



## A Sobering Time

*"If you can keep your head when all around you are losing theirs..."*

The Poem "If" written in 1895 by Rudyard Kipling

We are entering the 13<sup>th</sup> trading day of 2016 and we have had one up day so far (yesterday, actually). We've had the worst start to a year....ever.

But the sell off has been orderly. There has been no panic. Despite two weeks of relentless selling, market volumes have not spiked higher at all, and the best measure of volatility and fear, the CBOE Volatility Index (VIX) is sitting at a moderate level of 27 (it hit over 50 during last August/September's brief pullback).

What this looks like to me, and given the timing for it which literally was day one of the New Year, is that either A) huge hedge fund(s) is/are in trouble and are in forced liquidation or B) some large sovereign wealth funds are selling.

My bet is on B) Sovereign Wealth funds.

Why? If you think about it, the largest sovereign wealth funds are in Saudi Arabia, the Emirates, Norway, etc....all oil producing nations. With the collapse in oil prices, cash flows are way down and they are selling within their investment portfolios to cover budget deficits on the other side of the balance sheet.

We won't know for many months, but that is my guess.

What this does is simply force the Central Banks to remain loose and accommodative, and the US Fed Reserve might even cut rates again and give back that 0.25% they just raised. Despite that increase, monetary policy around the globe remains accommodative.

The short term markets are being driven by two things right now: oil prices and a strong US dollar. What about China you say? I've always said China's economy matters however; their small, illiquid closed stock market does not. Their currency is overvalued and they need to devalue it to remain competitive with other nations

like Korea and Japan, so there will be dislocations as the adjustment happens. Capital outflows lead to asset liquidation, etc...are part of that process.

With respect to oil prices, while I do believe there is some oversupply, the main cause of what's happened is geopolitical, and the centuries old feud between Saudi Arabia and Iran is driving it. Expect lower prices near term but pain levels are high, no one is making money, and the populations are stirring to greater angst in the Middle East. We are close....real close to an oil bottom, and as production gets shuttered down, supplies will reach & shortfall, maybe by Q2 or Q3 of this year. Its been said many times that the best cure for low oil prices is low oil prices.

A lot of talking heads are talking bear market. Well folks, the average TSX stock is down over 20% ahead from the highs, and the average S&P 500 stock is down that as well. There's already been a bear market, just not in the overall indices.

I do believe this is still a "correction" within an overall bull market that has years to run. It's not fun, but it's that volatility that is the price of admission for higher long-term returns. It creates opportunities because a lot of mispricing happens.

I believe the US is not going into recession, and that accounts for about 50% of Global GDP. Europe is a mess, but getting better and that's another 20%. China is about 10%. Canada? About 2% of global GDP. If you believe the US is going into recession, then sell everything. I do not believe that is the case.

Where's the short term bottom? As I said, in oil prices, I think its real close, between today and 60 days if I had to guess. Market wise, short term corrections always seem to end with a bit of panic selling, volumes spike higher, as nervous types make the mistake they always do of selling at or near bottoms.

Selling pressure in China will create new capital outflows and I think that capital outflows to the US and Europe.

Cooler heads will prevail, and take advantage of the exceptional opportunities created. It might take a few weeks but its coming.

As always, if you would like to discuss your portfolio or holdings, please do not hesitate to contact us.

Stay tuned,

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