REVIEW AND COMMENTARY - 2015

The markets in 2015 were not kind to our predictions last year. Despite our expectations of better equity performance relative to bonds and cash, the direction of oil prices significantly impacted our predictions regarding Canadian equity markets. The SP/TSX index was down 8.3% for the year and the SP/TSX Energy Index, which separately was down close to 23% over the year contributed more than half of the loss to the broader SP/TSX Index. Canadian Bonds posted marginal gains which was better than the broad composite. Despite a positive interest rate environment for income oriented investors, the Financial and Utilities indexes, which would normally respond constructively in a positive interest rate environment, posted losses of 1.7% and 3.5% despite increased dividends and the prospects of better earnings. The Canadian Bank index, as subset of the Financial Index posted a loss of 4.4% last year for the first time since 2008 when the world was in the midst of the US financial crisis. Even more of a surprise to many investors was that preferred shares prices, considered a more conservative income investment, struggled in 2015 posting a loss of almost 15% (worse than the broader composite) for the year as measured by the SP/TSX Preferred Share index. While it is difficult to explain such variances to the norm, particularly short term, one perspective is that many international investors became increasingly cautious on Canadian investments given the weakness in the Loonie. The Canadian currency experienced a loss of 19% over the year compared to the US dollar, with significant weakness in the last half of the year.

What about oil and the Loonie? In more recent history, we need only to look back to 2008 to see similar performances for the commodity and currency. During that year Energy prices were down 33% and the Loonie lost over 20%. The next year, both rallied smartly, the Energy Index gained close to 40% and the Loonie was up almost 14% which helped the broader SP/ TSX index gain close to 35%. Of course global markets all bottomed in early 2009. If we go even further back to the 1980’s when for just over the first half of the decade oil prices fell, Canadian GDP continued to expand and the Loonie bottomed about the same time as oil prices (1986). We think both oil prices and the Loonie will bottom in 2016.

Our predictions for last year were the following;

Canadian and U.S. equities will provide a better return that long bonds and cash combined.
Crude prices will end the year higher than the presently reside ($48 U.S./barrel WTI).
Interest rates in Canada and the U.S. will not go lower.
The U.S. Dollar will peak against the Cdn dollar by the third quarter 2015.

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Our equity prediction was inaccurate, most noticeably in Canada. Even without energy included the SP/ TSX would have posted negative performance. The US equity index, namely SP500 and the Dow Jones Industrial Average, posted marginal gains of 1.4% and 0.2% for the year. The concerns of many equity investors remain oil prices and the strength of the Chinese economy. Any sense of weakness in either creates a quick and pronounced reaction worldwide. Despite increasing tensions in the Middle East, crude oil inventories remain high with flat out production by the largest producers and the unseasonably warm weather tempering demand. Voluntary supply cuts never materialized from the major producers which was a surprise to us. The Saudi's have posted an estimated budgetary deficit of approximately 120 Billion Cdn Dollars for 2016- (yes, a deficit) and this is with crude price estimates higher than actual crude price levels. While the Saudi's are wealthy, they will not be able to remain solvent forever at present levels. Somewhere around $80USF per barrel is their breakeven when they include their social spending programs. They presently appear resolute to endure even lower prices and pressure more marginal producers who are unable to sustain production at present, or lower, levels for much longer. If the Saudi's are running enormous deficits, imagine the pressure the majority of the remaining OPEC producers are experiencing? Recent friction with Iran suggests that the Saudi's will not be the first to voluntarily reduce production. China appears to be slowing but it isn't going into a recession. Despite all the worry about the Chinese equity markets, The Shanghai Composite posted a gain in 2015 of almost 10%. The PBOC (Peoples Bank of China) has exerted downward pressure on their currency which has been of some assistance to equity prices but continued devaluation will create further uncertainty in global markets until stability returns to the Yuan.

Another prediction that interest rates in Canada and the US would not go lower was partially correct. Canadian bonds, measured by mid and long term composites, did post positive returns suggesting interest rates did move lower. In the US market, as measured by the US Treasury 10 year and 30 Year bonds, the returns were 1% and -2.9% respectively thus suggesting that rates in the US had gone up.

We expect the following for 2016.

Geo-political tensions will continue to increase pushing oil prices lower short term but oil prices will bottom in 2016 and improve from current levels (35USF) by the end of 2016.

Bonds will not perform as well as equities in Canada or the US.

Interest rates in the US will not be raised by the Federal Reserve as much as presently expected (four times in 2016).

Thank you for your continued confidence and patience in 2015 and all our best in 2016!