RBC Wealth Management
Dominion Securities

George Stedman, CFA

RBC Dominion Securities Inc.
1501 McGill College, Suite 2150
Montreal, QC H3A 3M8
Tel: 514-840-7626
Fax: 514-840-7639
george.stedman@rbc.com
www.georgestedman.com

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Second Quarter 2019

The second quarter of 2019 was like the first, only more so. The yield on the 5 year Canada bond, which fell from1.88% to 1.52% in quarter one, continued all the way down to 1.39% in quarter two. Trump tariffs, real and imagined, have led to an economic slowdown. The Canadian dollar, which gained 2.1% in the last quarter, gained another 1.9% in the 2nd. The perception is that the Federal Reserve will be quicker to cut short term interest rates than will be the Bank of Canada.

As a result of the foregoing, among the top performers in the second quarter in Canada were Utilities up 22.4%, and Real Estate Investment Trusts were up 15.8%. Both are beneficiaries of low interest rates because of their substantial dividend yields.

As in the first quarter, in the second quarter rate reset preferred shares were among our poorest performers. Rate reset preferreds benefit when it is thought that their dividends will be reset higher, based on the five year bond yield prevailing on their reset date. I am of the view that these preferred shares, many of which yield a tax advantaged 5% or so, have been oversold. Today these preferreds, which were originally issued at $25, are trading at prices in the teens. At these prices many would have dividend yields of 4% or more even if bond yields were at 0% on their 5 year anniversaries.

Bond yields going to zero is hardly impossible. After all there are over $12 trillion of bonds today that have yields below 0%. Even in Europe, where negative bond yields have been a reality for going on 3 years now, many preferred shares yield 4% or so.

Weakness in preferred shares might also be a consequence of increasing credit risk but evidently that is not the case now. Many of the same corporations whose preferreds have slumped have seen their bonds rally as their yields have declined. So the decline in preferreds has been a consequence of the expectation of lower bond yields in the future, exacerbated by their low trading volumes.

It can now be said that stock markets have more than made up for the losses that occurred in the last half of half year. Last year's decline was caused by rising bond yields and a worry that

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more hikes were to come. Always with markets it is not so much the change but the speed of the change that move markets. The change in the second derivative.

Last year bond yields, and the fear of rising interest rates, rose quickly, so stocks fell quickly. The S&P/TSX is now up all of 3.9% over the last 12 months after tracing a big V. We ought to remain mindful not to project recent results into the future. It does seem, however that ups and downs of the stock markets are sharper nowadays.

Kristin, the kids and I are now in Britain visiting family. We have been learning about British history. We've learned that the poster: Keep Calm and Carry On was created during World War II but it was not used. One of the surviving copies was discovered in the 1960s and was reproduced and it became iconic. My variation: Keep Calm and Carry on Rebalancing Consistently.

Sincerely,

George Stedman, CFA
Portfolio Manager, Vice-President
Please visit us at www.georgestedman.com

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