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Investment Commentary

As is often the case, several major investment themes from 2015 began to reverse themselves in early 2016. The Canadian dollar, commodity prices and Canadian equities all advanced materially in the first quarter after generating dismal returns last year.

After dropping over 8% in 2015, the TSX Composite climbed more than 3% in the first quarter, buoyed by strength in the energy (+7%) and materials (+20%) sectors. Similarly, U.S. high yield corporate bonds gained momentum following a weak 2015 (-10%). U.S. high yield bonds have rallied 8% since mid-February and ended the quarter in positive territory as non-investment grade corporate interest spreads settled back to levels seen earlier in 2015.

The quarter was also highly uneven in terms of the impact that macroeconomic news had on markets. Investor sentiment leaned heavily toward fear in January as equity markets worried that the U.S. Fed would begin to aggressively normalize monetary policy (Goldman Sachs initially forecasted four rates hikes in 2016). At one point during the month, the S&P 500 was down almost 11%, while the US dollar continued to climb against most major currencies.

By February, the outlook had changed significantly as the Fed got cold feet about tightening monetary policy, appearing to shelve its earlier rate hike plans. Meanwhile, the President of the European Central Bank hinted that additional monetary stimulus might be needed to boost the European economy. These two events provided support for a significant stock market rally that saw the S&P 500 rebound over 12% from its 2016 low in mid February to end the quarter up marginally (+0.8%).

The sudden change in sentiment around monetary policy also caused a sharp reversal in the value of the US dollar against the Canadian dollar. By the end of March, the U.S. dollar had actually declined 6% relative to the Canadian dollar since the start of the year.

Returns for our client portfolios were generally flat in Q1. While many of our investments actually appreciated in constant currency terms, positive performance was offset by the decline in the US dollar, which lowers the value of our US holdings when translated into Canadian dollars on our quarterly client statements. To mitigate this risk going forward, we are considering hedging some of our US dollar exposure in our pooled funds on behalf of Canadian clients.

Finally, we wanted to share some interesting thoughts from Ethan Harris, a senior economist at Bank of America Merrill Lynch. As many of you may know, we are usually somewhat skeptical of the value of investment advice provided by economists as we believe that broad forecasts about the economy are often difficult to convert into useful investment ideas. In addition, predictions that find their way into the press are usually either extremely bearish or bullish in order to garner attention. For example, since the Great Recession of 2008 an entire industry seems to have sprung up which caters to those enthralled by the thought that the next economic apocalypse is just around the corner.

In a note to clients in early April, Harris summed up a basic truth about risk in the markets in three simple words: "it's always something". In other words, there is always risk out there. The risks just rotate and are different depending on the time period. "Doom and gloomers" always find something worrisome to point to as a reason to be out of the market, but over the long haul the trend of the market is upward and figuring out how to time the market over the short term is exceptionally difficult. One need only look to the month-to-month stock market gyrations in the first quarter as evidence of this.

Of course, these comments should not be taken to mean that investors should be blasé about risk. Rather, we manage risk by adhering to a disciplined strategy of investing in profitable and growing businesses at attractive valuations that we believe will prosper over the long term regardless of short term macroeconomic factors.

We wish you all the best this spring and thank you for your continued support.

Yours truly,

John Fisher

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