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Q1 2014
Investment Commentary

Stock markets advanced modestly in the first quarter of 2014. The S&P 500 and TSX Composite indexes increased 1.3% and 5.2%, respectively, although the rise in the indexes masked a fair degree of volatility over the period. The S&P 500 declined almost 4% in January, before fully recovering in February and eking out a small gain in March. After significantly underperforming the S&P 500 in 2013, the TSX topped the US market in Q1 on the strength of a rebound in commodity stock prices.

After a strong run for both bonds and stocks, market commentators seem to be near evenly split over which is asset class is overvalued. The only thing many market experts seem to agree on is that one of them is overvalued! While we agree that neither stocks nor bonds are presently inexpensive, we don't believe that bond and equity bears can both be correct in this instance.

The bearish camp on equities subscribes to the view that economic activity is lacklustre and future corporate profit growth cannot justify current valuation multiples. On the other hand, the bond naysayers argue that interest rates are at historic lows, causing a bubble in bonds that will eventually burst as rates rise.

Our issue with both these investment views is that interest rates are unlikely to rise significantly if corporate profit growth is weak and equity returns turn negative. Conversely, if central bankers do see fit to raise rates, it will be because the economic growth is accelerating, unemployment is declining and corporate profit growth is healthy, all of which would presumably translate into a positive environment for equities (and a more negative one for bonds).

It is difficult to predict which, if either, of these two views is correct and this is why at Bridgeport we focus on selecting the correct asset allocation for clients given their set of particular circumstances. Over the longer term, having an appropriate asset allocation will have a greater impact on returns and risk mitigation than trying to predict which asset class will perform better over the next 12 months (which is a difficult game at best).

We added one position to our Equity portfolios during the quarter: McDonalds Corporation. The company obviously needs no introduction with over 35,000 franchised and corporate-owned restaurants around the globe sporting the famous golden arches logo. We were attracted to McDonalds due to its strong brand identity, favourable economic model ($8.5 billion of operating profits generated on $28 billion of revenue) and healthy dividend yield.

We acquired our position in McDonalds at an attractive valuation as the company has experienced growing pains recently and investors are not particularly bullish on the stock. Our experience suggests that such moments are the perfect time to purchase strong companies like McDonalds as they are rarely inexpensively valued when everything is going well and we see no long term issues with the company's business model.

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In our non-registered High Income portfolios as well as our new High Income Pooled Fund, we recently added bonds issued by River Cree Casinos, a native owned, Edmonton-based casino, and preferred shares issues by JP Morgan. Both offer healthy returns relative to the credit risk we are assuming.

We wish you all the best for a warm spring after our long Canadian winter!

Please feel free to call if you have any questions.

Yours truly,

John Fisher, CPA, CFA