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Strategic Outlook, January 2016

The past year has not been an easy ride for investors, to say the least! Were it not for our decisions to invest in securities hedged in U.S dollars, returns would have been anemic at best. At the beginning of this New Year, investors are obviously looking for an answer to this fundamental question: What can we expect in 2016? And, since the theme is about strategic outlook: What can we expect from financial markets with respect to returns and market volatility?

To get a good grasp of the issues, we need to explain the unique economic environment facing most of the developed and emerging countries. The 2008-2009 Great Recession set the stage for the use, on a very large scale, of an unconventional technique known as "quantitative easing". In simple terms, central banks proceed to drastically lower key interest rates so that credit can become widely available for businesses as well as individuals. If the latter borrow on a larger scale, the money will be used, either to purchase goods, or to produce goods and services, purchase equipment or finance capital expenditures. In short, increasing credit availability will, in theory, lead to economic recovery and, in return, avoid sinking into depression.

Six years have passed since the U.S. Federal Reserve introduced this policy and was subsequently followed by China, Europe and Japan. We can now see that the worst scenario, a global economic depression, has fortunately not materialized. The United States has accomplished the feat of reviving their economy and is pursuing a path of moderate growth. Meanwhile, Europe and Japan are struggling to achieve minimal GDP growth. As for China, its growth rate is decelerating.

For the global economies as a whole, the Organization for Economic Co-operation and Development (OECD) is forecasting rather moderate growth in 2016. Overall, we can see that the growth rate has been modest for most of the global economies over the past few years. The majority of economists with whom I consult "forecast" a lack of real strength in

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the major economies over the coming years: No recession (but no major expansion either) some deflation or some inflation (although moderate in both cases). This sums up the economic environment.

During the transition period from January 1, 2011 to December 31, 2015, financial markets posted the following gains(*):

S&P 500 Index (in local currency): 12.55%

MSCI ex-U.S. Index (in USD): 1,62%

China Index (in local currency CNY): 7.33%

Nikkei Index (in local currency JPY): 15.36%

S&P/TSX 60 Index (in Canadian dollars): 2.88%

(*) Source: Bloomberg

What explains the robust expansion of financial markets over the past six years despite an environment of moderate global economic growth?

Dear readers, this expansion is largely due to the fact that central banks intervened on numerous occasions to add "liquidity" in order to prop up financial assets. This is why there have been several phases of quantitative easing and why the normalization of interest rates in the U.S. has been deferred on several occasions. The goal was to not only avoid a depression, but also support the illusion of wealth.

On December 16th, the U.S. Federal Reserve ended its unconventional economic strategy by raising its key rate by 0.25%. According to Mohamed El-Erian, a reputable economist and strategist for whom I have great respect, we are today at a crossroads. More specifically, during a speech he recently gave in Phoenix which I attended, he mentioned that we have arrived at a point where major decisions will have to be taken.

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There are two possible scenarios to which Mohamed El-Erian assigns probabilities of 50% in either case. If we turn left, central banks will continue to intervene, will maintain negative real interest rates (nominal rate less inflation) and subject our economies and our markets to artificial conditions that no sound capitalist system can viably sustain. In that case, asset class returns in your portfolios will be lean and fragile, especially in the case of government bonds. Stock markets will certainly become more volatile. Risk will be exacerbated.

If we turn right, politicians extricate themselves from the inertia they maintain under the guise of economic austerity, take the lead and put in place strong economic policies designed to promote sustained economic growth. (Let's remember that over the past six years , none of the federal budgets have been approved in the U.S.!) Under the conditions of strong governmental leadership, markets would react positively because currently inflated asset prices could start to be validated by the real economy. This would allow for a continued expansion of stock prices with contained volatility.

In this context, it seems prudent to pursue our profit taking strategy within your portfolios and maintain higher liquidity levels in order to be opportunistic when warranted. We began this operation some months ago and intend to continue it during the coming months. I am well aware that there is a cost to maintaining liquidity in a portfolio, especially if markets soar; however, presently there is too little potential reward for the level of risk. Over the past few years, my strategy has concentrated on growth-generating assets, while the coming months will be focused on preserving profits and capital.

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News about our team

I am very pleased to announce that our colleague, Annie Bertrand, has been appointed Investment Advisor. Annie has occupied several positions and assumed various responsibilities in environments similar to ours. Over the past few years, she has actively participated in the meetings we have held with many of you. She will now be in a position to continue this relationship, but also to participate in the business development activities of Groupe conseil Wermenlinger, while continuing to coordinate our team. I have had the pleasure of working with Annie over the past twenty years and I have always been impressed by her competence and her adaptability. We all wish her a great deal of success.

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I will also take this opportunity to inform you that a new colleague, Julia Ainsworth, CFA, M. Sc., joined our team in August 2015. Her mandate involves primarily research, client servicing and business development. Julia has had a multidisciplinary education. She earned a Master of Science in Microbiology and Immunology and a Bachelor of Science in Biochemistry from McGill University. This scientific background has developed the analytical skills she applies in the financial sector, where she chose to pursue her career. Over the past few years, she has formalized her financial knowledge by taking courses offered by the CFA Institute, the CSI, the Autorité des marchés financiers and the Institute of Canadian Bankers. She earned the CFA designation in 2013. She previously worked at Richter Family Office.

I have known Julia for the past six years and have no doubt that she will be highly successful in her new responsibilities as Investment Advisor within our team.

May I take this opportunity on behalf of our team and myself to sincerely thank you for your trust and your business. It is a real privileged to serve you.

One final point. On behalf of our team, I would like to take advantage of this opportunity to thank you for the confidence you have shown. We all feel very privileged to work with you.

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Vice-President and Portfolio Manager

Mr. Laurent Wermnlinger is registered as Portfolio Manager with the self-regulatory organizations. In accordance with IIROC Regulation 1300, he is authorized to make investment decisions and to give advice relative to securities for managed accounts. Aside from Mr. Laurent Wermenlinger, no member of Groupe conseil Wermenlinger can exercise discretionary authority on the account of a customer, approve discretionary orders for a managed account or participate in the formulation of investment decisions made in the name of a managed account or in advice given for such account.
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