Spring 2016

Investment Management

The age of intervention

The 'January Rule' says that the move in January predicts whether the balance of the year will be strong or weak, and the first five trading days of the year have a good record of predicting a similar trend for the balance of January. When the monthly January result contradicts the first five days, the rest of the year is relatively flat. When the two confirm each other, the average gain for the rest of the year (since 1932) is roughly 11.6% in 'up/up' years, and -6.6% in 'down/down' years.

Global equity markets started the year on a rough note, with both the first five trading days, and the month of January as a whole, down sharply. Based on the 'January Rule' and the 'Sell in May Rule', cash might be a good investment to preserve capital; but with unprecedented monetary and fiscal policy intervention (post financial crisis), perhaps cash is the worst investment?

We started off the year favouring stocks over bonds, the US$ over the CDN$, government bonds over corporate bonds, and an overweight position in cash. We increased that cash overweight as a result of the January sell-off. That appeared to be the right call as interest rates and commodity prices continued to fall. The global equity market sell-off pushed into February, and the CDN$ continued to weaken against the US$; however, by mid-February, commodities, including oil, caught a speculative bid, and the US$ started to weaken mid-March.

Despite the current economic fundamentals, global equity markets are back in the black, thanks to even more monetary/fiscal policy intervention and higher commodity prices; policy makers keep playing the music and investors keep dancing. As a result, we hedged all of our foreign bond exposure into CDN$'s back in March, and half of our US equity exposure earlier this month. We now have a neutral cash weight, an overweight in equities, and an overweight in corporate bonds, including high yield. While our core holdings continue to focus on quality and sustainable dividends, we have tactically invested in index exchange traded funds (ETFs) that track the S&P/TSX Composite Index and S&P500 Index to give us indirect exposure to resource stocks, but we're not ready to own any particular resource stocks directly. While international stocks appear to offer better value, the economic picture is less clear.
Intervention muddies the water and often has negative long-term consequences, but the good news is, if you can handle the volatility, the short-term results are often positive, as is portfolio performance since March.

Gordon Bell
Portfolio Manager

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Money changes everything

Our history is littered with the intrusive introductions of disruptive innovation. A disruptive innovation or technology is any development that replaces existing markets and value networks with new ones: controlled fire, gunpowder and democracy. More current examples of these innovations would be the introduction of Wikipedia and what that meant to the encyclopedia salesman; the use of plastics rather than metal, wood or glass; the evolution of chemical photography to digital photography. Automobiles are often cited as a disruptive technology but in fact, until the introduction of mass produced autos by Henry Ford, they were mainly for the wealthy and did nothing to replace the use of horses and wagons.

More recently, disruptive technologies have changed the way we communicate, the way we work and the way we entertain ourselves. Remember the video store? How about eight tracks and cassettes? When was the last time you saw a film reel break at a movie theatre? Change is constant and part of what makes us humans tick. We constantly strive for more, for better, for faster and for easier. It's the common thread in the evolution of our species.

It shouldn't surprise anyone then that innovation will soon have a greater impact on financial services. It wasn't that many years ago that our only option to make payment at a merchant was to write a cheque, pay with cash or for those who accepted it, a credit card. As times changed so did our forms of payment - people once carried large amounts of cash with them to make payments, those who used credit cards were considered less financially worthy. Today, the opposite is true, a pocketful of cash is usually a mark of those without access to credit or those who prefer to not use regular channels. In fact, there are limits to how much cash one can deposit or pay for most goods and services. Investment dealers no longer deal in cash in any amount; banks are required to record and report deposits greater than $10,000 cash to regulators.

For most of us, the days of cheques and cash as the dominant medium of transferring value are gone. We use our debit cards, smartphones, PayPal accounts, credit cards and digital currencies.

At the forefront of the digital currency evolution is Kenya. In a country where the majority of people don't have access to bank accounts, most have use of mobile phones. The currency of choice for many Kenyans is called the M-Pesa (*m* for mobile, *Pesa,* the Swahili word for money). It's a mobile phone based, money transfer, financing and micro financing service.

The technology was developed in the UK but has first been put into practice in Kenya. Much like a pay as you go phone system, you're able to go to kiosks on the street or in stores and fill up your phone with M-Pesa. You don't need a smart phone, just a regular mobile phone with internet access. You can then make payments or transfer money in any amount with anyone who accepts it: taxis, stores, businesses, services and other people can all accept this form of payment. It's based on the Kenyan schilling. In Kenya, it is no longer necessary to build bricks and mortar banks or offer teller and deposit services. In fact, the commercial banks in Kenya fought this technology but surprisingly the Kenyan government allowed it to proceed without intervention. Today they have M-Pesa interest bearing accounts, loan provisions and the ability to store value at very little cost.

While this is a currency that still derives its value from an underlying fiat currency (all currencies today are fiat currencies: that means their values are derived from the issuing governments' ability to pay rather than the physical: gold as an example). The introduction of digital currencies like Bitcoin, are causing the foundations of monetary policy and financial banking institutions to be swayed a little. By controlling the money supply and access to it, governments and commercial banks have been able to limit access to capital and thus control commerce. As digital currencies become more prevalent and evolve to the point where people are using them two things will most likely happen: central bank's ability to influence economic directions will become limited, and the cost of banking will drop. Economies will more accurately reflect their true health and people's access to financial transactions will no longer be limited by their ability to accumulate wealth.

One of the truths about change is that once you open the door, rarely can it be closed. The way we pay for things, the way we do business and the way we manage and invest our money will continue to change as surely as the Model T replaced the horse and buggy, and battery driven cars like Tesla will replace internal combustion powered vehicles. Where we go next is hard to predict, but what I can say for sure is that it will continue to change.
It's a brave new world; it always has been.

Jeff Stathopulos
Portfolio Manager

IMPORTANT DATES

MAY 2ND
TAX DEADLINE

MAY 23RD
VICTORIA DAY

Gordon Bell, MBA, CFA, CAIA
Portfolio Manager
Tel: 250-868-5522
gordon.bell@scotiawealth.com

David Allard, MBA, CFA, CFP, MFA
Portfolio Manager
Tel: 250-868-5525
david.allard@scotiawealth.com

Jeff Stathopulos, CIM, CFP
Portfolio Manager
Tel: 250-868-5521
jeff.stathopulos@scotiawealth.com

Lynette Kimmich, **CIM**
Senior Associate
Tel: 250-868-5517
lynette.kimmich@scotiawealth.com

Alanna Cooper, **CIM**
Senior Associate
Tel: 250-868-5519
alanna.cooper@scotiawealth.com

www.yourlifeyourplan.ca

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