The PFP Monthly

Wealth Management
Dominion Securities

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Alex Mainella, CIM, CFP
Vice-President,
Portfolio Manager & Wealth Advisor
alex.mainella@rbc.com
905-764-3045

Shawn Mottahedeh, MGA
Associate
shawn.mottahedeh@rbc.com
905-764-3523

Adrian Palmisano
Associate Advisor
adrian.palmisano@rbc.com
905-764-5552

Kyra Bailey
Associate
kyra.bailey@rbc.com
905-764-5669

The PFP Group of
RBC Dominion Securities
260 East Beaver Creek Road
Suite 500
Richmond Hill, ON
L4B 3M3

www.thepfpgroup.com

Staying active as risks abound

- Despite the challenging market environment, we have been able to create value for clients through an active approach towards diversification, stock selection and tactical shifts.
- The BoC's rate hike further validated our bearish outlook on fixed income. It also creates the need for further shifts within the asset class.
- We continue to see equities as the most favorable asset class moving forward and are exploring long-short strategies to create an advantage in the current climate.

Active management working in this challenging environment

This summer has been tough on Canadian markets. From the beginning of June to the first week of September, stocks and bonds are down roughly 1-2%, taking their total returns for 2017 to somewhere between 0-1%. If you're a traditional Canadian investor, that kind of market performance is going to act as a drag on your portfolio regardless of what you're holding.

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We have been able to create value for our clients despite the challenging climate through an active approach towards geographic diversification, stock selection and tactical allocation. Meanwhile, our technical analysts at RBC Capital Markets believe major indices have entered trading ranges. In other words, they expect greater divergence in the market as certain economies, sectors and companies pull away while others continue to lag. This leads us to believe that, despite the benefits of low-cost indexing, active portfolio management will become even more important in creating value over the next twelve months.

This is particularly true today as political, economic, and even weather-related risks threaten to destabilize markets. The laundry list of issues includes U.S.-North Korean geopolitical tension; extending the U.S. debt ceiling in December; debates over U.S. hurricane relief funding alongside tax and immigration reform; ongoing NAFTA and Brexit negotiations; bubbling Chinese credit; a murky outlook for commodity prices; and tightening global monetary policy. These issues will require increased portfolio vigilance as each has the potential to negatively impact markets.

Equities: defensive short term, overweight long term

The risks outlined above have us cautious about equities in the immediate term. We have thus shifted a modest portion into cash in order to be redeployed as opportunities arise. That said, we continue to see equities as the strongest asset class now through 2018. This is particularly true in Europe, as it currently has a strong combination of relatively low valuations and attractive growth prospects. We are thus maintaining our overweight position in this area.

We are also maintaining our neutral position in North America. The confluence of factors mentioned above have the potential to have an outsized effect on Canada and the U.S., leaving us wary of adding more to these countries. We have already begun the process of shifting our U.S. positions to be more defensive through our overweight position in the health care sector. Meanwhile, Canadian equities are beginning to look inexpensive from a historical perspective, likely due to fears over the housing and energy markets. We feel these fears are largely overplayed and therefore see sufficient reason to maintain our neutral stance in this space.

BoC rate hike creates need to further shift fixed income

The Bank of Canada's (BoC) interest rate hike this week came as a shock to some. To us, it was just a matter of time before interest rates continued the (slow, steady) march upwards. The inevitable result has been that fixed income continued to take a beating. What's interesting to us is that short-term rates have risen by more than those in the long term. This makes shorter duration bonds more attractive on a relative basis. It also makes holding diversified preferred shares (preferreds) more favorable as roughly 80% of this market is based on floating rate and rate reset structures. We are therefore cutting further from long duration bonds in favor of laddered short-term strategies as well as diversified preferreds. To us, these areas present the best areas within an asset class on which we are considerably bearish.

Active advantage

With risks aplenty and indices trading in ranges, we believe the ability to go short as well as long will prove to be a strong advantage in the current environment. We have thus begun a thorough due diligence process on a long-short hedge fund strategy to be initiated by the end of the year. We feel this alternative strategy fits in with our belief in the need for further active management for the foreseeable future.

We will continue our pension-style focus on capital preservation and long-term growth. We feel privileged to use our discipline to continue to create value for our clients and their families.

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