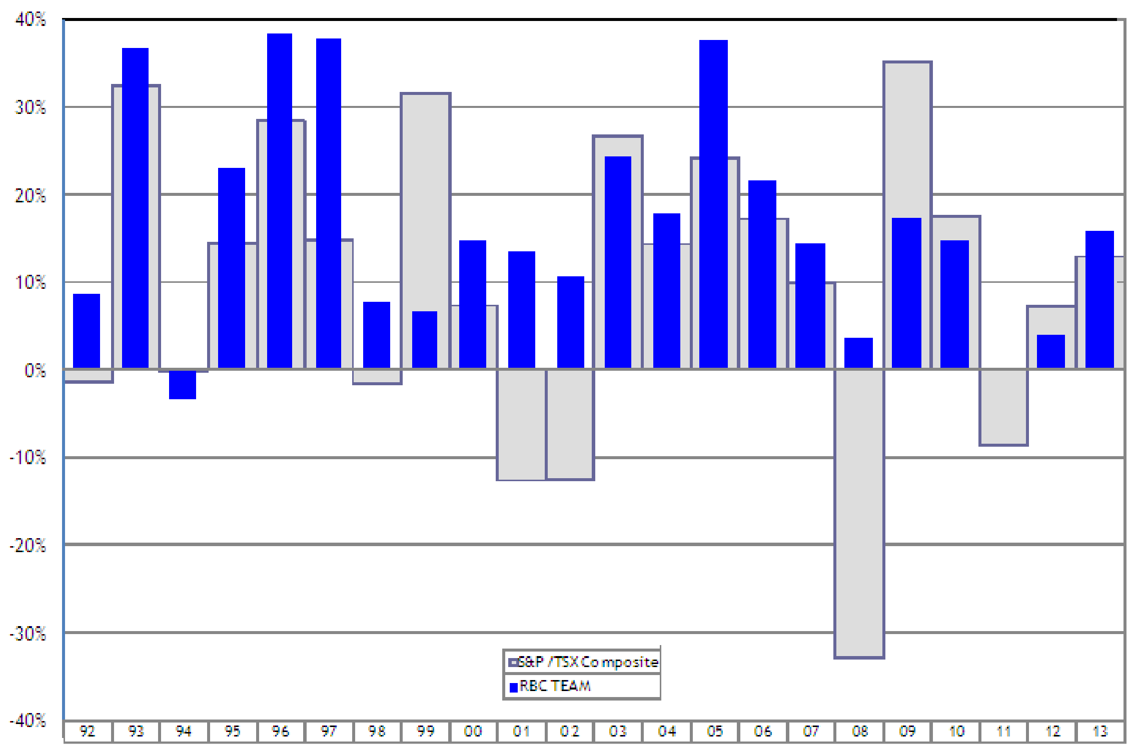
October 27th, 2014

"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: 14,543
TSX 200 Day Moving Ave: 14,655
% Above/Below 200 Day Moving Ave: **-0.76%**
Levels for change: 100% stocks - **TSX 15,390** and 100% fixed income – **TSX 13,940**

Weekly Quote

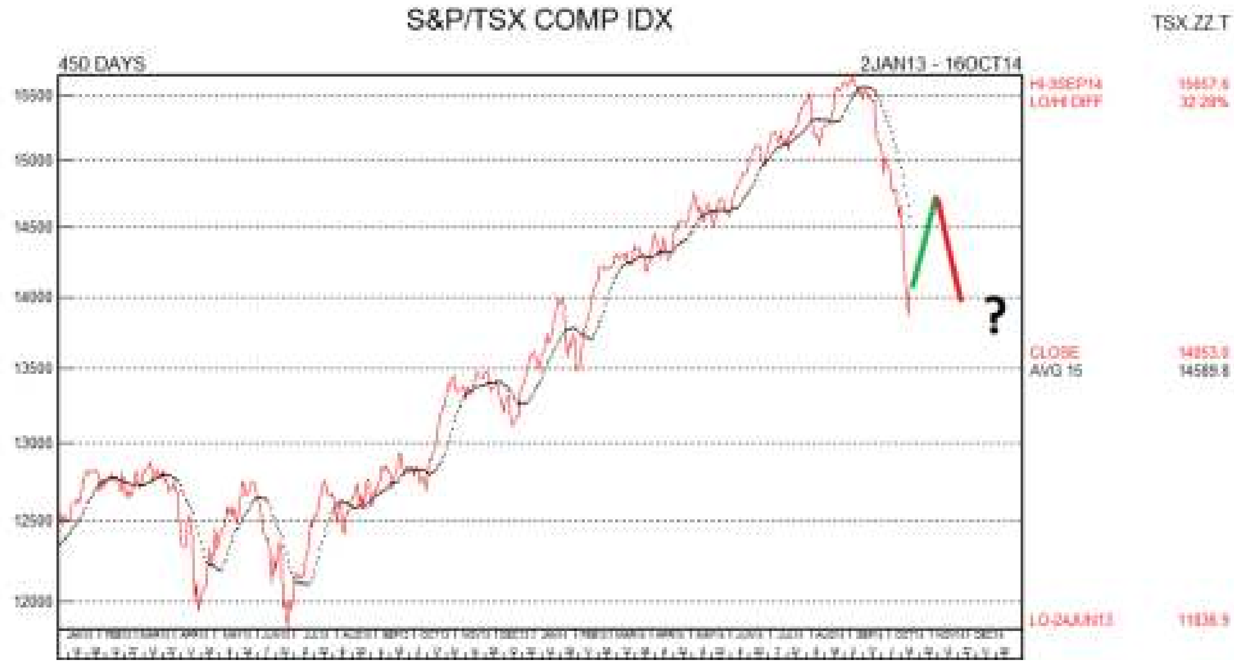
"Never ask the doctor what you should do. Ask him what he would do if he were in your place. You would be surprised at the difference"

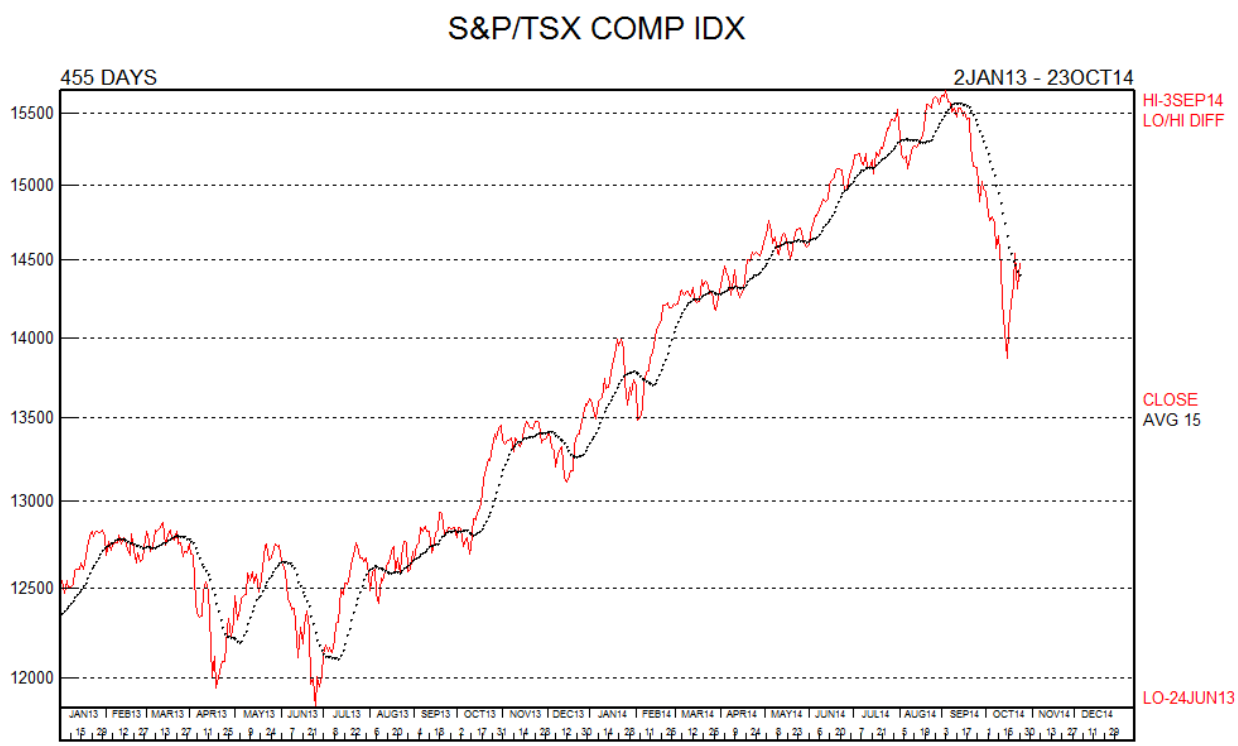
– Gerd Gigerenzer, Psychologist

<u>Market Update – “The Rebound”</u>

Talk about a market that loves to follow the script!!

Below is the chart I put in the weekly comment from a week ago…and then a chart of what actually happened:

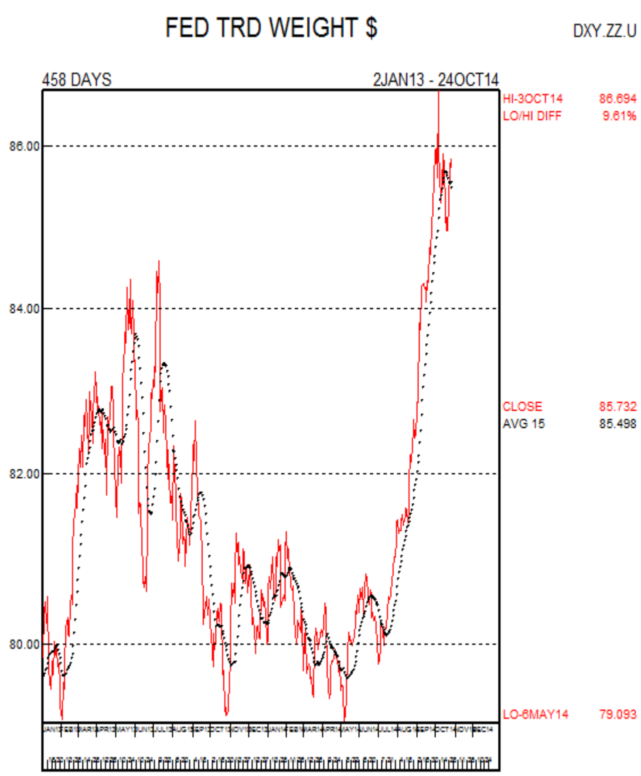


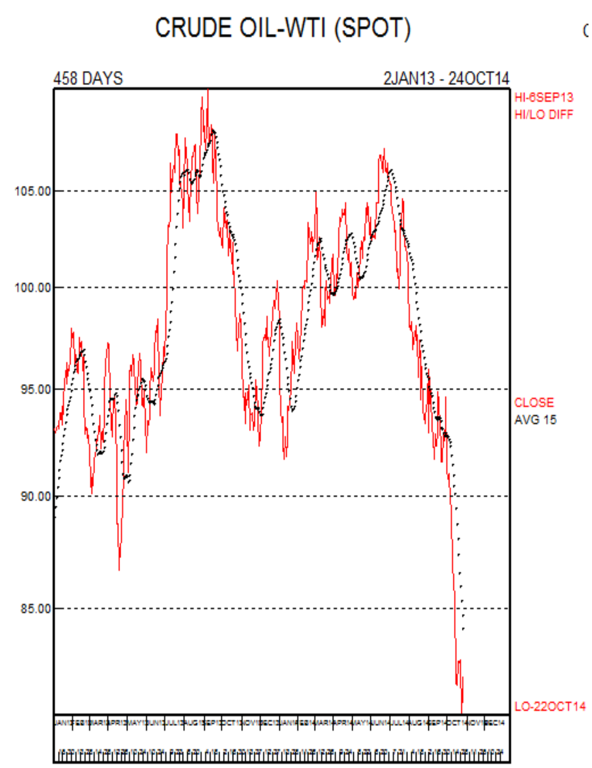


The “green line” marking the expected uptrend pretty much made its target of TSX 14,615 set the week earlier.

But remember, the stock market is the “tail being wagged by the dog”. Where we are looking for a turn is in the currency market and the crude oil market.

Below you can see that the US dollar (FED TRD Weight basket) did not weaken very much and crude oil has actually gone lower.





It is my strong belief that the stock market is not out of danger of a serious decline until the US dollar starts to weaken again and crude oil starts to rise in price. (Discussed below)

Looking forward to this week I would expect the most interesting day to be Wednesday. This is when we will hear from the US Federal Reserve. **My expectation is for the FED to stick to their plan to end the QE3 program at this meeting and state they will keep watching the markets and be “data dependent.”**

That leads nicely into section two of the weekly comment.

Big Picture Thoughts

Lost in the daily squiggles of the charts of different markets is the over-riding reality that the world is simply awash in a sea of digital money. The source of this money has not been another's labour or savings…it has been created, by fiat, with a computer.

Government debt (deficit spending) was created to stabilize the necessary "inflation rate" through good times and bad. But in 1987, Alan Greenspan took what was a central banking tool to be used in "moderation" and "ramped it up on steroids". The idea was to buy time and allow the economy to heal. But, that didn't happen…so more money was created to allow the world more time to heal. But that didn't happen either. So more money was created and interest rates were lowered…but, in 2001, that caused a "technology stock bubble and a subsequent technology stock crash".

More money was printed and interest rates were lowered to "record lows" to allow the financial world time to heal again. This time the asset price dislocation happened in the real estate and mortgage markets. They crashed…so they printed more money and lowered interest rates to zero to allow financial markets and banks time to heal so we can return to normal…and that was six years ago!

We are consolidating about 40 years of history in the above paragraphs…so you are excused if it didn't seem that simple to connect…but there you have it.

So what do we see today?

…**an incomprehensible pile of debt strewn around the world held down at an artificially low interest rate by central bank manipulation.**

But who cares? If the world is ticking along just fine…why do we care? And if we keep ticking along just fine, won't we at some point, start a real economic recovery where the economy fires on all cylinders?

Unfortunately, nobody knows. If the truth be told, the FED probably thought the economy would have been light years ahead of where it sits right now after 6 years and $4.38 trillion dollars of stimulus.

Last week, John Mauldin (Thoughts from the Front Lines) free weekly newsletter penned an article that was one of the best he has ever written in my 15 years of reading his work. (*The Flat Debt Society*) He centered his arguments on the theme of the following paragraph:

> *"When there is no inflation, the choices are between a deflationary boom and a deflationary bust. And the sober reality is that we move from one to the other only when the stock market crashes. What create the recession are not excess*

inventories or capital spending as in an inflationary period but the collapse ***__in asset prices__*** *which had been pumped up by the general mood of optimism."*

The idea of a "deflationary boom" feels right to me when I look back at the past 15 years of my career. When I visualize a "deflationary boom" I see an air hose attached to a balloon with a pump attached at the end. The pump keeps running at higher and higher revs and the balloon only gets marginally bigger. The pump, at some point, reaches its "red line" revs but the balloon is now actually getting smaller!

The timing for this is anybody's guess, but after the "red line" revs stopped inflating the balloon the "deflationary bust" would come.

How we got to this point in financial history is well documented fact…how it will all work out remains to be seen. Some call it "financial repression"[1]. I would not argue with that definition.

To finish the weekly I am going to make a philosophical statement (not financial) that the global banking system is "fragile" not "antifragile"[2].

It is **far easier to figure out if something is fragile than to predict an occurrence of event that may harm it.** The global economy needs "daily attention and support" from the global central banks. If this is not a fragile situation…well, nothing is!

When something is "fragile" the efforts and costs in keeping it in tact have three unintended consequences:

1. Continuing artificial efforts and costs to maintain a fragile situation INCREASES the level of fragility.
2. The ultimate "revisions to the mean" tend to get magnified when fragility is supported.
3. Balanced systems away from the fragile system receive "poor" input data and stop functioning in a balanced sort of manner. They too, become fragile!

Clearly, points 1 and 3 have been demonstrated in markets and in the economy during the past 15 years. It remains to be seen if point 2 will be a reality.

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[1] **Financial repression** is a term used to describe measures sometimes used by governments to boost their coffers and/or reduce debt. These measures include the deliberate attempt to hold down interest rates to below inflation, representing a tax on savers and a transfer of benefits from lenders to borrowers.

[2] **Antifragile** - "Some things benefit from shocks; they thrive and grow when exposed to volatility, randomness, disorder, and stressors and love adventure, risk, and uncertainty." Said another way, "anything that has more upside than downside from random events or shocks is antifragile; the reverse is fragile."

In summary…the BULLS need more inflation…period. A rising US dollar and falling oil prices are like *kryptonite* to inflation! The route to get the US dollar falling and oil rising is some type of American QE program AGAIN. But I can't see that happening in the present political or economic situation. **If it happens, it will take place at lower stock market levels than the present.**

But the BEARS are in a tough corner too. Every time the stock market starts to decline they sit and worry about a FED announcement that will give a giant boost to asset prices again…in other words, *get the balloon inflating again by revving up the pump*!

Truly, we are living through a fascinating portion of human financial history!

As a final thought, consider this:

"Authors, artists, and even philosophers are much better off having a very small number of fanatics behind them than a large number of people who appreciate their work. The number of persons who dislike the work don't count—there is no such thing as the opposite of buying your book," – Nassim Taleb, "*Antifragile*"

I know much of what I write is controversial. I have always tried to challenge my readers to think outside of the mindless daily headlines in the news. Maybe the quote above fits for financial advisors too.

Your feedback is always welcome!

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.