RBC Dominion Securities Inc.

Money Never Sleeps

THE NEWSLETTER FOR THE INFORMED INVESTOR

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RBC Dominion Securities

Whack-A-Mole Environment

Expect the Unexpected in 2016

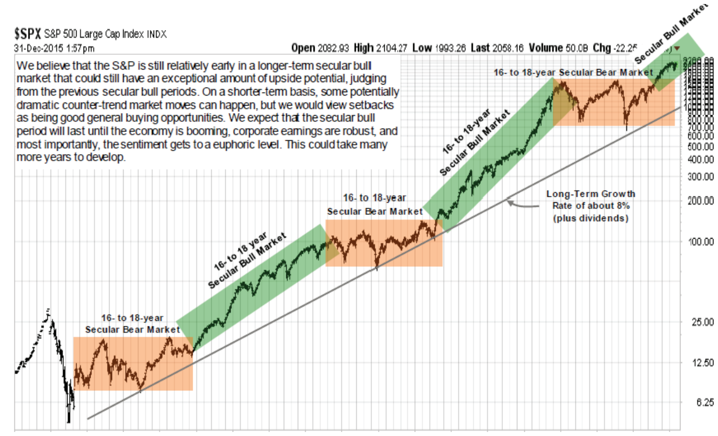
"To make big money, one must bet on the unexpected."
- Billionaire Financier George Soros

'Tis the season for prognostication. While forecasts for 2016 are all the rage at this time of year, especially for markets which are increasingly dominated by hedge funds rather than investors, we know most forecasts are really an exercise in futility. We have often seen how the consensus opinion can be wrong, as the forecasts are usually made within a current context of news events (i.e. What is "known"). The predications from a year ago had a consensus of +10-15% for 2015, which were adjusted lower as the year wore on. So we thought in this issue, we would touch upon some themes and trends we think might impact 2016.

A bit of a backdrop first. Over the past seven years, the S&P 500 has tripled from 666 in March 2009 to about 2100. The TSX in Canada is now standing where it was (approximately) as of January 2007. We've been stuck in a trading range of about 10% for almost two years. But even though there has been a lack of progress recently, I think that it is going to get more volatile, but there is still plenty of room to go higher, with the long-term trend to the upside still intact. Earnings AND sentiment will be the drivers. Investors are still way too pessimistic to be anywhere near a top, despite a triple in the USA, and with Obama gone in November, no matter who wins the Presidency, will be viewed as a positive.

Here's how it looks on a chart courtesy Fidelity Investments:

Long-Term Market Cycles 1925-2015



Source: Fidelity Investments and RBC Wealth Management

RBC Wealth Management
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Whack-A-Mole Environment

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So here are some themes that investors need to watch:

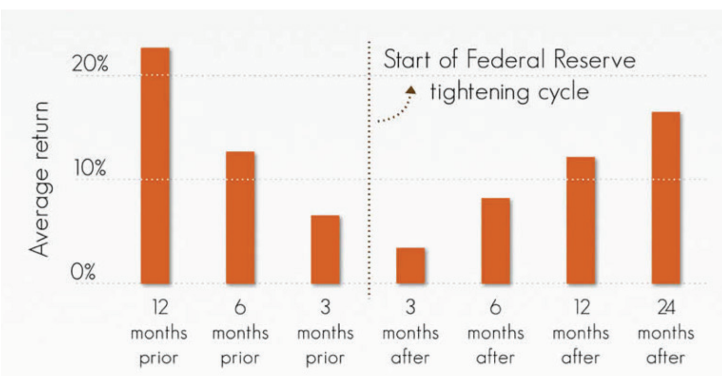
1. Interest Rates

For the first time since June 2006, the U.S. Federal Reserve raised rates in mid December. While 0.25% is virtually zero in the context of the big picture, the signal to the markets is clear: The decade of an engineered zero interest rate is over. The benefit to the overall economy has been little, and has simply encouraged more risk and more debt.

Every single one of the 17 Federal Reserve members expect the Fed funds rate to increase at least 0.50% before the end of 2016, and 10 of the 17 expect rates to rise at least 100 basis points in the next 12 months. Personally, I doubt it. It's an election year and the Fed is usually neutral in election years. Besides, the U.S. (and global) economy are still fragile. I think there's a better chance the rates go back to zero before they go to 1.00% in 2016.

How have markets performed in past eras of Fed hikes? Here's a chart:

How Markets Have Performed During Past Fed Hikes



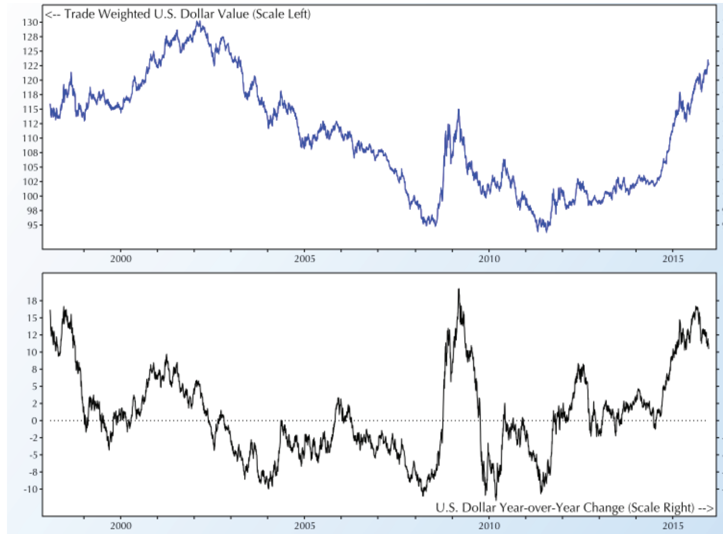
Source: Fidelity Investments

2. Currencies

The Canadian dollar begins 2016 trading at eleven year lows. While the argument for the lower dollar is easy (soft economy, crashing energy and commodity prices, huge deficit spending and lack of fiscal discipline by governments), the investment case for Canada becomes more bullish for every cent the loonie falls. The current $0.71 loonie is closer to its 1998 low of $0.63 than its 2011 high of $1.08.

The U.S. dollar has had an incredible run, and its lofty price is starting to impact U.S. earnings, especially in multinationals. The euro, Japanese yen and Chinese yuan are all intentionally lower trying to spur exports. The Greenback index was at +10% in 2015 after +13% in 2014. The consensus is so heavily weighted towards the U.S. dollar, I think that reverses at some point in 2016.

Trade Weighted U.S. Dollar vs. U.S. Dollar Year-Over-Year Change



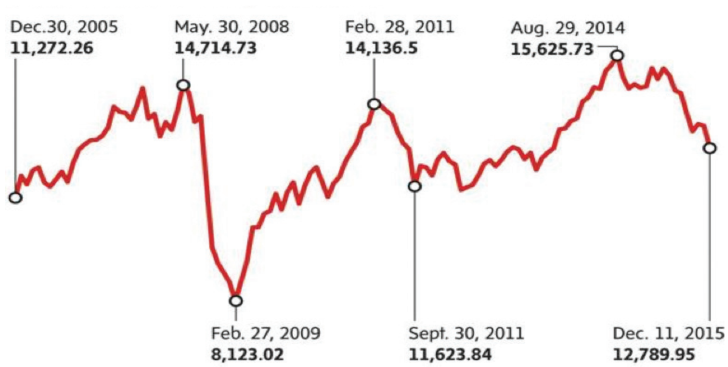
Source: Day Hagan Asset Management

3. Equities

The Canadian market has suffered through three years of pain now, though 2015 was exceptionally brutal. The triple whack-a-mole of low commodity prices, economic slowdown, and foreign investment outflows have conspired to make the TSX the worst performing market of a developed nation in 2015.

After 30+ years, I've learned that the best solution to low commodity prices is lower commodity prices. And we are there in oil, nat gas, copper, gold, silver, etc. Yes, it can be painful at the bottom, but the reversals and upside when they come can be spectacular. I don't know where the bottom is, but those pain levels are very high so would guess it's close (Maybe Q1 2016?).

Lost Decade: S&P/TSX Performance



Source: Bloomberg

4. Geopolitics

The terror attacks in Paris and San Bernadino made it clear that terrorism is not going away any time soon. The U.S. deal with Iran still has ramifications not yet known. Russia remains a wild card, and even more dangerous as a weakened economy and domestic issues will give Putin more cause for "distractions."

5. The Impact of Technology

The rapid advancement of technology and the impact it's having in our day to day lives amazes me each and every day. We live in a world where the world's largest taxi company (Uber) owns no vehicles. The world's most popular media company (Facebook) creates zero content, and the world's most valuable retailer (by market cap) (Ali Baba), has no inventory, and the world's largest accomodation provider (Air BnB), doesn't own any real estate.

It's incredible when one really stops to think about it, and still more to come as biotech, 3D printing, drones, just to name a few, continue to advance.

And now for some way-out-there thinking (AKA "my personal predictions") on market-impacting items (AKA "Black Swans") in 2016:

1. ISIS destroys strategic pipelines across the Syria/Turkish borders, cutting 3 to 4 million barrels of production. Oil prices explode.
2. The Fed reverses policy as the U.S. economy slows and CUTS interest rates.
3. Cyber attacks increase (in the financial zone especially).
4. German leader Merkel resigns as her immigration policy backfires. The EU goes into disarray.
5. The UK leaves the EU.
6. The EU disagrees on immigration policies and eventually crumbles.
7. China's economy collapses. Leaders do what all politicians do: create a distraction and ramp up the rhetoric.
8. Tensions rise between Israel and Iran.
9. Brazil Olympics are a disaster. Venezuela officially becomes a failed state.
10. Canada introduces Euro style negative interest rates.
11. Marijuana is legalized.
12. Prince Charles finally becomes King of Great Britain.
13. President Obama, in search of legacy, uses his Presidential power to push through legislation on gun control, ramp up the debt, social program give aways, etc....
14. The bubble finally bursts in real estate markets in London, New York, Toronto and Vancouver.
15. Donald Trump becomes President of the United States (hey, why not?).

Looking ahead for 2016, in case you missed it, is a Presidential election year in the U.S. The history of market performance in the fourth year is bullish. Of the last 45 occassions, markets have been positive 66% of the time with an average gain of about 6%. Having said that, 2015 didn't pan out as a year 3 or year ending in "5" (Source: Stock Traders Almanac).

The average length (756 days), shortest (61 days) and longest (2836 days) of bull markets. So far, this bull market is running 2486 days.

Expect a continuation of slow growth, low yields, and stock market returns in line with modest earnings growth (plus an occasional deflationary shock) that is part of structural debt deleveraging environment which has been going on since 2008-09. Have a plan…and stick to it.

Notes

Over the past five years, the Athens Stock Exchange (Greece) is down 55%. The TSX Venture exchange is down 85%. Hard to believe.

It has been reported by several news sources, including the Guardian and CNBC, that the Obama administration spent a reported $500 million for military training in Afghanistan. The net result was a grand total of five men trained for military service, their whereabouts of which is unknown since they've disappeared. Oh, and also another $43 million for a service station. So $543 million got them an unused service station and no trained men. You can't make this stuff up.

The latest auditor general's report (Ms. Bonnie Lysyk) for Ontario, reported that Ontarians have paid a stunning $37 billion more than the real market rates for our electricity over the past eight years. Doing the math, works out an average overpayment of $1,370 per year per family of four, or $10,960 over eight years.

Around the GLOBE

Canada (Buy)

- Continues to drag and be hurt by the collapse in energy/commodity prices
- All new governments running huge deficits now
- Expect GDP of 1.5-1.75% for 2016

U.S. (Strong Buy)

- U.S. election will start making headlines in next 2-3 months
- Has a split personality right now – domestic demand robust, whereas foreign demand for U.S. products is anemic
- Strong dollar has weighed materially on exporters and multinationals
- Should grow at 2.5% GDP

Europe (Buy)

- Remains fragile after two back to back recessions
- Low resource prices, low borrowing costs and a cheap euro helping
- Still a mess but getting better
- Expect 2.0% GDP

Asia (Selective Buy)

- China is the key – its ascension as an economic force matters, expecting 7% GDP (but in reality it's much lower)
- Massive stimulus in Japan helping Nikkei exchange to +7% in 2015
- India has been strongest market thanks to new PM Modi's pro-business policies

Emerging Markets (Selective Buy)

- Russia remains globally relevant from a military standpoint, but has ceased to be a global economic power. That being said, its market is cheap.
- Latin America is a mess, but Brazil now so beat up it's interesting.
- Overall, high U.S. dollar and rising U.S. rates have played havoc with EM's
- There is value in EM's but expect volatility

Quotes

"He has no enemies, but is intensely disliked by his friends."
Oscar Wilde

"Growth is not a cure all, but the lack of growth is a kill-all."
Prof. Paul Collier, Oxford

"The market can stay irrational longer than you can stay solvent."
Economist
John Maynard Keynes

"When it's in the newspapers, it's in the price."
Famed Money Manager
Bill Miller

A Special Welcome to All New Clients Who Have Joined Us

Thank you especially to clients who have mentioned our name to people they know. As a sign of gratitude, four times a year we'll randomly select a client who has introduced our services to a friend for special acknowledgement via a nice dinner at one of the finer restaurants in London.

Please Don't Keep Us a Secret!

We are very happy and proud of the clients we serve in our practice and we are always open to serve more clients just like you. Should you be talking to someone who is unhappy with their current advisor, or would like a second opinion, we would be grateful if you passed on our numbers:
519-675-2011 or 1-800-265-5911.
Thanks for keeping us in mind.

Congrats, Shawn T., our winner this quarter!