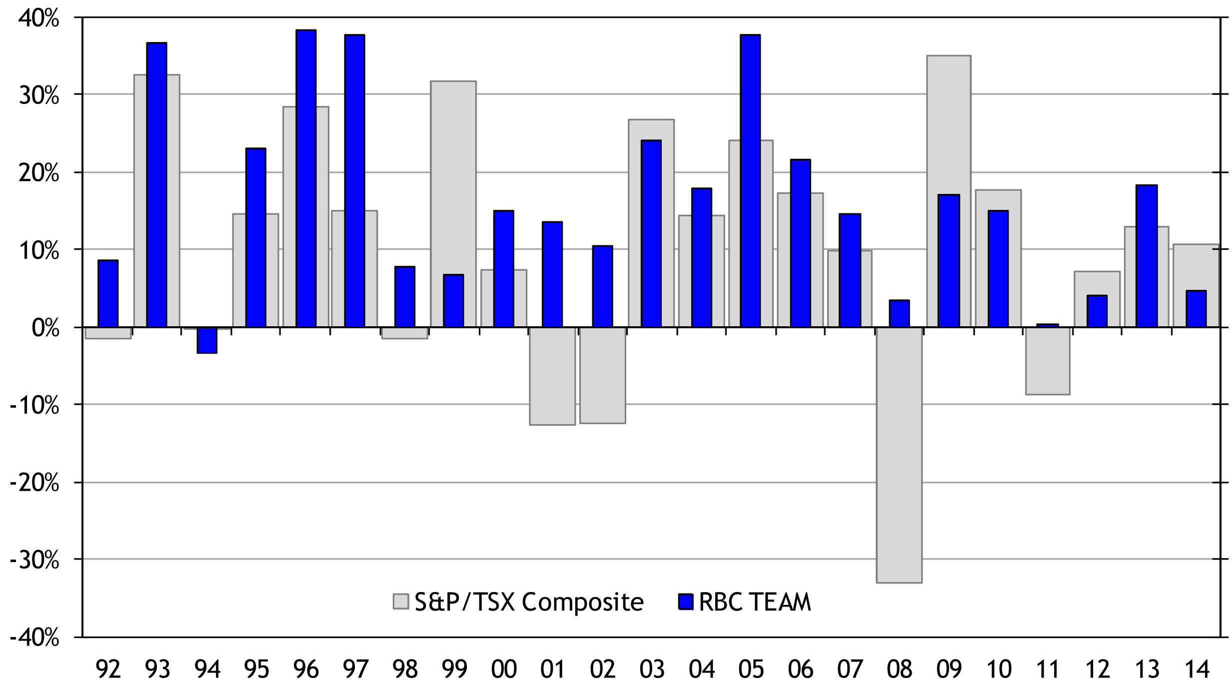
February 2nd 2015

“Won2One” with Nick Foglietta

Tactical Equity Income Model Portfolio Record



Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: **50%** Equities/ **50%** Fixed Income
S&P/TSX 60 Closing Value: 14,673
TSX 200 Day Moving Ave: 14,832
% Above/Below 200 Day Moving Ave: **-1.07%**
Levels for change: 100% stocks - **TSX 15,573** and 100% fixed income – **TSX 14,090**

Weekly Quote

“*Our people are suffering and demand respect…we must bleed to defend their dignity”*

Alexis Tsipras – New Greek Prime Minister – and they are bleeding. Greek bank stocks lost 1/3 of their value in 3 trading days since the election last Sunday. The decline stems from a “run” on deposits and the promise to cut the debt burden of the people at the expense of the banks.

Super Bowl Stock Market

Even if you are not a football fan and you didn't watch the game, I think you will find it interesting how the ticket sales for the Super Bowl get fouled up by speculation…much in the same way financial markets have become distorted!

The hype for the Super Bowl is always sky high…but this year saw near rabid Seahawks fans descending upon Arizona and demand for tickets was extreme.

Twenty four hours before the game the lowest price for a ticket was around $9000 US …the average price was $10,500. (TiqIQ ticket vendors quotes) You may ask yourself, "are people really that crazy about football to pay that kind of money to get into the Super Bowl?"

The answer to that question is actually "NO!"

Let me explain: Ticket "scalpers" go out and sell tickets to the Super Bowl when prices are going higher, even if they DO NOT HAVE THE TICKETS to sell! The scalpers are essentially SHORT SELLING tickets for the Super Bowl.

These guys are smart…and they are risk takers. What they are speculating on is a supply\demand curve that usually exists for this sporting event. **This usually sees the price of the Super Bowl tickets peaking right around the time the two participants are known**. (About two days after the divisional finals.) The prices slowly decline from this peak until about 12 hours before the game and then, as tickets free up from different sources, the prices tend to decline a bit quicker right up until game time.

The concept is to sell tickets to people at the higher prices that you don't own and then fill the orders at lower prices as the demand curve weakens and there are more tickets available at lower prices closer to game day. The scalper pockets the difference between what the buyer paid and what the scalper paid.

The profit target is around 30% using this strategy.

But in rare cases, too many people try to play this scalping game and there is a "short squeeze" on tickets where ticket prices do not start to decay in the normal fashion. The "short squeeze" sees the scalpers running around paying anything to deliver tickets to their clients and not lose face!

So to be clear, it is not the desperate fans running around paying $10,000 per ticket…it is desperate "scalpers" trying to fill their "short" ticket sales driving up the prices.

In the past, there have been many ticket scalpers put out of business when the conditions are similar to the ones we have at this year's Super Bowl. We will hear how it all turns out sometime this coming week!

There is an interesting parallel to what happened at this year's Super Bowl to ticket scalpers and what is happening to bond investor around the world right now.

Normally, supply demand curves would have kicked in at interest rates quite a bit higher than they are today stopping the decline in yields. Just like with the Super Bowl tickets where real buyers are not interested in $10,000 nose-bleed tickets, real investors are not interested in 0% bonds!

But the Central Banks are the "scalpers" in the mix and they don't care about the actual yields on the bonds. They have their own agendas so the normal price mechanisms fail to take over.

At some point, investors must ask themselves the question below….

<u>When Does an Investment Lose the Right to be Considered "an Investment?"</u>

One could almost call the question above a riddle. But a riddle was not my intent! It is a deadly serious question I have been thinking a lot about this week.

An investment MUST **<u>potentially</u>** yield a **return** or an **advantage**. The definitions of "return and advantage" shift depending upon the asset class but the fidelity of the definition remains universal.

My thoughts center on the global bond markets. We know interest rates have declined to "*saver-punishing*" lows. Actually, I think we have passed that point in time. Let me explain below: Look at these statistics

- In 2013 there were a total of approximately $140 trillion US dollars of global government (sovereign) T-bills and bonds outstanding.
- As of January 21st 2015, about 16% of those T-bills and bonds had NEGATIVE interest rates attached to them. (JP Morgan report)
- As of January 21st 2015, about **<u>$49 trillion of those outstanding T-bills and bonds had an interest rate of less than 0.5%</u>**

So my question to you is: **Is an investment that has no potential for capital appreciation and pays less than 0.5% really an investment?**

Ponder that question for a moment. It is really important to consider for the rest of this essay.

I am going to "take the under" and say that when there is no potential for growth and the yield is less than 0.5% then the asset no longer qualifies as an investment. So what is it?

To keep things really simple, let's refer to these low yielding bonds as "*dead money sitting in the dead money parking lot."*

There are three reasons why I think money would choose to sit in the "dead money parking lot":

1) It is trying to gain exposure to the underlying currency and is willing to accumulate no return while it waits.
2) It is worried that prices of assets priced in the dead money currency are going to decline and feels it is better served "earning nothing rather than losing value."
3) It is just plain scared of what is going on in the financial world.

If you are still following along with the reasoning here (I'm proud of you already!) then the next logical step becomes interesting.

Let's say an investor has $1,000,000 of "dead bonds" in their possession. The investor is diligently trying to control risk, but it is a daunting task to control risk against the global central bank cartel. The central banks hollow out the markets and destroy the natural price mechanisms that produce "positive asymmetrical" risk situations[1]. To restate in English…*the central banks cause the continuation of what shouldn't happen and hold back the inevitable from happening*!

So our fictitious investor with the "dead bonds" decides to take $100,000 and participate in the central bank sponsored "asset casino" while holding the balance of their investment in the "dead bonds". Because there is so much "dead money" now these types of decisions can actually be very BULLISH for stock, commodity, and real estate markets in the medium term.

But here is the rub…the underlying assets (stocks, bonds, real estate, and commodities) are all trading off the same **risk free base line** of zero percent interest rates. **If interest rates rise for ANY reason, the value equation will shift violently.**

We see examples of this in Russia and Venezuela right now. Currency crashes have been too steep and the central banks of those two countries have quickly raised interest rates trying to keep the capital at home.

The bottom line theme I want to leave you with in this editorial is the bond markets are controlled by the "scalpers" (Central Banks) not the investor community. Investors are welcome to try and play along with "front-running" what these "scalpers" are anticipated to do as long as they realize they are participating in an artificial market that continues to offer less and less reward for more and more risk!

…and now you know!!

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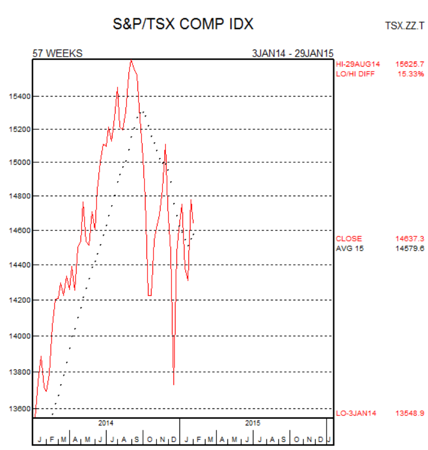
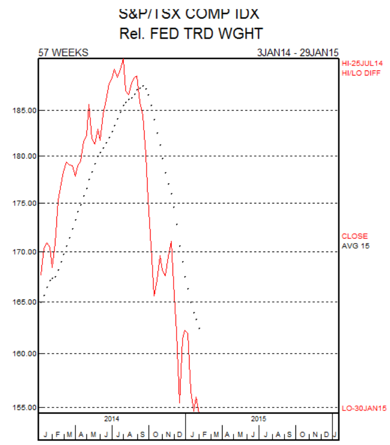
[1] Positive asymmetrical risk – an investment situation that has greater upside volatility potential than downside. For example: Owning a stock that has a $1.00 stop loss on the downside but unlimited upside.

Broad Thoughts

Canadian Stocks - The overall Canadian stock market has been buoyed by the decline in the Canadian dollar. The side by side charts below show the TSX from January 2014 to present, first in Canadian currency and second against a global basket of currencies.





If it was not for the large drop in the Canadian dollar the TSX would be trading around its 52 week lows right now. Hmmm?

Forecasters' Nightmare – Interest rates are supposed to be 4% on T-bills and 5% on 10 year bonds this year. (Taken from 2010 forecast by Bureau of Labor and Stats in US!)

CBO's Year-by-Year Projections for Calendar Years 2010 to 2021

	Estimated, 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Year to Year (Percentage change)											
Real GDP	2.8	2.7	3.1	3.1	3.5	3.8	3.0	2.5	2.4	2.4	2.4	2.3
PCE Price Index	1.8	1.3	1.2	1.4	1.6	1.7	1.9	2.0	2.0	2.0	2.0	2.0
Core PCE Price Index[a]	1.4	1.0	1.1	1.4	1.5	1.6	1.8	2.0	2.0	2.0	2.0	2.0
Consumer Price Index[b]	1.7	1.6	1.3	1.6	1.8	2.0	2.2	2.4	2.3	2.3	2.3	2.3
Core Consumer Price Index[a]	1.0	0.9	1.0	1.4	1.7	1.9	2.1	2.3	2.2	2.2	2.2	2.2
GDP Price Index	0.9	0.9	1.3	1.6	1.7	1.7	1.9	2.1	2.0	2.0	2.0	2.0
Nominal GDP	3.8	3.7	4.4	4.7	5.3	5.5	5.0	4.6	4.5	4.4	4.4	4.3
Employment Cost Index[c]	1.8	2.1	2.3	2.6	2.8	3.0	3.3	3.6	3.7	3.6	3.3	3.2
	Calendar Year Average											
Interest Rates (Percent)												
Three-month Treasury bill	0.1	0.3	1.1	2.5	3.5	4.0	4.3	4.4	4.4	4.4	4.4	4.4
Ten-year Treasury note	3.2	3.4	3.8	4.2	4.6	5.0	5.3	5.4	5.4	5.4	5.4	5.4
Unemployment Rate (Percent)	9.6	9.4	8.4	7.6	6.8	5.9	5.3	5.3	5.2	5.2	5.2	5.2
Nominal GDP (Billions of dollars)	14,649	15,184	15,858	16,609	17,483	[illegible],441	[illegible]9,362	20,258	21,162	22,093	23,062	24,064
Tax Bases (Billions of dollars)												
Domestic economic profits	1,234	1,308	1,355	1,422	1,433	[illegible],469	1,515	1,521	1,541	1,554	1,601	1,658
Wages and salaries	6,403	6,702	7,070	7,377	7,832	[illegible],281	8,710	9,109	9,543	9,982	10,417	10,865
Tax Bases (Percentage of GDP)												
Domestic economic profits	8.4	8.6	8.5	8.6	8.2	8.0	7.8	7.5	7.3	7.0	6.9	6.9
Wages and salaries	43.7	44.1	44.6	44.4	44.8	44.9	45.0	45.0	45.1	45.2	45.2	45.2

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve.

Hey, they were not even within an order of freaking magnitude of the correct number!

Final Thought

My goal is to remain highly accessible to clients in this unprecedented time. I cannot possibly imagine what each of you is thinking about your present financial condition.

I'm sure many of you don't even look at your portfolios or the financial news…while others follow along closely and have concerns.

Please don't hesitate to call or email if you want to discuss ANYTHING. I have trained my whole life for exactly the moment we find ourselves at. Nobody knows how it is going to play out but we can make sure your investments match your feelings.

About the author: Nick Foglietta is a Vice President, Investment Advisor at RBC Wealth Management in Nanaimo, B.C., Canada. He has been managing money since 1988.