

June 9th 2017

“Client Comment”

You are receiving this email because you are a client of Nick Foglietta's and you own one or more positions in the Tactical Equity Allocation Model (TEAM Model), or you are part of the Exchange Traded Fund (ETF) TEAM Model, or you are a prospective client considering the TEAM model for your investment portfolio.

Present Status of TEAM Models:

Canadian Models:

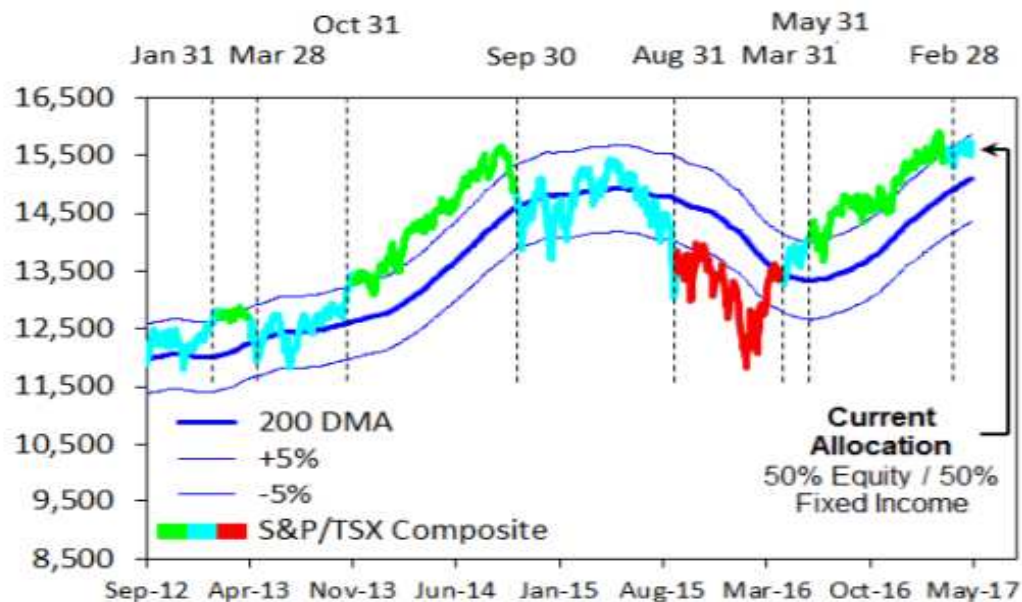
TEAM I – changed from 100% stocks on March 1st 2017 to 50/50 cash/stocks
TEAM II – changed from 100% stocks on March 15th 2017 to 50/50 cash stocks
ETF TEAM – changed from 100% stocks on March 13 2017 to 50/50 cash/stocks

US Models:

TEAM – 100% stocks
ETF TEAM – 100% stocks

Canadian TEAM I Record of Asset Allocation since inception – Sept 2012:

ASSET ALLOCATION



Investors and Traders Take Notice - Parabellum

Executive Summary

The time has come to begin to plan for a potentially lengthy “flat” to “down” stock market in the US. Canadian investors have already been dealing with a flat market, but the signs are spreading that the US is reaching the same situation.

What makes present portfolio management so difficult is that taking money out of stocks or real estate assets leaves little income on the investment capital. In other words, you sell and you get stuck with less than a 1.5% rate of return on your money!

From my perspective, the challenge is to “de-risk” portfolios in a manner that allows for continued exposure to growth assets but has a mechanism to quickly change to a lower risk profile if market conditions warrant such a change. **To build this mechanism into your personal portfolio I need you to work with me to establish two “numbers” that are representative of your personal feelings and objectives:**

1. ***What is the rate of return your portfolio MUST earn to accomplish your financial goals?*** (You arrive at this number by taking your annual budget and subtracting your other sources of annual income...wages, pensions, etc. The net difference is divided by your portfolio value and that is what your portfolio must earn.)
2. ***What is the largest capital loss you can mentally manage on your portfolio where you will not get nervous and start to sell positions in the midst of a market correction?***

With the two personal “goal posts” above established for you, together we will be able to adjust your financial plan and investment asset mix of stocks, bonds, and cash to hopefully achieve both objectives.

In part one I am going to make the case that **three reliable signs** have chimed in to say US stocks are nearing the end of their BULL cycle:

- Distribution top consisting of “churning” market, narrowing up/down breadth, and less importantly in today’s world, lethargic trading volumes. (Trading volume has lost much of its validity due to off market transactions and ETF structures.)
- Flattening Yield Curve
- Oil price surge of more than 80% from trough to peak

Part two will view some of the alternative options investors might consider in light of the fact that they will be raising some cash by strategically adjusting their portfolio.

It has taken me quite a while to arrive at the investment strategy presented in this letter. The easiest course of action for a financial advisor in the past few years has been to ignore the facts and let the bubbles grow. Bad news has not had a lasting impact on stock or real estate prices for years but the signs of “exhaustion” are springing forth like weeds on a manicured lawn. **I am not saying that markets have finished their bubble growth...I am saying it is time to have an actionable market strategy to deal with the change in direction when it eventually comes and to ensure that, as your financial advisor, I completely grasp your personal preferences and risk tolerances.**

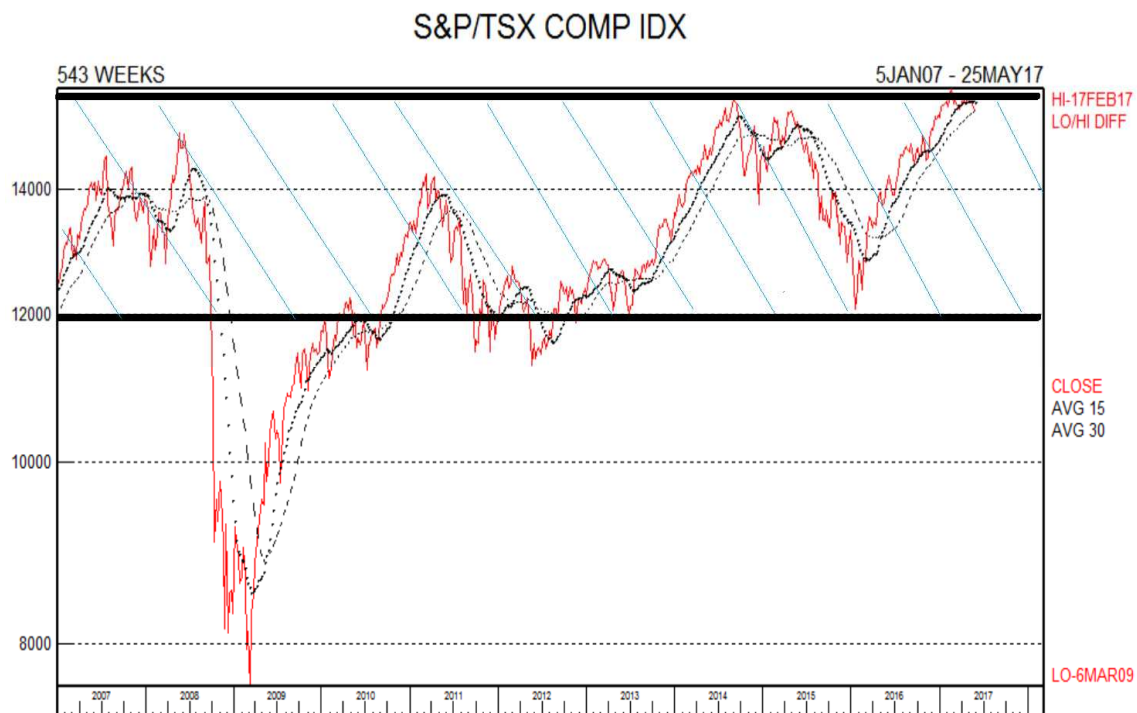
The rest of this report is the supporting data to the plan outlined above. If you are not interested in the supporting data feel free to stop reading here. You don't need to read any further to calculate your “personal rate of return required” or your “acceptable capital loss” amount.

Hence, “parabellum” – **if you want peace, prepare for war!**

Where We Stand

On numerous occasions in these comments, I have discussed how pathetically “flat” the Canadian stock indexes have been. Since this story is rather old I am simply going to post the same chart I have used in the past and let it speak for itself.

(Remember, the way I like to view the 10 year chart of the TSX below is to simply forget the large 2008-2009 decline even happened and just focus on the long, sideways move in the TSX index over the last 10 years.)



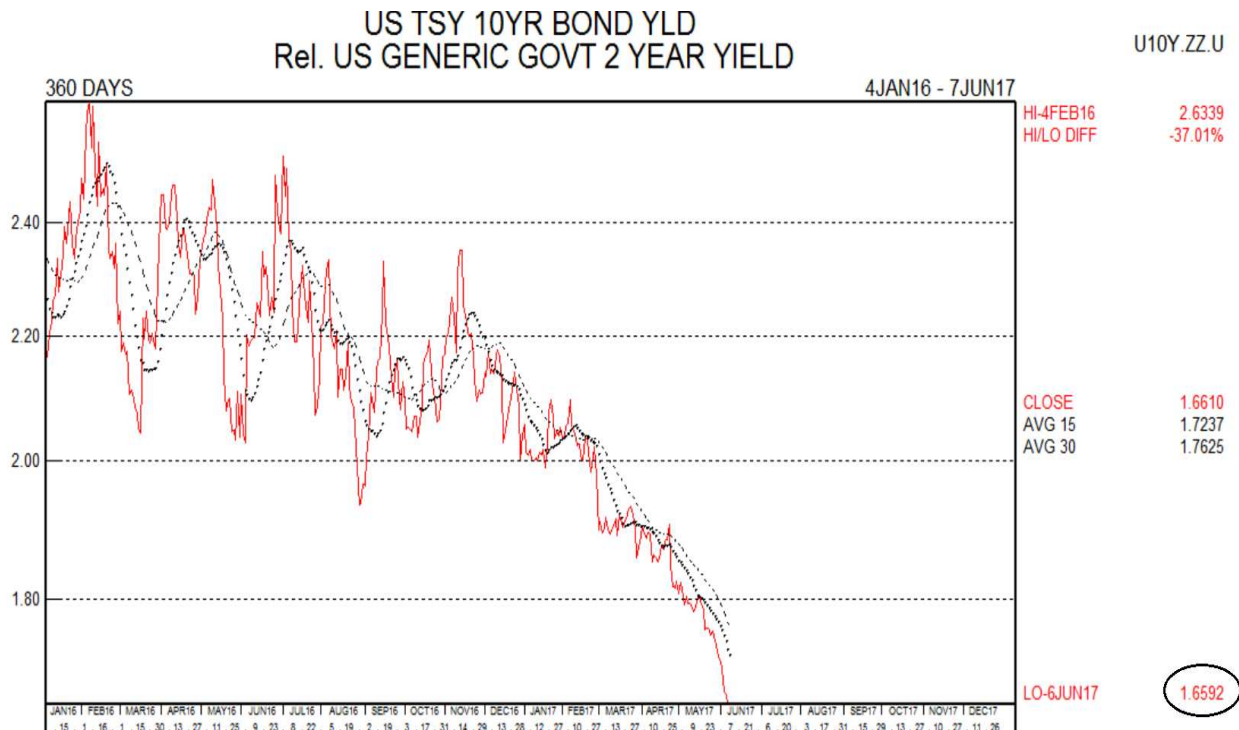
Now let's take a closer look at the three factors mentioned above relative to the US stock market indexes.

The US market capitalization weighted S&P500 index is still BULLISH. I have shown using the black box below where it has had some momentum stall, but the trend is still BULLISH and we should remain BULLISH on US stocks.



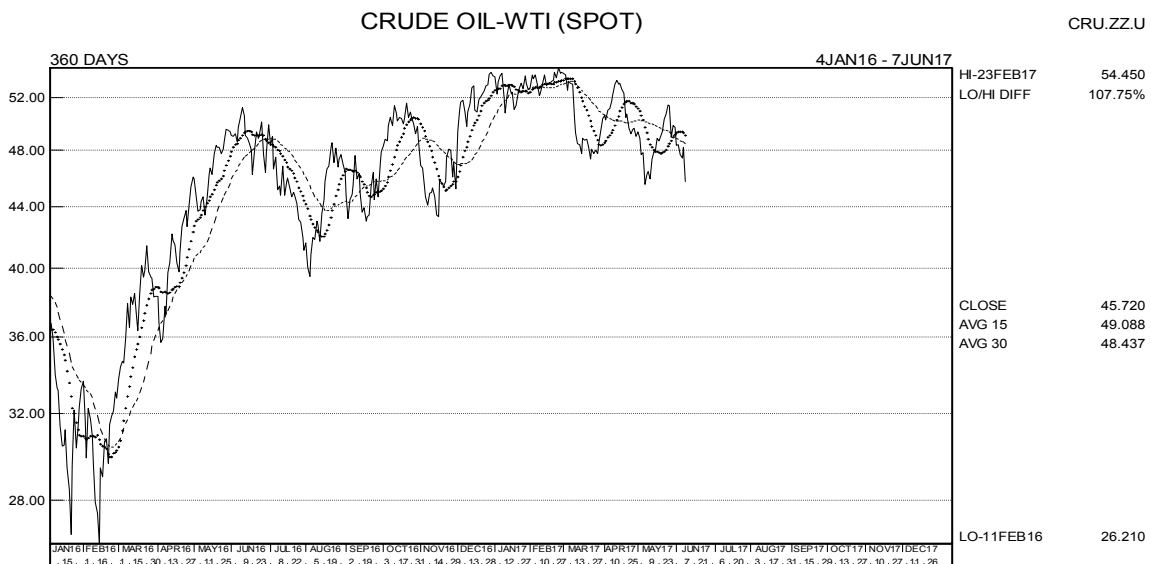
If my exhaustion theory is correct the range shown by the black box above should be hard to pull away from and a drop below the S&P500 2300 level should be viewed as a possible change in direction by both investors and traders.

The next chart is the catalyst for writing this report. What you are looking at is what financial analysts define as a “flattening of the yield curve”. What this means is that the net yield difference between short term interest rates and longer term interest rates is shrinking. One of the latest and most reliable indicators of an economic slowdown is the flat or “inverted” yield curve. (Please remember, interest rates have been greatly manipulated via Quantitative Easing so this indicator may have a faster impact than in previous market cycles as the curve flattens.)



If the US Federal Reserve stays true to its projection of two or three 0.25% interest rate hikes yet this year, the trend on this chart could accelerate lower from here. My expectation is for the June 6th, 2017 low spread on yields of 1.6592% shown in the bottom right corner to fall to the 0.80% level by November 2017.

The 80% surge in oil prices is the last piece of evidence I want to enter at this point. There are more esoteric technical indicators I could include but, to keep things simple, this will do.



The run out from sub \$28.00 prices in February 2016 to the \$54.00 peak in February 2017 clearly makes the hurdle of an 80% increase. These types of moves in crude oil prices have been an excellent indicator of an oncoming recession in the US.

In summary, these are not “imminent indicators” of a US recession...they are precursors. The US market is still moving in an upward trend or a BULLISH trend. But it also feels like that trend is “exhausting” itself.

Remember...parabellum!

What To Do

This is going to be very simple. No financial mumbo jumbo and no long stories attached.

1. Please consider your own personal financial circumstances and try to calculate the two numbers mentioned in the executive summary section of this report. (The minimum acceptable rate of return for your portfolio to meet your budget needs and the maximum acceptable capital loss on your portfolio.)
2. After step 1 is complete, together, we will adjust your portfolio so that you remain holding your **minimum percentage stock market exposure** in long term individual stocks and funds like TEAM.
3. With any monies resulting from the trimming of your long term positions in your portfolio, we will invest in S&P 500 based exchange traded funds (ETFs) that can be bought and sold in a single trade to quickly get down to your **minimum percentage stock market exposure** should market conditions require this change to be made.
4. We will explore alternate asset classes that may enhance your rate of return during the next BEAR market once it begins.

So that's it. Keep it simple. Know what we need to do IF the investment climate changes slowly or suddenly.

Realize, this strategy is completely in keeping with the financial plans I have been working on with many of you since January. Quantifying rates of return and risk profiles is what sits at the very core of every financial plan!

Please contact me to set up a meeting to discuss the contents of this letter.

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

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