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Al Gair, MBA, CFP, CIM
Vice President &
Associate Portfolio Manager

Bonnie Walmsley
Associate

2500 - 666 Burrard Street,
Vancouver, B.C. V6C 3B1

T: 604.665.5526

E: al.gair@rbc.com
E: bonnie.walmsley@rbc.com

www.gairwealthmanagement.com

In the last issue of the Fortnighter, I discussed the possibility of a short-term correction in the major equity markets. A 10% pullback is considered the standard definition of this and we didn't quite get there – the S&P 500 index dipped by about 6% and the TSX index basically went along for the ride. A few short weeks later and markets have pretty much recovered – in fact, the TSX is now trading at about a 3-year high as gold and base metals prices have bounced back.

Hold on – gold prices are going up? Wasn't gold in a free fall a short while ago and other commodities getting clobbered with concerns about the Chinese economy and the strength of the US dollar? Next thing you'll be telling me is that the Canadian dollar is going up. Well, it is as well!

One of the hallmarks of a normal market is that as soon as people start getting complacent about a trend, some external event comes along and upsets the apple cart. Do you remember what set off the "mini correction" we had over the past 6 weeks? It was another emerging market currency "crisis" (many economies, like Turkey and South Africa, run both fiscal and trade deficits. They need to fund these, which means they have to increasingly sell their own currency to pay back borrowers in some other currency – like the $US. This can send their currencies into a tailspin).

Sounds serious – and it could be if the situation spilled over to more substantial emerging markets economies. But for now, the markets are shrugging it off – and a slightly weakening US dollar has helped the situation. This brings us back to the surging gold and commodity price question.

The US dollar is weakening slightly as the market realizes that the US economy is still growing slowly and new Fed chairman Janet Yellen retains the Fed's "accommodative" stance on monetary policy. Since gold and commodities are typically priced in US dollars, as the US dollar declines, their prices go up. As does the Canadian dollar.

So, is this a trend? More importantly, is this a trend that would warrant a change in long-term investment policy?

I don't believe so. Most important, the US economy is recovering - and may, we believe, start gathering steam at some point. This supports a strengthening US dollar. Furthermore, the Chinese economy, while still incredibly strong, is moderating and undergoing a fundamental shift to being more service based. Both these "big picture" items argue for a stronger US dollar and moderating commodity prices.

On the surface, that points to bad news for Canada. However, two things help us out. At a 90 (or 80) cent dollar, Canadian companies become a LOT more competitive. And who is, by far, our largest trading partner? The US! So, this "natural hedge" leaves us confident that Canada will remain a decent place to invest. But given a choice, we still see the US market as a better option for the foreseeable future.

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