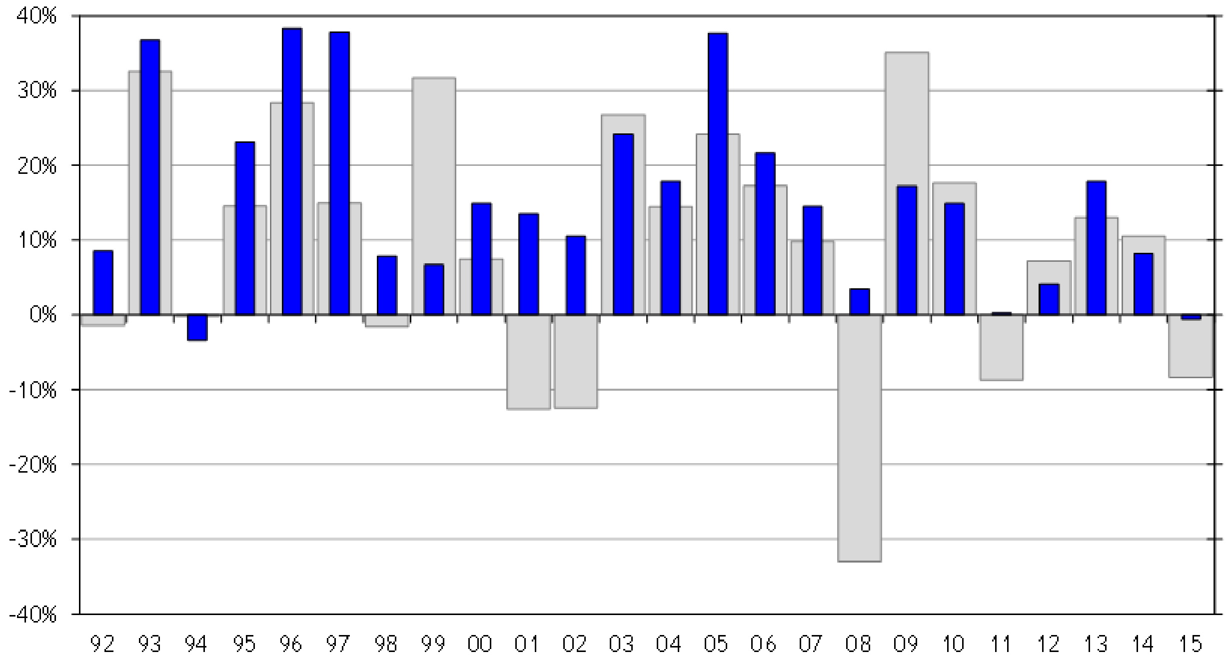
June 13th, 2016

"Won2One" with Nick Foglietta

Tactical Equity Income Model Portfolio Record



Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: 100% stocks
S&P/TSX 60 Closing Value: 14,040
TSX 200 Day Moving Ave: 13,331
% Above/Below 200 Day Moving Ave: **5.30% Above**

Levels for change: 50% stocks - **TSX 14,001** and 100% cash at – **TSX 12,701**

Weekly Quote

"A mountain of junk debt hangs over corporate Canada"

Bloomberg markets news – June 13th 2016

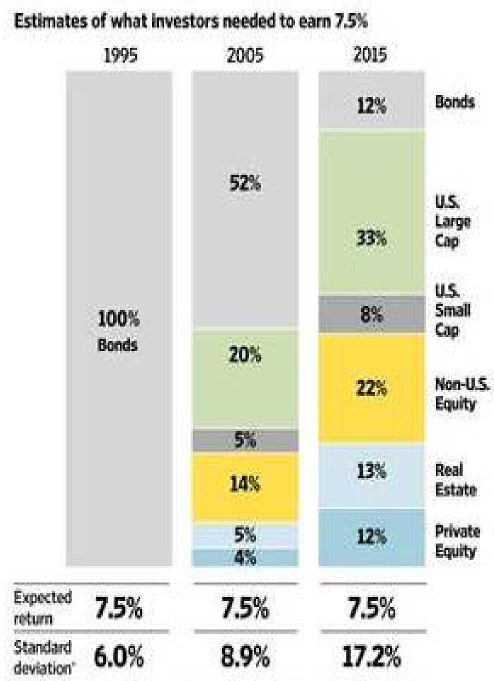
Valuation and Volatility of 2016 Summarized in a Single Graph

The Wall Street Journal published this excellent summary last week.

It visually depicts the exact challenges that investors face making investments today.

WSJ brain teaser: How to allocate for 7.5% (1995 vs 2015)

A quick visual to show how much more volatility we're taking on to get a return similar to that of bond returns in 1995…the standard deviation is incredibly high.



It is amazing to think that 20 years ago investors could buy only fixed income and receive a 7.5% rate of return on their savings.

So let me ask you a direct question. **Are you willing to allocate your portfolio in the positions shown above for 2015 to try to make a 7.5% rate of return?**

Take a few seconds to think about the risk implied with the portfolio shown above. Also consider how exposed it is to potential sharp moves in currencies and asset prices.

I really liked this graphic because it leads into the next section of the weekly which came from a reader's question about negative interest rates. (Hint: Is it possible to keep interest negative forever? And if not, what happens to the asset classes in the 2015 asset mix matrix if/when the change occurs?

<u>Switzerland and Negative Interest Rates</u>

There were a number of comments back last week about the negative interest rates chart I showed in the weekly comment. Let me post it below again to refresh your memory:

Sovereign Bond Yields (%)

Country	Yield (%)			
	1-Yr	2-Yr	5-Yr	10-Yr
Switzerland	-0.514	-0.792	-0.731	-0.302
Japan	-0.265	-0.225	-0.225	-0.120
Germany	-0.529	-0.519	-0.378	0.146
Austria	-0.504	-0.483	-0.357	0.329
Netherlands	-0.180	-0.527	-0.401	0.352
Finland	-0.503	-0.470	-0.250	0.417
France	-0.488	-0.440	-0.188	0.481
Belgium	-0.500	-0.488	-0.323	0.521
Ireland	-0.175	-0.380	-0.055	0.779
Italy	-0.145	-0.160	0.214	1.131
Spain	-0.164	-0.099	0.482	1.503
United States	0.649	0.867	1.347	1.828

Data Courtesy: Bloomberg

In the body of the message last week it was stated that nearly $11 trillion U.S. in bonds around the world have a negative interest rate attached to them now.

Rather than discuss the financial concepts around negative interest rates I want to look at two practical applications as to the impact they have in the world today.

1. **Places with negative interest rates force investors in those regions to move their capital to a different asset class…and often out of their country.** Below I am showing a chart of the Swiss yield curve. On the chart you can see that every maturity out to 30 years has a negative interest rate attached…and a 30 year rate only pays 0.072% per year!

Name	Last
Switzerland Overnight	-0.950
Switzerland 1W	-0.990
Switzerland 1M	-1.030
Switzerland 2M	-0.960
Switzerland 3M	-0.980
Switzerland 6M	-1.000
Switzerland 1Y	-0.780
Switzerland 2Y	-0.915
Switzerland 3Y	-0.963
Switzerland 4Y	-0.924
Switzerland 5Y	-0.889
Switzerland 6Y	-0.796
Switzerland 7Y	-0.737
Switzerland 8Y	-0.608
Switzerland 9Y	-0.512
Switzerland 10Y	-0.454
Switzerland 15Y	-0.211
Switzerland 20Y	-0.074
Switzerland 30Y	0.072

Reality is that no "non-computer modeled, investing their own money" investor is going to hold ANY of these bonds. At the very least they would just hold cash in Swiss francs.

Clearly, the situation is Switzerland is completely central bank, computer generated idiocy. So investors who used to use Swiss bank accounts and the likes…what do they do?

The go out and buy a house or 2 in Vancouver, or New York, or London. Or they buy some other asset that is already overpriced rather than holding a negative interest rate bond.

2. **The world has "traded" like there is no limit to the central bank's ability to create more debt and drive interest rates lower.** It may be a fact that there is no limit…I don't know.

   But, in Japan last week, the primary dealer for Japanese bond markets stated it is going to step away from making a market in Japanese bonds. Let's view the Japanese yield curve:

	Name	Yield
	Japan 3M	-0.240
	Japan 6M	-0.355
	Japan 1Y	-0.269
	Japan 2Y	-0.269
	Japan 3Y	-0.267
	Japan 4Y	-0.262
	Japan 5Y	-0.262
	Japan 6Y	-0.257
	Japan 7Y	-0.262
	Japan 8Y	-0.233
	Japan 9Y	-0.194
	Japan 10Y	-0.149
	Japan 15Y	0.011
	Japan 20Y	0.194
	Japan 30Y	0.275
	Japan 40Y	0.317

An interesting thought that comes to mind when we look at these yield curves that are deep into negative territory more than 10 years out is the idea of "**bond repudiation"**. In other words, the cancelation of existing bonds…

I will not speculate on what that might look like across asset classes, but I will guess that it could very easily lead to higher interest rates in the countries where the repudiation takes place. Why? Because if you are canceling bonds on one hand…how do you issue more of them on the other? If issuance stops…the central bank game of QE gets short circuited and "natural buyers" become the market again. **And my guess is "natural buyers" would not buy until yields were significantly higher**.

Linking higher yields back to the Wall Street Journal graphic in part one of the weekly, is that it is very difficult to "buy value" in today's world. *Chasing price* is never *buying value*…but we have become a world of price chasers!

That is likely enough said on this topic for today. Truly, it is beyond the scope of my retail brokerage skillset to understand the dynamics of all this across the globe. But we can't just ignore it either.

Stay alert!

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.

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