January 10, 2019

## *Post 2018, reflections!*

2018 was a tough year for investors. Most global markets endured two stock market corrections within the year. We saw U.S. stock markets jump right out of the gate, then fall more than 10% by mid-February. Prices rallied from the February low, peaked in late September only to fall by about 20% to the Boxing Day low. Naturally this prompted the talking heads to debate bear markets, recession and future doom. Canadian markets had an even more difficult year, the worst since 2008. From mid-July towards the year end low, Canadian stocks fell 17%. Global markets fared no better. From Europe to Japan, to China, stocks retreated for most of the year. All this in a year where corporate profits grew by over 20% in the U.S.!

In the 10 days since the Boxing Day lows, U.S. stocks, which were hit the hardest at the end of year, have since strengthened, recovering about half of the decline in December. We've seen a similar recovery in Canadian and global markets.

Canadian bonds, which were down for most of the year, rallied in November and December on safe haven buying, to eke out a slight positive annual return.

For the year 2018:

| | |
|---|---|
| Canada Stocks (TSX total return): | -8.9%* |
| U.S. Stocks (S&P500 total return): | -4.4%* |
| Canadian bond universe total return: | +1.4%** |

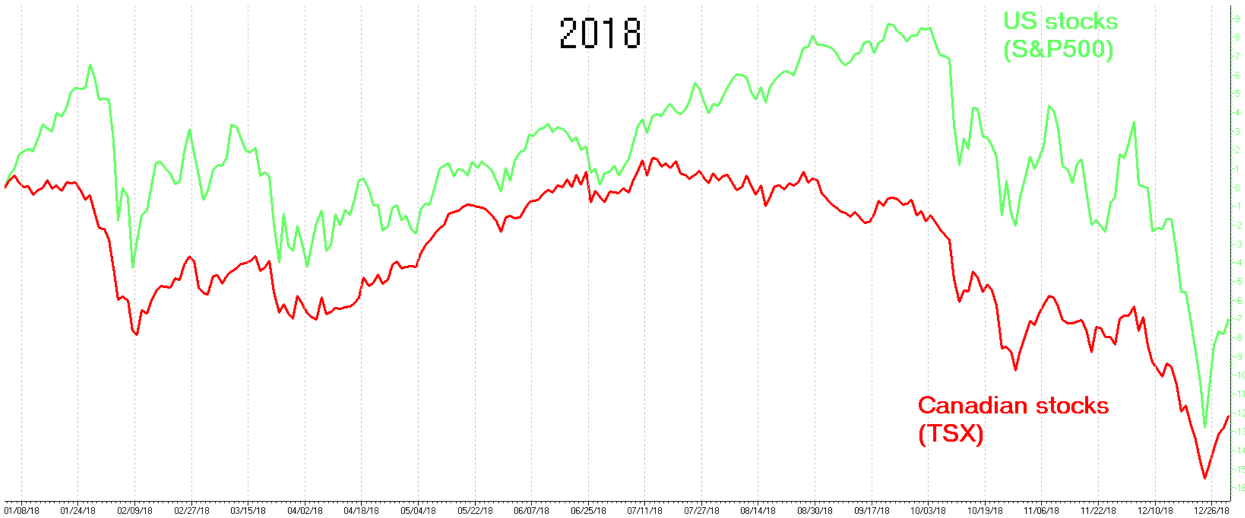
*Morningstar; ** Segals Rogerscasey Canada

Balanced investors (holding a mix of U.S. and Canadian stocks along with cash and bonds) had their first negative return year since 2008.

In today's world there are plenty of headline worries. Will Italian banks fail? What will the UK do? To Brexit or not to Brexit! After decades of globalization where most of the benefit accrued to owners of capital, and not so much to earners of wages, populism has now become well entrenched. The counter action, protectionism, enters the scene. Even so the global economy is still growing led by growth in the U.S. Market fears about the U.S. raising rates so quickly as to snuff out this expansion, have now eased, on recent comments by the Fed. Trump and his wall make for nervous headlines. Did you know that Mexico has its own wall to protect its southern border? In fact there is enough uncertainty to ensure job certainty for the talking heads for a good time to come.

So what was the cause of the panic at the end of the year? We think the extent and severity of the "sell-off" was worsened by indiscriminate liquidation of positions by about 160 hedge funds going out of business. They needed to liquidate by December 31 and so they sold, and sold, and sold! The big, "smart money" wasn't there to buy since they may have known the extent of the necessary liquidations. The market may be a measuring stick but it is most certainly a voting machine. If you make people nervous, they sell.

The market was unable to withstand the headline rhetoric from Trump, the naysayers' negativity on China's growth, the doom and gloom of Brexit, and a U.S. government shutdown to get funding for "the wall", plus a trade war with China. Add in hedge fund liquidations and "Voila".




Source: Thomson One

In late 2016 we saw the markets rally higher after the U.S. election, the "Trump bump". Exaggerated rhetoric can also damage markets in spite of positive underlying fundamentals. Perhaps now we've seen the "Trump dump".

Underneath all the headline noise, global growth is moderating but still growing. China will inject enough stimuli to boost their economy; in the UK, Britons will somehow survive themselves; Canada will benefit from continued trade with the U.S. where the government will re-open and elected officials will get paid. There are no signs of impending recession at the moment.

Until we see some resolution to these concerns, in particular trade, volatility may persist especially for the first part of the year, but we see a better 2019 as a whole. The stocks markets have priced in a profit recession which is, in our opinion, too negative. Yes, profit growth will slow, but profits will still grow and with stocks prices at these lower levels we should see good upside as some of the worries begin to fade.

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