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We haven't been doing much added buying of stocks recently. In last quarter's letter I observed that stocks, at least by some measures, are arguably as expensive as they've been since the great stock market bubble of the late 1990's (when they were unquestionably far more expensive). I referred to Robert Shiller's Cyclically Adjusted Price-Earnings Ratio. Not much has changed on that score, stocks have been relatively steady the last few months. Perhaps stock markets are waiting for economic gains to catch up to the stock market rally.

Secondly, I've often observed that there is something of a seasonal pattern to the stock market. The old adage, 'sell in May and go away, come again after Labour Day', always comes to mind at this time of year. That is a cute saying but not literally practical advice. Unfortunately that seasonal pattern only holds about three-quarters of years.

At least in recent years, it seems that at some point in the year we've had a 10% stock market sell off. For these reasons and perhaps because of a lack of imagination on my part, we haven't added any wholly new stock selections to portfolios for some months. I regard these periods of waiting as a time for reflection and study. We are carefully monitoring and going up the learning curve on several new potential stock selections, some of which I hope to introduce to portfolios this summer. On the fixed-income side of portfolios, after spending a year and a half talking and thinking about rate-reset preferred shares, I'm no longer as interested as I was. The Preferred Share Index has returned about 35% since last summer. (Some 70% of the Canadian Preferred Share Index is rate-reset or floating rate preferreds which stand to benefit if interest rates rise.) Bond yields have picked-up modestly since then but are still within the same range as the last few years. The 10 year US Treasury bond now yields 2.35%, up from 1.3% in July, but well below the 3% reached in late 2013 and early 2014. The corresponding levels in Canada for 10 year bond yields are a yield of 1.55% now versus lows around 1% in the first half of last year and highs of 2.6% in late 2013 and early 2014. It is just too soon to know if the era of ultra-low interest rates is over. Without going too far out on a limb, mid-term bonds (5-10 years) seem moderately more attractive at least than they've been in some months.

Of the three broad asset classes and general sources of risk in your portfolio, for stocks we are waiting and studying, for fixed-income we want the ladder of maturities to include at least some mid-term bonds and, for currencies, we're similarly torn. Fundamentally, the Canadian dollar appears a little undervalued with Purchasing Power Parity versus the US dollar now around $1.24 ($0.80) compared to current levels of $1.33 ($0.75). However PPP is a notoriously poor predictor of short term price movements. I liken PPP to an anchor that currencies swing widely around. Interest rates are much higher in the US at the moment and, the pressure on the US central bank to raise short term interest rates seems higher too. The Canadian dollar could remain undervalued for a while yet.

In a way I'm glad we've been in a quiet period in the markets. I've just finished being Assistant Coach for my son's hockey team and I've been a member of my sailing club for so long that this year they went and made me Commodore. If you'd like to have a consultation with me on a sunny Friday afternoon this summer, you are welcome to look for me on my boat.

Sincerely,

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