Investment Notes

September 30, 2016

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

For the quarter ended September 30th and for the Year to Date ("YTD"), the TSX Composite's total returns were + 5.5 % and + 15.8 % respectively. These results compared favorably with the S&P 500 total return (in $US) of + 3.9 % and + 7.8 % respectively. In $ CDN they were + 5.4 % and + 2.2 % respectively. The TSX's performance was heavily impacted by a rise in energy stocks which had a 20.7% weighting (+ 26.6%) and gold which had a 7.2% weighting (+ 76.8%). On a global basis, the only markets which beat the TSX YTD in price terms in local currencies were Brazil (+ 34.6 %) and Russia (+ 30.9%).

Commodities markets, while generally doing well YTD, in many cases had flat to slightly negative performances for the quarter. For example, Q/Q and YOY performances were: gold (-0.1 % and + 24.4 %), silver (- 2.0% and + 39.0%), copper (+ 0.9 % and + 3.3 %), WTI (- 0.6% and + 29.6 %), Nat Gas (0.0 % and + 23.4 %). The two exceptions were zinc (+ 13.7 % and + 47.9 %) and nickel (+ 12.1 % and + 20.0 %). Supply interruptions from the Philippines were largely responsible for the latter.

In the Canadian Federal bond markets, (2 – 30 year maturities) yields fluctuated by about 5 basis points ("BP") whereas in the US Treasuries market yield increases ranged from plus 4 BP to + 18 BP. However, in the one week since quarter-end, given the continued improvement in reported economic data, bond yields in both Canada and the US rose sharply. For example for the week, the two year government bond maturities, Canadian and US yields rose 7 basis points ("BP"); five years 11 BP; ten years 17 and 13 BP respectively; thirty years 15 and 13 respectively. We expect yields to continue to firm as we approach the Fed's next meeting however, the most we see at this point is a 0.25 % increase with an indication of likely further increases in 2017.

Commentary

Regardless of how distasteful one finds last Friday's divulgence of Candidate Trump's secretly recorded comments and whether one approves of Secretary Clinton's handling of her e-mails, stock markets are likely to shrug off whatever the US election outcome is and focus on three things: a) likely continuing improvements in the US and Canadian economies, b) expected improvements in Q/Q reported earnings and c) the impact of likely rising interest rates. While some worry about the impact of rising rates on the economies and stock markets we make three points: 1) the yield curve steepened this week which does not imply a yield curve threat to equites; 2) equity yields in both Canadian and US markets still exceed government and corporate bond yields up to five year maturities and 3) while rates will likely rise, we think the slow speed at which they rise and the relatively low levels they may reach will not impact equities to any great extent.

That said, as we look ahead to the next year we cannot ignore the seemingly major political and financial hurdles investors and markets will have to deal with. Before year-end, we are faced with elections in the US (as stated not much expected impact) and a referendum in Italy. The latter could impact markets depending on the outcome. In the first half of next year France and Germany will head to the polls and markets will have to deal with a possible Frexit (unlikely in our view) and a possible changing of the guard in Germany. Also, there could be a series of further dislocations in the Euro banking area particularly in Italy and Germany. Brexit discussions will start in earnest. And finally, Mr. Putin and his "games" will continue to add to the uncertainty.

20 Queen St. West, #3308
Toronto, ON M5H 3R3
www.globe-invest.com

Tel. (416) 591-7100
Toll free. 1 (800) 387-0784
info@globe-invest.com

However as stated, in spite of all the foregoing, equity markets to date have been taking it all in stride. On a further positive note, in spite of all the skeptics, if OPEC can finally maintain some discipline, it would auger well for energy stocks in general and Canadian in particular, not to mention the Canadian economy as activity and capex in the oil and gas sectors may start to rise. To refocus on the US economy, we see continuing improvement in consumer spending (autos and housing), residential investment, net exports (just starting to pick up), labor compensation and just starting, a pick-up in corporate profits. At this point the two drags on the economy are inventory accumulation (or lack of it) and government spending.

As for equity markets, the forecast top-down 2017 TSX earnings' estimate produces a '17 estimated price earnings ratio ("PER") of 16.2. In the US, we use two bases for our '17 estimated PER: Yardeni Research and the Thomson Reuters consensus. The former is 16.7 and the latter 16.2. So while not cheap based on historical averages, given what we think will be a pick-up in Q3 earnings and beyond and continuing relatively low yields, we remain positive.

Peter Brieger, HBA, CFA
Christine Poole, MBA, CFA
Wendy Sanita, CFP, CIM

BNN Dates:

October 12 @ 1:00 pm – Christine

October 24 @ 6:00 pm – Peter

November 15 @ 6:00 pm – Christine

December 14 @ 1:00 pm – Christine

December 19 @ 6:00 pm – Peter

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