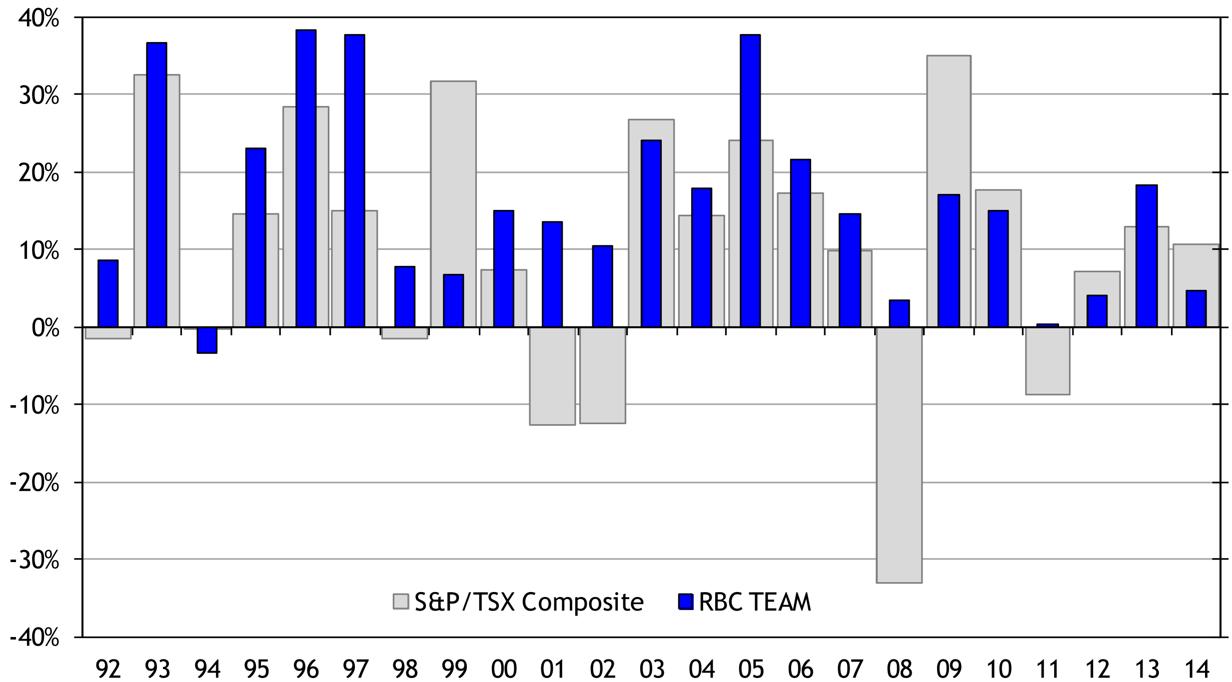
December 14th 2015

“Won2One” with Nick Foglietta

Tactical Equity Income Model Portfolio Record



Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: **0%** Equities/ 10**0%** Fixed Income
S&P/TSX 60 Closing Value: 12,789
TSX 200 Day Moving Ave: 14,320
% Above/Below 200 Day Moving Ave: **10.70% Below**
Levels for change: 100% stocks - **TSX 15,031** and 100% fixed income – **TSX 13,604**

Weekly Quote

"The bank is now confident that Canadian financial markets could also function in a negative interest rate environment," Stephen Poloz – Bank of Canada, Empire Club (Toronto) speech, Dec 8th, 2015

Nick comment – This would be an awful decision!

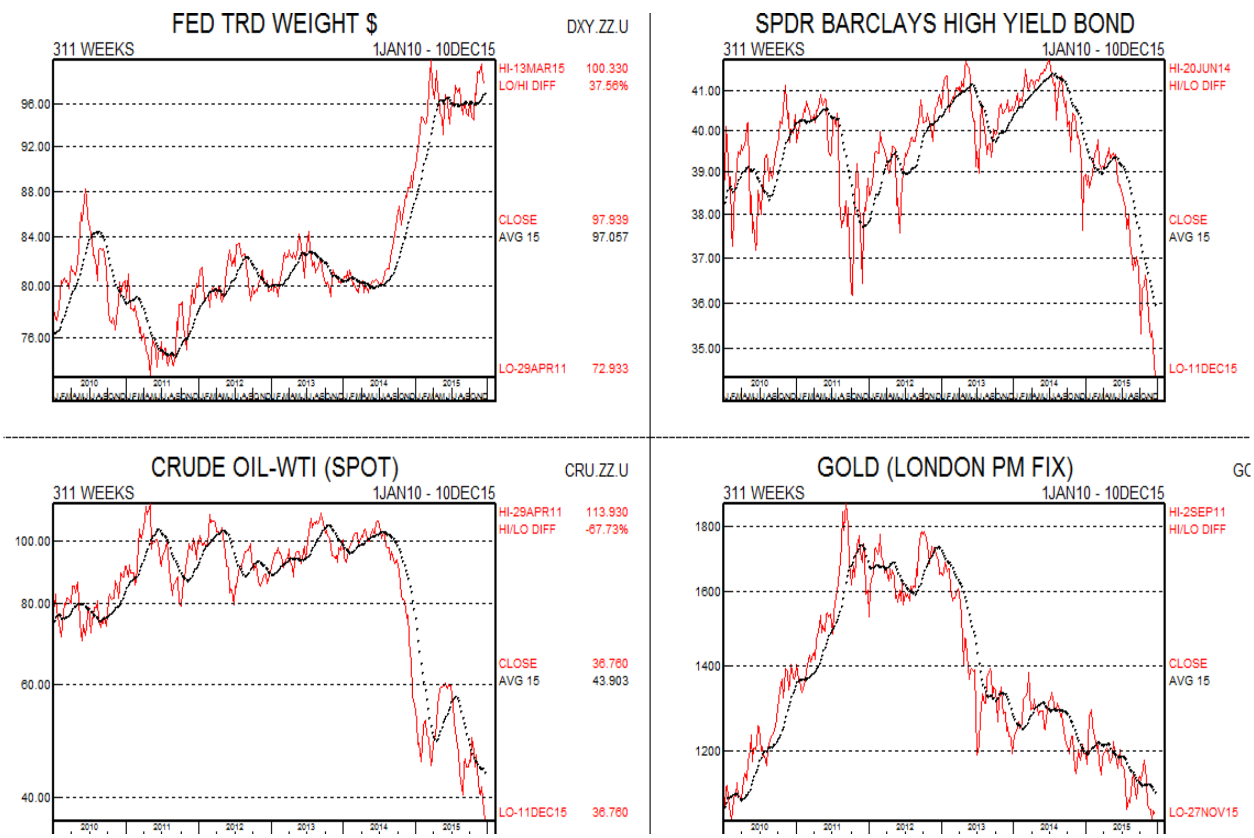
Time to Use the "R" Word?

It is time for the readers of this weekly comment to seriously consider the possibility that the US and Canadian economies have stalled out and might be entering a recession.

Let me be clear, I am not saying they have entered a recession…I am considering the fact that they might be starting to recess.

Why I bring this point up now is, if you think the US and Canada are starting an economic recession, it will not matter if the US Fed raises interest rates next week or not. If they raise rates it will accelerate the recessionary trend, but if this recession has already started then the increase will not be the cause!

I am going to show you four charts that would offer a clue as to whether or not a recession has started. (Not including stock prices.)



The top, left hand chart is the US dollar index. It should keep going higher if the US is in recession.

The second chart is the Junk Bond index that trades on the NYSE. It represents close to $9 trillion in "junk credit" pricing. It should keep going down if the US is in recession.

The next chart is Crude Oil. Crude oil will stay low if the US is in recession.

The final chart is Gold bullion. Gold should start to move higher RELATIVE TO OIL if the US is in recession.

The past week I spoke to a number of you who were asking me for some "indicators" to watch as to what might be happening in the global economy. In the hopes of keeping things relatively simple I think the four indicators above are worth watching **away from the stock markets themselves.**

Speaking of possible signs of recession…check out the next section of the weekly editorial.

Bank of Canada and Negative Interest Rates…What Does It Mean?

Let's summarize the bullets released for the text of Bank of Canada (BOC) Governor; Stephen Poloz's speak last week:

- **BOC POLOZ: NOW SEES EFFECTIVE LOWER BOUND FOR POLICY RATE AROUND -0.5%**
- **BOC POLOZ: CANADN FIN MKTS COULD FUNCTION IN A NEG INT RATE ENVRIONMNT**
- **BOC POLOZ: 'SHOULD THE NEED ARISE' FOR UNCONVENTIONAL MONETARY POLICY, 'WE'LL BE READY'**

I guess this is the Canadian version of the ECB's Mario Draghi "*whatever it takes"* speech. As the bullet points above crossed the news wire I watched in real time the Canadian dollar get absolutely slaughtered. We lost 1.15 cents in seconds…

And so should the Canadian dollar get hammered. There are only two reasons a central bank entertains and employs negative interest rates.

1. To lower the relative value of the currency.
2. To prop up and support the banking system in the country.

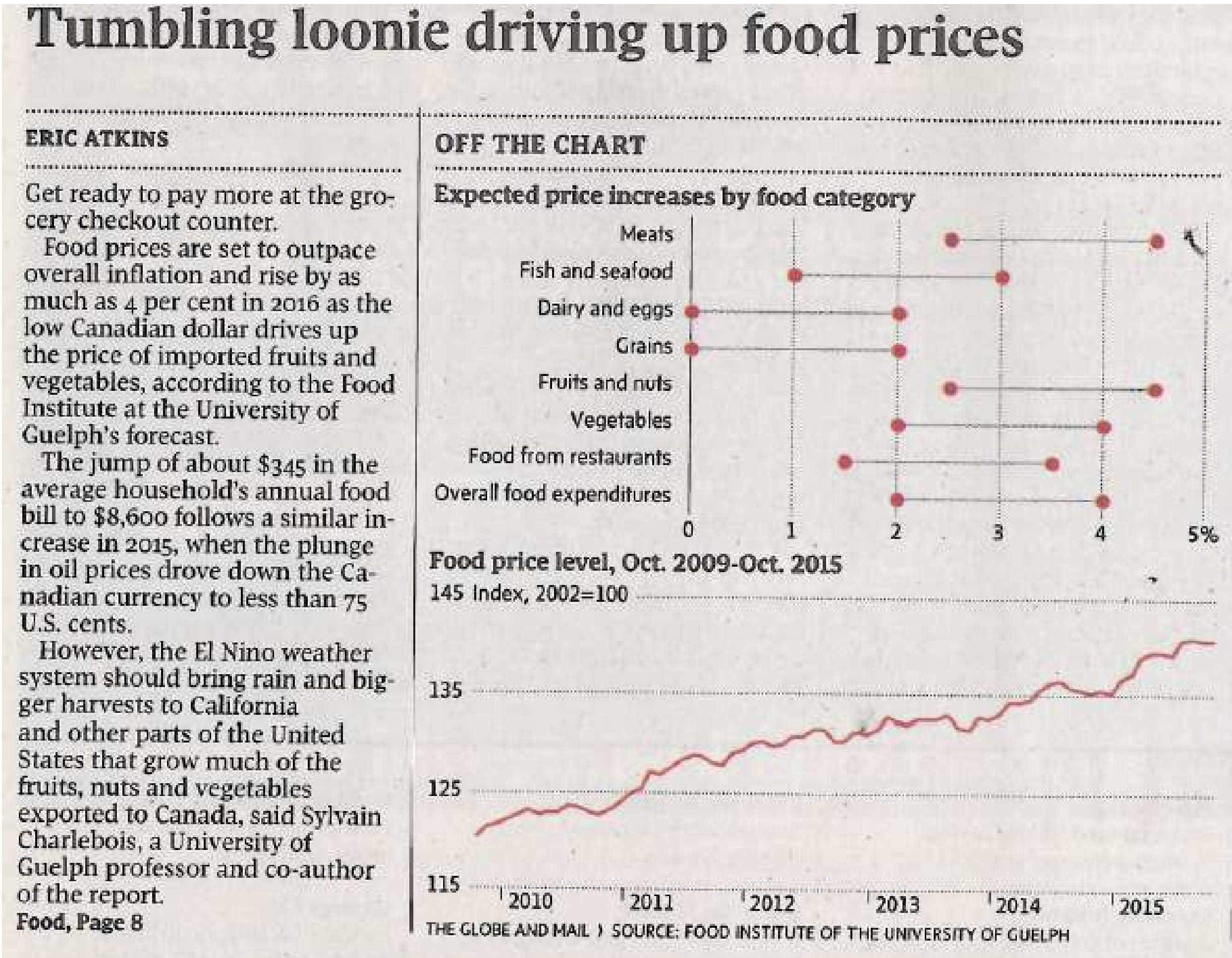
To be clear, negative interest rates do not flow through to consumers. Your mortgage will not become a negative interest rate. If the Bank of Canada rates went negative I would still expect floating rate mortgages to stick around the 1.75% level.

(Example: In European nations where interest rates have gone negative it has become very difficult to QUALIFY for a mortgage. This happens because the lenders are nervous about the collateral value of the underlying homes they are mortgaging. So even if one can AFFORD the mortgage doesn't necessarily mean they can GET a mortgage.)

There are so many places that negative interest rates will influence our lives in Canada if they come to pass. The impact on the currency is the number one trigger for these influences.

I am going to comment on three instances I believe to be significant. Two are negative and one is positive.

1. **Lower fixed income rates on savings**. Already low savings interest rates will get lower if the BOC gets to negative interest rates. In reality, the barn door is already wide open on this problem. If your GIC or bond falls from 1% to 0.50% does it make much difference? The pain is already being felt. But savings rate returns would be lower still if NIRP (negative interest rate policy) were implemented.
2. **Import cost would rise on the weaker Canadian dollar**. Here I am specifically thinking about food costs. Rich and poor both need to eat, but food takes up a much higher percentage of the poor family's budget. The already high food prices will certainly get worse if NIRP is employed.



Tumbling loonie driving up food prices

ERIC ATKINS

Get ready to pay more at the grocery checkout counter.

Food prices are set to outpace overall inflation and rise by as much as 4 per cent in 2016 as the low Canadian dollar drives up the price of imported fruits and vegetables, according to the Food Institute at the University of Guelph's forecast.

The jump of about $345 in the average household's annual food bill to $8,600 follows a similar increase in 2015, when the plunge in oil prices drove down the Canadian currency to less than 75 U.S. cents.

However, the El Nino weather system should bring rain and bigger harvests to California and other parts of the United States that grow much of the fruits, nuts and vegetables exported to Canada, said Sylvain Charlebois, a University of Guelph professor and co-author of the report.

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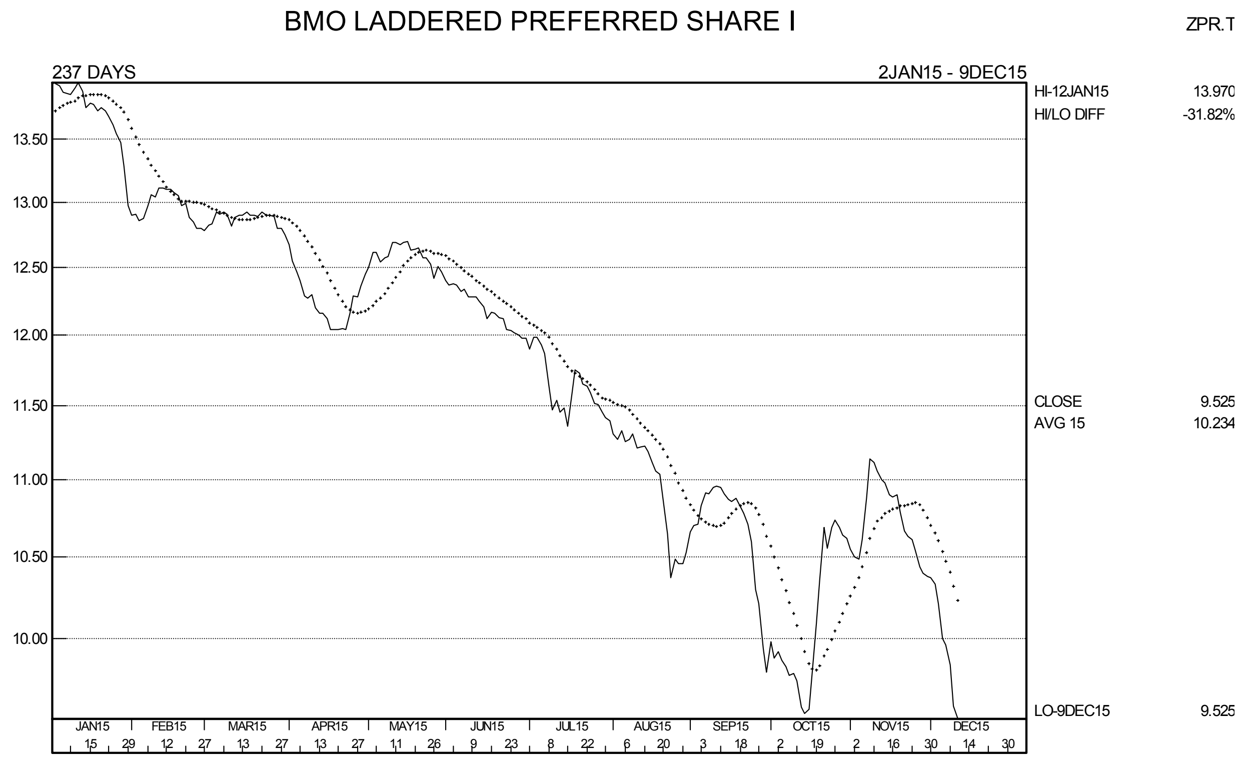
3. **Export industries will benefit**. If commodity prices can stabilize there could well be opportunity in the sector.

The other investment area that will be challenged is the fixed/floating rate preferred share area.

Last month, when the world was focused on the US raising interest rates and "the American economic recovery", the fixed/floating rate preferred share market took off to the upside because **it is one of the few investments that actually benefits from higher interest rates**.

Then a number of weaker global economic numbers were issued, the slide in commodity prices resumed, and the BOC started talking about negative interest rates. The result has been a fall back to the old low levels for fixed/floating rate preferred shares.



Over the past couple of weeks I have had numerous calls about these investments. **The way I continue to view them is one of the only ways an investor can hold a higher yielding position (5%-6% current dividend) AND actually look forward to higher interest rates if they should come**. It is important to understand that if interest rates do go higher, it will not be a positive for bonds, or real estate. There are only a handful of stocks that benefit from higher interest rates too.

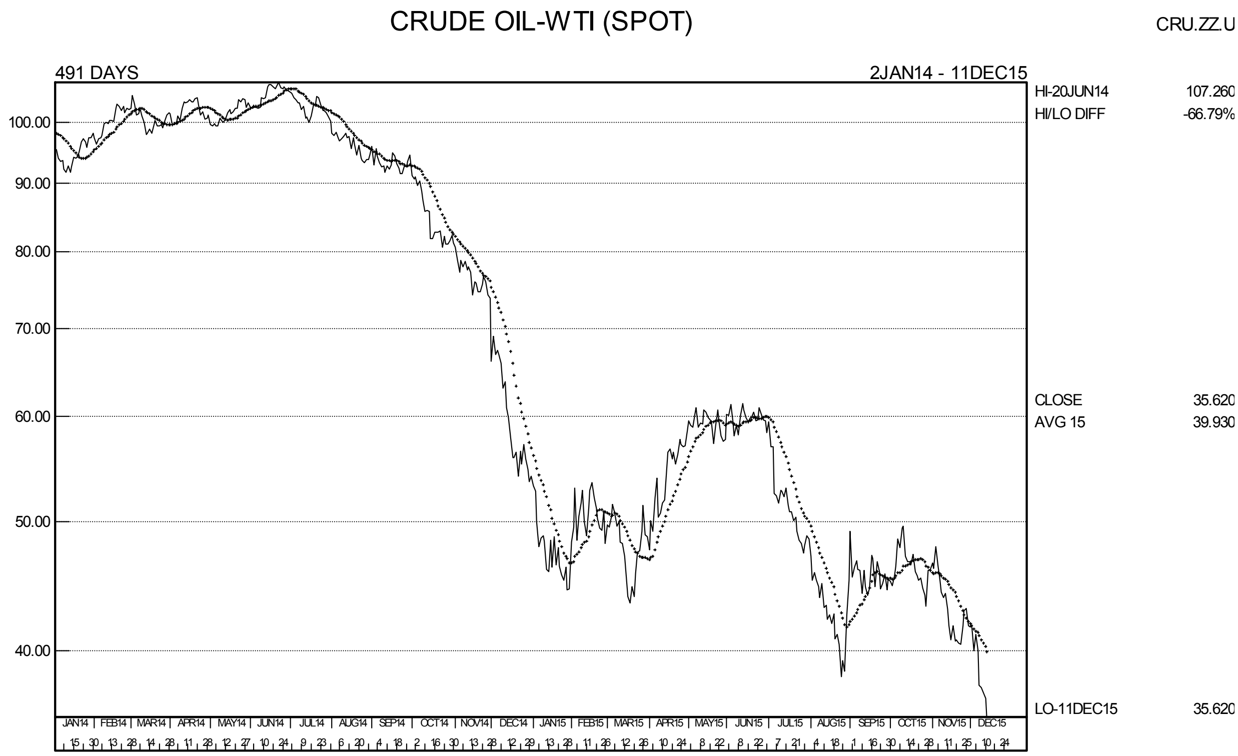
Therefore, the fixed/floating preferred share still has a place in a conservative portfolio.

In summary, the Bank of Canada has started to walk down an unknown path when it comes to interest rate policy. Stephen Poloz says “We’ll be ready!” I say…We’ll see!

Crude Oil Update

The beat-sown for oil continued the past week with West Texas Intermediate (WTU) Crude prices falling below $40 US per barrel and continuing to decline to close at $35.62 on Friday.

The present decline in oil has been “orderly”. Below you can see the WTI price has more or less worked its way lower.



We will take a more serious look at Oil in the 2016 Forecast edition of my weekly comment. For now, I just think we should see the low oil price as an indicator that points to a global economic slowdown that may end up being a global recession.

The S&P 500 Has Been Ramped Up by the US Federal Reserve

There continues to be an ongoing debate as to how much influence monetary policy has had in “asset prices” around the world. (Asset prices equals stocks and real estate.) In the weekly comments I have maintained a view that the influence has been significant.

And for the first time that I have seen, in terms of stock prices we now have proof.

When I first saw the chart below I actually didn’t believe it could be true. But the data does not lie…the US FED has been a major driver of the ramp up in US stocks.

What you are looking at is the red plot of the actual S&P 500 stock index in the US and the blue plot of the same index but the chart creator has taken out the **DAY BEFORE, DAY OF, AND DAY AFTER** each Federal Reserve policy meeting since 1998.

That is one incredible chart and really shows how much effort the FED has put into talking up the stock markets in the US.

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.