherwise. So, we will be wary, but we maintain a positive outlook.

Forward Looking Information and Disclaimer

This document may contain certain forward-looking statements. These statements may relate to future events or future performance and reflect management's current expectations. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Although the forward-looking statements are based upon what management believes to be reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. Neither the Funds nor their respective managers assume any obligation to update or revise any forward-looking statement to reflect new events or circumstances. Actual results may differ materially from any forward-looking statement. Historical results and trends should not be taken as indicative of future operations. The Fund is not guaranteed, its value changes frequently and past performance may not be repeated. Unless otherwise indicated and except for returns for period less than one year, the indicated rates of return are the historical annual compounded total returns including changes in security value. All performance data take into account distributions or dividends paid to unitholders but do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns.

strathbridge
ASSET MANAGEMENT

121 King Street West, Suite 2600
Standard Life Centre, P.O. Box 113
Toronto, ON
M5H 3T9

Tel: 416-681-3900
Toll free: 800-725-7172
Email: info@strathbridge.com