Investment Notes

September 29, 2017

GLOBEINVEST
CAPITAL MANAGEMENT INC.

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Overview

GLOBAL EQUITY INDICES	QTD	YTD
S&P TSX Composite Total Return (CAD)	3.7%	4.4%
S&P 500 Total Return (CAD)	0.5%	5.9%
S&P 500 Total Return (USD)	4.5%	14.2%
DJIA Total Return (USD)	5.6%	15.5%
NASDAQ Composite Price Return (USD)	5.8%	20.7%
D.J. Stoxx Price Return (USD)	5.1%	18.4%
France CAD 40 Price Return (USD)	7.6%	23.1%
German DAX Price Return	7.6%	25.5%
UK Price FTSE Index Price Return (USD)	4.1%	13.5%
Hang Seng Price Return (USD)	6.9%	24.4%
Shanghai Price3 Return (USD)	6.9%	12.7%
Japan Nikkei Price Return (USD)	1.5%	10.7%
MSCI World Index Price Return (USD)	4.4%	14.2%
CURRENCIES AND COMMODITIES		
CAD/USD	3.9%	7.7%
DX/Y Index	(2.7%)	(9.1%)
GOLD	3.3%	11.3%
COPPER	8.9%	17.3%
ZINC	14.4%	22.2%
LUMBER	13.2%	22.4%
WTI	11.4%	(4.2%)
BRENT	20.1%	6.4%
BOND YIELDS	9/30/17	01/01/17
GOC 2 YEAR	1.53%	0.76%
GOC 5 YEAR	1.75%	1.09%
GOC 10 YEAR	2.11%	1.72%
GOC 30 YEAR	2.47%	2.31%
US TREASURY 2 YEAR	1.48%	1.19%
US TREASURY 5 YEAR	1.94%	1.99%
US TREASURY 10 YEAR	2.33%	2.44%
US TREASURY 30 YEAR	2.86%	3.07%

For Canadian investors, most notable was the strengthening Canadian dollar relative to the US dollar, up 3.9% in the quarter and 7.7% year-to-date. In the Canadian Government bond market, yields rose substantially across the whole yield curve. Both the Canadian and U.S. yield curves flattened, but more importantly, both remain positive, with 10 year yields higher than the 2 and 5 year yields.

Commentary

We are in the 8th year of the US economic and stock market recovery. That longevity plus the observation that equity valuations are on the high side worries some as they see geo-political, economic, political and monetary clouds on the horizon. We don't deny there is a plethora of risks, any one of which could derail equity markets' upward path, but we don't put a high probability of their happening in the near-term. As we have said ad nauseum, we expect that given the severity of the 2008/2009 recession, a full economic recovery would take longer than in the past and have lower growth rates than in prior recoveries.

However, now the global economy is showing signs of acceleration with the suggestion that US economic growth could be 3.0% this year, rising to about 3.1% next year. In this week's Barron's, well-respected strategist Byron Wein, joins Ed Yardeni in opining that the economy and markets could be in an uptrend until at least 2019. For the first time since the Great Recession, we face the prospect of a synchronized global economic recovery.

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Not much talked about to date is the good news that will follow the devastating and tragic aftermaths of the recent hurricanes. There will be massive rebuilding and reconstruction efforts, which we think will provide the US economy with a positive incremental impetus lasting perhaps as long as a year. Other positives are:

- Trump's proposed tax reforms go through maybe not in 2017 but more likely in 2018. If corporate tax rates decline from 35% to 20%, it could add as much as $10.45 to the current 2018 consensus earnings of $145.00 per share. Applying the current forward price to earnings multiple of 17.7x, it could add as much as 185 points to the S&P index;
- The US consumers' net worth is at highs and their income is rising;
- A pick-up in capital spending plans appears to be starting;
- There does not appear to be excessive enthusiasm/positive mania shown by retail and institutional investors. We will discuss the ETF phenomena below;
- The bond yield curve is positive and unless the Fed starts to raise rates more than expected, it should remain so for a while. That implies no economic recession on the horizon;
- On a technical basis, while we and others have expressed concern about the narrowing of leadership in the S&P 500, Byron Wein points out that on an equal stock weighting, the S&P is still up 8% YTD;
- Also on a technical basis, the S&P 500's advance/decline lines continue to rise and show no signs of reversing any time soon;
- Finally, US Secretary Tillerson has indicated potential talks with North Korea, which hopefully will reduce the rhetoric and fears of a hot war.

Some Negatives

- Energy prices start to rise more than currently expected. While only about 7.3% of the US CPI, a sudden upward move could increase inflation (as measured by the CPI), which might cause the Fed to become more aggressive in rising interest rates. That could negatively impact market valuations;
- If the central banks withdraw liquidity at greater rates than expected, that could hurt both bond and equity markets;
- The "800 pound gorilla" in the room is the ETF phenomena. ETF AUM growth has been exponential and this type of cash inflow we think, has largely ignored market valuations when purchasing equities. Should an "event" occur that causes investors to change their view of equity markets and start to redeem, the market impact could be quick and severe.

Summary

A recent edition of Ed Pennock's "Idea Hub", made the following observation: "It is said that while market bottoms are events, tops are processes. Translated, markets bottom when panic sets in. Therefore, they are more easily identifiable. By contrast, market tops form when a series of conditions converge, but not necessarily at the same time". We agree and

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that means that while we remain constructive on the economy and markets, we continue to be vigilant about watching conditions that may signal a market top.

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BNN Dates:

October 11 @ 1:00 pm – Christine

November 10 @ 1:00 pm – Christine

December 12 @ 1:00 pm – Christine

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