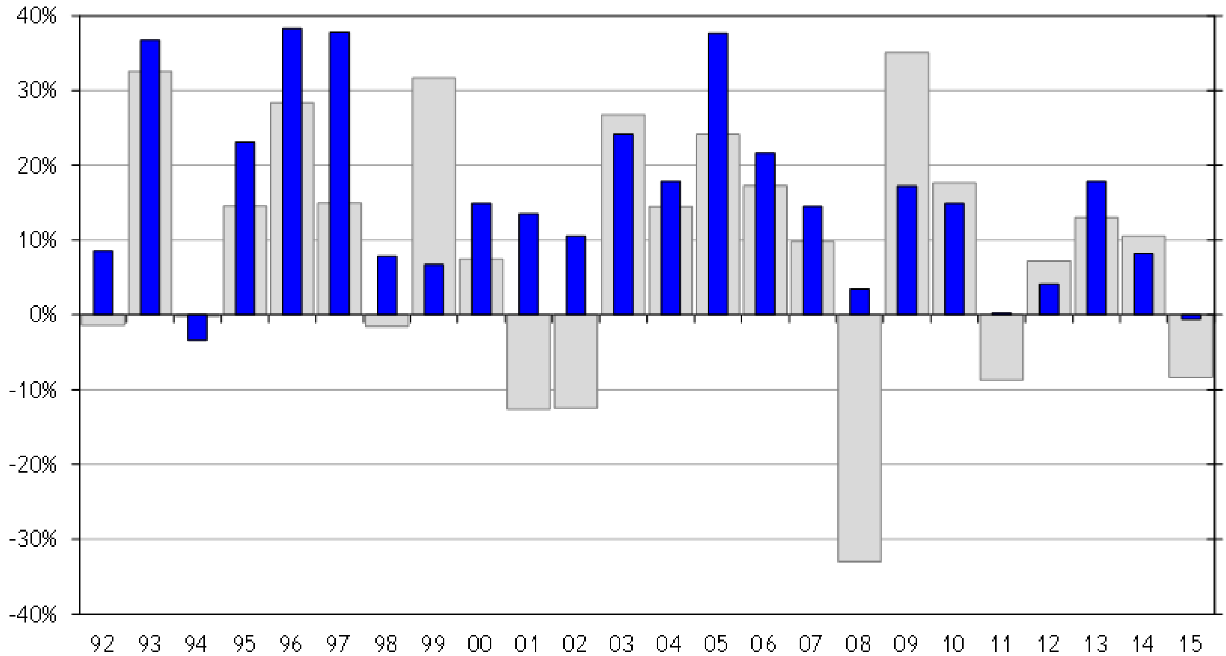
March 14th, 2016

# *“Won2One” with Nick Foglietta*

## Tactical Equity Income Model Portfolio Record




## Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: **0%** Equities/ 10**0%** Fixed Income
S&P/TSX 60 Closing Value: 13,522
TSX 200 Day Moving Ave: 13,588
% Above/Below 200 Day Moving Ave: **0.48% Below**
Levels for change: 100% stocks - **TSX 14,333** and 50/50 at – **TSX 12,967**

*Weekly Quote*

Bank of Japan Gov. Haruhiko Kuroda on Thursday revealed a model of sorts as he navigates uncharted territory in monetary policy: “Peter Pan Model”.
***“I trust that many of you are familiar with the story of Peter Pan, in which it says, ‘The moment you doubt whether you can fly, you cease forever to be able to do it,’” Mr. Kuroda said. “Yes, what we need is a positive attitude and conviction.”***
The remark underlined a core element of Kuroda’s philosophy as he has battled to defeat Japan’s deflation: It is all about confidence and expectations.

*European Central Bank (ECB) Insanity!*

And right after the Bank of Japan Governor made the giant leap into "paralleling fantasy stories with monetary policy" we had the ECB take its best shot at the "Peter Pan Model".

Let's first review what took place on March 10, 2016 at the ECB meeting:

***What Happened:*** *This morning, the European Central Bank cut its key lending rates and expanded its asset purchases, as part of a package of policy measures aimed at spurring growth and inflation in the eurozone.* ***The ECB lowered the deposit rate further into negative territory, to -0.4% from -0.3%, and announced a surprise cut in its benchmark rate to 0.0% from 0.5%. The ECB also announced a €20 increase to its monthly bond purchases, to €80, which will now also include purchases of nonfinancial corporate bonds.*** *This move is expected to ease financing costs for corporate issuers. Additionally, the ECB unexpectedly announced that it will make four-year loans to banks, charging rates "as low as its deposit rate", to stimulate lending to households and businesses.*

***ECB's Revised Outlook:*** *The eurozone's GDP forecast was reduced by the ECB's economists in this morning's report, to 1.4% in 2016 and 1.9% in 2017, from 1.7% and 1.9% respectively, while inflation is now expected to be 0.1% in 2016, compared to the 1% previously expected. In a news conference following the release, ECB President Mario Draghi noted: "It's a fairly long list of measures, and each one of them is very significant and devised to have the maximum impact in boosting the economy and the return to price stability -- we have shown we are not short of ammunition…From today's perspective, we don't anticipate it will be necessary to reduce rates further."*

***Market Reaction:*** *Spreads on European corporate investment grade bonds are ~12 bps tighter following the news that the ECB will serve as a significant new investor in the bond market for the foreseeable future. While the euro initially plunged following the news and stocks rallied, comments by Draghi stating that further rate cuts are unlikely later led to a 1.2% in the euro vs the US$ and a 1.5% decline in stocks.*

Clearly, the response to the ECB announcement on Thursday was mixed. Two years ago, stocks would have gone straight up on this type of news announcement. In 2016, stocks rose for 20 minutes by about 2% and proceeded to fall from the high prices of the day to lose about 2%....hmmm? The next day…back to about where it all started.

The part about lowering the purchasing standard for the "monetization of investment grade bonds" was the real shocker for me. **The central bank will now be purchasing, and hence propping up the price, of medium quality corporate bonds**. That is so far outside the mandate of the central bank it cannot be seen with the naked eye!

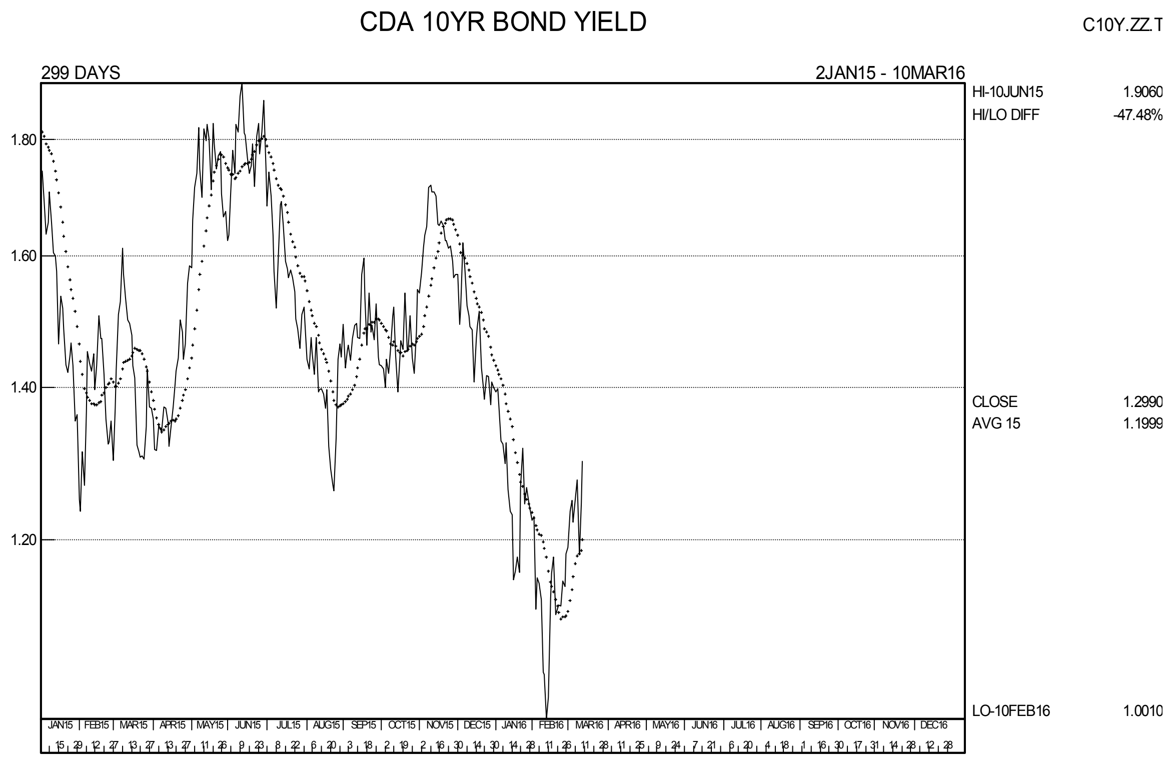
Bloomberg news reported a fair analogy that balances the scope of the ECB announcement with the political reality in Europe:

*"If I were ill and there was only one doctor in town, I'd still make an appointment even if my complaint was chest pains and the sign over the door read **Fallen Arches a Specialty.** The ECB is being forced to continue treatment on problems that are beyond the scope of its abilities."*

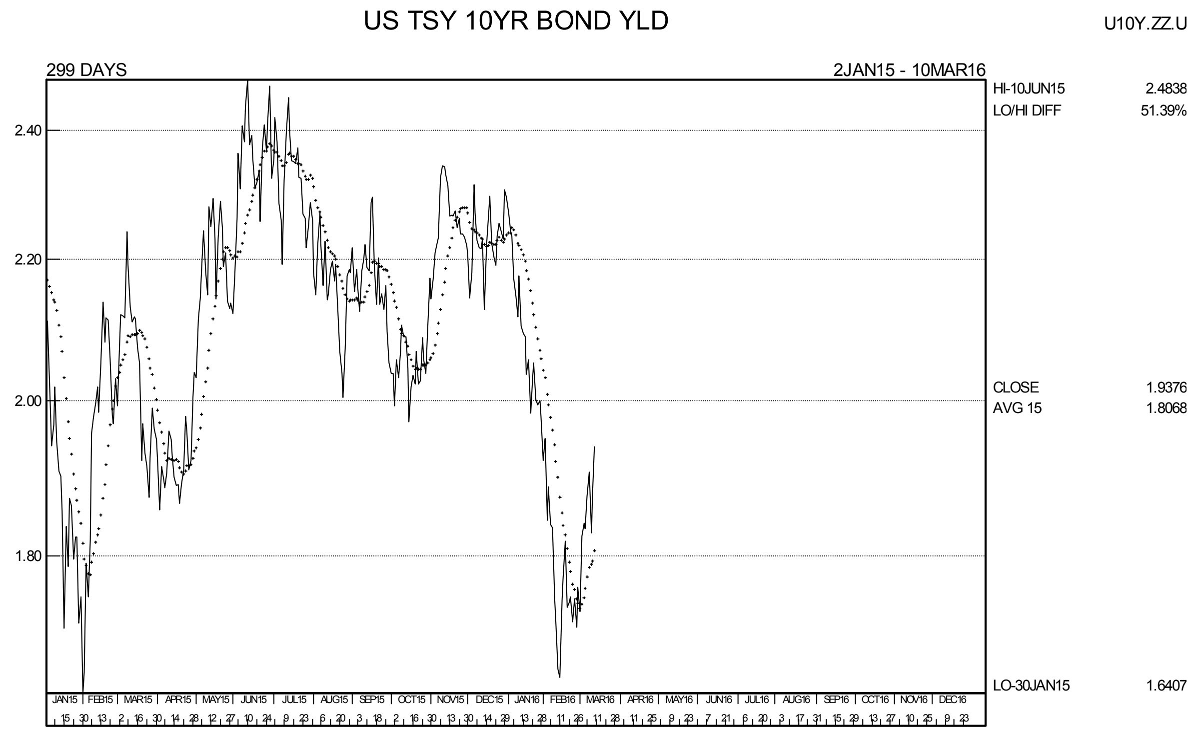
I'm not going to make a larger observation at this point. **All I'm saying is the ability of central banks to manipulate asset prices is waning…period**. With asset prices near or at all time highs please stay vigilant in monitoring the situation.

*Interest Rate Charts in North America*

Take a look at the yield on the Canadian 10 year bond.




Since the middle of February, the 10 year yield has gone from 1% up to 1.3%. This bounce has coincided with near perfection to the bounce in commodities and stock prices.




The U.S. 10 year yield chart is exactly the same but it starts at a higher yield level.

Over the next few months let's watch to see how tightly correlated the bond yields continue to correlate with stock and commodity prices.

*<u>Quick Update on Oil</u>*

The chart below will help you understand why crude oil ran up so quickly over the past month or so.

Before I show it to you let's review what a "short sale" means: Selling something short means you actually sell the asset before you own it…and they try to buy it back at a lower price.  The difference between the two prices is your profit or loss.

E.g. Sell 100 barrels of oil at $35.00 and then buy them all back at $30.00.  (Assuming the price falls to $30.00)  The speculator makes $5.00 per barrel of oil…or $500.00

OK…got that?

Now let's look at the chart below showing the price of oil and the number of shares "sold short" of the crude oil exchange traded fund.


Sending WTI crude to its highest since 2015...


Notice how fast the red “Oil ETF Short” line has dropped on the top chart at the same time the price of crude oil has surged.

Remember our example, to close a short sale position the speculator has to BUY the oil back again that they sold short! When you add to this situation, the number of speculators that try to pile on and buy oil when the price changes direction you create an environment called a “short squeeze”.

The result” now you are back to the opposite situation. The red “Oil ETF Short” line is back to where it was six months ago. But notice the green “Oil ETF Long” has now become elevated. These are speculators who have bought oil hoping the price will go higher. **If the oil price reverses…the “Oil ETF Long” crowd will want to sell their positions and that will likely bring about a return of the “short sellers”.**

I hope this helps you understand why the price of oil is so volatile.

***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.***