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Market Correction: buying opportunity or more trouble to come?

The month of October saw Canadian and global stock markets fall close to seven percent; and as we write this letter, markets continue to be under pressure. Some downward movement in stock prices was expected at some point, given the long run of remarkably low equity volatility combined with reasonably good stock market performance.

We have discussed over the past year how we have prepared for markets to head 'south' at some point by emphasizing high quality in terms of stock selection. We did this by concentrating on lower risk companies that sell goods and services that people 'need' rather than 'want' and ensuring we do not fall for the proverbial trap of chasing high areas of the market (e.g. U.S. technology stocks, which have taken it on the chin of late). We also ensure that our typical client has a reasonable amount of bond related investments.

We have also discussed the challenging conditions in the bond market (namely low interest rates on safe, and even somewhat risky bonds, combined with increasing interest rates which push bond prices down). The trailing twelve-month return in the Canadian bond market – in aggregate - is negative 0.59%, evidencing this challenge. Our fixed income strategy has been to avoid (downward price sensitive) long-term bonds and ensuring high quality in terms of bond and preferred share issuers.

While taking this overall approach has helped mitigate risk, October still saw the largest one-month decline since August 2015. Perhaps this is a good time to add the proverbial words all of us financial advisers say when things go down: please try and think long-term when it comes to financial markets. Warren Buffet would surely agree. This past month saw him buy the most stocks he has in a long time.

Of late, it is protectionist trade worries, increasing interest rates, Brexit concerns and an Italian government budget showdown with the E.U. that's driving prices down. Further issues are excessive levels of government debt, and our world's various central banks now holding a whopping twenty five trillion dollars' worth of assets on their balance sheets (mostly government and corporate bonds of which a lot was bought with 'printed money'). While the European central bank and the Bank of Japan are still expanding their balance sheets, the U.S. Federal Reserve has begun selling some of their bonds back into the market. This combined with a U.S. government deficit approaching one trillion dollars means a ton of U.S. treasury bonds need to be sold, which in turn can lift medium and longer interest rates higher.

With all this negativity, what's positive?

Firstly, we have a reasonably strong global economy and very low unemployment levels in North America and Asia, plus increasing employment in Europe. Also, most companies are doing well in terms

of corporate earnings growth, and the global stock market's forward 'price to earnings multiple' is now a reasonable 15.5x earnings (due to lower share prices and higher earnings), meaning share prices now look reasonably valued.

In addition, when we see certain areas of market 'crushed', it's not likely that things will go down significantly from here. Looking at market history, it is when almost everything is trading at high prices, that markets tend to fall a lot. So what's crushed? Chinese, Turkish and Argentinian stocks, combined with 'still searching for more pipeline capacity' Canadian oil and gas producers; and junior mining stocks where prices are so low, these unloved companies will surely not register on this Christmas' speculative buyers' shopping lists.

Positives, in terms of the Canadian economy, is the reasonably successful resolution of NAFTA (assuming it's ratified by the new U.S. congress); and also the economic contribution of a (forty billion dollar) LNG facility – with the possibility of more LNG investments to come.

At this point, we conclude with little in way of predicting where markets trade in the short-term. If Warren B says he can't do that, how can we? We will say though, we do not believe we are in the early stages of financial market 'Armageddon'; and overall, at today's prices we feel quite comfortable with the investments we manage on your behalf.

While we feel we have an appropriate balance in client portfolios, in terms of risk and return, we understand some will feel concerned. Please do not hesitate to call in with any questions or to discuss your portfolio.

Kind regards,

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