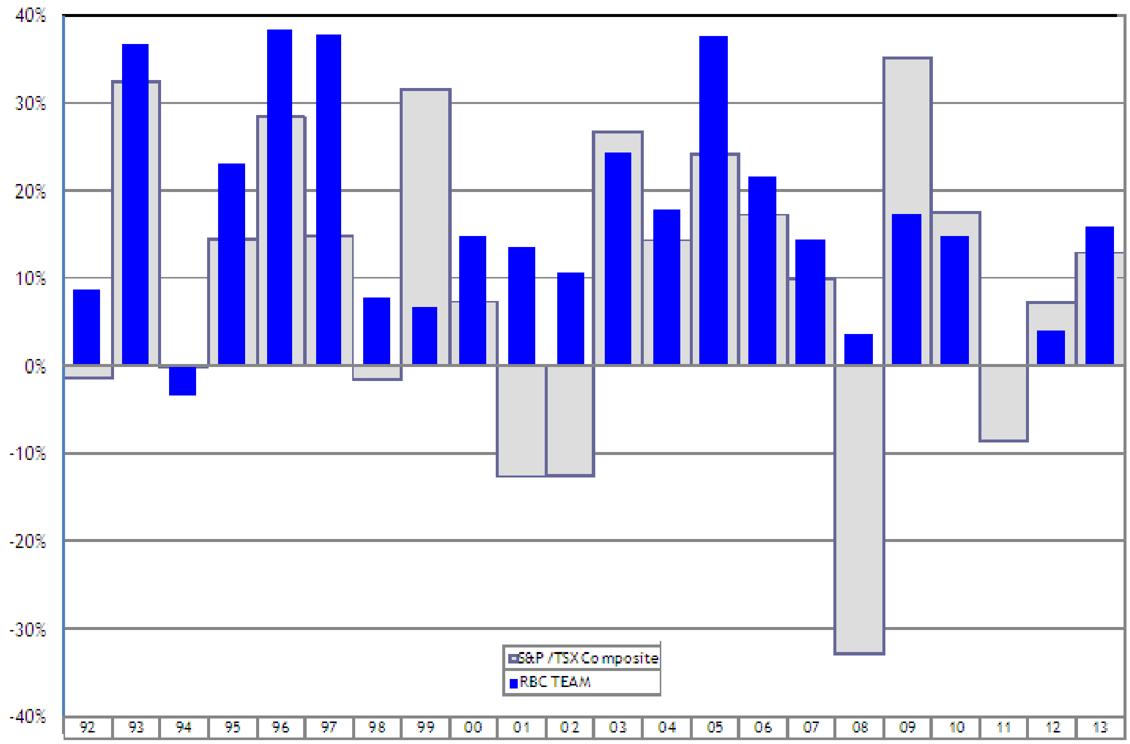
December 23rd, 2014

"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: 14,570
TSX 200 Day Moving Ave: 14,810
% Above/Below 200 Day Moving Ave: **-1.62%**
Levels for change: 100% stocks - **TSX 15,549** and 100% fixed income – **TSX 14,069**

Weekly Quote

"Little thieves are hanged, but great ones escape"

Russian proverb…

Russian Test Case

What an incredibly difficult time to have picked to go on vacation!

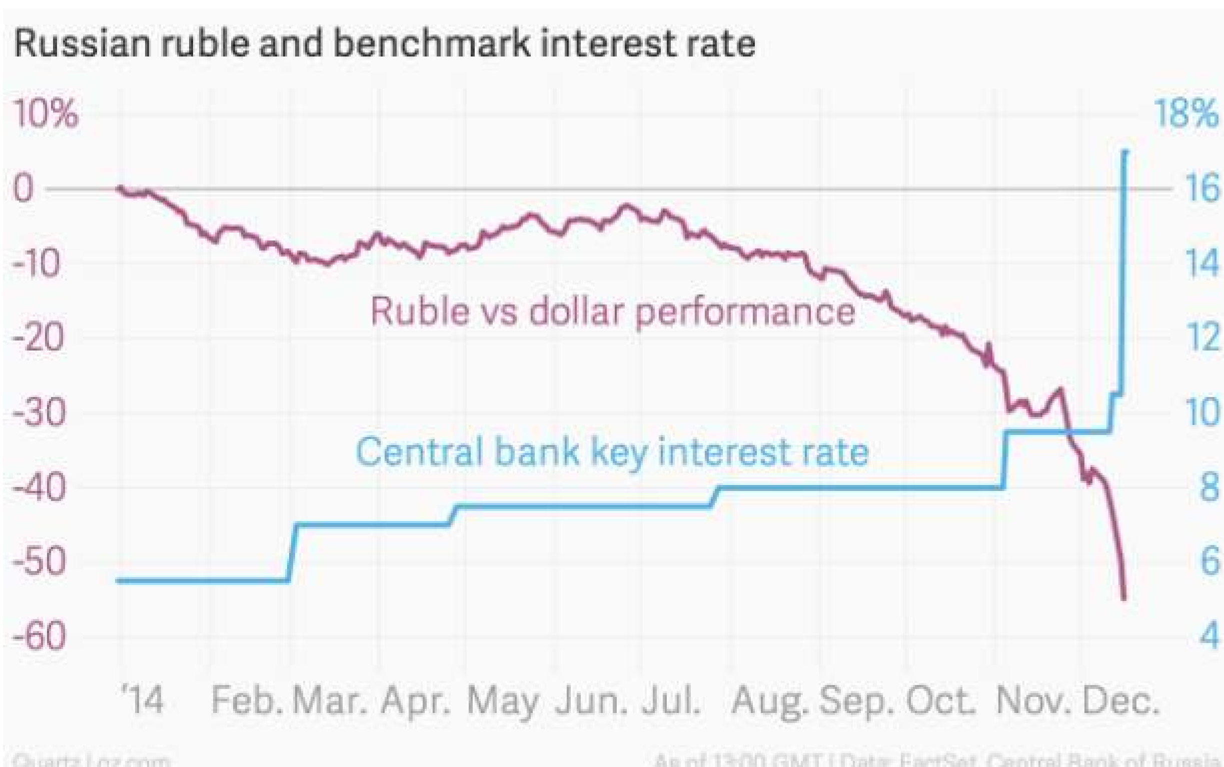
Usually, when I leave absolutely nothing happens to financial markets…it is like my vacation time is equivalent to “financial valium”.

Clearly, our 2014 vacation was not like that!!

Our family was in Hawaii and upon leaving I was hoping to use the time to try and process what we had watched transpire in 2014 and write some comments looking forward to 2015. **But the past two weeks are likely to contain an interesting example of what is to come in 2015…almost like a movie trailer.**

Once again, it was not the stock markets that caught my eye. The show was most spectacular in the currency markets!

The 1 year chart below is of the Russian Ruble priced in US dollars and Russian central bank interest rates.



You can see the Ruble had lost more than **half of its value** vs the US dollar since September. **That is the same as saying that the price of everything imported into Russia has doubled in four months**!

The Russian central bank tried to defend the devaluation using the usual central banks' bag of tricks during this time period but the onslaught of speculative selling was too great. The greatest attempt to stop the devaluation of the Ruble came on December 14th when the Russian central bank raised the interest rate from **10.5% to 17% in a single overnight jump.**

The large gain in the Ruble from 70 back to the 60 Rubles to the US dollar was due to this central bank intervention…but I doubt it will be enough.

Russia is a case study…what is happening in Russian at the end of 2014 is going to have both financial and geo-political fallout next year.

Consider some of the following:

- The most obvious thing to consider is what 17% interest rates and a 50% reduction in the Rubles purchasing power must be doing in Russia itself. Russian citizens and Russian corporations are heavily indebted…the effects are the nothing less than a bludgeoning to the nation.
- Geopolitical tensions have soared as Russia collapses into a Zimbabwean hyperinflation. Vlad Putin is not the most stable leader in the world…what he is considering to do next is anyone's guess?
- Financial "rush to safety". With clearly a new level of risk elevated in global financial markets, money flees to the US dollar. This continues the roaring increase in the dollar…one of the two main risks I have continued to focus on in these weekly columns.
- Commodity prices (oil) continues to get punished as the US dollar rises. Yes, I agree there are many more contributing factors culminating together to cause the commodity "crunch" but at the end of the day I care less about "why" something is happening and more about the "what" is happening.

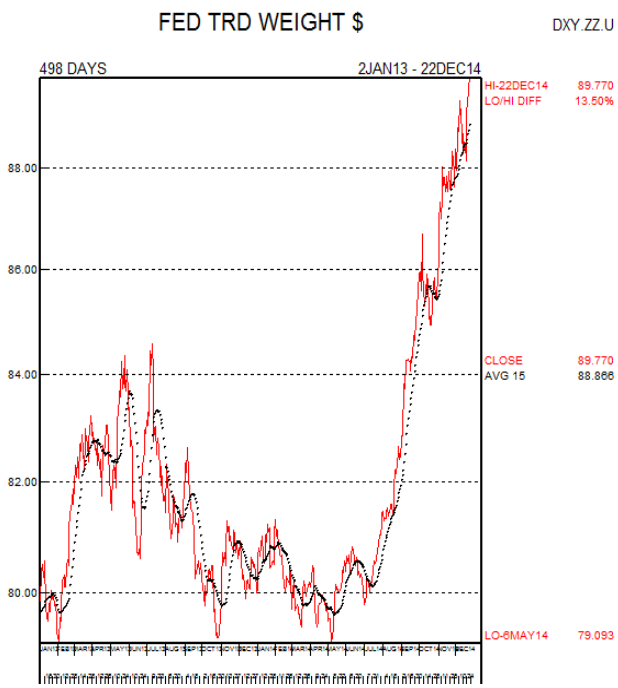
More countries around the world continue to employ "negative short term" interest rate policies to try and force money out of bank accounts and into their economies. The trouble they are having is **a large percentage of the money "influenced" by negative short term interest rate policy tends to flow out of the native currency and end up in US dollars.**

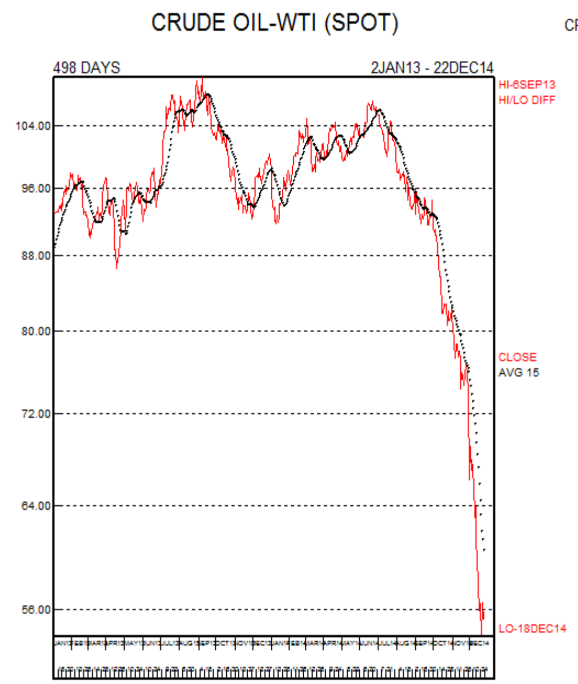
The above unfortunate correlation leaves the country in a more vulnerable position than where it was BEFORE negative interest rates were deployed.

At the end of the day, I end up looking at the stock markets where volatility has once again moved significantly higher. The numbers of days where stock markets are having intra-day moves of more than 2% have increased dramatically again.

Remember, as stated many times in these editorials before, a greater frequency of 2% intra-day moves in stock markets is not BULLISH. Concentrations of 2% moves <u>in either direction</u> tend to be signs of a change in direction in the stock markets.

The bottom line continues to be the price of oil and the rapidly increasing US dollar.





The insane amount of impact these two charts have on so many different areas of the economy is mind-boggling! One country after another (like Russia and Venezuela) are being picked off like fish in a barrel by the relentless move in oil and the US dollar.

Try to imagine what could happen to stop the US dollar's appreciation.

There is no doubt it is the strongest major economy in the world right now. The statements of the US Federal Reserve continue to reinforce the idea that higher interest rates are just around the corner.

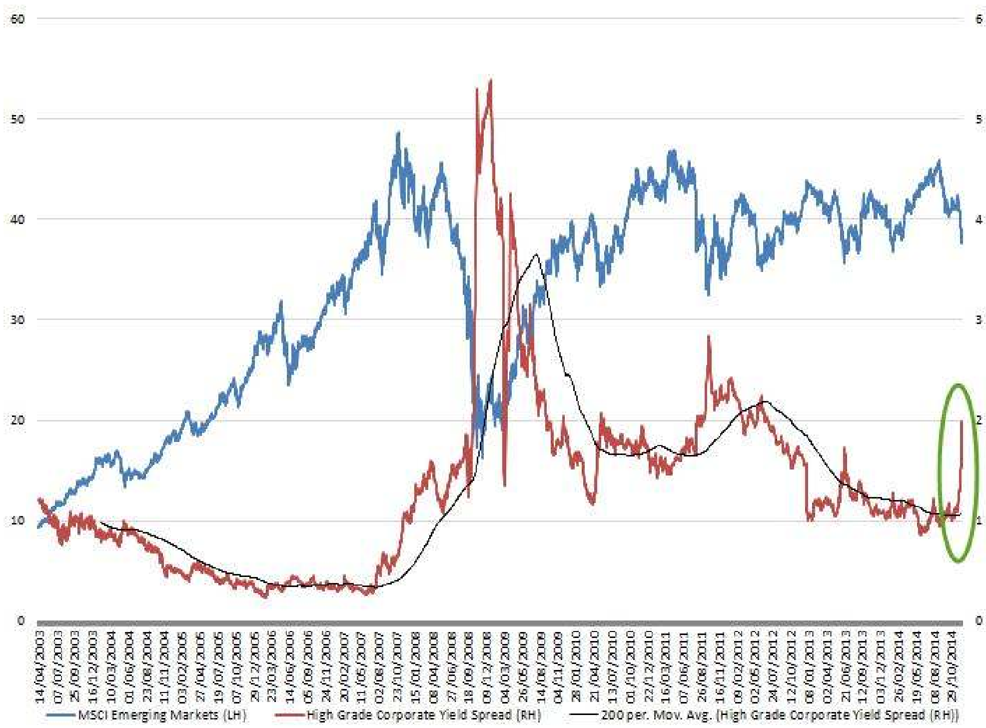
What other country is really forecasting such a move for interest rates?

The irony is that the higher the US dollar goes the tougher it is for other economies in the world…especially emerging markets. As these economies flounder, money flees from them and races back to the US. And this causes the US dollar to rise…

Wash, rinse, repeat…

But check out the chart below,

Emerging Markets (stocks) in blue   Emerging Markets “credit spreads”



Notice the spike in the red “high grade corporate yield” chart in the past three weeks (green circle)…it coincides with some major weakness for the “emerging markets” stock markets. (blue line) Remember, if you add all of the “emerging markets” together they now represent just a shy under 50% of global GDP vs approximately 23% in 1998! That is a huge difference in impact!

Canada is not immune to these issues!

If oil prices do not get back to WTI $80.00 per barrel our “oilsands companies” are in for a world of hurt…and that translates big time back into the western Canadian economy.

Next week I will write a review of 2014 and look at some of the currency and commodity issues mentioned above more specifically and from a Canadian perspective.

Merry Christmas!

Let me wish you each a very Merry Christmas! As you gather with family and friends during the next week please remember to be thankful for all we have.

Sincerely Nick and Robyn!