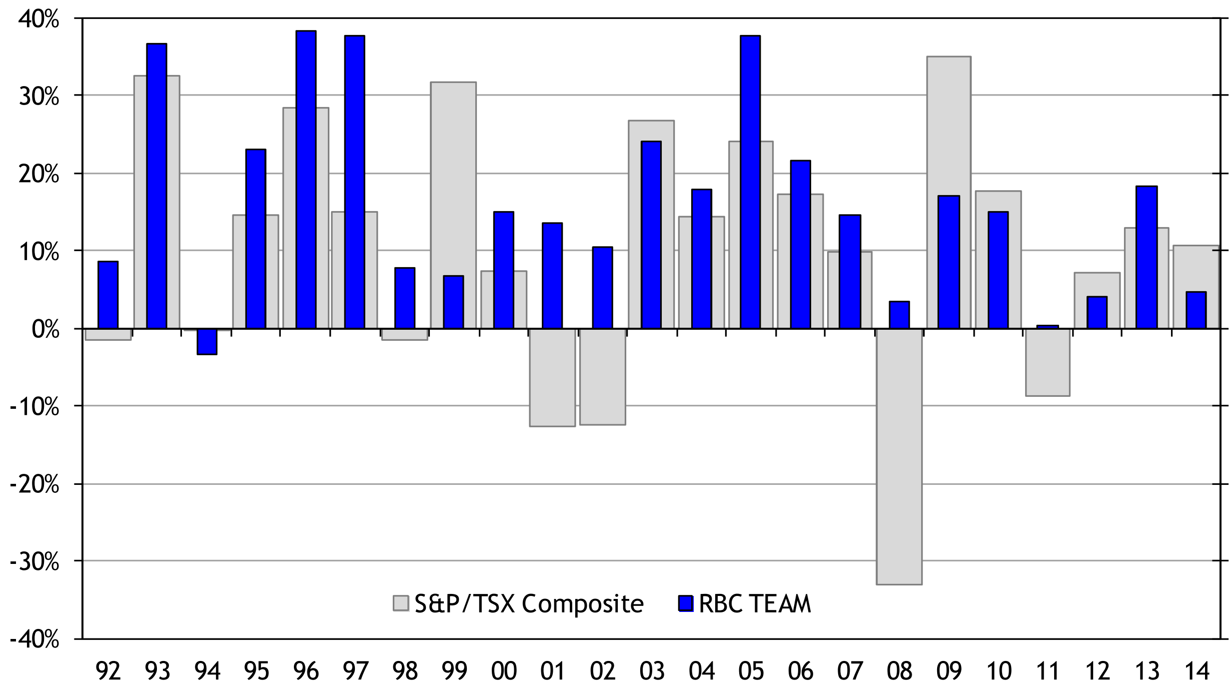
July 13th 2015

"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: 14,412
TSX 200 Day Moving Ave: 14,831
% Above/Below 200 Day Moving Ave: **2.82% Below**
Levels for change: 100% stocks - **TSX 15,572** and 100% fixed income – **TSX 14,090**

Weekly Quote

"*Every breaking wave on the shore, tells the next one there'll be one more*"

Song: Every Breaking Wave, U2

Nick comment: Reminds me of following the European/Greek negotiations.

Not Much To Say this Week

What can I say? I just had nothing to write about that was "value added" or "was worth repeating" this week. My Mom always said, "If you don't have something nice to say…keep quiet!"

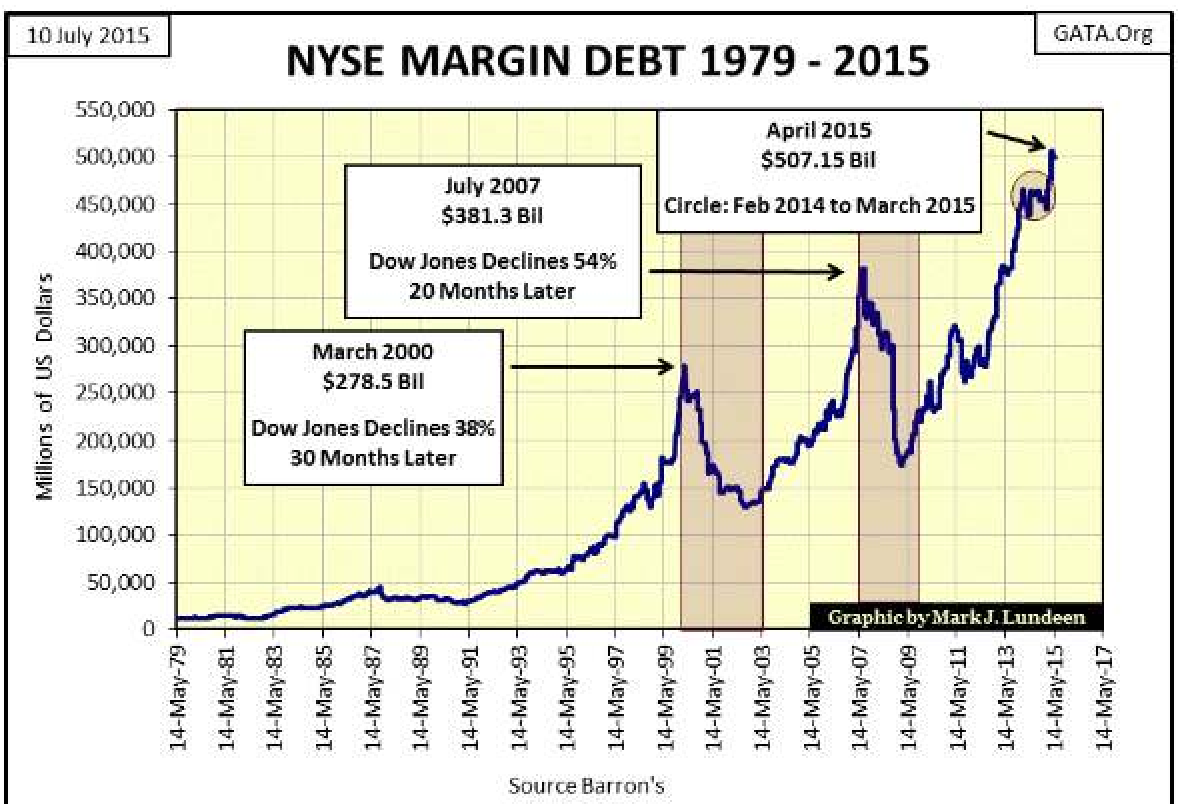
Both situations in Europe and China have become surreal. The concepts of just pouring more money into bankrupt scenarios can only be done when the money is printed out of thin air and cost nearly nothing to produce.

The only thought I had that seems worth stating is **why doesn't anyone talk about the option of Greece just walking away from the bargaining table, defaulting on all the debt they own, and returning to their own currency?** If you look at the terms of the latest agreement and how the Greeks are basically selling their souls…how can that be any worse?

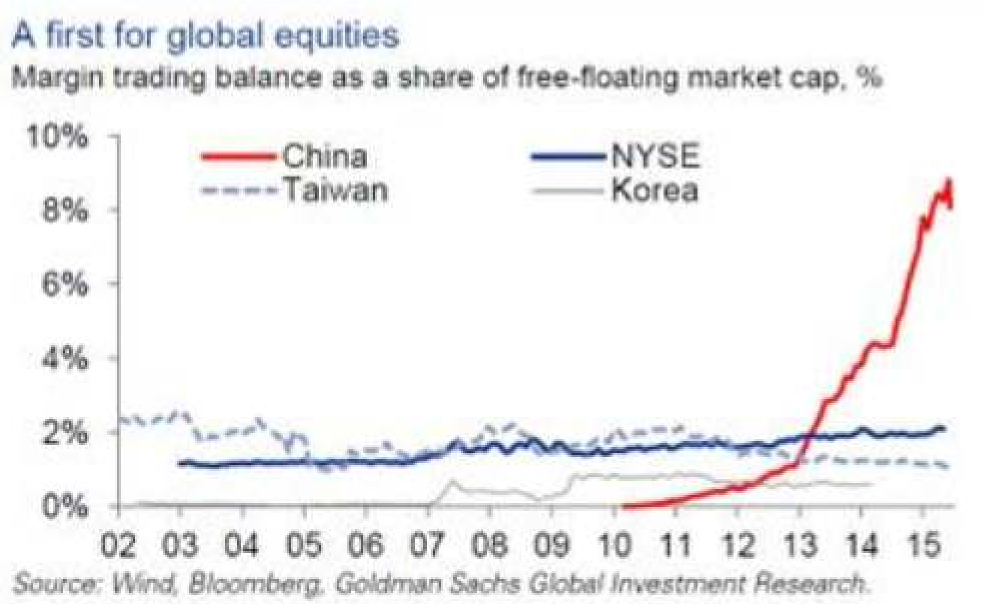
Anyway, hopefully next week I will have something of value to bring to the weekly comment.

A couple of interesting charts and thoughts I came across during the past week:

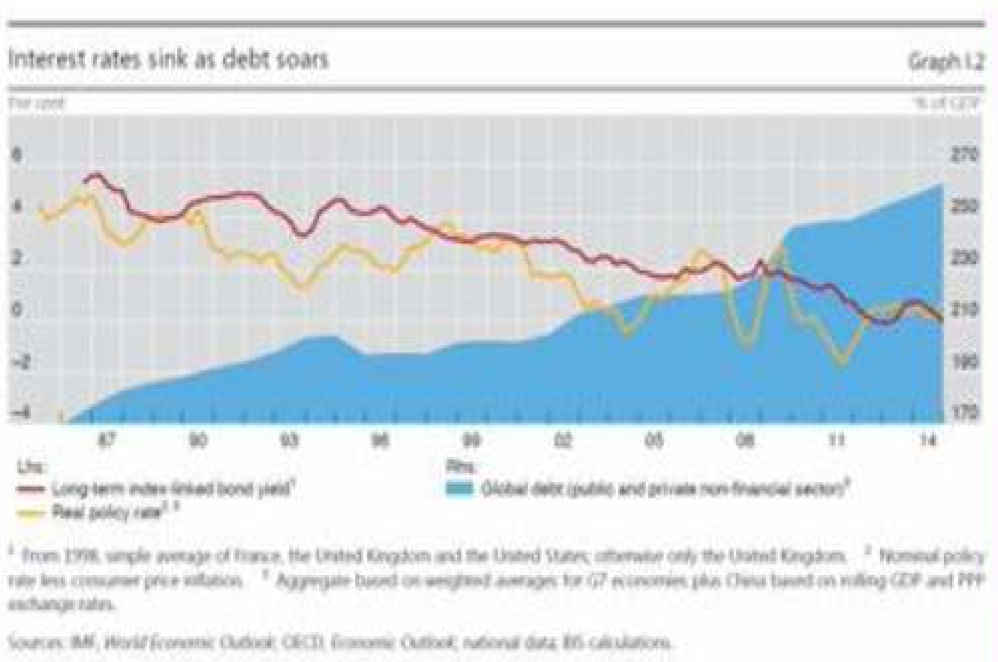
Check out the following chart of margin debt on the New York Stock Exchange. Look where the previous peaks have been.



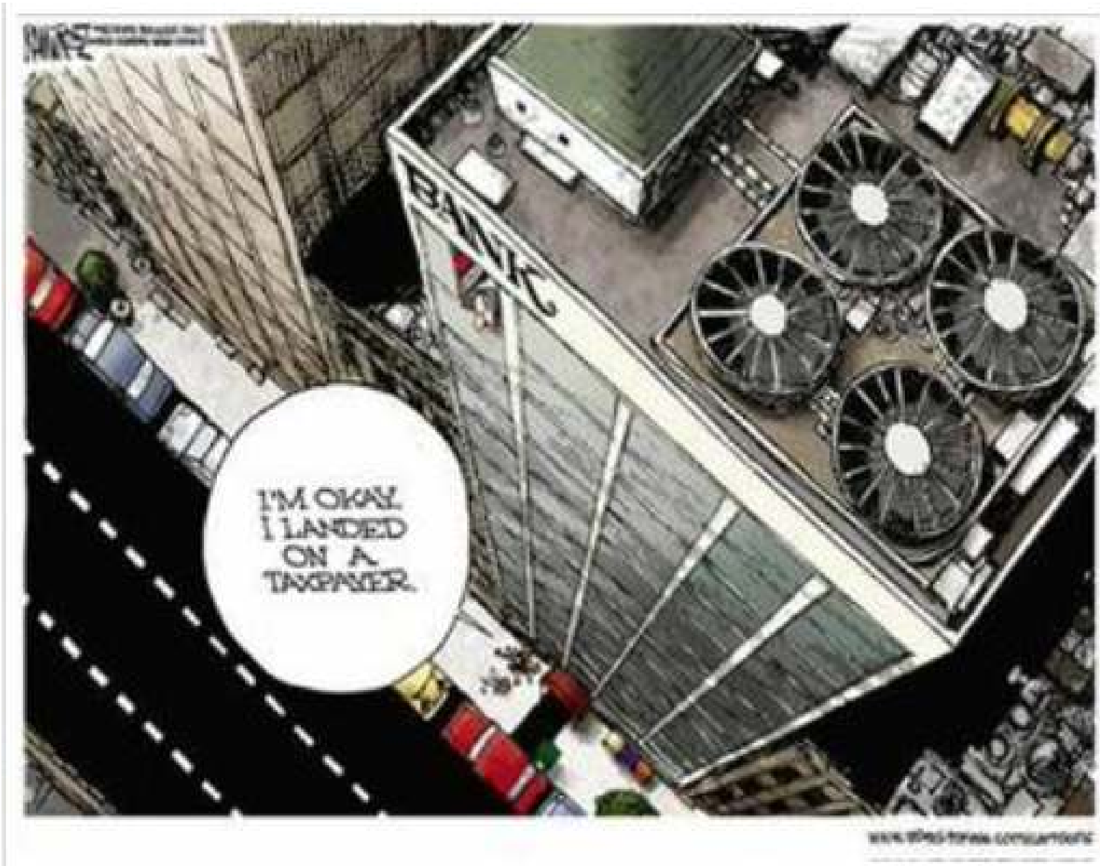
Ok, now check out the same data plotted against the margin debt in China! You have to smile…the NYSE margin debt looks like a “flat line” when compared to Chinese debt! No wonder the Chinese government has made it “illegal” to sell stocks on that market.



Another tidbit I came across compares the growth in global debt vs. interest rates. Obviously, the margin borrowing above could never have happened if the chart below had not been instigated by reckless central bank policy. (Sorry for the blurry pic)



At the end of the day, I guess the following cartoon basically sums up why the central banks (and banking community in total) are not too concerned about what they do in terms of reckless activity:



The last cut out I included this week is an excellent look at what is happening to the **rate reset preferred share market**.

These “safe” shares have been beaten up during these bizarre financial times. The one-pager below done by RBC is an excellent update on what is going on with these shares and offers some advice as to what a person should do with them at their present low valuations.

Rate Reset Preferred Shares - What's happened?

Lower government bond yields and increasing calls for a rate cut are hurting. With RBC CM changing its call to a cut yesterday (July 8th), 4 of the major 5 Canadian banks are now forecasting a 25 bps rate cut from the BoC on Wednesday. These calls for a cut come after a disappointing April Canadian GDP report (released on June 30) and the ongoing Greek situation/Chinese market drama have spurred a ~30 bps decline in the 5-year yield (to the lowest level since February 4th) since June 26. The market is now pricing in a full 25 bps rate cut from the BoC by the end of the year and assigning about a 15-20% probability to an additional rate cut. None of this is good news for rate resets, especially issues with upcoming reset dates, as lower 5-year yields mean new fixed dividends on extended issues will be reset lower and a lower 3-month T-bill rate reduces the appeal of floaters. Rate resets and floaters comprise ~2/3rds of the preferred share market.

Thoughts on Valuation:

Unless there is a pressing need for clients to raise cash, we don't think this is an environment that clients should be selling into. This is an illiquid, out-of-favor market right now and the price action we are seeing is a function of that. *Many perpetual issues have been beaten up despite the recent move lower rates and a number of rate resets offer 5% cash yields until reset dates that are not for 3-5 years. At today's prices, many of these rate resets will continue to offer a 5% cash yield after the reset date should the 5-year yield return to the mid-1% area by the time these issues reset. The forward market currently projects a 2.25% 5-year yield in four years' time.*

Some valuation buffer for lower yields still exists. Unlike earlier in the year where the preferred share market had not fallen as quickly as government bond yields, the preferred share market is establishing fresh lows even though the 5-year yield is ~12 bps above the February low of 0.59%. This suggests the market could be better braced for this move back to the lows in the 5-year yield than earlier in the year as this time a bit of a valuation buffer has built.

Exhibit 2: Preferred Share Market Declines since May have Led GoC 5-Year Yield Decline

Source: Bloomberg, RBC DS

Have a good week and, as always, feel free to email or call with any questions.

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.