Commentary for the Fourth Quarter of 2016

December markets were dominated by what market pundits have coined as the “Santa-Claus” rally. The U.S. Financial Services sector has been the primary beneficiary and has continued to rise throughout the month of December on the hope that the Trump administration will deliver on promises to reduce regulations and boost economic growth through tax cuts and fiscal stimulus. In Canada, markets were muted, given the lacklustre growth of our economy. Growth in 2015 was a subpar 0.9% and was expected to have improved only modestly in 2016 to 1.3%. Estimates for growth in 2017 are around 2% based on an expected recovery in energy prices, along with the expectation that Ottawa will increase the pace of fiscal stimulus. The one caveat is the rise in U.S. protectionist sentiment, which may hurt demand for Canadian exports. While President-elect Trump did not reference NAFTA in the plan for his first hundred days in office, concerns that the U.S. may push for new trade terms may induce Canadian exporters to hold off making investments. Further stock-market gains in Canada and the U.S. will have to be supported by rising earnings and a strengthening economy.

Also in December was the widely expected rate hike by the U.S. Federal Reserve (Fed). The Fed raised rates for the second time during this tightening cycle, moving the funds target rate to between 50 and 75 basis points – the decision was unanimous. In the policy statement, the committee acknowledged that moderate growth has become more consistent since the middle of the year, while the jobs market remained solid and the unemployment rate has declined.

Looking back at 2016, global markets have seen a turbulent year, but surprisingly have shown resilience after the Brexit vote and the U.S. presidential election result. The U.S., U.K., and Japanese markets are significantly ahead of where they started the year. However Europe, which faces a series of major elections in 2017, has shown no real change.

On the fixed income front, the yield spike has been driven as much by the outlook on inflation as real rates. Fears of deflation, which were dominant earlier in the year when oil prices plunged, have faded. Inflation expectations are rising due to acceleration in wages and growth, as well as the expected fiscal stimulus. Since higher growth and inflation can benefit emerging market growth, emerging market assets and commodities are holding up. High yield bonds, on a total return basis, outperformed investment grade bonds in the quarter. Our fixed income strategy is positioned to mitigate rising rates and to benefit from improving corporate fundamentals. We will not be immune to rate increases, but the short duration of the portfolio and focus on credit and flexible fixed income strategies should enable us to navigate and capitalize on volatility in this asset class going forward.

So, what are our investment specialists doing?

In the fixed income space Mackenzie, our Core Fixed Income manager, positioned the portfolio with a shorter than benchmark duration and avoided the long and very short end of the yield curve. The market reaction to the proposed American spending policies and the raising of rates by the Fed caused a steepening of the yield curve, but our portfolio was largely protected by most of the shift due to the portfolio positioning.

The value managers within our lineup (Canadian Value, U.S. Value, and International Value), have not changed their stripes. Their mandates performed well in 2016 due to their adherence to intelligently buying what is out of favour, and waiting patiently for markets to recognize that value. Financial stocks, for instance, have been negatively impacted by low rates, higher rates means that they can earn more as the spread between what they pay savers and charge borrowers increases. It remains to be seen whether this trend will continue given the continued low growth environment, but for now the proposed U.S. economic policies have bolstered our value mandates, which is welcome relief as those mandates have lagged the broad markets significantly over the last year as value, as an investment style, was out of favour.

We encourage you to speak with your Advisor to ensure your portfolio is well diversified and positioned to meet your investment objectives. Regardless of current market conditions, it is always prudent to follow a sound financial plan that reflects your long-term financial goals.

Sincerely,

Corrado Tiralongo,
Chief Investment Officer
Counsel Portfolio Services