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Navigating the Trade Winds

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In this edition:

- ***South of the border, the year 2015 ends on a very positive note;***
- ***In contrast, the New Year is shaken by widespread investor anxiety;***
- ***The impact of a low oil price on the Canadian economy.***

Dear clients,

The patience of investors was duly rewarded with a sustained rally in the final quarter of 2015. On the other side of the border, the S&P500 propelled forward in Q4 with a 6.5% gain, this welcomed rally almost pushed the index into positive territory for the past year. The final tally was -0.7%. In contrast, the world wide appreciation of the green-back, including against our loonie, turbo charged the yearly performance of US holdings. In Canadian dollars, the gain clocked in at 10.7% in Q4 and 6.9% for the year. Therefore, our decision to favour the US market alleviated the poor performance of the S&P/TSX. In fact, the TSX ended the year well into red territory with a loss of 11.1%. The relentless descent of oil prices sealed the faith of Canadian markets and there literally was no place to hide on Bay Street.

	Closing	Change	
	31-Dec-15	Quarter	YTD
Stock Indices	**30-Sep-15**	**Quarter**	**YTD**
S&P/TSX	13,010	-2.2%	-11.1%
S&P 500	2,044	6.5%	-0.7%
MSCI EAFE*	1,013	6.0%	2.7%
Currencies			
CAN$ (US$ / C$)	0.7225	-3.8%	-16.0%
Euro (US$ / EUR)	1.0861	-2.8%	-10.2%
Commodities			
Oil (WTI)	$ 37.13	-17.6%	-30.5%
Gold	$ 1,062	-4.7%	-10.4%
Volatility index			
VIX	18.21	-25.7%	-5.2%

** MSCI Europe, Australiasia and Far East*

Well, if 2015 ended with a bang, 2016 started with a whimper. We can hear the collective moan of investors everywhere. The usual culprits were back, including the state and future of Chinese growth. This one was for the record books, the worst start of the year for the S&P 500 ever (-6% in 1st week)! If you believe in the Wall Street truism "As Goes January, So Goes the Year", then the rest of the year will be challenging. This brutal start cannot be ignored, far from it, but by the same token we cannot jump to hasty conclusions, considering that statistically speaking this truism is not entirely true. Since 1950, the S&P 500 in January has risen 39 times and fallen 27, for an average monthly return of 0.9%.

At this moment, the all-important technical levels reached in August and September 2015 are holding steady on all major US indices. We believe that the 1850-1875 levels on the S&P 500 will resist the onslaught. In terms of volatility, this past year broke one major record, the strongest weekly advance ever. Back in mid-august, the VIX exploded for 118%, week over week. It culminated in a blowout at the 53 level, and this top coincided with the bottom for the year on the S&P 500. We noticed one interesting turn of events these past days: although the "fear index" did advance noticeably, we did not witness the same levels as august, which is a positive sign.

Oil's impact on Canada

For the first time in twelve years, Oil breached the 30 US$ level and this collapse makes it hard to be optimistic for our economy. Nevertheless, our best bet is that our ailing "commodity currency" will kick-in and stimulate the expansion of our foreign trade. We believe that despite all the stimulative measures promised by the new Trudeau government, be it renewed deficit spending or negative rates whispered by Mr Poloz, that the Canadian economy will be running well below full potential.

It is important to realize that for equities, all is not lost, even though the S&P/TSX is officially in bear market territory. With the energy sector down 26% in 2015 and 6% in the first week of 2016, to say that big and small oil are in a bind is quite a euphemism. The sector alone accounts for one fifth of the TSX market capitalisation, therefore, the demise of oil is vastly responsible for the majority of the 20% correction on the TSX since the 2014 top. We are hoping that the TSX is nearing that defining moment of a corrective capitulation. Because our market is still viewed as a commodity play, the present correction did not spare other sectors as plenty of collateral damage occurred for most of the sub-indices in the TSX. We believe that in the upcoming months, the base metals will find some footing and much needed stabilization and this will support the entire market.

In the final analysis, although Canadian and foreign commodity complex companies are not out of the woods yet, some giants still want to grow and are throwing themselves in the M&A adventure. This strong trend will reinforce itself and arguably, the major predators will be American companies that are enticed by a strong currency and depreciated foreign assets. This latent market bid could act as a catalyst for the Canadian market. That being said, we must also mention that the average 3.50% dividend yield on the S&P/TSX is a strong attraction in a stable or rising market.

Conclusions and perspectives

In our opinion, there is a prevailing dichotomy between investor's perception and the true state of the Chinese economy. We must not equate a rebalanced currency with an economy in distress. As long as this currency devaluation remains orderly and well contained, we shall not be too concerned. Let us not forget that in Q4 2015, emerging and European countries surprised to the upside, including some Chinese economic numbers that came in much better than expected.

All things considered, as long as the indicated technical support levels are not violated, we shall persist in thinking that gains are very possible for 2016. Obviously, we will encounter several bouts of increased volatility, which is usually the norm in an environment where the Fed increases or indicates that rates are rising. For these reasons, we must maintain diversification in quality stocks, staying away from speculative ones. We remain underweighted in Canadian equity, as well as in commodity complex stocks, but we are monitoring the situation quite closely. Finally, the current unfavourable conditions puts an emphasis on prudence, hence, we recommend that our clients keep a portion of their holdings in fixed income.

The Alizé Capital Team