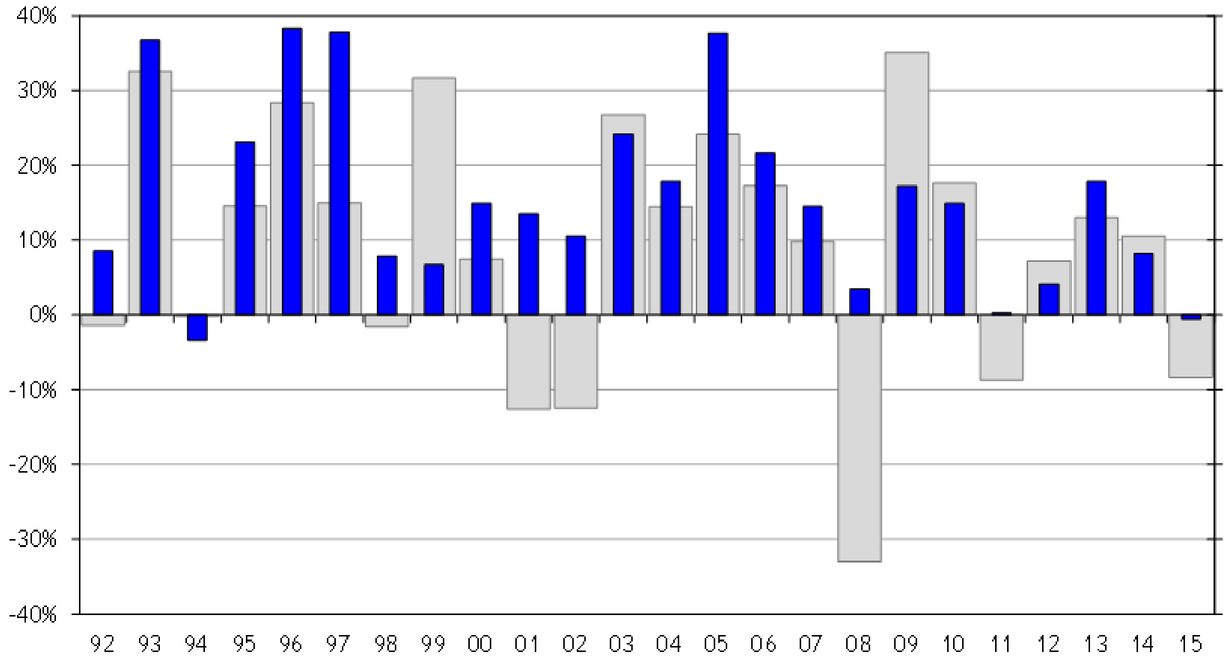
March 2nd, 2016

"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: 12,797
TSX 200 Day Moving Ave: 13,683
% Above/Below 200 Day Moving Ave: **6.50% Below**
Levels for change: 100% stocks - **TSX 14,367** and 50/50 at – **TSX 12,999**

<u>*Weekly Quote*</u>

"Stocks better decide whether a Trump Presidency is BULLISH or not soon!"

Zerohedge Tweet right after Christie endorsement.

General Comments

There was a lot of stuff that caught my eye this week. But none of it was worth writing a full section of "commentary" on. Therefore, I picked a few snippets to bring to your attention:

American Politics: There have been an amazing amount of blogs and editorials written about the U.S. political situation. To say that it is "polarized" is an understatement! **My thoughts have shifted from "what" is happening to "why" it is happening**. Not that I can answer the question, but I believe it will bring you to a better place of predicting what might take place in November this year.

G20 Summit: That was a real joke! If the leaders know they can't get anything together BEFORE they meet…why meet? There is a life-lesson in the G20 inaction. When there is lots of "wiggle-room" in the financial condition of the world during times of true prosperity, the world leaders have a lot of options they can realistically choose. But when interest rates are zero (or lower) and debt levels are extreme the available choices are few and difficult. It will be interesting to see when the world starts to face this truth.

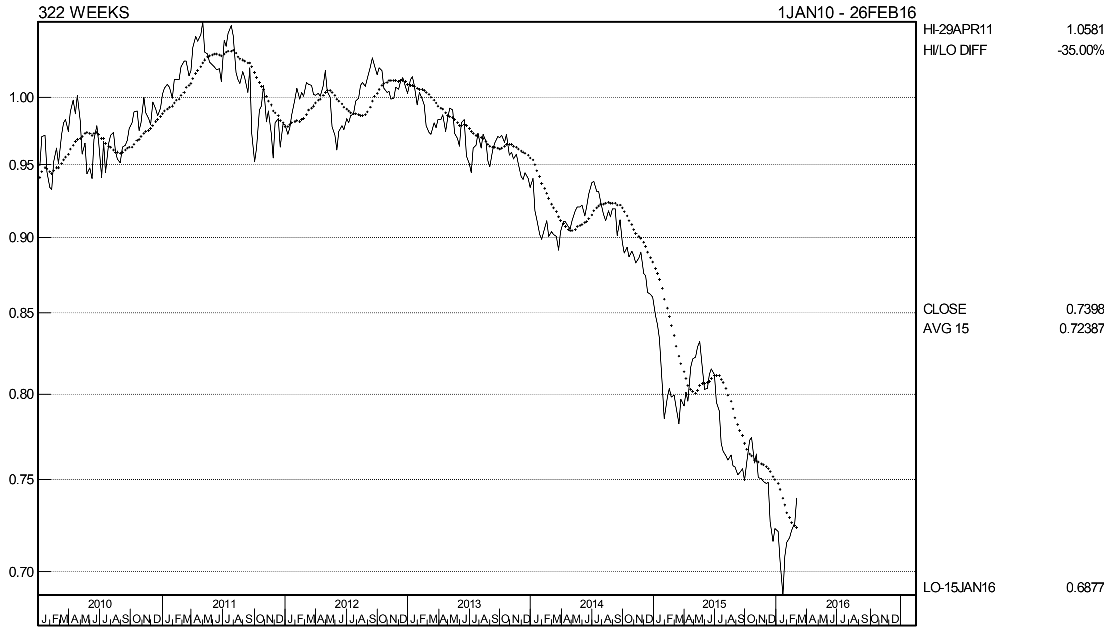
Berkshire Hathaway's Annual Letter to Shareholders: Warren Buffett's annual letter was much different than I anticipated. My expectation was an action plan that would better equip Berkshire going forward. (Remember, Berkshire has severely underperformed the S&P 500 for the past 6 years.) Instead, the letter was dull and focused on accounting valuations rather than market performance. Maybe this is a sign the 2016 will be the last year of Warren Buffett's tenure at Berkshire Hathaway. (Full disclosure…I have never owned a share or Berkshire Hathaway.)

Canadian TEAM Asset Allocation Notice: The Canadian Tactical Equity Allocation Fund (TEAM) will move back to 50% stocks IF THE TSX CLOSES ABOVE 12,999 ON FEBRUARY 29TH. Stock markets have stabilized while the 200 day moving average has been plunging. This would be a nice entry point if it happens. As always, I am comfortable with whatever happens. I don't feel like stocks want to go down much; I can't see them moving a lot higher either. The 50/50 mix is fine with me!

Canadian Dollar: The bounce in the Canadian dollar worked to stop the "short selling speculators" who were a large part of the large decline we witnessed during the past 6 months. Hedge funds were looking at a "*short Canadian banks and Canadian dollars*" as a way of shorting the Canadian housing market. All of this shorting now appears to be premature!

Take a look at the chart below of the Canadian/U.S. exchange rate. Again, it would not surprise me if the Canadian dollar trades within $0.05 of where it is today for the rest of the year.

CANADIAN DOLLAR



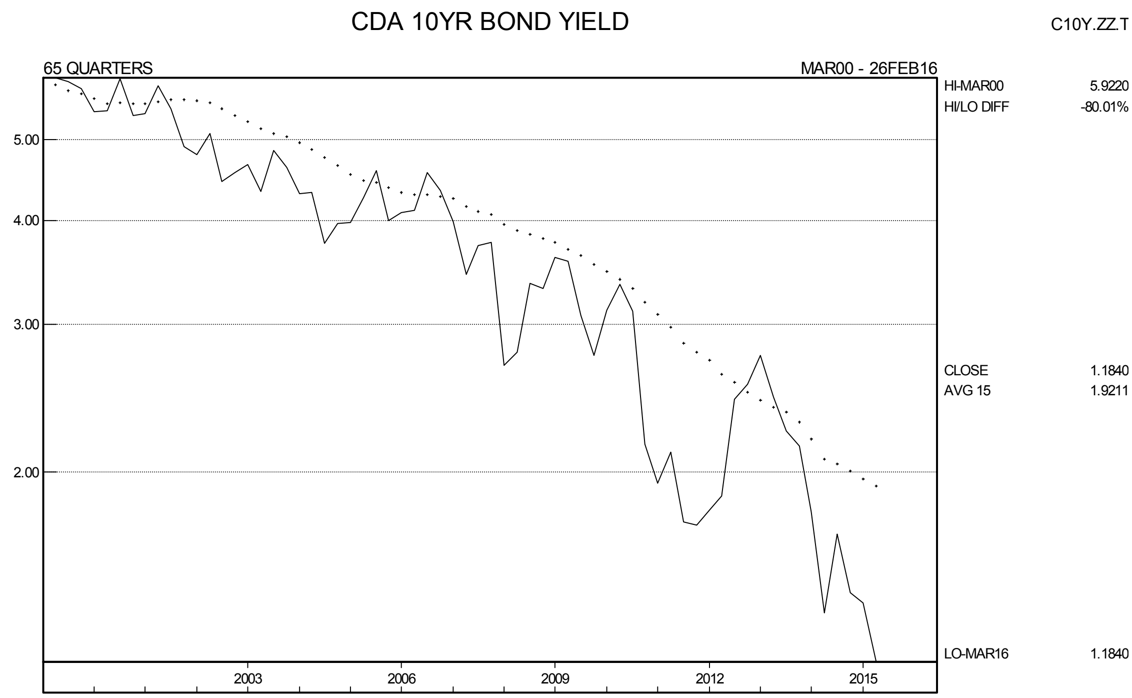
Canadian Interest Rates (3 month T-Bills and 10 Year Canada Bonds): There has been talk about negative interest rates all over the financial news lately. Our Bank of Canada Chair has used the term in his speeches. So how close are we really?

Chart 1 shows the yield on 3 month Government of Canada T-Bills.

CDA 3 MONTH T-BILL

Clearly, at 0.46% there is not a lot of room between where the rate stands and zero. But the interest rates have been this low for Treasury Bills for a long time.

Look at the 10 year bond in Canada. I think that is the real story!



As you can see the 10 year yield is closing in on 1%. **If there is a bout with inflation on the horizon please let the 10 year bond in on the secret. Right now it looks poised for very slow growth into the future.**

Final Thoughts: Financial markets feel like they are ready to "tread water" for a while. Low interest rates make this an easier thing to do than when interest rates are high. Investors need to be patient and do their best to collect so income.

The next section of the weekly is about the beleaguered Preferred Share market. As beat up as preferred shares are today…they still pay a pretty good cash flow and offer investors an opportunity to profit from a raising interest rate environment. (If and when it shows up!)

Preferred Share Update

The following commentary was produced by *Blackrock* this past week on the overall Canadian preferred share market:

What a year it has been for preferred shares. 2015 saw preferred shares come under significant pressure largely due to the decline in the benchmark Government of Canada (GoC) 5-year bond yield. ***The majority of the negativity has come from the fixed-reset segment which comprises***

two thirds of the market. *It is these rate-reset preferred shares that are set to have their dividends reduced at their next reset date.*

Furthermore, the lack of growth in China attributing to a decrease in demand for commodities coupled with the precipitous decline in energy markets, has all contributed to a stalling, resource-driven Canadian economy which has put added pressure on Canadian preferred shares. ***In addition, the market saw a new rate reset structure (NVCC) with a floor/minimum feature that was introduced which forced current preferred issues, especially in the same sector, lower in favour of these newer issues with higher reset spreads***. *Perhaps the only glimmer of light seen in the preferred share space last year was the increased growth of preferred share ETFs and the increased presence of institutional activity in the market. Attracted by pref yields that were substantially above bonds, a greater presence of institutional participation was reflected in the purchase of new issues and the use of ETFs as proxies for the preferred share market.*

A big trend that was clearly seen was tax loss selling through the sale of individual issues with offsetting purchases in the ETF as a means to stay invested in the asset class. As we look into 2016, we expect to see an increased level of volatility in general.

With capital requirements under Basel III, many banks will look to bolster their Tier 1 capital ratio through the issuance of NVCC (non-viable contingent capital) preferred shares as these are the only compliant instruments at the moment. Tier 1 securities previously issued by banks do not meet this NVCC requirement and will need to be gradually phased out by 2022. We have already started to see this trend occurring with several recent bank new issues possessing much higher reset spreads.

Higher stock market volatility will continue to add to the volatility for preferred shares.

I want to make two comments on the preferred share markets:

- **Lower interest rates are tough on rate/reset preferred shares**. The reason we purchasing rate/reset preferred shares was based in the idea <u>3 – 5 years ago that interest rates were poised to go higher</u>. At the time, our then Central Bank of Canada Chair Mark Carney, kept warning Canadians to prepare for higher interest rates because they could hold interest rates down forever. A similar message was being proposed by then U.S. Fed Chair Ben Bernanke.

  But higher interest rates did not happen. As a matter of fact, much lower interest rates occurred!

  The real point to consider is **if you believe interest rates will NEVER rise again.** If an investor believes interest rates will stay low forever, then rate/reset preferred shares will not recover in price very much.

On the other side of the coin, **if you believe interest rates will rise again (and possibly rise a lot if the central banks lose control of the yield curve) then rate/reset preferred shares will be one of the best asset classes an investor can hold.** Time will tell…

- **Investors need to be aware of the strengths and weaknesses of the "Non-viability Contingent Capital" (NVCC) preferred shares being offered at a rapid rate these days**. The *Blackrock* excerpt above mentions some of the positive details of the NVCC preferred shares. (Higher dividend yields, higher "floor reset" spreads at maturity.) *Blackrock* also mentions why the banks are issuing these types of preferred shares…Basil III requirements. The question investors should be asking is "what's the catch"?

  The "catch" is issuer of these types of preferred shares can force the preferred shareholder to take common shares IF CERTAIN PROBLEMS ARISE WITH THE ISSUER.

  I will not go into the details of how it all works but I just want you to be aware of what is going on with these shares and why they offer such high dividends compared to other classes of preferred shares.

Any client who owns even a single share of NVCC preferred shares has already heard from me. If I have not called you, you do not own any of these shares!

As long as you understand the risk of owning these shares I believe they are a good investment. But investors cannot hold these shares blindly. There could be a good reason to sell the shares at a loss if some real financial challenges develop in Canada.

Bottom line: As rough as the ride has been in the preferred share markets since 2013 I can't make a case to sell these investments. The yields on preferred shares are quite a bit better than other fixed income investments…and we all know how tough it is to access yield in today's world.

But most importantly, a fixed/floating preferred share exposure will give investors a hedge against the potential higher interest rates that would come if central bankers lose the confidence of the global investment community. You don't have to read much financial news to realize this is becoming a distinct possibility.

If you have questions about these investments please feel free to call.

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.