



# RBC Wealth Management Dominion Securities

**INVESTMENT & WEALTH MANAGEMENT**

*Today and for the Next Generation*

**With Nick Foglietta**

**May 18, 2017**

## The Great Narrowing: Market Exhaustion

Moody's Downgrade of Canadian Banks – in a nutshell, “high debt levels and soaring house prices could lead to a more challenging operating environment for banks in Canada for the remainder of 2017 and beyond.” – Moody's

Let's dissect this idea a little bit on the following pages.

Continued on page 2

“We're the  
fricking  
Guardians of the  
Galaxy!”

**-Rocket Raccoon**

SOUNDS LIKE  
SOMETHING JANET  
YELLEN WOULD SAY

### Tactical Equity Income Model Portfolio Record

#### Tactical Equity Income Model Present Conditions:

TEAM Model Asset Allocation: 50% stocks 50% cash  
S&P/TSX 60 Closing Value: 15,610  
TSX 200 Day Moving Ave: 15,147

% Above/Below 200 Day Moving Average: **3.05% Above**

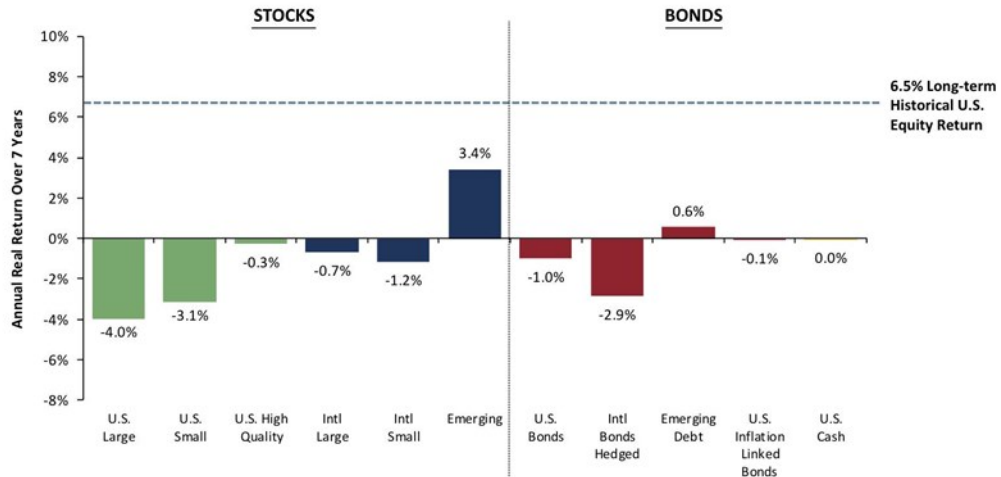
Levels for change: to 100% stocks - **TSX 15,904** and 100% cash at **14,390**

### In This Issue

- The Great Narrowing: Market Exhaustion

## 7-Year Asset Class Real Return Forecasts\*

As of April 30, 2017



## The Narrowing

What is challenging about the Canadian financial landscape at present when it comes to a bank's business model? The yield curve is "steep", real estate prices are high so distressed homeowners are able to sell at a profit rather than be foreclosed upon, investors are pouring money into stock based investments that earn the banks fee revenue since interest rates on fixed income investments are so low...It doesn't get any better for a bank than it is right now in Canada!

So why a warning by Moody's now?

My first thought is that, historically, Moody's has been very late to start cutting investment ratings and have ended up looking like "arsonists hanging around the burning buildings" by the time they actually made ratings

changes. The second thing that came to my mind, it makes no difference if the economy keeps improving or if Canada begins to lurch towards a recession, the real estate bubble is peaking under both scenarios. (Higher interest rates will come if the economy keeps improving, or the debt bubble will burst if we have a recession...neither is great for the real estate markets.)

Whatever the motivation for the change, I am taking the action as another sign of "market exhaustion" and encouragement to stay focused on being conservative. When the next real estate downturn comes I believe that Canada, Australia, and New Zealand will be the epicenters of the mortgage challenges. We will see.

Continued on page 3

U.S. Stock Market Performance – From the Canadian investor’s perspective, US stocks have continued to perform nicely. As I have stated before, a large amount of the performance has simply been the decline in the Canadian dollar when compared to the US dollar.

But even the US stock market itself has become a bifurcated example juxtaposing a small number of growing companies back dropped against a large number of flat/falling stocks. The charts below drives that point home with style!

Chart 1 shows how Facebook, Apple, Amazon, Netflix and Google (Alphabet) have increased in value by \$260 billion since March 1<sup>st</sup> and the other 495 stocks in the S&P 500 have lost approximately the same value!

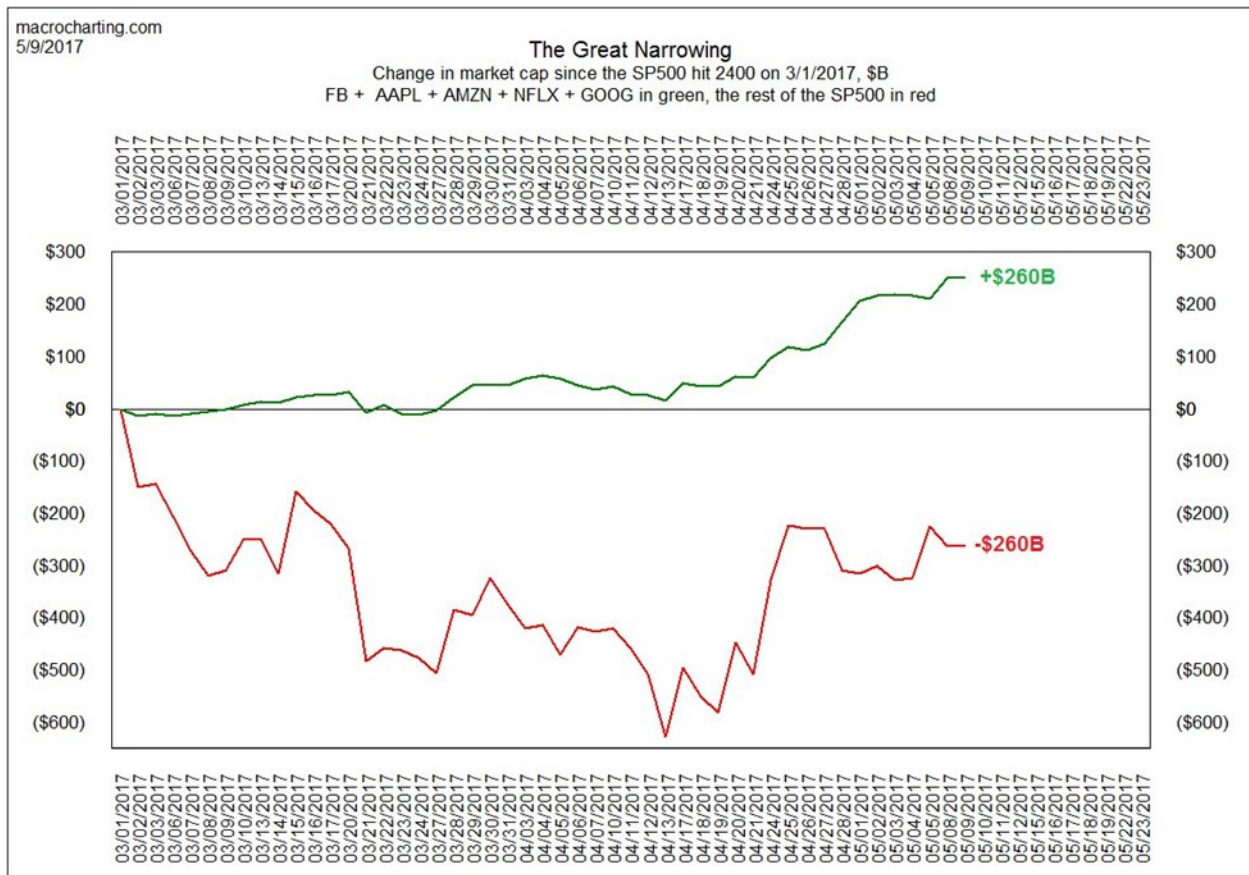


Chart 2 on the following page drives home the same point over a longer period of time. It compares a “market capitalized” view of the S&P 500 vs. an “equal weighted” view.

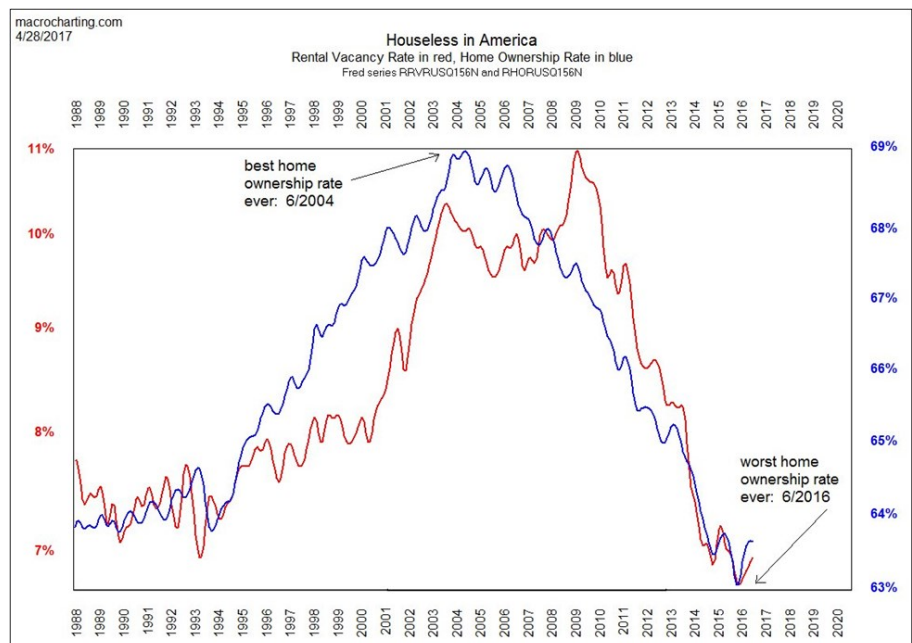
Continued from page 3



The timeframes of the charts above are short, but it does remind me a phenomenon I have seen at “exhaustion moments” in the past. Only a few large capitalized companies carry the stock markets higher in the exhaustion phase of the cycle.

### Is Canada is Heading into a Housing Recession?

An editorial caught my eye that was looking at the aftermath of the US housing recession in 2008. What happened to all the people who ran into financial trouble when they could not afford to keep their homes anymore?



Continued on page 5

The chart on the previous page is fascinating. You need to think about it for a while, but you will see just how devastating a true housing recession is!

The blue line on the chart shows the home ownership rate as a percentage of population across the entire US. Notice it peaked in 2005. When the home ownership peaked, not surprisingly, there was the largest number of vacancies available in the US rental market at the same time. When the bubble burst and people started losing their homes the vacancy rate plummeted at the same time! The people who lost their homes had to live somewhere....

But here is the key to remember.

People tend to defend their home with most of their savings before they have to turn in their keys to the mortgage lender.

**Therefore, when the eventual recovery begins they no longer own assets that benefit from the recovery.**

Realize that these types of concerns are premature. Yes, the mortgage market in Canada is suffering, but it might get bailed out by the Feds and the problem may simply evaporate for the present time. But the reality check for me is there are more “cockroaches” showing up around Canada’s frothy real estate markets. This is a good time to do a personal review and make sure your exposure is reasonable and on a solid foundation.

## ***Wealth Management in Nanaimo, B.C., Canada.***

### ***Nick has been managing money since 1988.***

Securities or investment strategies mentioned in this newsletter may not be suitable for all investors or portfolios. The information contained in this newsletter is not intended as a recommendation directed to a particular investor or class of investors and is not intended as a recommendation in view of the particular circumstances of a specific investor, class of investors or a specific portfolio. You should not take any action with respect to any securities or investment strategy mentioned in this newsletter without first consulting your own investment advisor in order to ascertain whether the securities or investment strategy mentioned are suitable in your particular circumstances. This information is not a substitute for obtaining professional advice from your Investment Advisor. The commentary, opinions and conclusions, if any, included in this newsletter represent the personal and subjective view of the investment advisor who is not employed as an analyst and do not purport to represent the views of RBC Dominion Securities Inc. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. RBC Dominion Securities Inc.\* and Royal Bank of Canada are separate corporate entities which are affiliated. \*Member–Canadian Investor.

## **Contact Us**

Give us a call for more information about our services and products

### **RBC Dominion Securities**

#101 - 5050 Uplands Dr.  
Nanaimo, BC  
V9T 6N1

P. (250) 729-3234

F. (250) 729-3272

[nick.foglietta@rbc.com](mailto:nick.foglietta@rbc.com)

Visit us on the web at  
[www.nickfoglietta.com](http://www.nickfoglietta.com)