VERITAS

Winter 2017

DID YOU KNOW...

- Over the past year, the cost of eating out has risen by 2.8%, while the cost of eating at home has fallen 1.6%, creating the widest value gap between the two in 30 years.
- Dr. Henry Heimlich, the inventor of the Heimlich manoeuver, died in December. Since its creation in 1974, the manoeuver has been used, including by your scribe, to save thousands of lives.
- One third of the food produced for human consumption, or 1.3 billion tonnes, is wasted globally each year.
- At this time of year, many will be jealous to hear that Japan considers the practice of "inemuri", or napping at the office, culturally acceptable and a sign of diligence and hard work.
- The origin of the candy cane dates back to 1670. A German choirmaster needed to keep children entertained during long Christmas services, so he asked a local confectioner to bend hard candy into the shape of a shepherd's cane.
- Apple unveiled the iPhone 10 years ago, and has since sold over 1 billion of the devices, making it the best selling gadget in history.

CURRENT SITUATION

North American equity markets continued to build on their earlier 2016 gains in the last quarter to post very strong year end returns. The Canadian market was particularly strong, with the S&P/TSX total return index, which includes dividends, finishing the year with a 21.1% advance, owing in large part to sustained strength in energy prices, and thanks to strength in bank stocks, which on their own still represent 24% of the index. Not only was 2016 a strong year for the TSX, it also marked the first annual outperformance of the TSX against its US peers since 2009. US equity returns, while not quite as robust as here at home, were nevertheless better than average with the broad S&P 500 adding 12% for the year, and reaching record highs in the process.

We had mentioned in the last edition of *Veritas* that given the uncertainly in the US political arena, and the bizarre race for the presidency, we were holding more cash than normal in our clients' portfolios. Our expectation was that if we experienced a surprise outcome on election night, equity markets would drop, and we would use the cash to take advantage of the declines. The cash was also intended to provide protection against the potential declines. We did experience the unexpected election outcome, and, at least initially, markets looked to be poised to decline some five to six percent when they opened the following morning. Come morning however, the overnight indicators had reversed themselves, markets opened strongly, and have continued to advance since election night. If there is one thing we can take away from this experience, it is that in the face of changing public attitudes, voting outcomes that historically would have been taken for granted can no longer be, as has been demonstrated by recent events such as the US election and the Brexit vote, both of which went against expectations.

On the topic of the new US regime, with the lack of detail that has been provided, it has been difficult to assess the Republican election platform. Speculation is that despite the strong words and tone during the election campaign, the policies, when enacted, will be less hard line. But of one thing we are quite certain, and it is that there will be a much more protectionist tone to the style of governing than that to which we have been accustomed. This could be negative for Canada depending on how severely protectionist the new economic policies turn out to be, but we will not know this with any certainty for some time to come because it will take months before the policies will be fully implemented. In the interim, our investment decisions will be based on visible economic fundamentals. The US economy is near maximum employment and wage growth is accelerating, the combination of which is creating an environment that is supportive of consumer and business confidence. We see evidence of this in recent data such as an increase in business spending, domestic foreclosures that are at 25 year lows, and the December Fed rate increase. Importantly, the Fed has said that more hikes are on the table for 2017, which signals that the Fed is very comfortable with the sustainability of current US economic growth. Paraphrasing from their release, the Fed said that inflation is moving toward their goal, and that delaying further rate hikes could lead to a "nasty surprise down the road."

As we have mentioned before, much of Canada's economic well being is dependant on the economic health of our largest trading partner, the US. The data that we are seeing in the US augers well for Canada, as does the sustained recovery in energy prices, which have remained at current levels long enough to encourage a pick up in spending on energy related projects in Alberta and Saskatchewan. The recovery in Alberta's fortunes will take time, but taking a phrase from the 2009 economic recovery, there are "green shoots". There is, however, one Republican policy proposal that, depending if and how it is enacted, could upset Canada's fortunes: the proposed Border Adjustment Tax. The proposal, which effectively taxes all imports into the US, could impact two of our largest exports to the US, auto parts and energy. But again, we do not know the extent to which this will be applied to Canada. Thus far, it seems that Mexico is more the target of the anti-trade rhetoric, and likely is to suffer more from it than we will.

OUTLOOK

Despite initial concerns, the incoming US administration's very generally articulated economic policies are being viewed as good for the US economy, and by extension, markets. Furthermore, the consensus is that the US economy has moved out of its "recovery" phase, which commenced in 2009, and is now poised to grow, largely based on the factors noted in the previous section. This optimism notwithstanding, markets, while not excessively expensive, could be vulnerable if earnings fail to materialise, especially given market gains last year, and the promise of further US rate hikes this year. We expect that bond prices, particularly in the US, will continue to decline, and stocks on both sides of the border will appreciate further, although we believe some of the positive performance was drawn forward to 2016, implying more modest returns this year. Furthermore, with the length of time markets have advanced with no correction, the levels at which they are trading and the unusual political environment in the US, we fully expect to experience several sell offs during the course of the year, but driven more by headlines and Tweets than fundamentals.

STRATEGY

We have been asked several times since the US election what we are doing in our client portfolios in response to the Republican win. With the uncertainty that goes along with any new administration, and the implementation of its policies, particularly in this case where the policies themselves are not clear, our response is that we are doing nothing different than we were doing before the election. Our job is not to bet on one single outcome. Playing the odds in this manner has no place in the discharge of our responsibility to our clients, which is the prudent stewardship of their capital. This is something for which a long term view is required, and while it must incorporate the current political and economic climate, necessarily it must look through it as well. This is why we continue to manage our clients' portfolios in the conservative, disciplined manner that has always guided us, focussing on the long-term objective of preserving our clients' wealth. Key to this discipline is not reacting precipitously to headlines, random social media posts, and media sound bites. Have a happy, healthy and successful 2017.

R. Guy Amighetti, CFA, TEP
Portfolio Manager

Tel: 604-632-4081
Email: rga@vici.ca
www.vici.ca