CIBC Wood Gundy

CIBC World Markets Inc.
606 – 5811 Cooney Rd
Pacific Business Centre
Richmond BC V6X3M1

Tel: 604 270-6457
Fax: 604 273-7684
Toll Free: 1 800 341-9909

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Summer Update

Financial markets and investor attention will always react (and sometimes overreact) to short-term events that dominate media headlines. Not that long ago, when we took a plane flight, we saw people either reading a newspaper, magazine or book; or perhaps watching a movie on a shared screen attached to the plane's ceiling. Today, we see most people with a personal electronic device. With many now reading the news online via Twitter, Facebook, etc., and having the ability to see one's portfolio value in real-time, we expect investors in financial markets are becoming more prone to trading off of short-term events.

These days, news headlines often involve Trump's latest tweets. So when we get asked about market conditions and risk in client conversations, Trump is often on the top of their mind. Our general response is:

1. He won't be there forever.
2. While not Trump fans, thus far his actions have not derailed markets. Given massive U.S. corporate tax cuts and aggressive fiscal policy, so far his (and the Republican Party's) economic policies have helped U.S. corporate earnings.
3. Trump's protectionist actions and posturing causes market jitters, but as of yet, no significant pull back in share prices.
4. From here, the dominant headlines of the day will probably continue to jump from 'Trump is doing this', to something else, back to 'Trump is saying that'- until the U.S. has a newly elected president – or perhaps sooner if the Democrats regain congress during the upcoming U.S. mid-term elections. A congress under Democrat control and a possible "Trump-unfriendly" Mueller report (on Russian/ U.S. election/ Trump campaign collusion) could lead to an impeachment vote.

While balancing risk and return these days does somewhat involve Trump, there are of course numerous other economic and political risks. The number one issue, we think, is that we are coming off of ten years of artificially low interest rates which incented a "troubling doubling" of global government debt, combined with an unhealthy increase in consumer debt (particularly in Canada). Corporations on the other hand were quite responsible in this area, until a couple of years ago, when they also joined in on the "low interest rate party". Combining the risk of a debt infused asset bubble with a bit of an over-valued stock market means a degree of caution is warranted.

Another concern is that we have not had a recession in eight years, so we are getting to the later stages of the economic cycle, thus we need to be prepared for the next economic downturn – which the stock market tends to discount in advance. Perhaps the long slow recovery from the last recession (which ended in 2010) means we can have a longer positive economic cycle; However, we are preparing for the next economic downturn by concentrating more on companies that sell goods and services that people 'need', rather than on companies that sell things that people 'want'.

When we use our traditional fixed income bond related investments as a hedge, we also see caution signals due to three main challenges:

1. Interest rates are low.
2. Interest rates are increasing which means bond prices are falling.
3. We are not earning much above the risk free rate of return on riskier areas of the fixed income market, which means we need to ensure a good degree of exposure to safer bonds; which in turn, brings us back to problem one and two.

In terms of how stock markets are performing, while up of late, declines earlier in the year mean year-to-date returns on Canadian, U.S. and European stocks are just up modestly, while the increased value of U.S. currency (on our U.S. stock exposure) is helping a bit with overall returns; and the bond market has generated just a tiny gain thus far this year, which is not a surprise given the bond market challenges outlined previously.

Having outlined these challenges and concerns, we are not overly "bearish"; cautious and prudent is how we would describe our stock, bond, and asset allocation process at the moment.

While stocks are priced at levels that look a bit overvalued, one can make the argument that they can perform fine going forward given the poor alternatives in the bond market, and a global economy that (at least for the next year or two), looks ok. Thus, we are structuring portfolios as best we can to prepare for a variety of possible positive or negative outcomes.

We hope you are having a great summer and as always please call if we can be of help with any investment, financial planning, tax planning, or estate planning matter whatsoever.

Kind regards,

The Pope Team

Neil Pope, MBA, CIM
First Vice-President, Portfolio Manager
(604) 207-8578
neil.pope@cibc.ca

Rick Aulik, CFP, CIM, FCSI
Investment Advisor
(604) 207-8585
rick.aulik@cibc.ca

Susan Christie, CFP, BA, CIM
Associate Investment Advisor
(604) 207-8570
susan.christie@cibc.ca

Melanie Burns
Client Associate
(604) 207-8583
melanie.burns@cibc.ca

Cheryl Sy, BSc
Client Associate
(604) 207-8581
cheryl.sy@cibc.ca

Sophie Tu, BComm
Client Associate
(604) 207-8576
sophie.tu@cibc.ca

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