Advisors

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Macro Concerns… Bottom Up Opportunities ?

A year ago we wrote: “Anyone who scans the investment landscape beyond the S&P 500 should be anxious.” Market signals were flashing caution and most financial markets disappointed investors in 2015. On the strength of a strong October the S&P 500 managed to eke out a small gain of +1.38% for the year. Small capitalization (cap) stocks were roughed up by -4.41%. Europe was down almost -3% due to the strength of the dollar. Emerging market stocks plunged by almost -15% while Commodities declined by a whopping -30%. Yield hungry investors chasing junk bonds saw losses of about -5%. The Developed Market star was Japan up over +9%, a position we hold in our Diversified portfolios.

Not much has changed in a year as caution is still warranted. Hype and excitement around a few big companies are classic symptoms of a bull market top and that is what we experienced in 2015. **Goldman Sachs reported that if you exclude Facebook, Amazon, Netflix and Google (now called Alphabet) and four other big-cap companies from the S&P 500, the index would have declined by -4% last year.** The same pattern existed in 2000 and 2007 where deterioration in market internals led to broad market declines. In addition, earnings and worldwide economic growth are struggling. Thomson Reuters expects earnings and revenues to have fallen in 2015 when fourth quarter numbers are finalized. *The Economist* reported that half of big listed American firms now have shrinking profits. Copper, considered a barometer for global economic growth because of its wide range of industrial uses, fell to a six-year low below $5,000 a ton in November while global corporate defaults are at the highest level since 2009.

Despite the rather gloomy tone of the letter so far we are getting more optimistic from a bottom up stock perspective and can imagine a market pattern similar to 2000. The bursting of the tech bubble coincided with the bottoming of value and small-cap stocks. Berkshire Hathaway, PepsiCo, Anheuser Busch, Southern Co., Wells Fargo, Diageo, and small-caps all started multi-year advances in March 2000. Last year growth stocks outperformed value stocks by a huge margin of over +8%. Moreover, this performance trend has been going on for several years to the point where the outperformance of growth stocks is at an extreme. Many stocks have already experienced a bear market. **About 30% of stocks in the S&P 500 index, 37% of stocks in the S&P 400 Mid Cap index and 46% of those in the S&P 600 Small Cap index are in bear territory, that is, down 20% or more from their respective highs.** European equities are looking more interesting as manufacturing data is surprising on the upside, banks are lending again, the ECB is engaged in aggressive quantitative easing, profit margins are low and on the mend, and valuations are modest.

Our portfolios remain defensively postured like 2015 as we expect volatility to continue and want to outperform during any decline. Our equity portfolios outperformed by about 2.5% in the July to September correction last year. Regardless of short-term market turbulence we see opportunity in large cap value stocks, mid- and small cap stocks, and international stocks. **Our hope is that at some point during the year we will be able to ring the all-clear bell and invest the cash currently in the portfolio.**

James G Tillar, CFA *Steve Wenstrup*

OUTSIDE COMMENTARY

By David Rosenberg, Gluskin Sheff + Assoc.

Excerpted from Breakfast with Dave January 6, 2016

As I said on CNBC yesterday Iam not looking for a down year for the S&P 500 but am cautious over the near-term (flat is the new up).

Since I do not see a recession, and you only get successive down years in a recession, I doubt therefore that we will suffer the ignominy of another retreat in the S&P 500.

That said, after seeing returns more than triple this cycle and price-to-earnings multiples above historical norms, it goes without saying that we have borrowed returns from the future in a very major way.

As was the case in 2015, if you are buying the market, be happy with the reinvested dividend comprising much if not all of your total return.

Again, like 2015, the key to doing better than that will involve agility, opportunism, more discipline than normal (as in raising and deploying cash at the appropriate times), and having concentrated positions in the right sectors (such as being long the U.S. consumer last year which would have garnered an 8%+ return).

In general, anticipate an environment where active will beat passive investment management. We had a taste of this in 2015; expect much more of the same this year.

As for the economy, I think we will be just fine, and there will be more of the “neither boom nor bust” cycle.

Consumer spending in real terms is up 3.2% on a YoY basis. New home sales are up 9%. Housing starts by 16%. And both auto sales and production are up 6%. So while still soft overall, keeping in mind how tight monetary policy is given the dollar strength, the restraint in financial conditions from the surge in high-yield credit spreads, and a still restrictive fiscal stance, the economy is doing all right.

The key will be when net exports finally stabilize and at what point the business sector will feel more comfortable over the outlook to start expanding. Not until these two areas start to gain momentum can we talk about the U.S. economy, in aggregate, reaching or exceeding a 3% annual pace.

Now that would probably justify multiples closer to where we are today, but is a trend that has remained elusive for a long, long time – we have not seen a “three-handle” on real GDP growth since 2005. Is that you, Godot?

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