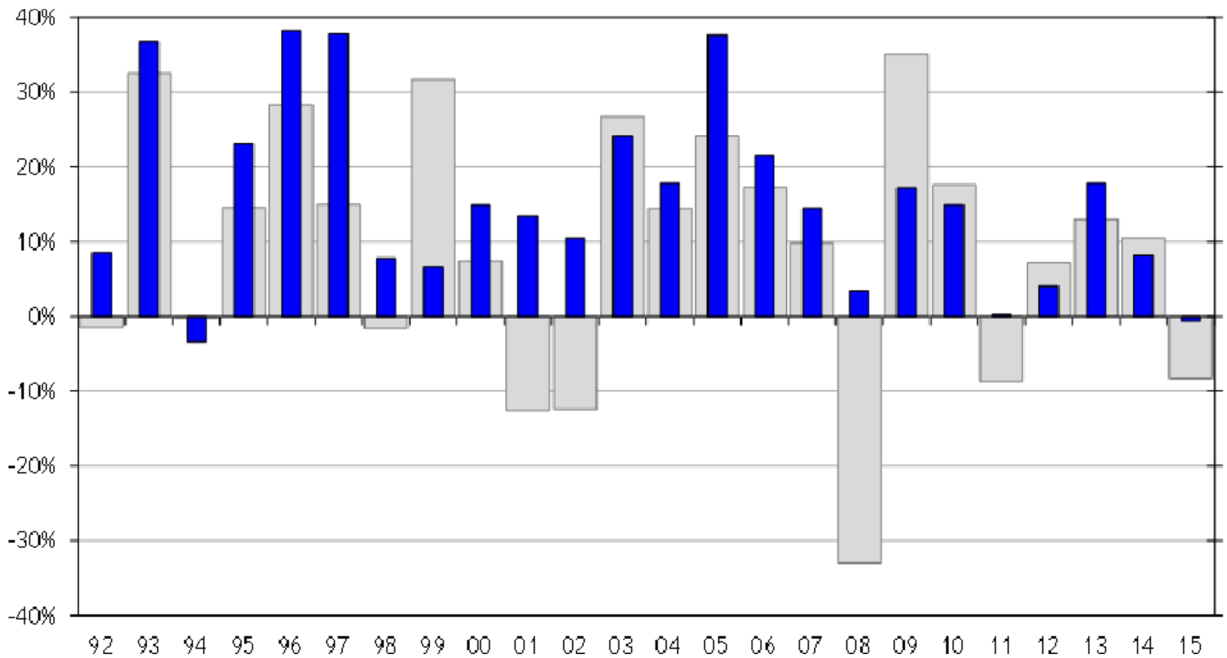
December 5th, 2016

"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: 15,052
TSX 200 Day Moving Ave: 14,201
% Above/Below 200 Day Moving Ave: **6.61% Above**

Levels for change: 50% stocks - **TSX 14,911** and 100% cash at – **TSX 13,490**

Weekly Quote

"Time for market shock factors to wear off: Brexit took three days…Donald Trump took three hours…Italian referendum took three minutes."

Twitter…

Passive vs. Active Management

In a typical week at the office, I have conversations with 60 to 80 clients, 30 colleagues/investment professionals, and a multitude of personal connections from all walks of life. On top of those conversations, I do a significant amount of reading from online newspapers (and the old fashion paper Globe and Mail) and blogs to get a grip on headlines and see what the mainstream media is focused upon. Finally, there is all the information from the paid subscription sites I belong to and the Twitter feeds that I follow.

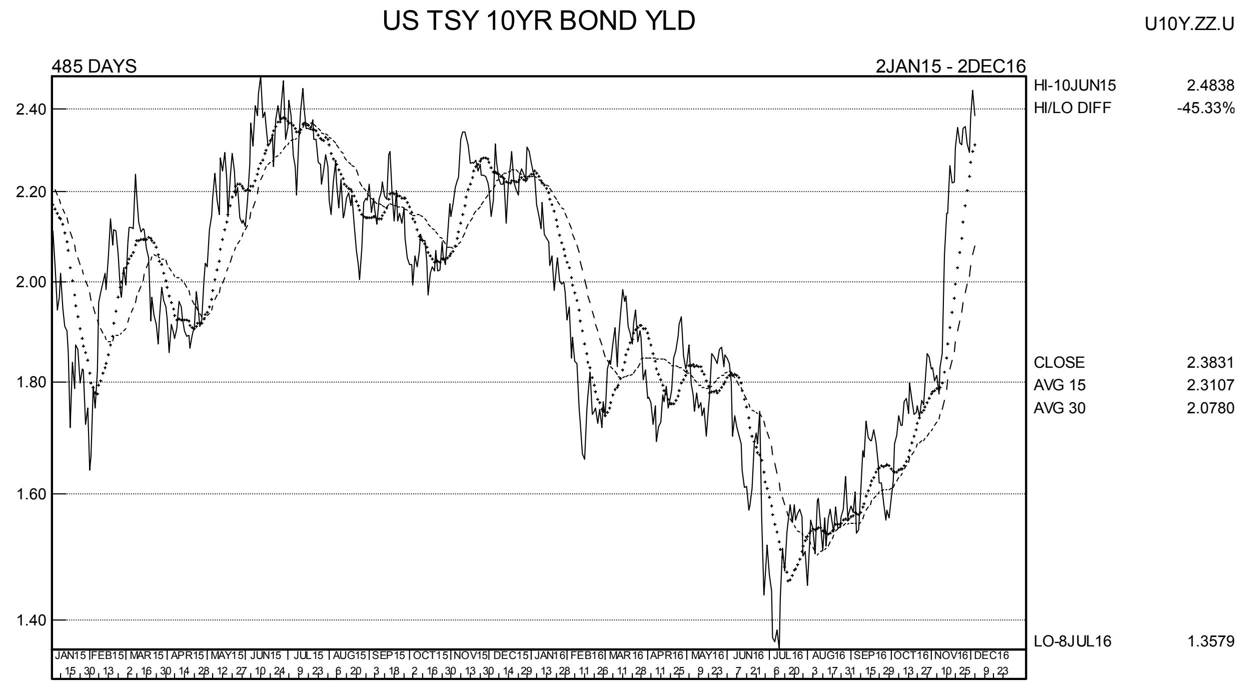
The point is that during a typical week I resemble a "big sponge" soaking up information about investments and the financial climate. What I love about gathering information from these sources is the huge variations of opinions. There are the ones who always think the world is a never-ending vending machine of financial wealth and that every day is the perfect day to buy financial assets. There are also the ones who always believe we are doomed to financial destruction no matter how cheap things get. Obviously, there are people who change their mind and move from side to side of the argument depending upon what they perceive to be transpiring economically.

Filtering the information into something <u>one can act upon</u> is the goal of the worthy financial advisor. At the end of the day, managing our wealth requires a balanced approach that attempts to add to investment classes being positively impacted in terms of price and avoiding those investment classes in negative price trends. Clearly this is much easier said than done.

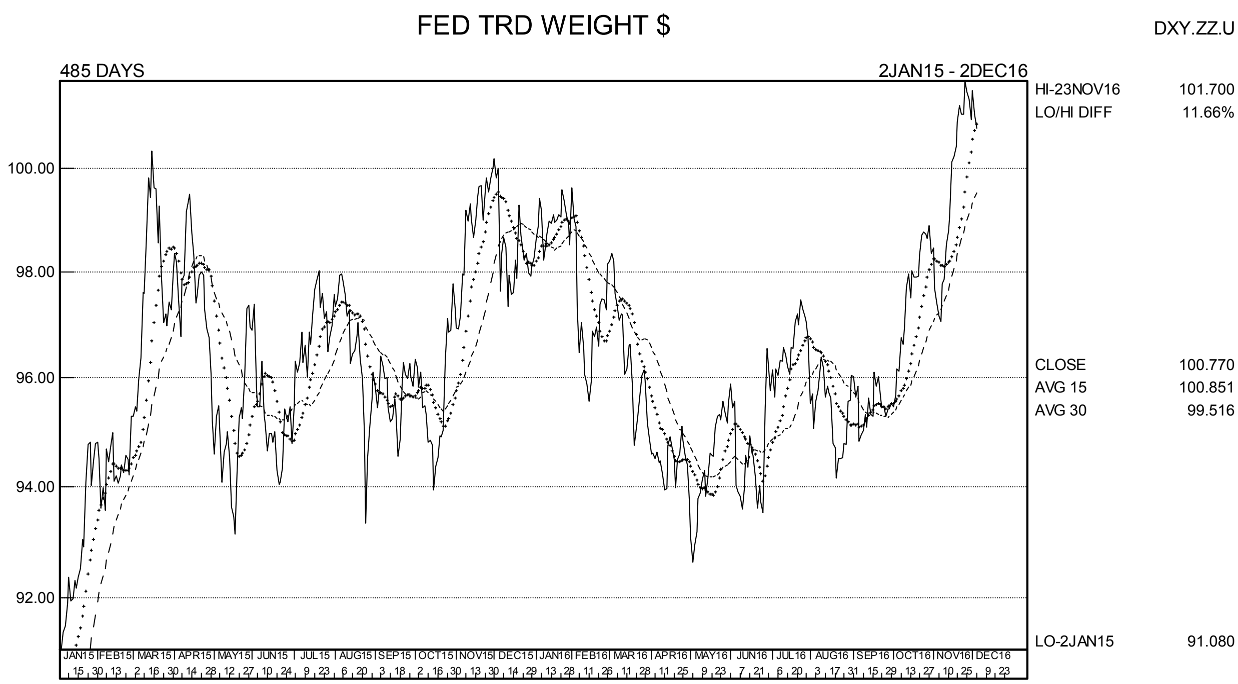
Which brings me to my point: **The most disturbing trend I see in 2016 is the complete faith in passive investment management strategies**. The reasoning behind the concept of passive management is seductive in that these strategies assume the set of financial conditions that exist today will basically exist long into the future. Yet, the financial conditions of today are completely manipulated into existence by the global central banks. In a strange way, that manipulation is exactly why people perceive the conditions as "almost permanent": They trust the manipulators can keep control of the situation!

Maybe they can…but I truly believe having a "plan B and C" makes a lot of sense it the financial world we see today.

How about a few charts. Let's start with a two year timeframe for the 10 year US Treasury bond. This chart shows the interest rate on the 10 year US government bond. The assumption is they will stay low forever. If interest rates stay low forever it will stay easy to borrow more money to buy "assets". Will that be the case? We will see.



Next we look at the US dollar index.

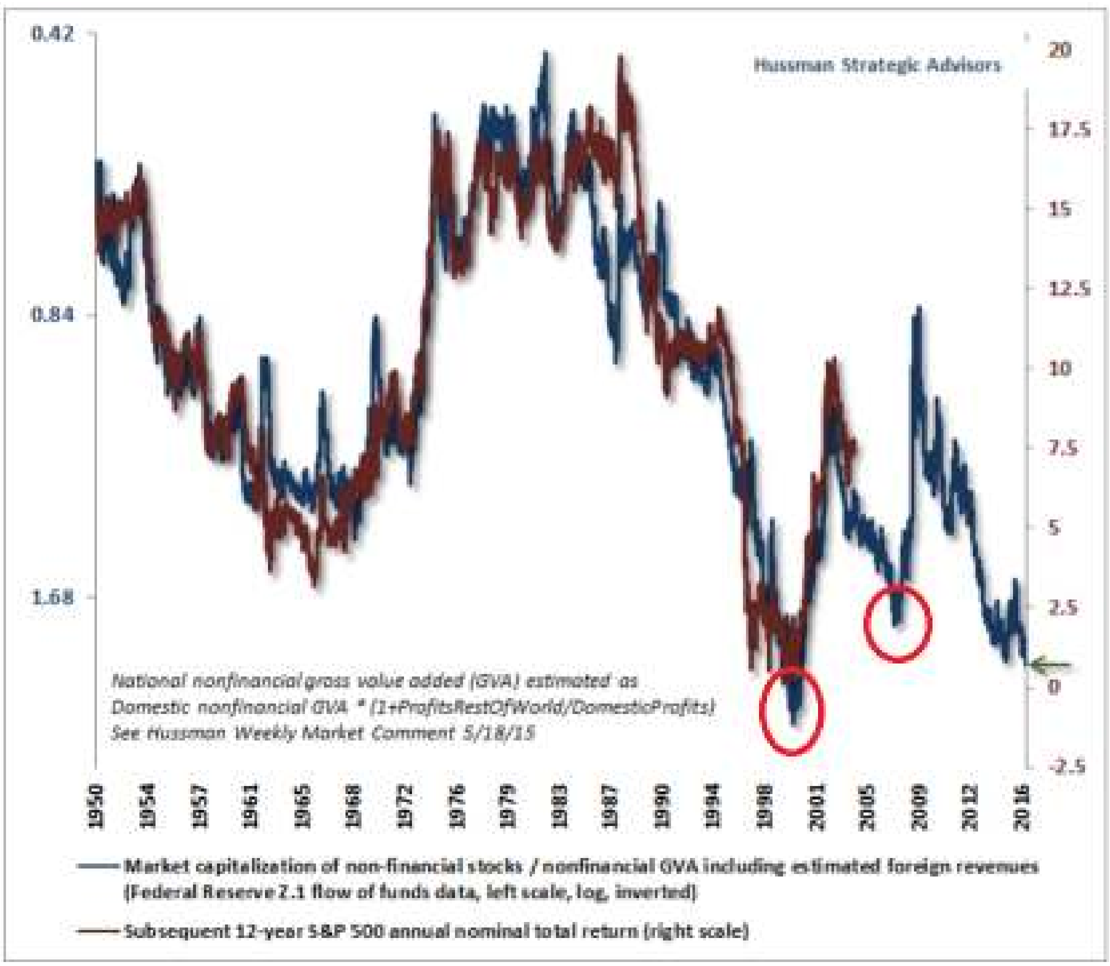


There is a fairly strong correlation between the rising US 10 year Treasury bond index and the US dollar's rise. That makes sense…people want to buy more yield so money flows to a currency with a higher interest rate. **But don't you think the continuations of these two new trends could change our financial world significantly?**

The highest forecast I have seen from any of the analysts at the larger brokerage firms is 3%. That seems to be "hopeful" rather than a forecast…I see no reason why there is any significance to the 3% level that would hold yields there.

A chart I have not used for a long time in these weekly comments is the chart of the expected historical rate of return. If you consider the (red circled) spikes lower in 2000, 2007, and consider the common denominator is investor confidence at both of those times, the present financial market becomes worth watching carefully.

Please remember what this chart is showing: *The blue line is the total value of non-financial stocks divided by non-financial "gross value added in the economy (flipped upside down on the chart…that is why the scale on the left goes low to high). The red line is the traced out subsequent 12 year returns the US stock market has delivered in US dollar terms*.



In English, the chart is stating that from the levels where US stocks presently reside the expected compound, annual rate of return is 1.27%...including dividends! Hmmm?

Money continues to rush around the face of the globe hoping to find some rate of return. The news flow is, at best, confusing to the investor willing to consider it with an open mind. A Brexit yes vote in the UK was supposed to be a bad thing…but now we are told it is a good thing. Donald Trump was supposed to be "the end of America as we know it"…now we are told he is the best thing that could have ever happened to financial markets. The "no" vote in Italy this past weekend will be spun by the media to be awesome too…just give it a few weeks.

Friends, my promise to myself has been that I refuse to just listen to what the media spews out and a daily basis and take it as gospel truth. It is not…

The reality is that there are two trends in place that cannot both keep going up at the same time. Stock prices and interest rates will not keep rising together. One will stop…the question is which one?

Working with financial markets is always an imprecise process. The financial conditions of today are extremely difficult and, yet, we are encouraged to ignore history and assume something has changed in the way valuations of financial assets are forever viewed by investors.

Don't be one of the people who always views assets as a "buy". Don't be one who always sees them as a "sell" either. As the trends in financial markets shift…shift along with them. Be wary of passive investing. It is all the rage in 2016, but that is what makes me nervous!

Wealth Management in Nanaimo, B.C., Canada. He has been managing money since 1988.