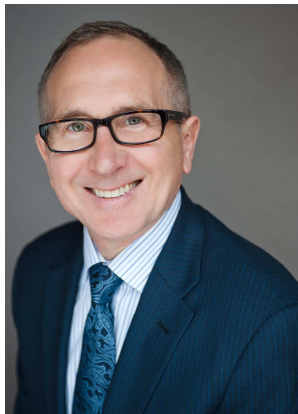


The Fortnighter



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Spring is in the air – and oh, what a difference a few months make. After the drubbing the markets (and portfolios) took in the fourth quarter of 2018, it's "no worries mate" in the first three months of 2019 – at least for the major market indices.

Yet while the stock markets are saying "full speed ahead", bond markets are talking (and worrying) about something called an "inverted yield curve". There are varying ways to define this term, but it essentially means that long-term rates are lower than short-term rates.

This is important because inverted yield curves have often been a harbinger of recessions. Low long-term rates imply slowing economic growth and inflation expectations – which, in turn, should lead to lower corporate profits and weak markets.

So why is the stock market bulling ahead? Well, for one, there's plenty of evidence to suggest that stocks can go up for quite some time after the yield curve inverts. Another reason might be that there is no consensus on which bond "time period" should be used to declare "the inversion" – i.e. the 10-year/3 month curve may be inverted but the 30-year/2-year is not (it's "normal").

Finally, it just may be that the stock market really doesn't care about this technical stuff at all – interest rates are basically low no matter where you look – short, long, whatever. As long as money is cheap and plentiful

(the punchbowl analogy), stocks and the economy can keep motoring.

My concern with the market's current situation is that (in my opinion) the bond market is generally "smarter" than the stock market. The market for bonds is largely the realm of large, institutional investors who spend their time analyzing companies and the economy, looking at long-term trends in earnings, asset health, economic growth, inflation, etc. The stock market is, well, the stock market – and while it also has an institutional component and is generally efficient, it's also a lot more "trend" and "emotion" driven.

It's also worrisome that economies like the U.S. and Canada are still piling on massive amounts of debt when their economies are growing – precisely the time when they should be paying down debt and being cautious. The time for cheap money is during downturns – not now.

In summary, if the "bond guys" (and girls) are signalling potentially weaker economic conditions ahead, I'm listening. We are, after all, a lot closer to the end of this cycle than the beginning. It also suggests some measure of defense in portfolios – like more cash, higher-quality holdings – and even hedge products (like gold). Again, stocks have a history of "climbing walls of worry" – and I'll be happy if they do. But, for now, the "smart money" in the bond market has my attention.