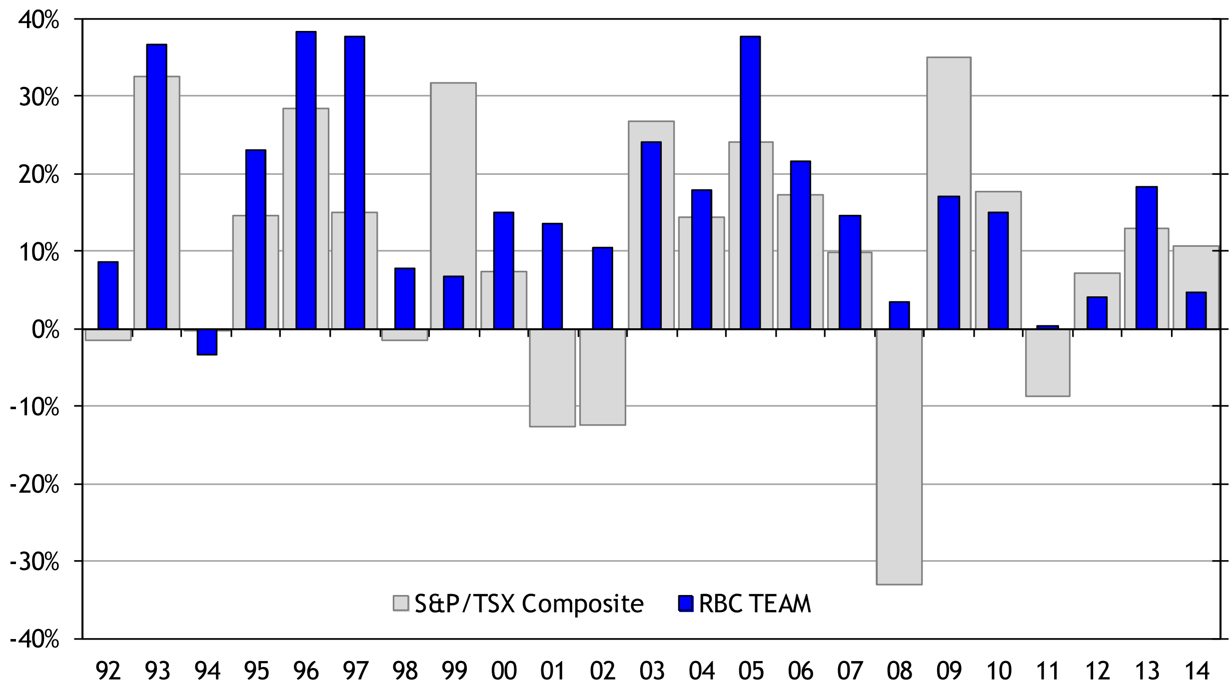
May 11th 2015

"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:	15,171
TSX 200 Day Moving Ave:	14,911
% Above/Below 200 Day Moving Ave:	**1.75%**

Levels for change: 100% stocks - **TSX 15,656** and 100% fixed income – **TSX 14,165**

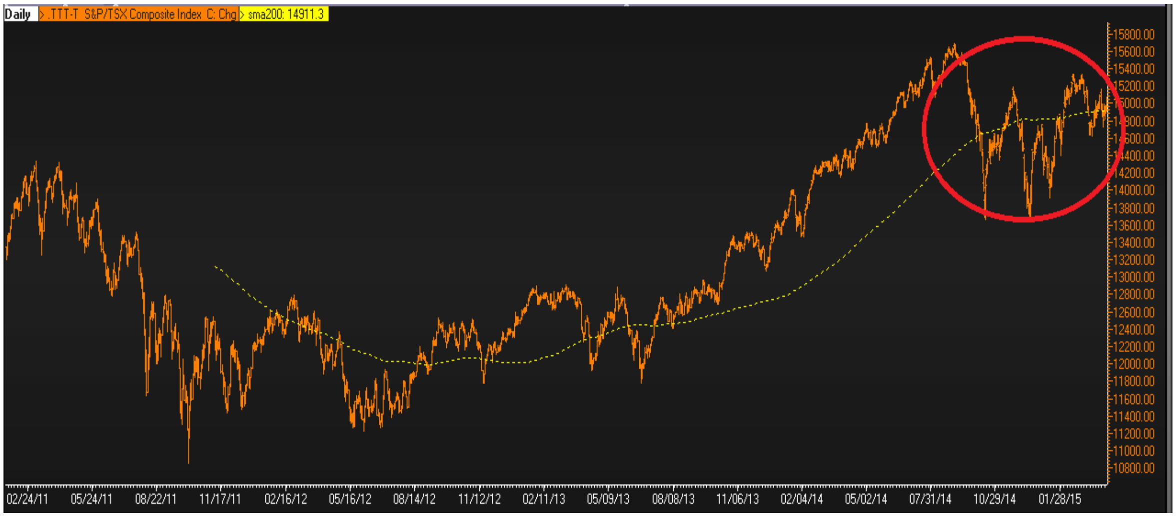
Weekly Quote

"Did I mention the stock market doesn't have any memory one day to the next?"

Doug Kass, Real Money Pro – TheStreet.com

__Price Volatility Across All Markets__

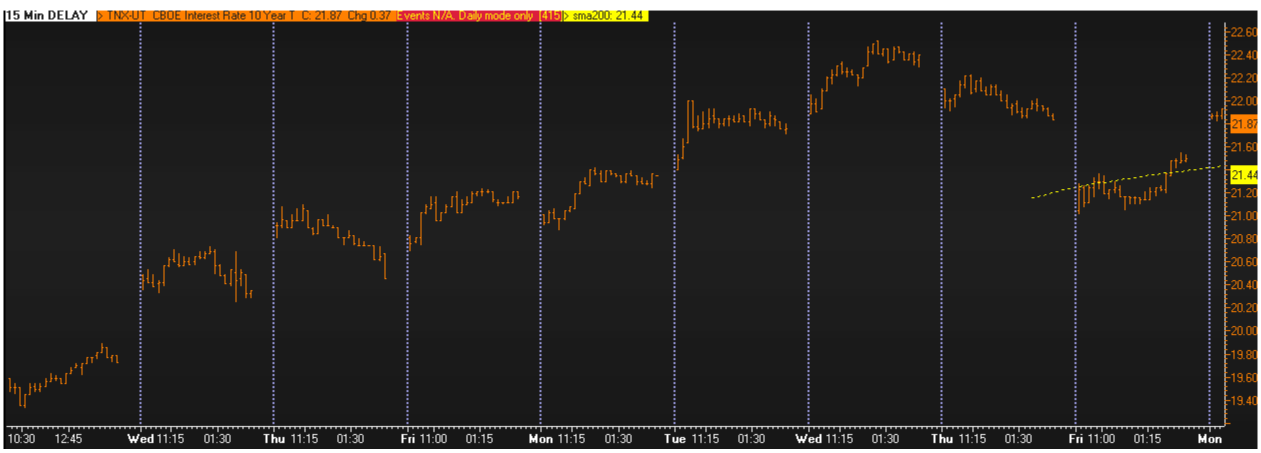
Currency, bond, and stock markets around the world have become “whippy” during the past six weeks. Last week was incredibly volatile.



The chart of the TSX above shows even the mid-term trend of the stock market in Canada has been “whippy” since September 2014.

What catches my attention is how the bond markets have increased in volatility. Why?

Because as growth slows globally (see below) interest rates would normally decline due to the weaker economic conditions that coincide with slower growth. But the exact opposite is happening…hmmm?



Check out the past 10 trading days on the US 10 year bond. (The scale on the right denotes the interest rate…20.00 is 2.00%) **The yield jumped from 1.90% to 2.26% and then fell back to 2.12% on Friday last week.** It is moving higher again today!

The currency markets are showing the same types of behaviours too.

As alluded to in my prior weekly comment, the "personality" of the markets is changing. Next week I will talk a bit about shifting trading strategies to meet with the potential changes in market personality we face.

Global Growth Continues to Slow

An April 2015 International Monetary Fund (IMF) update pegs **global growth** for 2015 at 3.5%. (This figure is now down from 5.25% just 15 months ago!)

The growth for the **US economy** has been lowered to just 1.5% in the same review and forecast. ("*Uneven Growth: Short and long term factors, April 2015 –IMF*")

Step back…take a deep breath…think about those statistics for a moment. That is a huge reduction of economic activity in the $75 trillion global economy!

The world has lowered interest rates and printed money for six years. It was supposed to create and support global economic growth. But all it has done is jacked up asset prices!

Jeremy Grantham is one of the most respected "quantitative managers" in the world. He described an incredible image in his quarterly newsletter that helped me to better understand the present state of US monetary policy: (to his credit, he has said the US economy was growing at about 1.5% for more than six months)

"Now, the question is how much will this (the IMF drop in expected US GDP growth) affect the Fed's beliefs?

Presumably enough to matter. This would be timely because, as you may remember, I have been anxious about ***the Fed's whipping our actual 1.5% donkey in the mistaken belief that it was a 3% racehorse. The danger was, as I said, that they would keep on whipping it until either the donkey turned into a racehorse or dropped dead.*** *Death from overstimulation."*

… the IMF paper been a necessary gust of reality that might just convince Ms. Yellen (US Federal Reserve Chair) that she is indeed dealing only with a humble donkey...

Mr. Grantham intimates in the rest of his letter that he believes the FED will just keep on whipping the donkey. (Just not as hard!) He doesn't believe the US stock market is ready to decline as of yet due to the FEDs "overstimulation" but believes that any level above S&P 500 level 2250 would qualify for a "reason to be defensive". (The S&P 500 is only 150 points away from this target)

At this point, I want to stray away from the US growth question and ask a different question.

The question I put forth…**What can the central banks or politicians actually do to rectify the global growth ills at this point in time?**

They can't go back in time and take all the money back that they puked all over the "too big to fail" financial institutions…they can't go back and raise interest rates in 2012 like they wish they had…they can't go back and tell the banks to lend the money to businesses and people rather than buy financial assets…they can't really do anything!

In the US at least, they have two choices:

1. They can choose to raise interest rates now or leave them at near zero.
2. They can choose to do another round of Quantitative Easing (QE). (Which is really just printing more money.)

As far as the US FED goes…that's it!

Jeremy Grantham and most other FED watchers (myself included) figure they might try a little "number one" before they jump right back in with both feet doing "number two"!

Stay tuned…this is getting more interesting.

<u>…Some more Interesting Central Bank Tales</u>

The Central Banks (CB) around the world are growing their interests in the stock markets. Japan has been the most notable "stock market investing CB", but sad to say, they are far from the only one now.

Why do we care about CBs buying stocks?

Well, last week I used the quote from Jim Grant (The Interest Rate Observer) that "**Central Banks around the world now have the mandate of being both arsonist and fireman".**

How objective are central bankers about their policy if their own balance sheet is tied to keeping stock prices higher at the expense of the general economy?

Let's take a look at the Swiss Central Bank…you know, those conservative Swiss types?

The table below shows that 18% of their assets are in stock holdings…that equals over $100 billion Euros…or about 15% of Swiss Gross Domestic Product (GDP).

Foreign currency investments and Swiss franc bond investments (end of Q1 2015)

▸ Print

Investment structure at the end of Q1 2015

As at 31 March 2015, the key asset allocation data for the foreign currency investments and the Swiss franc bond investment portfolio were as follows (figures of previous quarter are indicated in brackets):

	Foreign currency investments		CHF bond investments	
Currency allocation, excluding investments and liabilities from foreign exchange swaps				
CHF	-	-	100%	(100%)
USD	32%	(29%)	-	-
EUR	42%	(46%)	-	-
GBP	7%	(6%)	-	-
JPY	8%	(8%)	-	-
CAD	4%	(4%)	-	-
Other (1)	7%	(7%)	-	-
Investment categories				
Investments with banks	0%	(0%)	-	-
Government bonds (2)	71%	(73%)	43%	(40%)
Other bonds (3)	11%	(12%)	57%	(60%)
Equities	18%	(15%)	-	-
Breakdown of fixed income assets (4)				
AAA-rated	61%	(63%)	74%	(72%)
AA-rated	24%	(22%)	25%	(27%)
A-rated	10%	(10%)	1%	(1%)
Other	5%	(5%)	0%	(0%)
Investment duration (years)	4.1	(4.0)	7.7	(7.4)

(1) Mainly AUD, DKK, KRW, SEK and SGD plus small holdings in additional currencies in the equity portfolios.
(2) Government bonds in their own currencies, deposits with central banks and BIS; in the case of CHF investments, also bonds issued by Swiss cantons and municipalities.
(3) Government bonds in foreign currency, covered bonds, bonds issued by foreign local authorities, supranational organisations, corporate bonds, etc.
(4) Average rating, calculated from the ratings of the three major credit rating agencies.

Equities are managed on a purely passive basis, whereby broad market indices of advanced and emerging economies are replicated. Exchange rate and interest rate risks are managed using derivative instruments such as interest rate swaps, interest rate futures, forward foreign exchange transactions and foreign exchange options. In addition, futures on equity indices are used to manage the equity investments.

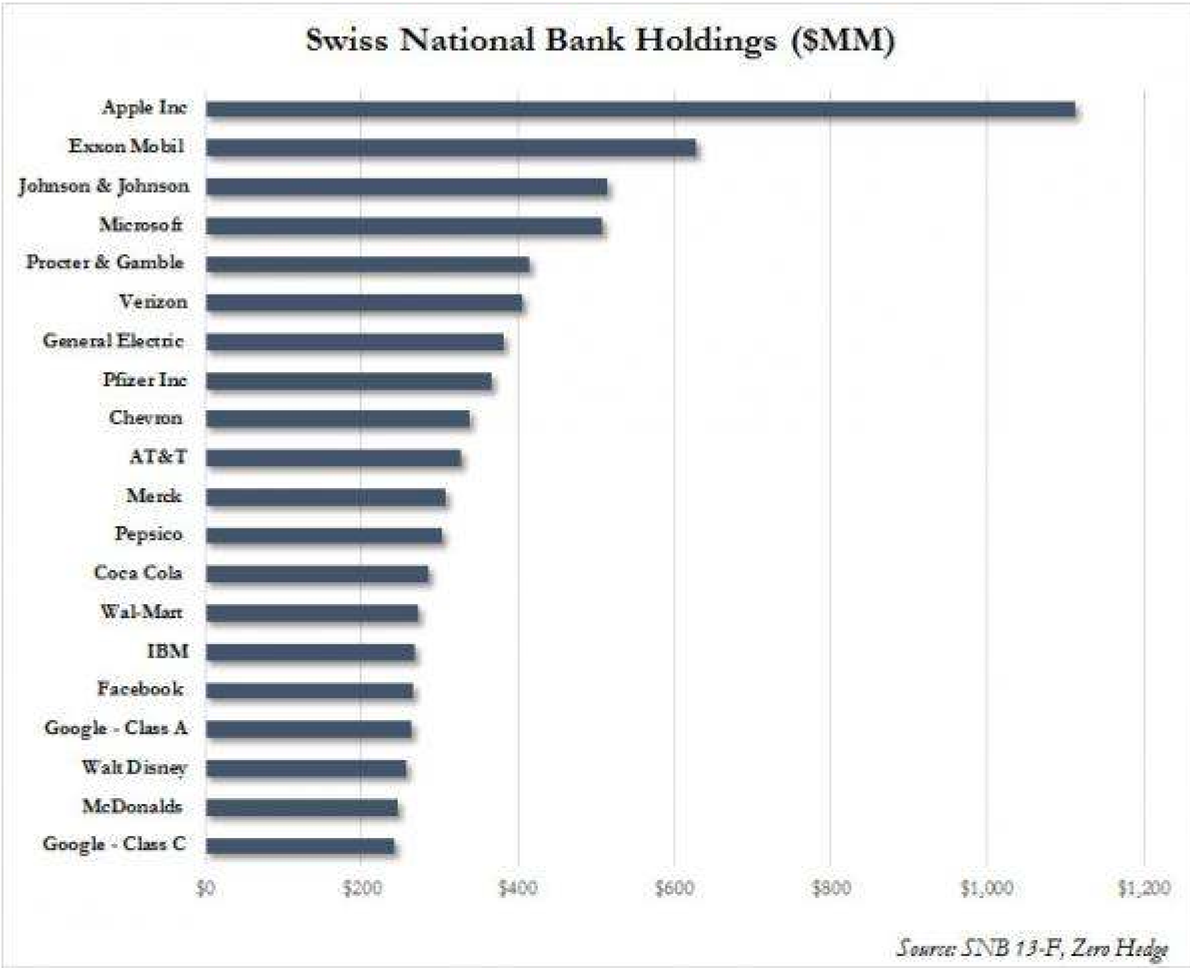
The investment structure at year-end is also published in the Annual Report under 'Asset management'.

Read the following carefully, then think about it for a few moments…

The Swiss National Bank buys Apple stock and lowers interest rates to force the yield-starved bond investor to give money to Apple, which uses the debt proceeds to buyback Apple stock, which boosts the value of the Swiss National Banks Apple stock.

It is one thing to buy house insurance on your own home as protection against the catastrophe…but should you be able to buy insurance on your neighbour's home? (If THEIR house burns down…you get the money!) I'm not sure there is much of a difference between these two situations.

Take a look at the amounts the Swiss National Bank owns in the US stock market.



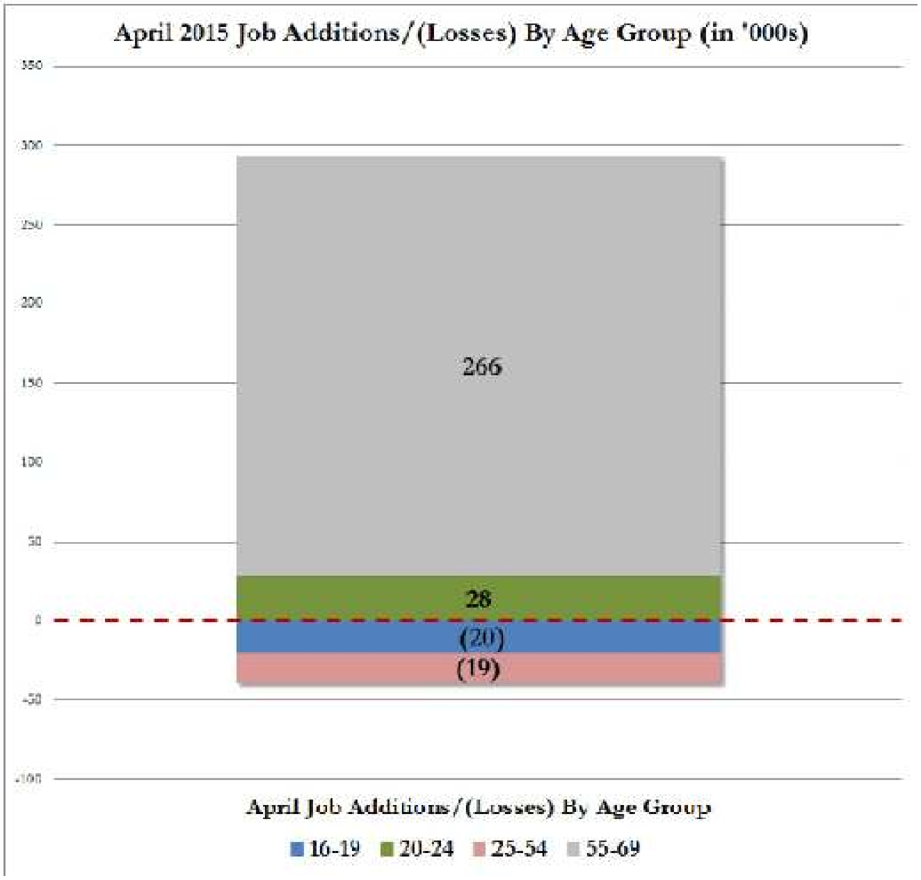
You may disagree with my position on the ability of CBs to buy stocks. That's OK...but I sure hope I don't see these CBs getting money from governments in the next downturn for the stock markets. That would truly be a tragedy.

<u>And Finally…US Employment Data</u>

No matter how many times I view the following two graphics I still come away in shock. The employment picture has completely been turned on its head.

The first graphic shows the age demographic correlated with the rise or fall in the level of employment. Look at the huge increase in over age 55 workers in the latest jobs number for April.

Think about that one for a moment…so much for "Freedom 55"!



The next graphic shows us that this trend is nothing new…it has been happening for more than 15 years!

We could infer a lot of different themes with this data:

1. We live longer so we work longer.
2. We didn't save enough so we have to work longer.
3. Jobs are so much more satisfying today that we choose to work longer.
4. Jobs are physically easier so we CAN work longer.

I'm sure you can think of some more themes too.

But what really is scary is not just the hike in number of "old" workers…but the lack of job creation in 19-24 and 25-54 age categories. To me, that is the unhealthy underbelly of the charts above…we need a strong jobs market when people are at the age when they are settling down and raising families.

Just a little more food for thought this week.

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.