THE RAE LIPSKIE PARTNERSHIP™ | PRIVATE WEALTH MANAGEMENT

March 2016 Overview

Pundit Pandemonium

We are sometimes asked by clients, especially in volatile times like we have been enduring lately, just how we navigate the perilous market waters. We see several ways to undertake the voyage.

First, investors can check out the market aphorisms that might apply: Buy low, sell high; Buy right and hold tight; Buy when the guns are blazing, sell when the trumpets blare; Buy the panic, sell the greed; It's not timing the market, it's time *in* the market; Bull markets are made of risk aversion; and, of course, the Buffett clarion call: Be greedy when others are fearful. Most such maxims are quite apt and even self-evident but, unfortunately, they become obvious only later when hindsight makes the current market murk crystal clear.

The second answer is simple also: Just listen to the pundits and follow their advice. So, herewith we provide a sampling of recent opinions on the outlook for various markets.

China - George Soros: "China Hard Landing Will Deepen the Rout in Stocks."

- Song Yu, Beijing-based Goldman Sachs economist: He's "not negative about China's economic prospects and dismisses dire predictions of an economic collapse."

Canadian Banks - Barclays Capital: Bearish on banks, steep cuts to target prices, "2016 likely to be even more difficult than 2015."

- CIBC Wood Gundy: Target prices on bank stocks suggest 20% + returns from mid-January levels.

Stock Market - Royal Bank of Scotland: 2016 will be a cataclysmic year, "sell everything except high-quality bonds."

- National Bank: "Overweight equities", expected return to TSX target in 2016 = 17%.
- Bank of America Merrill Lynch: "Risks have increased… significant near-term downside from current levels."
- BMO Nesbitt Burns: "2016 Surprise Recovery on the Way." TSX target return = 22%.
- John Paulson, Paulson & Co.: "There is a disconnect between the performance in the stock market and the performance in many companies… there's certainly a lot of value out there."

Interest Rates (10-year US Treasury bond, current yield 1.70%) - Guggenheim Partners: Yield to fall to 1.0% and perhaps even lower by year-end 2016.

- Wall Street Journal survey of 60 highly paid economists: average 2.5% by year-end, 3.0% by December 2017.

The Economy - Alliance Bernstein: "Global growth remains uneven and soft, concerns continue to impact the growth outlook".

- BlackRock Inc.: "… cheaper energy, more disposable income… ultimately that's going to re-accelerate the global economy… this is all good."

Oil - Goldman Sachs: "… too late for OPEC to prevent another large decline in oil prices."

- T. Boone Pickens: Huge drop in drilling means oil to double in price by the end of 2016.

Currency - Saxo Bank: From current $.73 level, the Canadian dollar will fall to under $.65.

- Scotiabank: "The worst has passed… and any near term losses are a buying opportunity" for the Canadian dollar.

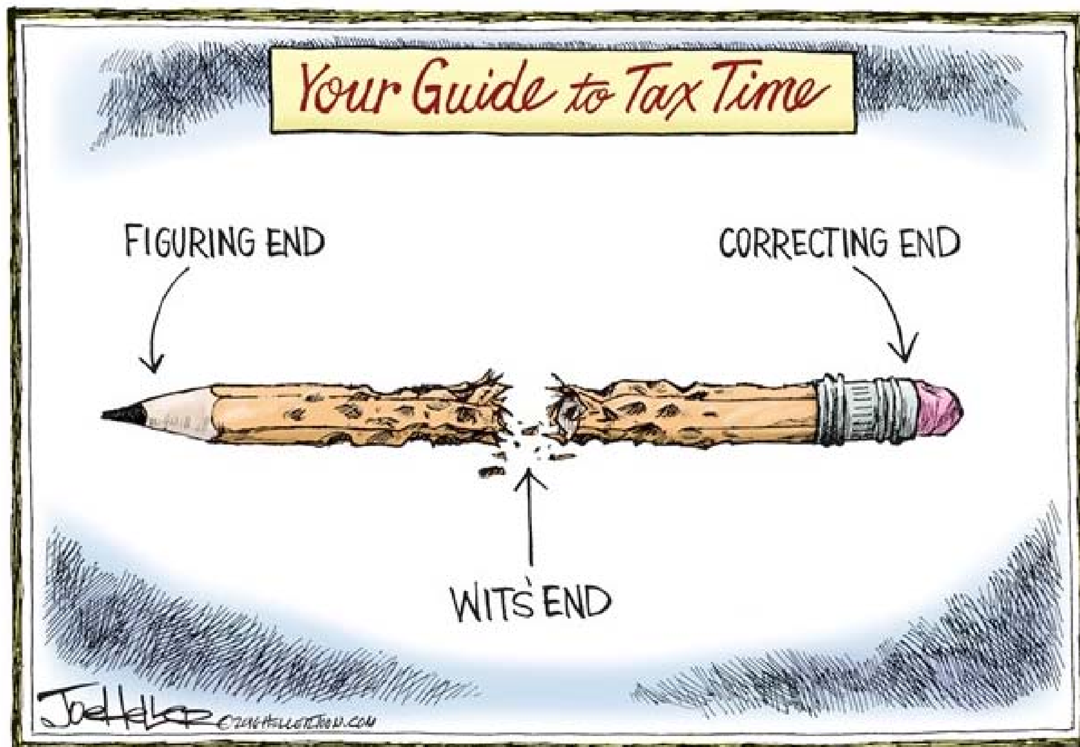
It is apparent that following the pundits works very well… if you happen to follow the right ones. This leaves us with a third option: concentrating on fundamentals, shutting out much of the daily noise and managing diversified investment portfolios that suit the needs of individual clients over a longer time horizon, emphasizing the asset class (stocks, today, over bonds) that provides the better perceived value. And that is our approach.

THE LEARNING CORNER

What is a blank-cheque company?

If your spidey sense perks up at the term 'blank cheque', there could be a good reason. A blank-cheque company, also known as a special-purpose acquisition company (SPAC), is set up as an initial public offering (IPO) to investors, with the funds raised to be employed in a somewhat undetermined fashion. 'Undetermined' is a key word here since that is where the blank cheque comes in. Investors are essentially counting on the reputation and track record of the SPAC's management team to invest their money profitably in currently unknown endeavours. If most of the funds are not deployed within two years' time, the money is supposed to be cheerfully refunded.

The reason for mention here is the recent completion of the biggest IPO in the U.S. so far this year. And it is a SPAC. Silver Run Acquisition Corp. raised $450 million in February for the purpose of buying up oil and gas assets on the cheap. What and where those assets might be, nobody knows at present, and the company has no operations or other assets. Basically, investors have provided a blank cheque to the CEO and are relying on his prior experience, and of course the depressed state of the industry, for future success. The funds raised in this manner are impressive, but the news article on this issue puts it into perspective, and provides a glimpse of what could be, with the notation that U.S. private-equity firms have raised for the same purpose a mostly unspent $100 billion. Now that's real money.



CHARTING OUR TIMES

They say that bad news sells. We do not know if The Globe and Mail sold more newspapers during the January scare in the stock market, but they sure tried. We checked out the Globe's front page (the front section that everyone sees, not the Report on Business) from January and February papers for headlines and connecting stories on the financial markets and replaced our normal chart in this space with the resultant listing. First, the mentions up to the market bottom on January 20th (January 21st paper):

- January 1: Investors Shaken
- January 8: Fallout Could Last 5 Years, Drain Billions from Economy
  China Pulls Plug on New (market) Circuit Breaker
  Canadian Stocks Sink into Bear Market Territory
- January 9: With Oil in Fast Retreat Can the Rest of the Economy Step up?
- January 12: Commodities Shock Ripples Across Economy
  Great Commodities Slump Enters Dangerous Stage
- January 21: Another Punishing Day for Markets
  Energy Stocks Take Brunt of Losses

Since that market bottom, the TSX index has enjoyed an encouraging rebound of over 10% at time of writing as left-for-dead commodities and currency both recovered nicely. And what does the Globe and Mail think of this progress? Here are the front-page news comments on financial markets since January 21st:

- January 23: Can You Trust this Little Rally?
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We have centered out the Globe ("Canada's National Newspaper") in this exercise but, in our experience, the general media shares the same tendency to blare out the bad news and downplay the good. Certainly not the best recipe for investor confidence.

IN THE OFFICE

Client Relationship Model 2 (CRM2) was instituted on July 15, 2013 by the Canadian Securities Administrators to ensure the investing public received pertinent information about their portfolios. The required changes were phased in over three years and we are now approaching the final stretch, with the last requirements coming into effect July 15, 2016.

At The RaeLipskie Partnership, we found we did not need to make many changes since we had already been providing our clients with the information requested in CRM2: quarterly statements; cost basis on securities held; receipts showing fees paid; and, performance reports which include deposits to and withdrawals from the account, change in value, and the percentage return for the previous year, as well as 3, 5 and 10 year returns, where available.

The biggest impact to RaeLipskie and its clients is the requirement to show returns annually based on the money-weighted rate of return calculation method (also known as internal rate of return, IRR). We have always provided your return using the industry standard of time-weighted rate of return (TWR). We are allowed to continue providing TWR and will do so, but to comply with CRM2, we will be adding a report to your June statement package showing IRR for June 30, 2015 to June 30, 2016. Subsequently, you will see this extra report with your December packages. Please be aware that, due to the different calculation methods, your TWR and IRR figures may be different, significantly in some cases.

We welcome the changes that CRM2 has brought to the investment industry. It requires all firms to play on an equal field. All clients will now easily be able to see information that we have deemed important to our clients in our 25+ year history.

If you have any questions about CRM2, please contact your portfolio manager.

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The RaeLipskie Partnership provides discretionary "fee-only" portfolio management for high net worth individuals, endowments and charities.

THE BIG PICTURE

Why Not This Time?

Sharply lower oil prices have been a shock to the Canadian economy. No big surprise there – one needs only look at the weight of the Energy sector in the TSX Composite Index to get a simple perspective of its relevance in Canada (even though crude oil production represents just 3% of Canadian GDP, but that's a topic for a different discussion). If we also consider what we like to call the "quasi-energy" companies (pipe manufacturers, equipment rentals, engineering providers, etc.), it's easy to see why the decline in oil prices from $105/barrel in June 2014, to the low $30s now has had a traumatic impact on the Canadian equity market and even the Canadian real economy.

But Canada, obviously, is an oil exporter. Other large and important economies are net oil importers. Despite the "shale revolution" in the U.S., for example, that economy remains a net oil importer, and on an impressive scale. Naturally, China is on the list of oil importers, as are Japan, India and a number of other substantial economies. According to the IMF (International Monetary Fund), traditionally, a 10% price decline in oil would be expected to have a 0.2% to 0.5% positive impact on global GDP. Let's see now, $105 to $35, that's a 65% decline in the price, so…..you do the math on the expected GDP impact., but let's just call it BIG for arguments sake. An interesting addendum to this relationship is that when the price decline is primarily a supply-driven event, as this cycle has been, then the positive impact on GDP is expected to be even larger.

However, watching the market, reading the news, and following the commentators would have one believe that this 65% drop in oil prices is an unmitigated negative for world economies. There is admittedly some logic to this rationale – some emerging economies that were previously seen as global growth contributors also happen to be net oil exporters and have been hurt by the decline. Despite the amazing growth in the shale oil industry's output, energy is still a tiny component of US GDP. However this is not as true when the focus narrows down to capital expenditures, a noteworthy portion of which has been fueled (pardon the pun) by domestic energy exploration. In addition, there has been some concern that consumers may not be spending their "oil dividend" – the effective tax cut of lower energy prices. With vehicle miles travelled in the US in 2015 hitting record levels, and recent US consumer spending trends moving up, that concern would seem to be diminishing.

Until someone repeals the "laws" of supply and demand (lower prices stimulate demand and smother supply), we remain optimistic that lower energy prices are not a precursor of weakening global GDP, but rather an indicator of better growth opportunities.

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QUOTE of the DAY

" Everyone has a plan till they get punched in the face."

- Mike Tyson