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For the year ended December 31, 2016 the S&P/TSX Composite Total Return Index appreciated by 21.1% driven largely by a big bounce back in energy and materials. The S&P 500 Total Return Estimate for the same period in Canadian dollars was 8.8%. Lastly, the Canadian Bond Index mid-term composite appreciated by 1.6% for the year.

What does this mean for the average portfolio?
First of all, it means that in order to have achieved the 21.1% return generated by the TSX one would have had to have 100% of one's portfolio in Canadian stocks and 70% of that concentrated in three sectors: energy, materials, and financials. This lack of diversification is not a prudent strategy for the long term investor. The prior year, a similar portfolio would have lost over 8%. We look to diversify amongst strong companies in more than just these three sectors of the economy.
In current times and where possible, some diversification in US stocks is prudent, especially in the technology sector, which is underrepresented in Canada. Although that strategy underperformed the TSX in 2016, it has outperformed over the last 3 years, 5 years and 10 years on average.
Finally, for anyone with fixed income investments, portfolio returns were reduced by the relative underperformance of fixed income securities such as bonds and GIC's. One type of fixed income security, the preferred share, having declined in value for a few years, enjoyed a strong rally in 2016.

What's in store for 2017 and beyond?
First of all, there is no indication of recession in the near term. In the US, there is nearly full employment, with some growing upward pressure on wages. The US Federal Reserve is on track to raise interest rates this year due to economic strength.

The republican agenda could supersize GDP growth, at least in the next few years. On the agenda are a number of items which, if adopted, would be bullish for business in the US. Some are, personal and corporate tax cuts, infrastructure spending (think fixing roads and bridges), deregulation of industry and repatriation of trillions of dollars of cash held by corporations off shore. This could lead to the biggest wave of corporate and government investment in decades.

For the first time in a long while, the party in power is in full control of the government (house and senate) so it is reasonable to assume that at least some of the republican agenda will be moved forward.

Since the election there has been a lot of movement of money as people try to figure out who wins and who loses in the coming environment. In the days after the election, blue chips stocks (or entire sectors) would drop 5-10% or more based on a tweet, only to reverse days later. Best not to react on such inconclusive evidence!

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The markets have rallied since the election evidencing that expectations have risen somewhat and therefore we could see a market pullback before further advances. (Remember, the higher the expectations are, the harder it is to exceed those expectations. Once expectations are too high, it becomes impossible to exceed them, and that sets the stage for disappointment, which in turn leads to a market correction, which again reduces expectations until the point where they are easy to exceed, and the whole things starts over again. This is a stock market cycle).

But in general we are early in this bull market, which has the potential to last many more years, though it is never a straight line upward!

Many central banks around the world including Canada, the UK, Japan and the Eurozone have ruled out interest rate hikes and may even engage in further easing, setting them apart from the US. This could set the stage for currency volatility around the world as the US dollar strengthens against other world currencies, including the Canadian dollar.

In sum . . .
Historically, companies that have consistently returned cash to shareholders through steady dividends, dividend growth and share repurchases have provided investors with very attractive total returns through economic and market cycles. This is not going to change. We continue to favour stocks over bonds.

As always, I will act prudently on your behalf.

Cathy Bayles
Portfolio Manager