THE RAE LIPSKIE PARTNERSHIP™ | PRIVATE WEALTH MANAGEMENT

September 2015 **Overview**

The summer months have certainly been tumultuous ones for the financial markets. Worries about everything from China to Greece to interest rates to commodities and Canadian recession converged to send stock markets reeling into correction territory. While this corrective setback was both overdue and a normal part of market dynamics (backing and filling, putting stocks in 'stronger hands'), the event has been stressful for investors. Funny how investor confidence so quickly turns to short-term crowd madness. In any case, following are comments on this heavy side of summer as well as other noteworthy observations.

Black Monday. If August 24th, when the Dow opened down 1,000 points, seemed like the worst day ever, it wasn't even close. Volatile, yes, as that index moved up and down during the day a total of 2,000 points, but it would barely register on a list of the biggest percentage downdrafts. Compare that day's 3.7% decline, for example, to the 22.7% plunge on October 19, 1987. Any 'experienced' investors who were around at the time will remember that day very well.

What next? We can't be sure, of course, but it looks as if the worst is over. Volatility will likely continue, but current fundamentals still support the market and it might comfort you to know that, with the U.S. election coming up next year, pre-election years historically provide the best market returns in the U.S. There hasn't been a down pre-election year on the market since 1939 and the average gain has been 15%. You will be further soothed, no doubt, by the fact that years ending in 5 have suffered only one down year in the past 13 decades. The combination of these historic factors will surely propel markets higher by the end of the year. (Just remember: past performance is no guarantee of future returns!).

The Blue Jays' Effect. There is no Blue Jays' Effect. However, since the fan horde tell us the Jays are obviously on their way to the World Series, it is worth noting that in their previous two World Series wins (oh yes, they will win too) in 1992 and 1993, the Canadian market gained an average of 12% in those years. (OK, the market was down one year and up the other, but who's counting?) Let the bandwagon roll on.

Dental Dollars. Much to the chagrin of toothless toddlers, the Tooth Fairy has apparently been cheaping out on under-the-pillow cash. According to a Visa survey, the average incisor inflow has dropped to $3.19 in the U.S. from $3.43 last year. Something to do with Obamacare maybe?

Election Fever. Do you have it yet? If not, you better contract it soon or you will miss out on the riveting Senate/Duffy/Economy arguments in Canada. And the U.S. election, entertaining as it is, is only 15 months away. Promises, promises.

Computing Power. Another milestone is being passed this year with the availability of DDR4 RAM chips for home PC's. These chips are 8 times the speed of the original DDR chips, contain 32 times the memory and only use one-half the energy. Not exactly Moore's Law but an excellent example of continuous technological progress.

Are you hangry? The Oxford Dictionary has introduced a number of new words to its online version that you will probably want to memorize, and use liberally (oxforddictionaries.com). Just remember, though, if you are hangry (bad tempered as a result of hunger), you will probably not be considered awesomesauce (extremely well thought of), but you could certainly be rando (exhibiting inappropriate behavior). The power of words.

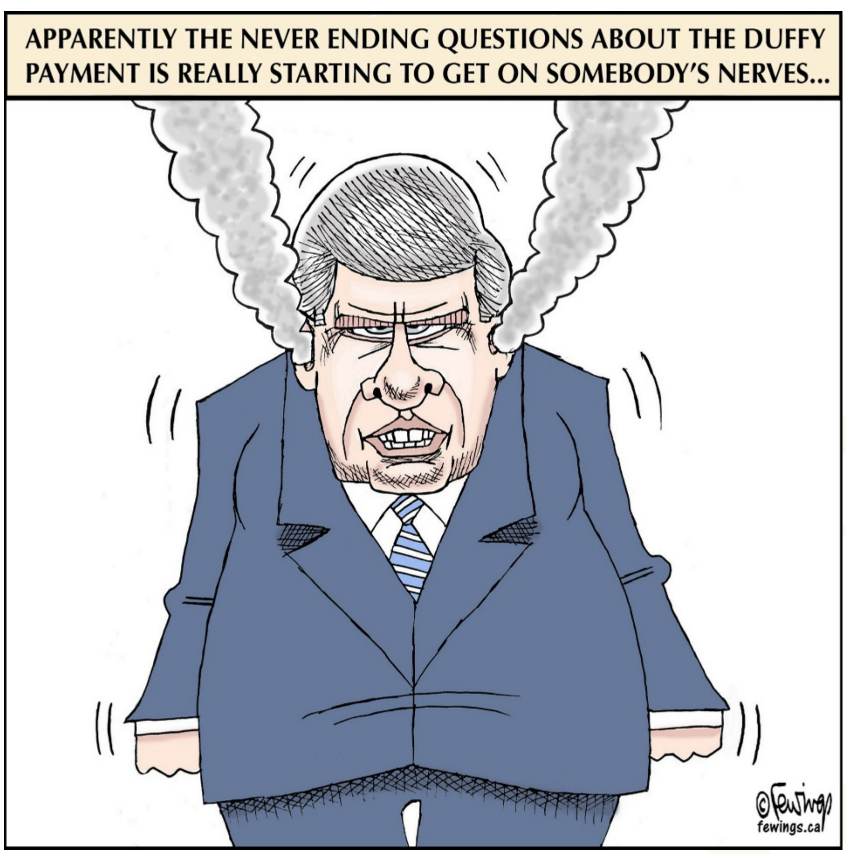
Magna Carta. Finally, a tip of the hat to the 800th anniversary celebrated this year of the Magna Carta: a much needed reminder of the misery permeating cultures that do not accept the wonderful concepts of liberty, justice, democracy and the rule of law contained in this ancient document, and of our great good fortune that we live in a society that does. Thank you, King John.

THE LEARNING CORNER

Is Canada in a recession?

There has been a lot of talk lately, generating more hot summer air, about whether Canada is in a recession or not. The answer is easy, you say, because Statistics Canada reported two quarters of economic decline and that fits the official definition of a recession. That would be true if there were such a thing as an ‘official’ definition, but there isn’t. The 2-quarter measurement has only come about because, at some point in economic history, somebody wrote a report that said the average length of recessions is 6 months. So we are not in an official recession, but we will still be inundated with the term in the election campaign.

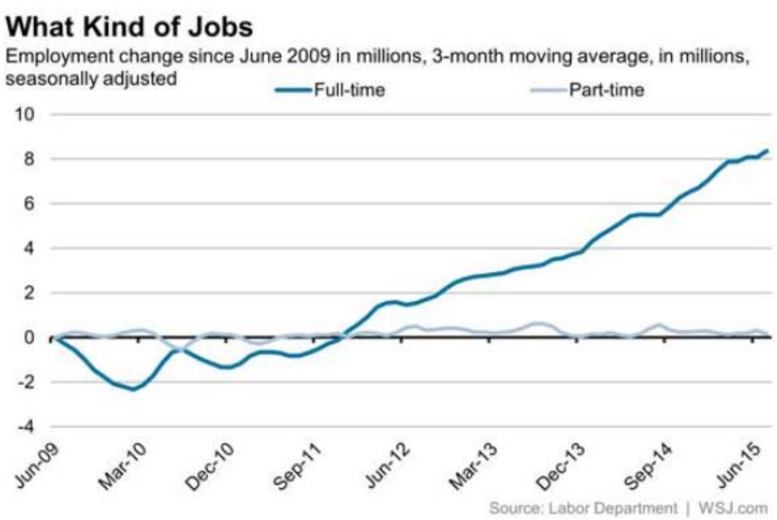
Yes, the economy has slowed, with a 0.8% annualized decline in the first quarter and a 0.5% drop in the second. These small reductions in activity are not exactly indicative of economic disaster and are specifically tied mostly to the resource sector. The rest of the economy is doing reasonably well with job growth continuing (mostly permanent jobs) and personal consumption actually showing gains in both quarters. This is not the stuff of economic recession. Further, the month of June showed 0.5% growth, a positive indicator going forward. If you want further context, and we are sorry to remind you of this, the first two quarters of 2008 suffered economic declines of 8.7% and 3.6%. Now that was a recession.



CHARTING OUR TIMES

In September of 2010, the National Bureau of Economic Research (official arbiter of U.S. recessions) declared that the U.S. recession that began in December of 2007 formally ended in June of 2009. We know time flies, but it is hard to believe that 6 years have passed since that dreary time. During the economic decline many jobs were lost, enough to raise the unemployment rate to its peak of 10% later in 2009. The chart below takes a look at employment progress since that time, showing the employment change and comparing the growth in full-time jobs to those considered part time.

We expect there might be two surprising aspects to this chart. First is the sheer number of jobs created in the U.S. economy since the bottom, standing now at over 8 million additions. These job gains have recouped the losses that occurred in the recession, taking unemployment to 5.3% in July. Of course, new jobs are instrumental in supporting economic growth through increased confidence and consumer spending, the lifeblood of economic activity. The second feature of interest is the fact, largely unreported it seems, that virtually all of the net additional jobs are in the full-time category, a statistic we see repeated in Canada. We suspect this does not jibe with the common view out there that all new jobs are 'just' part-time positions at McD's and thus not doing much for the economy. This chart tells a different story.



IN THE OFFICE

Thank you to everyone who joined us at our thirteenth annual Spring Charity Luncheon in June, and to those of you who donated despite the fact you could not attend. Whistle Bear Country Club was a wonderful venue and our speaker, Dr. Thomas William Deans, informed us that we should ensure we discuss our financial situations with our families, especially our wishes upon death. We hope those who attended and received a copy of his book gained even more insight. With your help, we were able to send over $7,500 to the Cambridge Community Foundation.

No, we don't want to remind you that summer is almost over, but the end of the year is approaching, and with it, your thoughts may turn to donations. We would like to remind you, however, if you are planning to donate shares to your favourite charity, please let our Admin Team know as soon as you can. If you leave the task too close to the end of the year, you risk getting caught in traffic with everyone else making donations. If you can let us know your wishes early, we can ensure the donations are made on time and correctly.

We are:

Ken Rae, CFA

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Ted Brough, CFA

David Paleczny

Jo-Ann Carlisle, CIM

Andréa Miljkovic, CFA

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THE BIG PICTURE

After nearly four years of moderate volatility, August witnessed a sharp spike in volatility (the negative kind). Some have called this the most widely anticipated correction on record. Others have suggested the market had become complacent. We prefer to remain focused on the long term while assessing the underlying fundamentals that drive the markets, and not respond in knee-jerk fashion to the latest headlines. Several, often inter-related issues, have been weighing on investor sentiment recently:

- **China Growth -** A slowdown in growth in China and what that might mean for global growth was a primary concern. Chinese economic growth has been moderating from its previous torrid pace for several years now as that economy transitions to a more mature service-oriented economy. The so-called devaluation of the yuan (hard to miss in the headlines, yet difficult to see on an actual chart of the currency) would seem to be a normal evolution towards more free and open markets for the world's second largest economy.
- **Commodities** – Global growth concerns were reflected in Canada's oil patch, with oil prices down to (and sometimes through $40/barrel). Sustained pricing at these levels will require some tough decisions by the producers, and likely will not be resolved quickly. Lower energy prices are starting to have an impact on the demand side of the equation – global oil demand grew at its highest monthly rate in five years in August, but is only starting to impact the supply side, where producers presumably hoped to "wait out" the decline. Tougher decisions on production and investment by those energy producers will now need to be made. For investors, some patience and positioning in high quality companies with sustainable balance sheets will be important.
- **U.S. Fed Tightening** – with continued strength in the broad U.S. economy and particularly the labour markets there, the beginning of a monetary tightening cycle by the Federal Reserve Board would appear to be in the works. While higher interest rates provide increased "competition" for equity investments, they are also a reflection of a strong economy and improving fundamentals for the companies we invest in.

So what will happen next? Our crystal ball doesn't have a "next week" setting, but it's interesting to note that in previous comparable corrections, the market subsequently had a positive return nearly two-thirds of the time; that was more than double the average return over all periods.

If you recall Warren Buffet's famous quote to, "Be fearful when others are greedy, and greedy when others are fearful", the recent volatility would certainly seem to be pointing to a preponderance of fear in the market. We will stay calm, stick to our long term view and assessment of the relevant underlying fundamentals, and hold positions in high quality, leadership companies. As "The Learning Corner" comments highlight, Canada's economic fundamentals remain quite acceptable, and not indicative of a need for a change in strategy.

QUOTE of the DAY

" Money isn't everything, but it sure keeps you in touch with your children."

- J. Paul Getty