RBC Wealth Management
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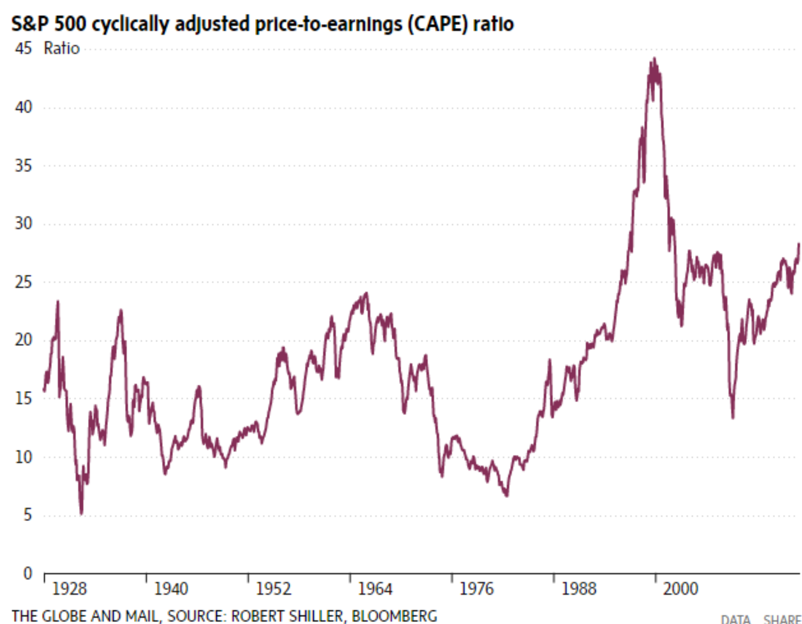
Year End 2016

Happy New Year. 2016 was, in the end, a good year. After a relatively bad 2015, the S&P/TSX Composite Total Return Index was up a world beating 21.1%. The S&P 500 Total Return in Canadian dollars was 8.8%. In Canada, of the 10 industry sectors in the TSX, the three strongest were Materials, up 41.2%, Energy, up 35.5% and Financials, up 24.1%. They are also the three sectors that dominate the Canadian stock market index because of their very large proportions in it. These three sectors, however, are not dominant in your portfolio.

The election of Donald Trump is thought to bring the prospect of lower taxes, which would be good for corporate profits, but also higher deficits, higher inflation and higher interest rates, which might not. To me the lesson of the election was the futility of making macro-economic forecasts. I think it was Peter Lynch who said if you spend 5 minutes in a year thinking about the future direction of the economy, interest rates, the stock markets and currencies, you've wasted 4 minutes, because nobody knows. In the case of the November election, to profit you would have had to predict two things right, the results of the election and the reaction of the markets. As Howard Marks (Oaktree Capital) observed, just before the election almost all polls were predicting a Clinton victory and before the election the stock markets appeared to be cheering for Clinton. "This could be seen in the fact that the markets went up when Clinton's odds improved in late October (recovering from some unpleasant WikiLeaks disclosures), and then they fell after the FBI's James Comey announced the discovery of an additional cache of

Clinton emails on October 28th, lifting Trump's chances. Thus there was a near-universal belief that a Trump Victory, as unlikely as it was, would be bad for the markets…While people search the market's behavior for logic, there really doesn't have to be any". (Howard Marks, "Go Figure" November 16th, 2016)

Barrons's (January 7th) discussed the threat of trade wars and other unpredictable actions. "Because of that uncertainty, Société Générale has dubbed this the Age of Enthropy, a term used in thermodynamics to reflect a higher level of randomness." When it comes to predicting the markets, I think that the best that can be hoped for is to identify a general level of over or under valuation. Norman Rothery, the Globe and Mail's value investor, offers some ground for caution (January 4th). He references the S&P 500's cyclically adjusted price-to-earnings (CAPE) ratio. "The S&P 500 traded at a lofty 27.8 times its 10 year earnings at the start of the year. That's 73 per cent more than its median level based on data from 1881 through to the end of 2016."



I started writing this letter January 7th, the 20th anniversary of the disappearance of Gerry Roufs in the Southern Ocean, during the Vendée Globe, a nonstop single handed around the world

sailboat race. Gerry was one of Quebec's great athletes. He was also my friend, teammate, competitor and hero, in that order. Observing that sad anniversary got me to reminiscing about twenty years ago. In January 1997, in the early stages of the great U.S. stock market boom that lasted another three years, I wrote to clients that rather than as a skydiver enjoying the view on a freefall, "I prefer to compare the stock market to a moving train – dangerous to jump on and off."

I wish you good health in 2017.

Sincerely,

George Stedman, CFA
Portfolio Manager, Vice-President
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