Equity Market Commentary

December Thoughts: The Iceman Cometh

North American stock markets ended 2018 with the worst quarter in 10 years, with above average volatility continuing for the 3rd month in a row. The Volatility Index, a measure of risk tolerance, increased to the highs of February 2018, levels previously not seen since 2011. It is always tough to pinpoint why markets sell-off; it is easy to place the blame on macro risk factors like US-China trade tensions, country specific issues like Turkish or Italian debt worries and bizarro Presidential tweets. However, risks like these are almost always present in investing, and while they must be monitored and assessed, their impact needs to be viewed comparatively to the size of the market. A 2% change in the S&P 500 Index represents a change in market value of $500B. December 2018 saw 6 trading days (out of 19) with a 2% or greater move up or down. It is difficult to attribute any one of these risk factors affecting broader markets to that degree, let alone the 9.2% fall in December.

Given the magnitude of the decline, we believe the market is adjusting to the expectation of a slowdown in the global growth rate. U.S. Interest rates (the initial culprit of the equity sell off) peaked in mid-November, but have since fallen back to levels experienced in the first quarter of 2018. Oil prices have collapsed. Growth stocks have been impacted considerably more than value stocks, reflecting the increased economic sensitivity of these investments. A slowdown has become evident in certain sectors of the economy: vehicle sales have plateaued; smartphone sales are declining; the semiconductor industry has excess capacity for certain types of computer chips; mall retailers and department stores are suffering, and higher interest rates and price increases have softened the real estate market.

Such is the cyclical nature of the economy. Baseball, and its nine innings, is often viewed as an analogy for the business cycle (i.e., early or late innings of the cycle). However, this oversimplifies the nuances of both. We need to consider that the length of the game can vary, extra innings are always a possibility, and even when the game ends, a new game will be played. Perhaps it’s a double-header. In the same way, markets can slow down and pick back up, expansions can continue longer than anticipated and downcycles can be quick.

December 2018

MWG Scoreboard

as of 12/31/2018

	Close	1 month	YTD
TSX Comp.	14213	-6.4%	-13.4%
S&P 500	2448	-9.2%	-6.2%
NASDAQ	6464	-9.5%	-3.9%
MSCI World	448	-7.2%	-11.2%
Volatility	25.45	40.7%	130.3%
CAD/USD	$0.73	-2.5%	-7.8%
WTI	45.41	-10.8%	-24.8%
Gold	1278.3	4.8%	-2.1%
Interest Rates (absolute levels)			
Canada 2 yr	1.86%	2.16%	1.69%
Canada 10 yr	1.97%	2.27%	2.04%
U.S. 2 yr	2.50%	2.81%	1.89%
U.S. 10 yr	2.69%	3.01%	2.41%
MWG Portfolio Returns			
Global Grwth		-5.98%	0.90%
Income Grwth		-3.81%	-7.40%

The U.S. consumer is still strong, as indicated by recent holiday shopping data. Large technology firms continue to invest heavily and generate strong profit margins. The fall in oil prices should positively affect the profitability of airlines, shipping companies and cruise lines. Healthcare spending and medical technology is continuing to grow at strong rates. Unemployment remains very low. The financial system in North America is very strong.

Moderate market corrections are typically 3-6 months in duration and year end trading for tax loss purposes may have caused additional distortions to this latest correction. We will be publishing a more detailed outlook for 2019 in mid-January, but expect market returns to approximate profit growth of 7% for S&P companies.

Global Equity Growth Fund

Target Weighting Changes

AAPL

CCO.T

Additions/Deletions

The Global Growth Fund capped off 2018 with a return of 0.90% although in the weak market of December, the monthly return was -6.0%. We are happy that our clients made money in a difficult equity environment, but attribute much of the performance to our asset allocation. With 80% of the portfolio in U.S. listed securities, the Fund's performance benefitted greatly from the 7.8% fall in the Canadian dollar versus its US counterpart. On a constant currency basis, our returns would have been more modest.

What worked and what didn't? Our large over-weights in technology outperformed on a relative basis thanks to strong returns for Microsoft (19%), Netflix (40%), Amazon (28%) and Mastercard (24%), although the outperformance was entirely front-weighted in the first half of 2018. Facebook (-25%) was the worst contributor to the group. Our consumer discretionary picks also faired mixed as BMW (-21%), Newell (-40%), Dollar Tree (-16%) while we made a trade in Costco (+16%). In Healthcare, pharmaceuticals and medical technology stocks worked while biotechnology stocks were persistently weak (although we note Celgene, the 3rd largest holding in the fund, received a significant takeover offer on January 2).

During the quarter, slightly increased our weighting in Apple while selling down the shares of Broadcom back to its target weighting on strength. We also reduced our weight in Cameco slightly as the uranium market rebalanced.

Income Growth Fund

Target Weighting Changes

APR_U.TO, CHR_U.TO, ET.TO, NWL.N

AZN.N

Additions/Deletions

SMU.UN

The Income Growth Fund lost money in 2018 with a return of -7.4%, a dismal performance mostly attributed to the weak Canadian equity markets, which makes up 80% of the fund's positions. The income fund was affected by higher interest rates that inversely affect high dividend paying share prices and the smaller size of most companies can affect trading liquidity and lead to larger losses in weak markets. We believe that the cash flow from our companies is strong and dividends yields should trend lower as markets recover.

What worked and what didn't? We had much more success trading U.S. equities earning healthy capital gains in companies such as Pfizer, Astra-Zeneca, Qualcomm and CenturyLink. Canadian equities were much more difficult, trending with the Canadian market in general. We believe Canadian equities valuations are cyclically weak as international investors pour money from Canada given its weak currency, housing and commodity dependence as well as rising business costs due to increases in regulations and taxes. It may be several years until Canada is viewed attractively as an attractive International Investment. Until then, weak valuations allow for the opportunity to collect good risk-adjusted yield for Canadian Investors.

As always, we appreciate your referrals so if you know someone that can benefit from our services, please do not hesitate to give us a call.