Commentary for the Fourth Quarter of 2019

Equity markets swing between central bank highs and trade tension lows
All year we have been focused on two inter-linked and somewhat offsetting trends: ample central bank liquidity and a weakening economic cycle. These two trends continue to intensify, with more central banks joining the "cutting club", and the risk that political events (trade tensions, Brexit, etc.) might push an environment of anaemic growth into outright recession.

A recent quote by FedEx Chairman and CEO Frederick Smith in the Wall Street Journal sums up our thoughts: "It's really a tale of two economies. And the stock market, of course, is very bullish. But the industrial economy does not reflect any growth at all, worldwide, to speak of."

The absence of inflation has allowed central banks to be much more pro-active than they would normally, injecting liquidity into the financial system and as such we are seeing signs of stabilization in the money supply – which buoyed both equity and bond markets worldwide to strong calendar year returns in 2019.

As a consequence, markets are likely to remain dependent on liquidity. Increasingly, markets have become reliant on the effects of quantitative easing (QE), the much-heralded policy that has seen central banks buy vast amounts of government bonds or other financial assets to inject liquidity into the economy. One of the QE side-effects has been to keep bond yields suppressed, which underpins higher equity valuations. Despite the unwinding of QE, I believe the path of least resistance is for equities to move gradually higher.

While all is still not rosy economically, and we are only seeing anaemic measures of industrial activity, there has been a stabilization in manufacturing surveys, which monitor changes in production levels from month to month. This bodes well for emerging market equities, which have lagged other markets this year.

Income Portfolios – finding yield
At this point, we don't expect central banks to make further cuts at their January meetings, however, we believe interest rates are likely to remain in this low range for years, reflecting the oversupply of money in the system. As a result, fixed income portfolios are more complex than they used to be, reflecting the need to search for higher returns in high yield and select emerging economies in order to compensate for lower interest rates in high quality government and corporate bonds. This introduces new risks that were not present in fixed income portfolios in the past and hence requires a more sophisticated and prudent management of a portfolio's risk – which is reflected in our Core Plus Strategy.

Balanced Portfolios – premium on downside protection
Our asset allocation reflects the belief that investors continue to benefit from globally-focused portfolios Pre-emptive moves by central banks seem to have postponed any recession thoughts and restored market confidence. Equities continued to rally in Q4 although mid-east tensions are now on the radar screen for investors. We continue to have a slight overweight to global fixed income. In the core Canadian bond market, we are still overweight corporate bonds although we have been bringing that weighting down while adding duration.

Growth Portfolios – Value stocks continue outperformance
Value stocks again outperformed Growth stocks and Value's emergence is often associated with better economic prospects ahead as investors prefer to buy cheaper companies in an environment where economic growth is accelerating. Other positive signs were broad participation in the rally from global markets especially the outperformance of European equities since mid-August. Should these trends remain in place and prove sustainable, global equities look to be setting up for a further move higher – helped considerably by looser monetary policy and renewed trade agreements.

Outlook
For 2020, we see Value stocks, represented by areas more sensitive to the economic cycle, fully returning to favour as long as we see the economic data stabilizing. The challenge on this front is two-fold: firstly, U.S. fiscal stimulus is waning and, secondly, trade tensions between the U.S. and China remain a key risk.

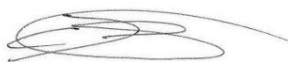
Which brings us on to corporate earnings (profits), where we think estimates for 2020 look high, particularly in the U.S. This is because the U.S. is in the later stages of its economic cycle. The economic cycle is how an economy fluctuates between periods of expansion (growth) and contraction (recession). At this late stage of the cycle (the period that precedes recession), companies' input costs such as materials and labour rise. We expect this to erode U.S. companies' profit margins, potentially leading to low, single-digit earnings growth.

On the other hand, earnings are depressed in Europe, Japan and China, providing the potential for more significant improvement in 2020. All in all, we are positive on international equities relative to U.S. equities and, as we mentioned previously, we think equity markets still have room to move upwards.

We believe that a balanced approach to portfolio management continues to provide the best opportunity to benefit from ongoing growth while providing downside protection should markets experience further turbulence. Our aim is not to chase exciting new trends nor take on any uncalculated risks, but to provide enhanced risk-adjusted returns over time and protect your wealth.

As always, we encourage you to follow a sound financial plan, and to speak with your Advisor to ensure you are on track to meeting your investment objectives.

Sincerely,



Corrado Tiralongo,
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