Excellent Returns in 2009 Despite Multiple Risks

Total Return Portfolio *

Performance as of January 18, 2010

3 month	6 month	9 month	12 month	Since Inception**
5.01%	15.21%	25.37%	28.64%	29.08%

* Return numbers are generated using AIMR compliant valuation software (Dataphile) and represent the average Time-Weighted return of all client accounts that are invested in the Total Return Portfolio. These return numbers are Net of Fee's. These return numbers are in no way a guarantee or promise of future performance.

**The annualized return since the Inception Date of 12/15/2008.

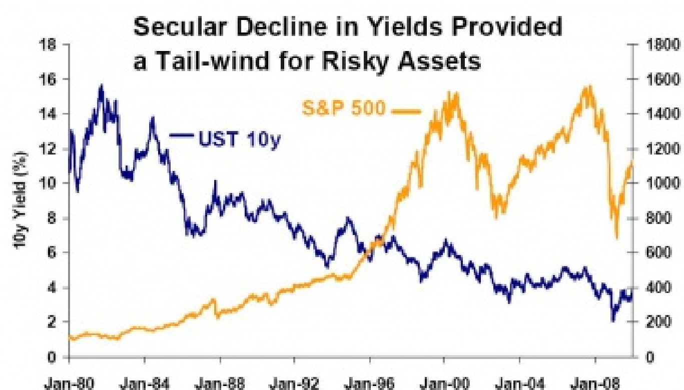
This will be a relatively succinct edition of The Armstrong Perspective. 2009 was an excellent year for the Total Return Portfolio. The macroeconomic trends that I have discussed in previous newsletters continue to affect markets. My strategies discussed in previous newsletters have yielded good results.

Macroeconomic Trends

As discussed in previous newsletters, governments and central banks around the world have generated gains in GDP through the aggressive use of fiscal (government spending) and monetary policy (low interest rates) in response to the 2008 financial crisis. However, no society has ever attained lasting prosperity through simply borrowing and spending. The fundamental unanswered question is whether the private sector will gain significant momentum before the public sector reaches the practical limits on its fiscal and monetary ammunition. The answer should be clear by the summer of 2010. The evidence of the private sector's contribution to the gains in GDP has been mixed so far, and no economic scenario, whether positive or adverse, can be ruled out yet.

What do I mean by the practical limits on the public sector? An example is the US government's finances. Deficits and projected deficits are enormous. So far America has been able to fund its deficits at low rates (partially through the Federal Reserve printing money to buy treasuries, which some would consider financial cheating). At some point though, concerns about debt to GDP ratios and inflation risks will increase and interest rates will need to rise to attract treasury buyers. Higher rates will impede the government's ability to "stimulate" the economy through fiscal spending measures.

Higher rates on perceived “risk-free” government securities raise financing costs throughout the economy and affect the value of all investment assets. The chart below is an interesting visual demonstration of the fact that ever-decreasing rates over the past couple of decades have supported asset prices. This has conditioned investors to expect unrealistically high returns in perpetuity. Consider the potential implications of the opposite trend. (Maybe some investments should have an asterisk next to their 20-year return numbers like a wind-aided 100 meter sprint time or a steroid-fuelled home run record.) Interest rates are notoriously difficult to predict, and I am not going to walk through that minefield in this newsletter, except to note that the consensus view sees rates rising by mid-2010.



Source: http://www.zerohedge.com/article/one-low-cost-capital-rule-them-all

Portfolio Strategies

I continue to believe that the Total Return Model Portfolio should have significant exposure to precious metals, energy and agricultural commodities investments in this environment. Oil recently closed above US$80 and gold briefly exceeded US$1200 in late 2009. My outlook for agricultural commodities for 2010 is positive. I have been somewhat repetitive (I prefer the word consistent) regarding these themes, but clients should understand that macro trends can take years (or even decades) to develop, especially secular commodities bull markets.

China and other newly developed nations have used this deflationary period as an opportunity to increase their global market share for commodities and raw materials. This is very long term thinking and bodes well for Canada should the secular commodity bull market continue.

Clients are also aware of my stated intention to incrementally increase the cash position in the portfolio, increase the average yield, and reduce the average volatility. These measures are a response to the fact that a significant portion of the market rally is now in the rear-view mirror. Preservation of capital is one of my key objectives. I have been executing these strategies in a patient manner. Examples are my profit-taking in CB Richard Ellis Group and Calfrac Well Services discussed in the previous edition of The Armstrong Perspective. I have also recently initiated a position in high-yielding Canadian power producer Northland Power Income Fund and I have added to a previous position in TransCanada Corp.

2010 Outlook

The financial media is now full of optimism about the economic recovery and investor sentiment is running high. This comes after all of the talk of a global depression less than a year ago. Strangely, the higher asset prices go the more confident investors seem to become about their future prospects. This inherently flawed thinking can be financially devastating to the average investor. The substantial increase the TSX in 2009 has caused me to become more and more cautious about the prospects of further downside volatility in the markets.

I am far less sanguine about the outlook for 2010, and I refuse to ride the fear/greed seesaw. When you become a client, I assume the responsibility of being your capital allocator and risk manager. A stock is a fractional ownership stake in a business, not just a piece of paper, and it makes no more sense for an investor to overpay for a stock, hoping to sell it to an even more optimistic buyer, than it does for a private individual to overpay for a private business or an apartment building. Right now there is a possibility that the market has run ahead of the economic recovery.

Using the strategies discussed above I intend to navigate the current environment and continue to achieve success in the way that we have defined it – generating satisfactory returns while keeping risk to an acceptable level. Thank you for your business, and I wish you and your family all the best in 2010!

Michael H.F. Armstrong *BA, CIM, FCSI*
Portfolio Manager

Michael Armstrong is a Portfolio Manager with CIBC Wood Gundy in Vancouver. He or his clients may own securities mentioned in this column. The views of Michael Armstrong do not necessarily reflect those of CIBC World Markets Inc. CIBC Wood Gundy is a division of CIBC World Markets Inc., a subsidiary of CIBC and a Member of the Canadian Investor Protection Fund and Investment Industry Regulatory Organization of Canada. This information, including any opinion, is based on various sources believed to be reliable, but its accuracy cannot be guaranteed and is subject to change. CIBC and CIBC World Markets Inc., their affiliates, directors, officers and employees may buy, sell, or hold a position in securities of a company mentioned herein, its affiliates or subsidiaries, and may also perform financial advisory services, investment banking or other services for, or have lending or other credit relationships with the same. CIBC World Markets Inc. and its representatives will receive sales commissions and/or a spread between bid and ask prices if you purchase, sell or hold the securities referred to above. © CIBC World Markets Inc. 2015.