Commentary for the Third Quarter of 2019

Equity markets swing between central bank highs and trade tension lows
Global equities have moved, almost on a month-by-month basis, between two connected but offsetting trends: central bank liquidity and trade tensions between China and the U.S. which is, in turn, influencing a weakening economic cycle.

As these two developments continue to wax and wane, we see markets see-sawing with them. On one hand, more and more central banks are following the U.S. Federal Reserve ("Fed") lead and cutting rates in an effort to prolong the current economic cycle. Markets have responded to additional liquidity by reaching record highs of late.

Interspersed in this are tweets and threats of tariffs and other political risks (Brexit, for example) that continue to threaten the current environment of slowing growth and could lead to an outright recession.

These risks have increased equity market volatility throughout the quarter, muting gains from developed markets and pushing emerging markets into negative territory. Year-to-date, it remains a very good year, with most major equity markets enjoying double-digit returns, supported by a robust single-digit return from bond markets.

An improvement in the trade war rhetoric between the U.S. and China could prompt a relief rally through Q4, but it is difficult to predict tweets or impeachment hearings, and there is evidence that the underlying tone of global trade will further weaken irrespective of the political environment.

An upside surprise could come if the Fed were to become even more aggressive in its interest rate cutting agenda, which would likely weaken the U.S. dollar and further loosen global liquidity conditions.

Income Portfolios – finding yield
The challenge we face is that over a third of global government bonds now trade at negative yields, which leads to a somewhat speculative search for income generation. Rather than sitting in low/negative yielding cash, we are relying on carry strategies such as high yield bonds and emerging market debt to generate income. In the core Canadian bond market, we favour higher yielding corporate bonds which are benefiting from declining interest rates, although our overweight to corporates has been reduced slightly of late.

Balanced Portfolios – premium on downside protection
Our asset allocation reflects the belief that investors continue to benefit from globally-focused portfolios. We are slightly overweight equities and continue to favour international markets over North America as U.S. markets, in particular, are expensive. We continue to patiently wait for this positioning to pay off as international markets have trailed year-to-date although a broad move by markets away from growth and into value could be a help for the eurozone, which is heavy on value stocks right now. The fixed income portion of the Strategic Portfolios provides an important buffer to equity markets in times of volatility and provides income for investors. Our downside protection strategies were active in July & August during periods of volatility, moving assets out of emerging markets in the short term.

Growth Portfolios – value stocks could be poised for comeback
Effectively we are confronted with the choice of owning ever-more expensive Growth stocks or increasing our exposure into inexpensive cyclical Value stocks. Given the absence of positive cyclical catalysts, we are sticking with our equal weighting between Growth and Value for now. Valuation spreads, or the difference between expensive Growth stocks and cheap Value stocks, increased in much of Q3 before Value stocks rallied through September. This spread is evident across all regions. As noted, Value stocks in Europe are approaching valuation levels last seen during the sovereign debt crisis. This does set up an opportunity for mean reversion in which Value stocks can come into favour very quickly.

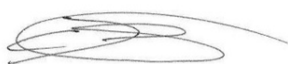
Outlook
The return of volatility to markets is actually now approaching normal levels. While it can be discomforting at times, it's a normal part of market cycles. Over the next quarter, we'll be watching to see how corporate earnings stand up against expectations and whether the September Value out-performance can be continued. We don't believe this is the time to make aggressive allocation changes to the Portfolios. We prefer to be patient for now and allow our risk mitigation strategies to make incremental changes.

What we said after the second quarter bears repeating: markets can move dramatically in either direction over the short term. It is vital for investors to be taking a much longer view than a few short months. Over the past few years, volatility has become an accepted event and we construct our portfolios to look beyond these gyrations and to smooth out unsettling market movements.

A balanced approach to portfolio management provides 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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