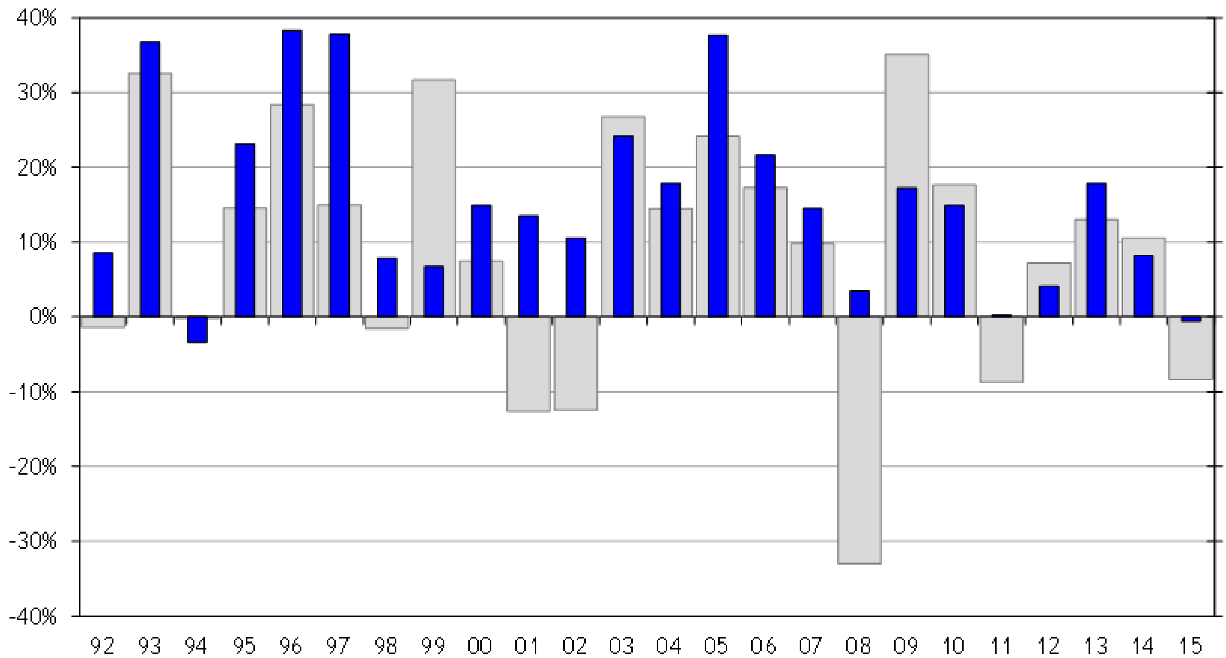
September 19th, 2016

“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: 14,450
TSX 200 Day Moving Ave: 13,643
% Above/Below 200 Day Moving Ave: **5.92% Above**

Levels for change: 50% stocks - **TSX 14,325** and 100% cash at – **TSX 12,991**

Weekly Quote

Please note the TEAM model shift back to 50% cash level is now at 14,325. That is only 0.92% away from Friday, September 16ths close.

Let's Cut to the Chase!

No charts, no theories, no big economic visions. This weekly is just stating the market conditions as I see them today.

1. Interest rate markets have stopped moving in perfect concert with the whims of central banks. Japan and Germany are the most obvious examples of this shift, but it is evident even in the U.S. and Canada.
2. Stock markets have seen volatility return. (Both up and down)
3. Economic numbers have continued to soften at a time when the most Quantitative Easing of the past 9 years is being applied by global central banks.
4. Most telling… many of you have noticed. Thank you for your calls and emails letting me know how you feel!

So what?

The "pulse" of the markets has changed. After a long period of investor paralysis, people are re-assessing portfolios again. Newsletter writers are writing more graphically about what they feel is happening. Clients are asking questions…

It has been incredibly painful to write a weekly newsletter when nothing ever seemed to change. Thankfully, we appear to be nearing an end to that period of time.

The FED is not going to raise interest rates on Wednesday this week. (If I am wrong about that…then batten down the hatches!) What is going to be fun to watch is how the markets respond to this "non-action".

The initial response should be positive for stocks and commodities. Bond prices are more of a question mark. And how long will the markets continue in a BULLISH direction?

Let me be blunt. The central banks have taken insane monetary policy to beyond extreme levels. Nobody knows what waits for investors around the next corner…and that comment includes the central bankers themselves!

Right now is the time to be clear about what your strategy is to handle rapidly RISING or FALLING markets. The term market is inclusive of stocks, bonds, and real estate. You don't need to make the changes right now…you just have to know what will cause you to act and when it will cause you to act.

If you are in doubt about the "what" and "when" of action in your financial plan, then I recommend we have a conversation!

September is here and it is time to refocus our financial plans given the nature of the change in the pulse of the markets….

If you did not read John Mauldin's September 15th weekly newsletter entitled "***Negative Rates Nail Savers***", I would recommend it strongly. It is 13 pages long and delves into a decent amount of historical context.

If you don't have time to read a long newsletter I will include a subsection from the newsletter – "*What Will Happen from Here*". (As context to the following, John is assuming that the US has a "garden-variety" recession in the next two year time frame. This view is actually held by the US FED too.)

Here is the most likely scenario I think we are facing. We are going to go into the next recession with interest rates still stuck in the sub-1% range, not giving the Fed much ammunition. There have been numerous studies from within the ranks of economists who could certainly qualify as High Priests that show quantitative easing didn't really do anything, other than maybe goose the stock market. There is also no data demonstrating any positive benefit from the so-called wealth effect, which was all the academic rage at the beginning of this process. Forget the wealth effect – the stock market going up does not trickle down to the average guy on Main Street.

(I find supreme irony in the fact that the very economists who derided supply-side economics as trickle-down economics have adopted trickle-down monetary policy. Seriously, that is so messed up on so many levels.)

My friend Dr. Lacy Hunt has identified some 15 serious research papers that say the money multiplier for government spending is very low or even negative. Of course, you can also round up many neo-Keynesian papers whose authors see a fabulous multiplier for government spending, so Paul Krugman and friends go on urging ever more deficit spending.

But the Federal Reserve will not sit on its hand and do nothing. ***<u>We will get quantitative easing on a scale that is currently unimaginable, blowing out the Fed's balance sheet to a level that is unrecognizable. Unless there is considerable pushback from Congress – and I do mean considerable, not just the usual suspects on the far right of the Republican Party grousing about an out-of-control Fed – we are going to see negative rates in the world's reserve currency.</u>*** *Then there will be a regular snowstorm of papers from the High Priests, conclusively demonstrating that negative rates will have all manner of positive effects on the* *economy and employment. And none of them will be worth the electrons used to publish them, because their conclusions are just theoretical blather, based on outmoded assumptions about the way the world works.*

The central bankers of Europe who are experimenting so exuberantly with negative rates came to Jackson Hole and told everyone that the rates are working wonderfully. Never mind that the hoarding of cash in Switzerland is at astronomical levels. (It's a fascinating arbitrage: bank rates are -75 bips, and you can insure your cash in a safe deposit box for about 10 bips. And in Switzerland you can find a bill worth $1000. It makes total sense.)

Negative rates will drive consumer spending down, not up. They will result in less income in retirees' pockets, forcing them to save more, work longer, and spend less. *A negative rates regime must be aggressively opposed by the public to the point that the Fed does not feel capable of actually initiating such a program. Our battle cry must echo William Jennings Bryan:*

> *"You shall not crucify the retiree and saver on a cross of negative rates!"*

The next 10 years will see an explosion of government debt and an implosion of the ability of governments to fulfill their promises. *Any economic or investment model based on past performance under previous economic conditions will be worthless. As in, just as worthless as the Federal Reserve's models. We are truly going to have to go outside of the box if we are going to figure out how to get our portfolios from where we are today to the other side of the coming crisis. There is truly no way to predict what our investment portfolios should look like six months or one year or two years or six years from now.*

This is going to be the most difficult investing environment of the last 100 years. Modern Portfolio Theory was created in 1952 by my friend and Nobel laureate Harry Markowitz, who argued that diversification among asset classes is the only true free lunch. I think MPT is going to become problematic.

We are still going to need to diversify, but I think we have to diversify among trading strategies that diversify among asset classes. Being long or short anything these days on a buy-and-hold basis is just plain dangerous. Maybe the *investment turns out wonderfully, but I think the risk versus reward of a one-way strategy is now much higher than most people think. <u>**In my view, if you are in a standard 60/40 portfolio, you are going to have your portfolio derrière handed to you.**</u>*

Then again, I could be a Cassandra. I could be wrong. The world could go along just as it has for the last 70 years, and we could pile up all the debt in the world and the markets wouldn't care. In that case the diversified trading strategy I will propose will underperform the never-ending bull market. It will not do poorly, but it will not match an S&P that compounds at 15% forever. So I guess you have to decide how much you think the S&P can compound from where we are today, given roughly 2% annual growth in GDP.

Friends, I could not agree more with Mr. Mauldin. In reality, his final paragraph defines exactly what my clients should understand.

If you believe John Mauldin is wrong and markets will continue to go higher for years in the future (given a few hiccups) then that is fine. I will not argue with your position. But should you not create some type of "parachute plan" in case he is right?

If your feelings are more in line with Mr. Mauldin, then stick with me and what we are doing because my modeling is trying to risk control the negative possibilities mentioned in the body of Mr. Mauldin's newsletter.

There are many blunt statements in the passages above. Please feel free to comment.

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.