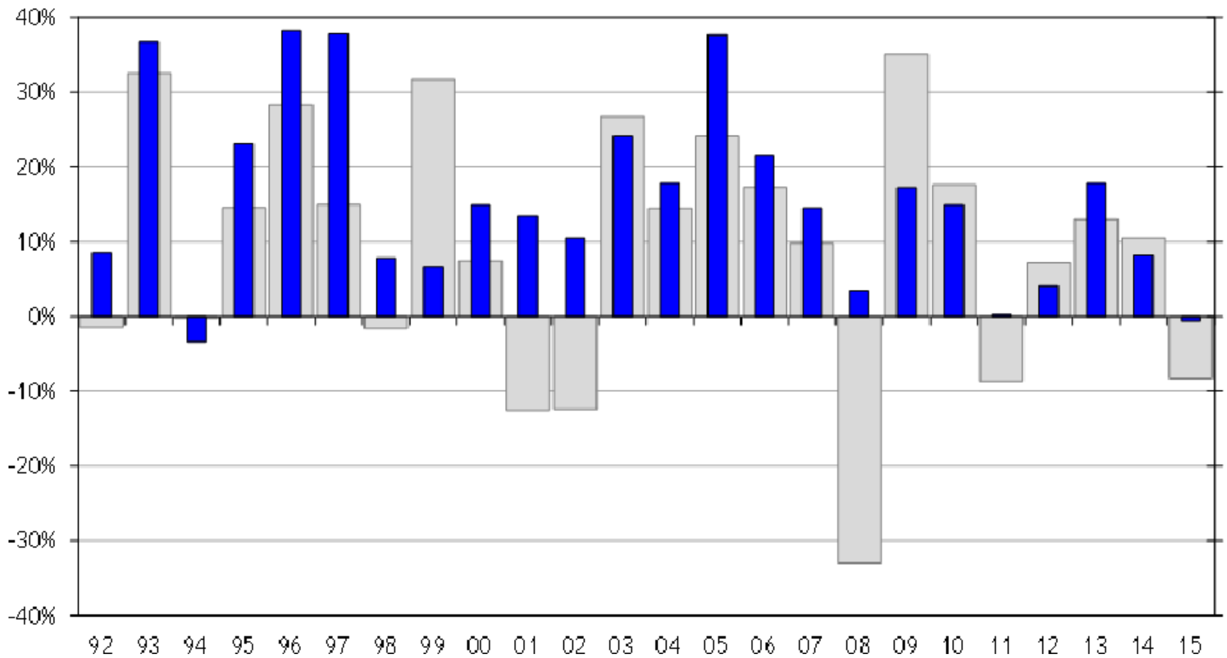
January 3rd 2017

"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: 15,288
TSX 200 Day Moving Ave: 14,407
% Above/Below 200 Day Moving Ave: **7.3% Above**

Levels for change: 50% stocks - **TSX 15,126** and 100% cash at – **TSX 13,687**

Weekly Quote

My hope is to morph the weekly comments from a "reporter/discussion" style to a "reporter/solution" style in 2017.

My New Year's style change note for the weekly comment.

A Few of the Data Sets for the Past Three Years

It is important to look **at 2014 to 2016 as time block**. This is because most of the world stock markets have only made marginal new highs from their three year perspectives and it is key that they stay above these levels to stay BULLISH.

The first chart is shows the past 3 years for the TSX index in Canada. The Canadian index has not yet cleared its' all time high made in 2014. Once cleared, the 15,537 level becomes a key technical level in 2017…we will discuss this in future letters.

The US market has already cleared its' all time high hurdles. The key level here becomes a holding of the (blue line) 200 day moving average throughout the year.

The final chart I will use today shows the 10 year bond yield in for the US Treasury bond for the same 3 year period. How low interest rates have driven up global asset prices is discussed in the second section of the weekly comment…but for 2017 we will continue to watch the level of global interest rates carefully. **I believe that <u>global liquidity is the key to global asset prices</u>. The governor on global liquidity at its most basic level, is the level of US interest rates.** (25.05 = 2.505% for the 10 year bond).

And so we begin the year of 2017. With all of the cross-currents running through markets this year you will see me referring to technical levels the markets a lot more.

The reason I get "more technical" after runs like we have seen since the Trump election is that they can often represent "blow off tops" to longer term BULL markets. What a blow off top refers to is the ***move in the market that even the most ardent BEARS get drawn into investing their cash into the blow off***. (We can't know if this is a blow off top until after the chart pattern has completed so we will take care to try and identify the pattern while it is in the making!) We will watch…

<u>"Addicted to CGI"</u>

The holiday season always sees a new crop of big budget movies hit the theaters. Families are gathered together and friends have spare time to go see these new creations of Hollywood so box offices tend to be quite busy.

When you look at all the trailers for these movies, one can't help but be amazed at the huge jump in the "computer generated imagery" (CGI) used to jazz up the films. It is funny to sometimes go back and watch an old *Indiana Jones* or *original Star Wars* flick to see the state of CGI (or lack of CGI) back 30 years ago. Wow, what a difference!

The way the financial markets traded over the holiday season left me feeling the same way! Volumes fell dramatically and global prices of financial instruments went dormant.

When the computer algorithms that comprise the vast majority of trading dry up there is not much human trading left to be seen.

As I thought about it the idea dawned upon me, "***how different are the computer generated images seen in movies from the computer generated prices I see on my quote screen?"***

The most challenging aspect of the past four or five years of working with financial assets is the concept of traditional value. Or said another way, what am I really getting for the investment dollars I spend when buying an asset? (Stocks, bonds or real estate). The divide between ***traditional measures of value*** and ***relative measures of value*** has widened immensely. Let's take a closer look at what this means.

Traditional measures are the ones that all of us "old-timers" learned to use when we took our securities licensing course back in the day. *Price to earnings, price to book, price to growth, enterprise value to sales, earnings before interest, taxes, depreciation, amortization (EBITDA),* etc. Oh how things have changed. In 2000, we were told those measures don't matter anymore ("*eyeballs on the screen*" was one of my favourite new valuation measures of that era)…and in 2009 the tax rulings of FASB-157 decided that we can use the traditional measures but companies can calculate their earnings, cash-flow, debts and assets within the equations any way they want to. These became known as "adjusted earnings". The result has made the published value of these ratios a shadow of what they meant 30 years ago under GAAP accounting.

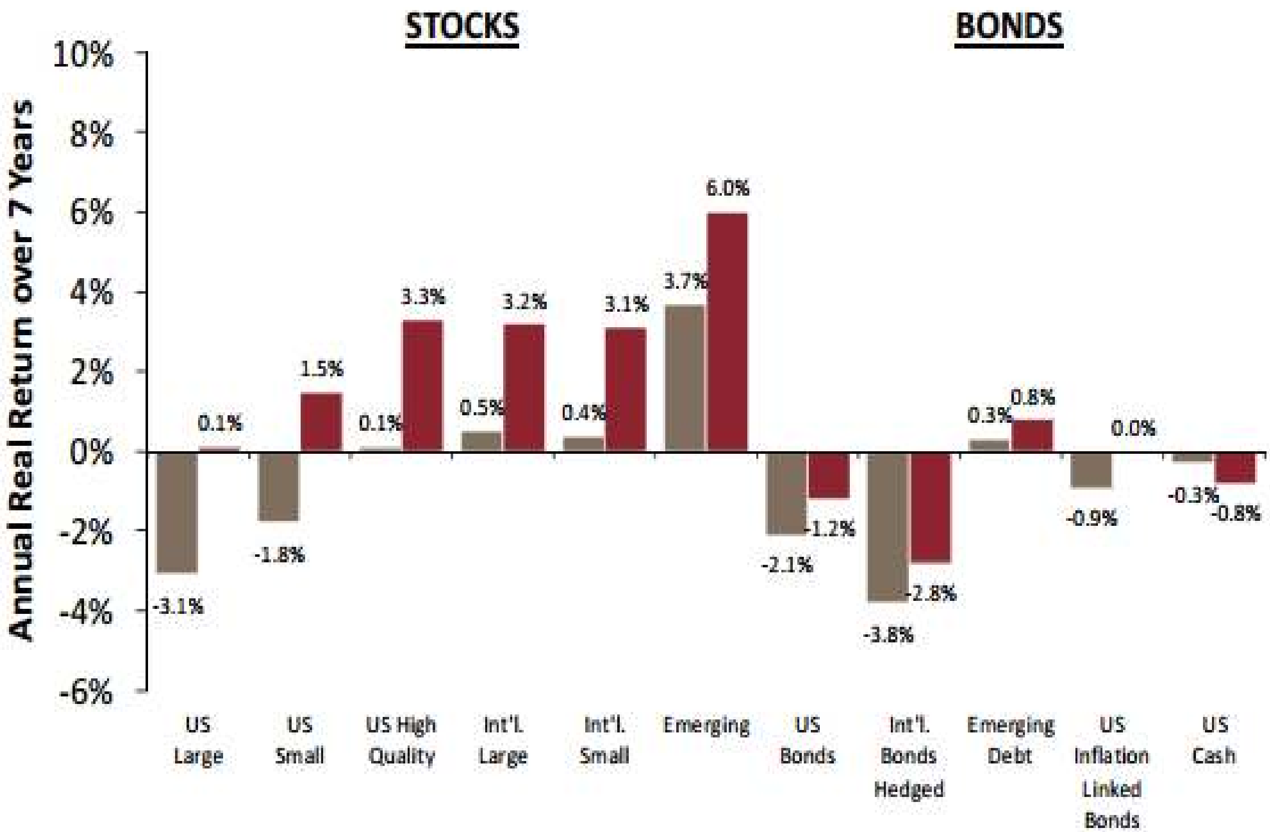
Relative measures of value always remind me of two elevator cars going up in a 100 story building. Both elevator cars start on the first floor going up…the first goes to the 77th floor and the second goes to the 80th floor. The cars have climbed a long way relative to where they started but the people inside the cars are only 3 floors apart! That is what happens when investors say that stocks are cheap relative to interest rates or real estate prices. **All of them have climbed a long ways in price so the absolute values are stretched, but the relative measures appear reasonable.** So by using "relative valuations" the investor only needs to look at how many floors separate the elevator cars…not the actual distance climbed by the cars.

My hunch is that computer algorithms are more wired to "relative value" than "traditional value". No matter how high the elevator cars have risen, the algorithms keep concentrating on how many floors separate the cars! I get the impression that Wall Street is totally comfortable with this concept. Relative values allows prices to stretch higher than tradition valuations…and who doesn't like higher prices?

Please don't interpret the message of the editorial as BEARISH or a forecast for lower prices. I have no idea what pricing looks like in coming months…especially when considering the reality that computer trading is growing rapidly AND American investors are the most BULLISH that they have been since 1999!

But, at the same time, please realize the elevator cars are not sitting near the ground floor either!

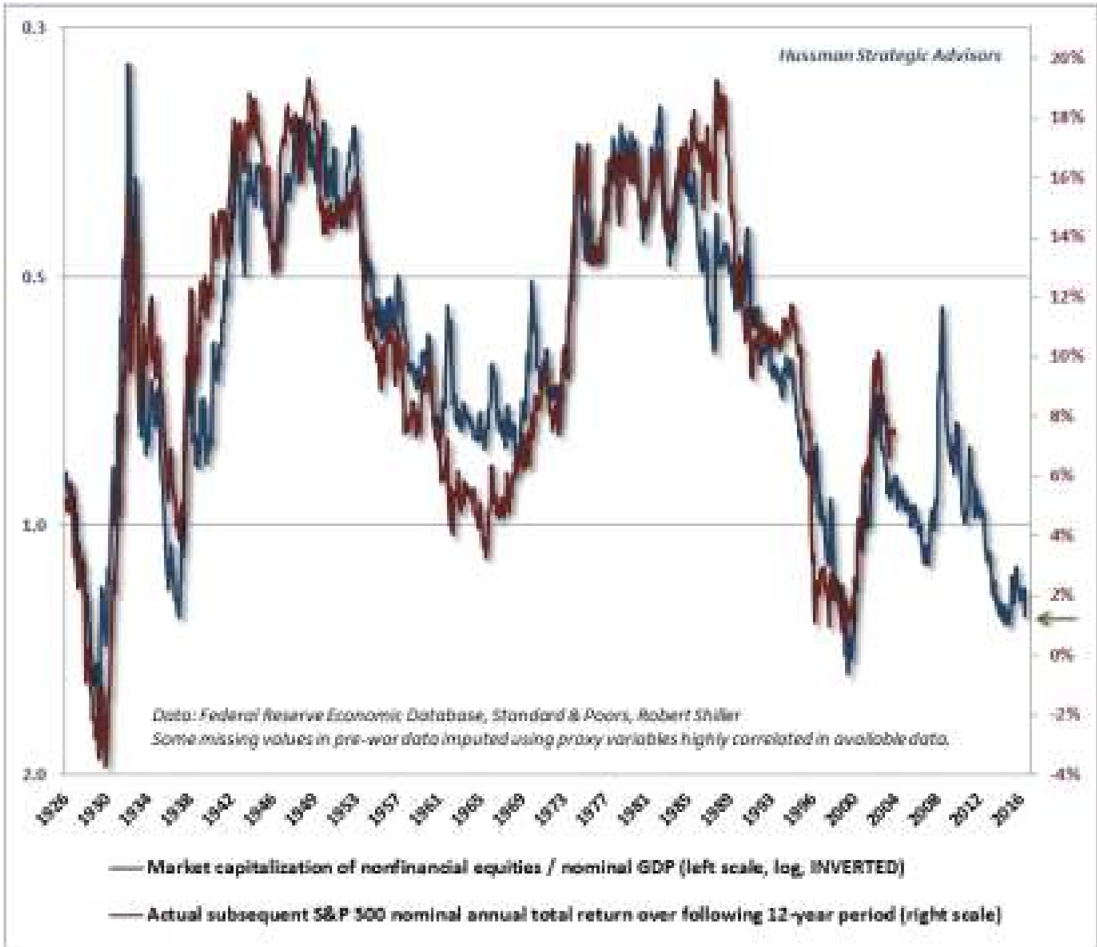
I will add two “traditional valuation” charts to drive that point home.



The above chart is done by Ben Inker of GMO Asset Management and shows the forecast annual return for a variety of asset classes listed on the bottom of the chart over the next 7 years. There are two assumption sets for the economy for each asset class…don’t get too hung up on the difference between the two numbers for each asset class…**look at how low the expected rates of return are for EITHER outcome!**

The reason the expected outcomes are so low for the next 7 years? **Because the elevator car is starting at the 80th floor!!!**

The next chart is a tradition valuation done by John Hussman. Again, I have used this graphic before.



Notice the green arrow on the right hand margin and where it is pointing…it is forecasting the total nominal return over the next 12 years to compound at approximately 1.75% from the present valuations. Again, why so low? **Because the US stock market is starting on the 80th floor!!**

Conclusion: I am so thankful that my job is not to sit down and try to guess where the top of this market is going to be. If the stock markets want to go up 50% in 2017, then my TEAM modeling will allow me to participate in that rise. If stocks decide that a 20% decline in a reality in the year, then TEAM will allow me to only participate in a fraction of that decline! That is why I can write the above editorial with "*no axe to grind*" for or against stock markets!

Strategically, I feel completely comfortable with what my trigger points will be in portfolios in 2017. They are a moving set of targets that are calculated on a daily basis and offer incredible downside portfolio protection to those interested in such protection.

And what really piques my interest in how many investors feel like the days to buy and sell are over…and believe Trump is the next Reagan…and how that making money in real estate is a simple a signing a contract and taking on as much debt as possible…and interest rates will never go up again, etc.

This is going to be totally interesting!

Enjoy the New Year…it has begun!

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