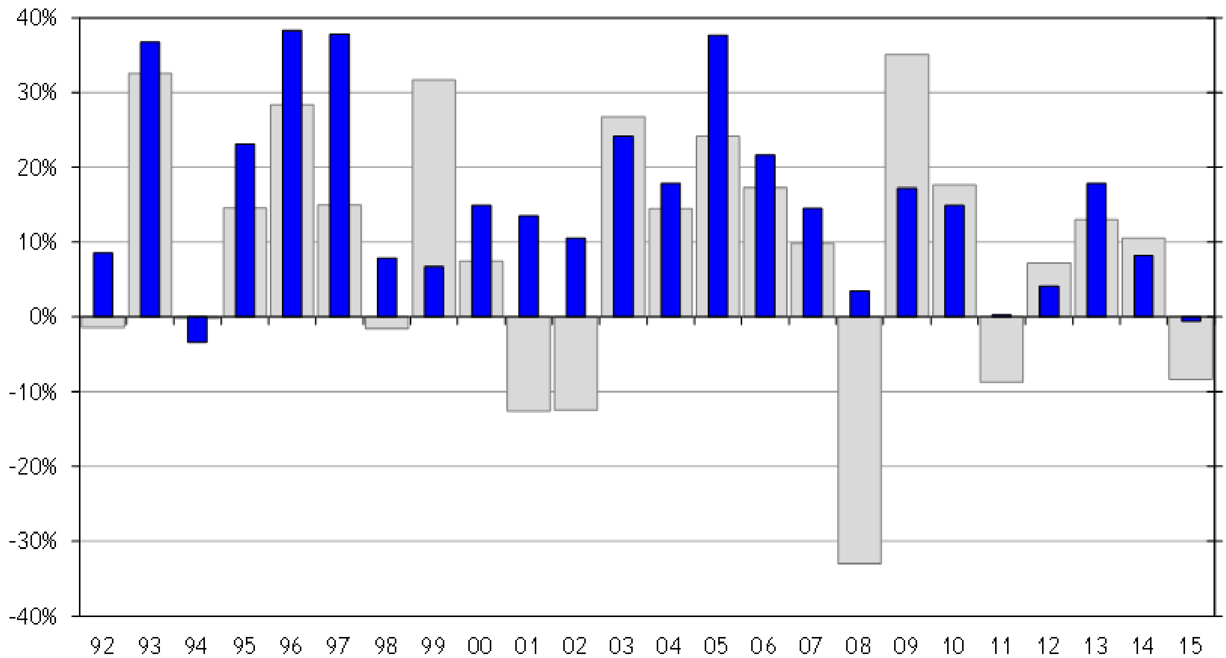
November 14th, 2016

“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: 14,509
TSX 200 Day Moving Ave: 13,961
% Above/Below 200 Day Moving Ave: **3.90% Above**

Levels for change: 50% stocks - **TSX 14,659** and 100% cash at – **TSX 13,263**

Weekly Quote

“Why I Believe the Next Stock and Bond Market Correction is Going to be Different”

Where does one begin?

There has been so much political chatter that I will spare you from anymore here. I got the election wrong and I got the initial stock market reaction wrong…I thought there would be a knee-jerk sell off in stocks IF Trump won. Not even close!!! The silver lining to the “two wrongs” was I was looking for a positive response to the US election and that did happen. (No harm…no foul)

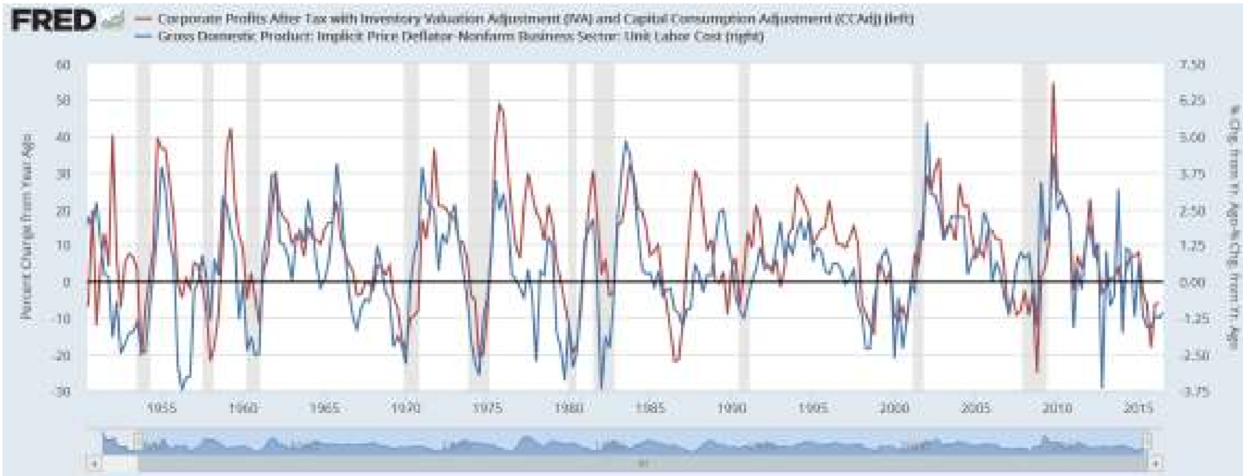
The RBC report I sent out on Thursday last week does a nice job of outlining the themes that a Trump Presidency brings into consideration. What I really want to pound away at in more detail this week is what INFLATION and PROTECTIONISM mean to financial markets. First, a little history…

When I look at the above chart I see a stock market that has been in the process of peaking for almost two years. I also see two significant dips that were “deflationary” scares. **Both of those scares were arrested by the central banks promising to do “whatever it takes” to solve the problem.**

The main thing to remember is “whatever it takes” meant more Quantitative Easing (QE) and lower interest rates.

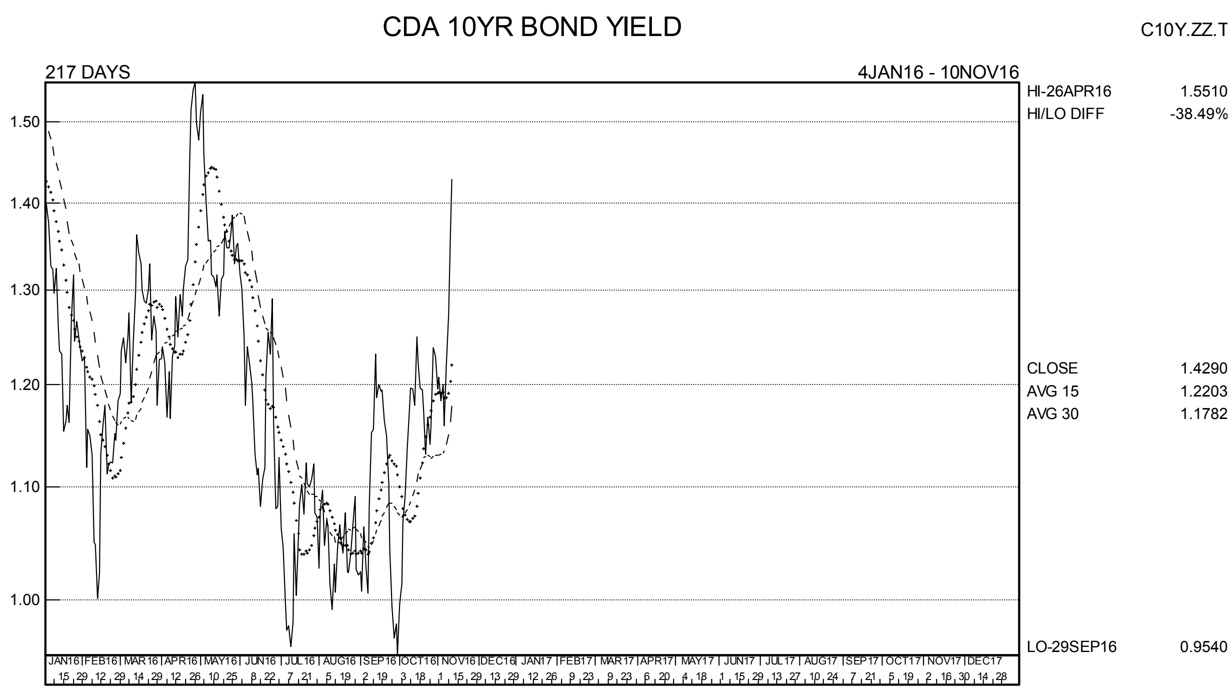
But deflationary scares are unlikely to be the scares of the coming years. **I think the central banks are going to be facing unwanted wage inflation pressures and stagnating asset market performance.** If this assessment is correct, the same “medicine” the central banks have been prescribing is not likely to be seen as a help. As a matter of fact, it may be seen as the source of the problem!

(The chart below show how corporate profits are stumbling because unit labour costs are rising faster than output prices.)



Let's delve into this idea a little deeper.

We begin with the bond market side of the equation. I am not going to mince words about where I see the returns for this side of our portfolios with a Trump economic agenda on the table. **If you hold bonds of a longer maturity than 5 years you are likely looking at zero percent rates of return at best in 2017.** If interest rates move up faster than I believe they will, then a loss will result from holding bonds in 2017!



So think about it. Investors holding balanced portfolios are holding 40% to 50% bonds. The bond portion of their portfolio is unlikely to offer any rate of return in 2017. So to make 5% returns, stocks are going to need to go up 10%....Hmmm?

(There are a number of ways to try and counteract this problem. Since I am not permitted to speak of them in these public weekly comments please feel free to call me if you want to talk about this issue as it pertains to you.)

When it comes to stock investing, the answer is not quite so concise.

Here is a simple statement: *In deflation and deflation scares, the central banks "medicine" is a tailwind for asset prices. QE and lower interest rates support asset prices and encourage speculation. During inflationary periods the correct central bank policy moves is to raise interest rates. This is not good for asset prices since it makes debt more difficult to carry…and we do have a little debt spread around the world!*

How fast do you think the central bankers will be to raise interest rates to fight an inflationary wave given they, themselves, and most of the free world are deep in debt?

Not too quick would be my guess…

Then we find ourselves in a world where you are trying to put the "inflation genie back in the bottle" and that is a difficult task. (Think early 1970s)

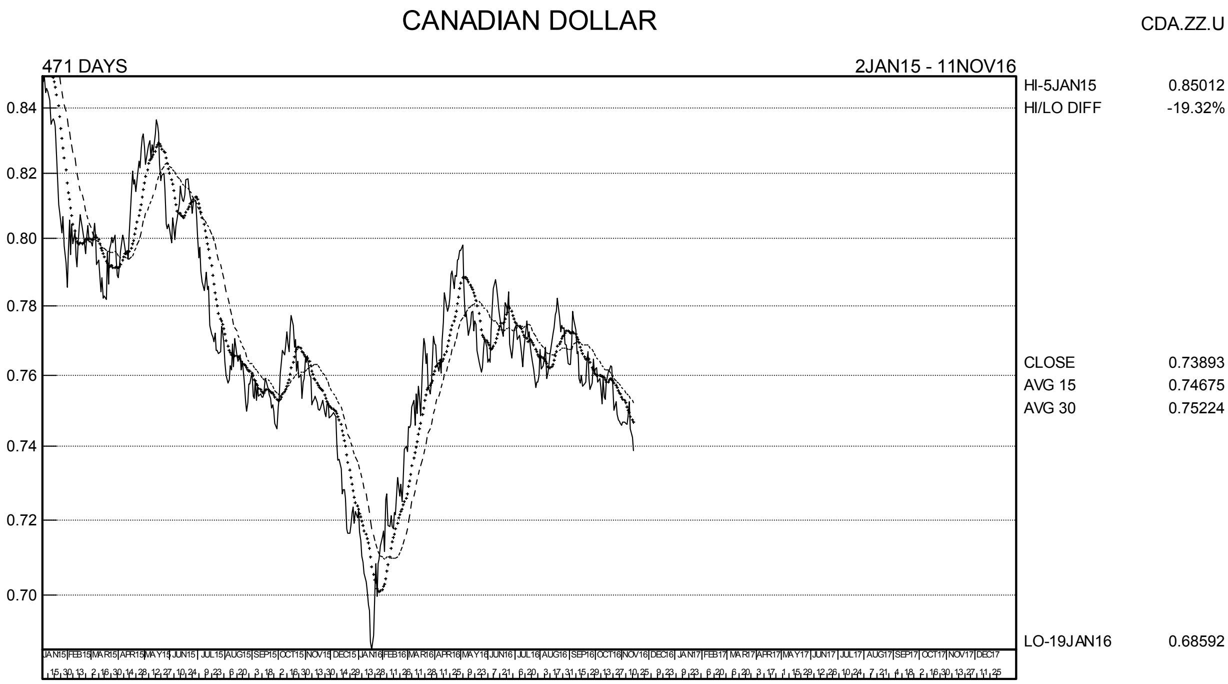
Massive tax cuts, huge deficit spending and protectionist policies that create higher costs to consumers on products in the US. What part of the above is not inflationary?

Yet, we live in an overly indebted world that sees almost all asset classes hyper-sensitive to changes in interest rates. In a word…be careful!

<u>*Canada and Protectionism*</u>

Finally, let's consider investment in Canada versus the US. My guess is that inflation is going to run hotter south of the Canadian border than in Canada. Our inflation rate in Canada will rise too but not as much as the US.

Interest rates are already reacting around the world. **If the US has more inflation than Canada, then it is likely their interest rates will rise faster than Canadian interest rates.**



This is important because it means the Canadian dollar is quite possibly going to keep falling for a while longer. It also means that Canadian stocks might be a less beneficial choice for the near term in portfolios.

As markets settle out from the Trump Presidential win in coming weeks watch to see if there is a bias away from Canada and towards specific sectors in the US markets.

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.

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