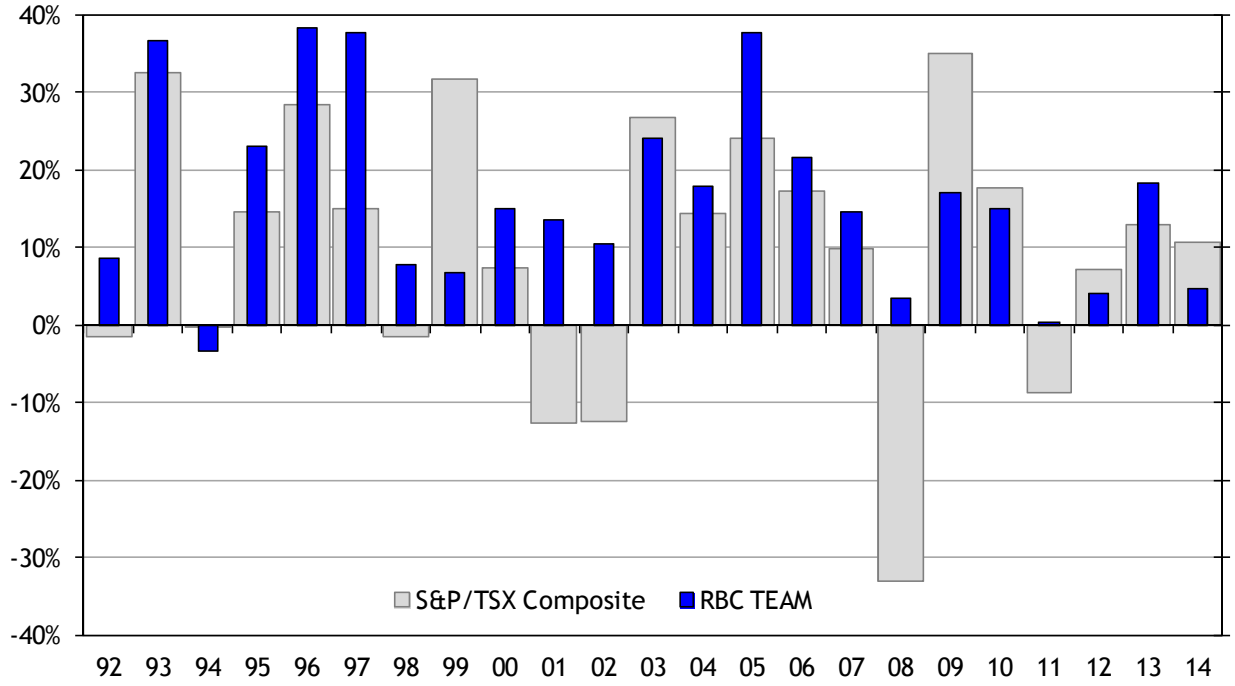
March 23rd 2015

"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:	14,942
TSX 200 Day Moving Ave:	14,910
% Above/Below 200 Day Moving Ave:	**0.21%**

Levels for change: 100% stocks - **TSX 15,640** and 100% fixed income – **TSX 14,162**

Weekly Quote

"*This FED is not hawkish or dovish…they are chicken!*"

David Stockman commenting on US FED backing away from June interest rate "lift off" and signaling no increases until at least September.

Follow up to Thursday's Email about US FED Policy

Thanks for the feedback from my short comment issued by email on Thursday, March 19th. Your questions are always helpful and make me think.

The following section of the comment was the portion many of you responded to:

"To his credit, Ben Bernanke's FED did not make the same mistake the FED made in the 1930s…they left interest rates low…actually too low!

A quick bit of logic: Just because you did not make the SAME mistake as someone else does not mean you didn't make a different mistake. The fallout from choosing to raise or not raise interest rates is not binary…there are lots of different mistakes the FED could make.

We will see if leaving interest rates too low for too long was a correct action or a greater/lesser mistake than the FED made in the 1930s."

Most of what you wrote was expressing a level of frustration with the US FED and their one-sided monetary policy and how it punishes savers…saying it was a clear mistake!

So let me make one more important point to what I was trying to convey in this section of the comment.

Interest rate policy has now been a ZERO for six years! If the policy was truly a solution, should not six years be a long enough time for the effects to be felt by the real economy?

The only way the FED will ever find out if it was correct or mistaken with its policy of Quantitative Easing (QE) is to start to raise interest rates to at least the inflation rate of approximately 1.65% and see if the economy continues to function.

They don't need to do this overnight…but they need to start the process.

What the FED is doing now only exacerbates the inequities in the market place and will prove to create a larger problem in the end IF QE WAS REALLY A MISTAKE!

For what it is worth, I don't think the FED will raise rates more than once or twice. I have been on record since last year that the FED would only raise rates twice (March and June 2015) and they have already blown that schedule.

It is really quite pathetic!

Long Term Impacts of Free Money

The following is a summary of an encounter I had with a retired contractor last week:

Retired contractor's phone rings: *Hey Mike, how's it going? (other party speaks) Why are you asking me that question? It's your company and your decision now? (other party speaks) OK, if it was me, I would not bid a job unless I could make 25% profit anymore. There is just too much work around to be working for less…*

After this conversation I asked the fellow, *"How much more expensive would that make the bid than when you used to run the company?"* Answer: **About 25% more expensive! Most of the time I ran the business we worked for wages. There were times when we could price jobs at "cost plus 15%" but they never lasted long…neither will this!**

This fellow went on to tell me his life story about how he and his young wife started in a small "fixer upper" to build sweat equity…three times…before he actually had enough of a net equity position for the bank to allow him to build his own brand new home 12 years later!

By comparison, when he retired last year he said he constantly saw "first home buyers" taking the plunge at the $500,000 level…basically borrowing the entire amount. *Why do banks do that today anyway?*

I just smiled and said, *"If they don't lend the person the money, then their competitor will…not saying it is a great idea, but it's the way it is."*
……

Free money is like a narcotic. *At first you avoid it because you understand it is harmful to your long term health. But you are constantly tempted…everyone else is doing it…the costs seem pretty low and the highs are immediate…maybe I should just try a little…that was easy…maybe a bit more would be OK…ha, this is great…why was I worried about taking this free money anyway?...wow, there is sure a lot of free money available!*

That progression does not take long to work through. Especially if you are constantly told by the media that you are an idiot if you are not taking advantage of the free money!

The irony is that people start to view CREDIT/DEBT as SAVINGS. This means if they have another $10,000 of credit available to them it is viewed as SAVINGS rather than debt. If they choose to spend their "savings" who cares…it was theirs to choose!

But free money is debt. Debt is borrowing tomorrow's earnings today. Or as I often like to state: Eating tomorrow's lunch today! The question is, **how many lunches in the future have we eaten as a world economy?**

You know I could trot out 25 different charts to show how far in debt the financial world at every level has fallen into…I'm not even going to bother. Because it (debt) does not matter until it matters! As long as the debtor can "roll" their debt…nobody cares!

I will make one other comment though…**I'm not sure our quality of life has been made better by creating a world where there is no natural progression of reward based upon effort.**

Going back to the conversation I had with the retired contractor at the beginning of this editorial…my friend spoke of the "sweat equity" renovations he and his wife did on the three "starter houses" with pride. The process of creating something together helped bond them together. They were investing in THEIR future well-being by working hard together.

Compare that scenario to a young professional couple who are both working in good jobs. They walk into the bank and all the bank sees is two *income streams to enslave for the next 40 years*! Like a street dealer, the bank knows they are already mentally "hooked" on the idea of "buying things they really don't need with money they really don't have".

Their combined starting salaries are "only" $135,000 but that will be double in 7 years' time. "*Hey, you DESERVE a $450,000 mortgage and two German car leases!"*

So where is the investment in their combined future? All that "stuff" was made possible by signing 15 pieces of paper based on future earnings and success. Where does that sense of accomplishment come from when the material trimmings are pulled out of a hat like a magician's rabbit at the bank?

It is no different for governments.

Budgets and deficits mean nothing to them anymore. At the central bank level, the world believes that the amount of debt that can be created is infinite today. Just ask Ben Bernanke or Mario Draghi…

It has been a while since I have written a rant like this one. I needed to get it out of my system. The world is much more than computer generated credits and debits…people's lives are more than the possessions they possess…happiness is built upon more than marble counter tops, how many trips you can afford, and what restaurants you choose to eat in.

Think about it…and if you think you know someone who might benefit from these thoughts feel free to forward this editorial to anyone of your choice!

Another Short Thought about the US Dollar's Meteoric Rise

Bill Gross, of PIMCO fame, and now of Janus Funds wrote an interesting editorial for his monthly comment. Below is one of the lines I found quite thought provoking:

"But common sense would argue that the entire global economy cannot devalue (their currencies) against itself.

Either the strong dollar weakens the world's current growth locomotive (the U.S.) or else their near in unison devaluation effort fails to lead to the desired results, much like Japan experienced after its 50% devaluation against the Dollar beginning in 2012."

Read that short segment again. Think about what Mr. Gross is saying.

You see, the "race to the bottom" for the currency markets is a futile race. The winners are the biggest losers…..

To give the US credit, at least they are trying to consider avenues that would allow them to "normalize" interest rates. (Where normal resides is anyone's guess…but I know for sure it is higher than zero!)

But the rest of the world is trying to crash their currencies so they can sell into the US. What a crazy financial world we face?

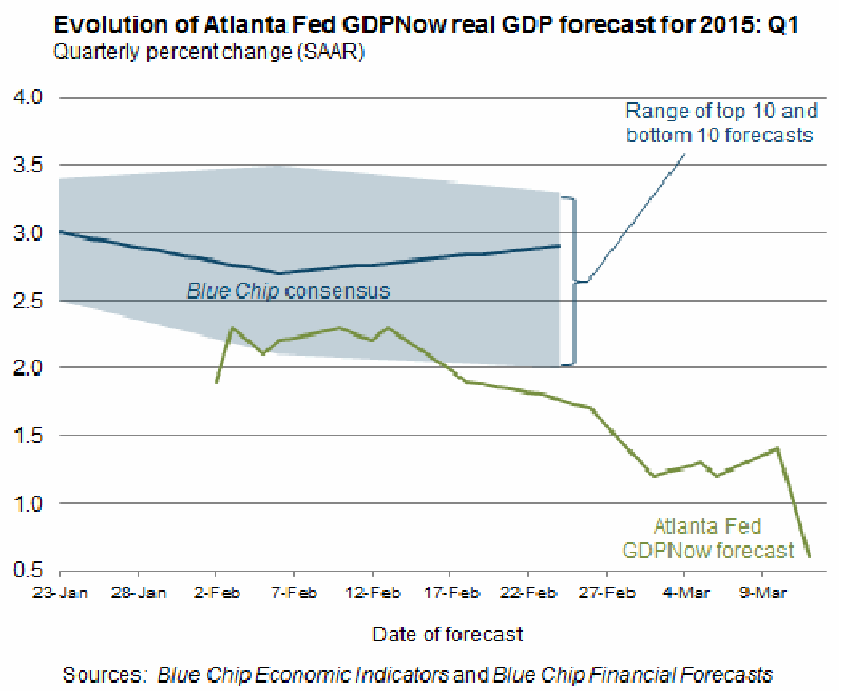
Ironically, the included quote from Mr. Gross and the opening rant editorial I penned are not that far removed from each other. Prudent savers and non-financial businesses are sadly caught in the cross-fire of these central banks.

Is there real economic growth taking place beneath the surface of all this financial hubris? Yes and No…

The closer one's business resides to the financial markets and business models the more likely your business is experiencing real growth. Banking and real estate are definitely the strongest pillars of the economy presently.

But there is a growing weakness in the US that is even starting to spill into the banking and real estate sectors.

The website GDPnow that is run by the Atlanta FED is telling us the higher US dollar is having an impact on US GDP. The chart below makes the point clearly:

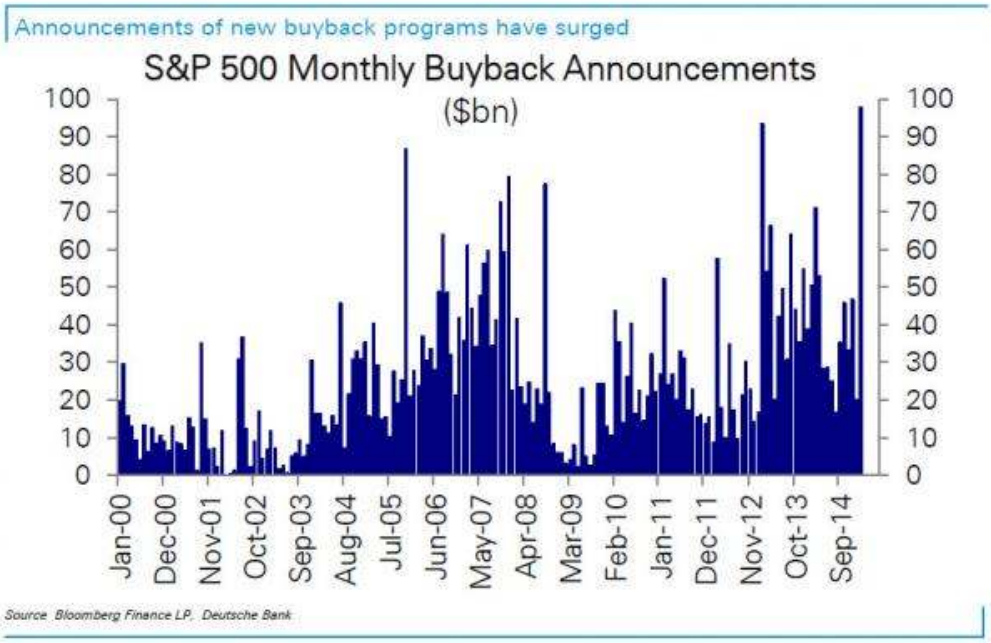


Here is a longer chart showing the juxtaposition of the economic data and the US stock market:

The scaling in the red line for the US macro-economic data is exaggerated. It makes the decline in the data look steeper than it actually is. But the fact remains, US macro data is declining.

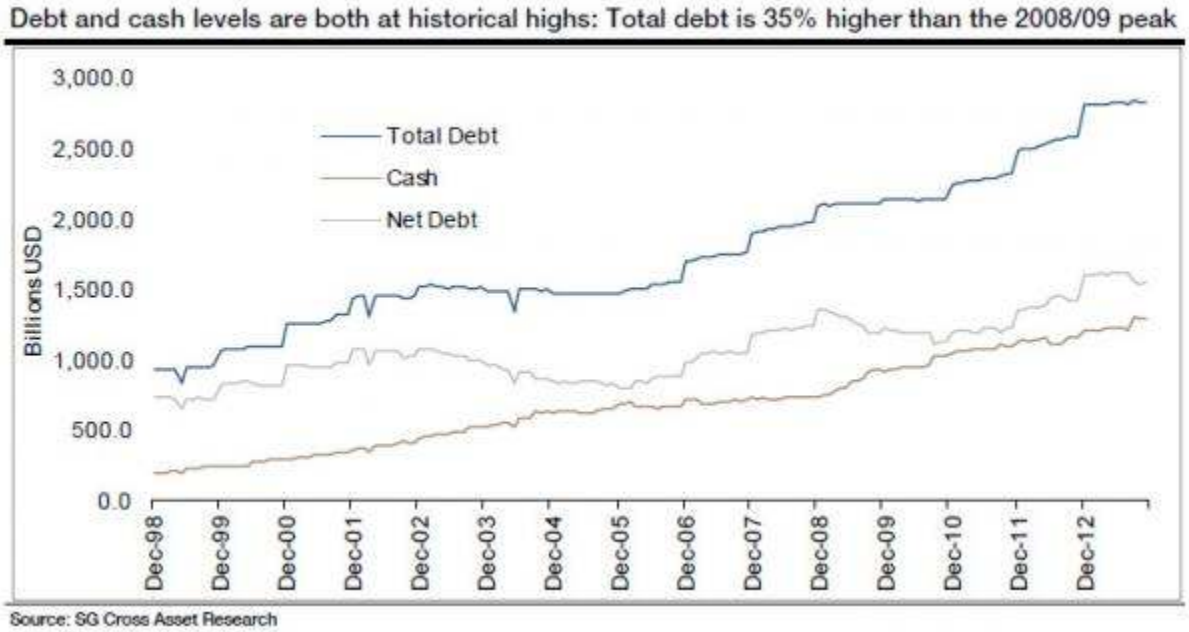
You may be asking, “Why has the US stock market been as strong as it has been if US economic data is weakening?” Good question!

Let's take a look at how US corporate buybacks have been progressing…



Hmmm…?

And just so nobody writes back and tells me that all the corporate share buybacks are being funded by the great earnings of the past couple of years…



So what does it all mean?

Honestly, I am not sure.

I believe **the FED just left interest rates at zero for too long**.

By suppressing interest rates for too long the FED has created a financial environment where individuals, corporations, and governments have made decisions they would not have made if interest rates had been even 2% higher.

As I write these weekly comments, I constantly get feedback along the lines of "when is any of this going to make a difference to the financial markets?"

Again, I don't know…but let's make sure we have a plan in place to manage these conditions!

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.