

BNN BLOOMBERG MARKET CALL

eResearch Corporation is pleased to provide two excerpts from Friday's BNN Bloomberg Market Call Newsletter.

Set out below are the respective Market Outlook commentaries from two leading investment analysts, plus Links to their respective 45-minute video interviews.

MARKET OUTLOOK

Ross Healy, Chairman at Strategic Analysis Corporation
Focus: North American Large Caps

As this bull market ages, what strikes me is that the real issue with this current market environment is that managements are no longer creating value, they are creating price. The market has also become so expensive that some of these efforts are being exposed for what they are and this is causing the market to become wary. If corporate managements have only been successful in creating price, what could be said about the outlook for the stock market? How long can a price creation market continue if we don't get some value support?

We have also witnessed some very unusual market volatility with the Dow 600 points up and then 800 points down. That is a lot of points in a short period of time. This kind of daily volatility has not been seen since 1987. In the period leading up to the break of Black Monday, the number of 2% daily swings in the market increased very substantially. It was the market's way of indicating that it did not have a clue as to which way it was going. In my experience, when market prices do not know what they want to do, they tend to fall. This is not to say that I expect another 1987 type of crash landing, however, I do not like the market's technical action.

At least two notable technical analysts observe that investor sentiment is quite poor, citing a very low put or call ratio and other measures as evidence that the market is actually quite cheap and is setting up for a good 2019. But I would like to offer another side of the issue. As Nick Taleb wrote in *Fooled By Randomness*, just because something has occurred many times at the same time as something else, does not mean that there is causality: it could be simply a randomness that looks like causality. What I see so far is not a flight to cash, but a flight of investment dollars into ETFs on the assumption that risks there are less because, well, they must be less.

My market parameters, which I have offered every month on BNN Bloomberg, have not changed by much. The floor value for the S&P 500 has slipped a bit and now stands almost right at 2,500. That puts the S&P in the centre of our range, which is bounded on the top by its fair market value for that index or 3,062 and technical support at 2,500. I expect that the bottom will hold for now, but note that I said “for now.”

VIDEO: Ross Healy's 45-Minute Video Interview <CTRL-CLICK> [HERE](#)

TWITTER: [SVInsights](#)

WEBSITE: strategicanalysis.ca

BLOG: [The Occasional Contrarian](#)

MARKET OUTLOOK

**David Driscoll, President and CEO of Liberty International Investment Management Inc.
Focus: Global Equities**

Given the sharp drop in equity markets since October 1, it is certainly a wonderful thing to be holding 20% cash multiplied by the equity weight in clients' portfolios. Despite not being fully invested, client equity holdings are up this year while the market is down. The difference is what is known as “alpha.” If an investor is up 5% and the market is down 5%, then the alpha is 10%. That is the way to evaluate a portfolio manager. If their alpha is consistently greater than 2% or more each year after fees, you have got a good portfolio manager.

The reasons behind our positive alpha are:

1. The stocks in our portfolios are companies that generate consistently rising free cash flows. They have the financial flexibility to deal with whatever the macroeconomic environment (slower growth) or politicians (tariffs, trade wars) throw at them. As a result, we have no need to trade these stocks and then incur transaction costs and capital gains tax. Instead, the clients can keep the nickels and dimes for themselves while never missing out on a dividend payment. Remember: two-thirds of all performance comes from rising dividends and the re-investment of those dividends, not stock price movement.
2. We have a fully diversified, global portfolio (both stocks and bonds) with no correlation risk. Each of the 30 stocks in the portfolio is out there in the world doing its own thing and not

competing directly with other stocks. We own one Canadian bank (TD), not all six of them. Since the Canadian banks' price performances have all been negative in 2018, we are not suffering from their under-performance.

3. We currently hold 20% cash times the equity weight in the portfolio. For example, if the asset mix is 60% stocks and 40% fixed income, the cash holding is 20% times 60%, which equals 12% cash. If it is an all-equity portfolio, the cash weight is 20%. Cash is known as a "synthetic short," meaning if you are 80% in stocks and 20% in cash, your equity exposure is only 60% (80% minus 20%) and you will not go down with the market unlike investors in index funds or ETFs, who are suffering the full brunt of this current equity sell-off.
4. Our portfolios all have a weighted average portfolio beta of less than one. This means less volatility relative to the market. If an investor had a portfolio of only semi-conductor stocks whose betas are around 1.50, their performance would be 50% worse than the market indexes. For example, if the market was down 10%, they would be down 15%.
5. The dividend growth among the Liberty global stocks has averaged 15% in 2018: about double the historical average of all publicly-listed stocks worldwide. This helps the portfolios to provide both income and growth. The faster the income grows, the greater the downside protection it provides. This is because that dividend income is guaranteed and provides cash for future purchases in a down market at cheaper prices.
6. Our bond portfolios are laddered. Think of each rung of a ladder as a year in which a bond matures. If a bond matures each year from 2019 to 2029 and interest rates rise, there will always be a bond maturing that can be rolled over into a higher coupon instrument. This is known as bond immunization. Think of it as an annual flu shot against rising rates.
7. If you own fixed income, it is important to own some inflation-protected bonds. For our clients, we have 5% of the portfolio allocated to these types of bonds. They are the only instruments that protect you from inflation on the fixed income side of your portfolio. If you own the Canadian 3% real return bond (RRB) due in 2036, the coupon is 3% plus the inflation rate (currently 2.4% in Canada), for a total payout of 5.4% for 2018. Given the current inflation rate, investors in short-term bonds or GICs are earning a "real return" (after tax and inflation) that is negative; that means their spending power is declining, not rising.
8. Being invested in international securities (stocks and bonds) gives you protection against a drop in the Canadian dollar (currently down about 5% this year against the U.S. dollar). While some may say they do not want to be invested in European markets or emerging markets, it is an imprudent comment. Year-to-date, our European stocks are up 3% while the comparable benchmark is down 11% and our investment in Jardine Matheson, a company with subsidiaries in

Southeast Asia, is up 10% against the Asia-Pacific indexes, which are down anywhere from 4% (Japan) to 21% (China).

If you own a fully diversified global portfolio, then you have nothing to worry about regardless of what is happening in the stock markets today.

VIDEO: David Driscoll's 45-Minute Video Interview <CTRL-CLICK> [HERE](#)

WEBSITE: <http://www.libertyiim.com/>

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Bob Weir, CFA, Contributing Analyst

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