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Keeping In Touch

Further to my email on Friday with regard to the decision of the Britain to leave the European Union, I wanted to further comment on the issue and provide some of the commentary that has been provided over the weekend from certain fund managers and economists. I, along with many of our portfolio managers do anticipate more market volatility going forward until the negotiations begin sometime in the fall. Volatility is nothing new as we have had volatile markets on a number of occasions during this last 8 year bull run in the markets. Corrections are common and provide buying opportunities. Portfolio managers take advantage of these times to buy more of the individual stocks and bonds that they want to own in their investment funds. They buy and sell for the longer term, which is why we invest for the longer term; to take advantage of these dips in the markets. We want to own good companies and be diversified for the longer term and in doing so we reduce our overall risk to current and longer term market volatility. Individual stocks with very little correlation to the geographic area of volatility tend to trade down due to overall global market negative sentiment.

With markets such as we have today, the key is not to go all-in with new buys as the markets drop more before they settle out and move upward again. If one is invested in good stocks and funds, the key is to remain diversified, collect dividends and wait for the market to rebound. At current levels today in North America the S&P/TSX is up 5.2% year-to-date and up 15.6% from its lows in mid-January. The Dow Jones is down 1.6% year-to-date and up 7.8% from its mid-February lows and the S&P 500 is down 2.1% year-to-date and up 9.8% from mid-February. Obviously, European markets are not fairing as well during this time and are also being hit with a much lower British pound that is creating further volatility in the foreign exchange markets. As I mentioned, we are not tied at the hip with the European Union market but we are not immune to the negative global market sentiment.

We are in the early stages of what could ultimately be a recalibration of the European Union. Of note, is the fact that the vote to leave the EU was a vote of non-confidence not merely on the economic association with the EU but more so on the political issues surrounding the unrestricted borders and immigration into the United Kingdom. David Cameron is steadfast in his commitment to fulfill the will of the people and pass the reins of Government over in early fall to a new Government whose mandate is to begin negotiations with the EU. This process could take as much as two years to complete, however it appears to be very clear that the intent is to establish a close economic and political alliance with all EU countries going forward as well as all countries in the Commonwealth, North America and Asia. It is the uncertainty that is affecting the markets as uncertainty creates volatility, impacts financial markets, affects currencies and overall tends to slow global growth. There is the possibility of a mild recession in the UK while all of this is getting sorted out.

What we are seeing in the Canadian markets is a downturn in the prices of commodities, primarily oil due to the forecast of slower growth. As well our banks and insurance companies are trading down due in part to the anticipation of lower interest rates for longer, but the drop is mostly market sentiment. As Scott Barlow reported in the Globe and Mail this morning, “Europe should have very little or no effect on Canadian Bank profits. Any selloff in domestic banks will almost certainly be sentiment-driven, not a reflection of endangered profits.”

What we are seeing in the US markets is a strengthening of the US dollar as money flows are seeking safety in US treasuries. Slower growth globally will affect US companies that trade globally and this is affecting such big names as Johnson and Johnson, Coca Cola and most global brand names. Likewise, China whose currency is pegged to the US dollar is experiencing a decline in exports as their currency makes it more expensive for countries to buy their goods. On the flip side, stocks in the UK are on sale because of the double whammy effect of the markets in turmoil and the British pound trading at 30 year lows to the US dollar. Given all of this, the Bank of England issued a statement that it is not concerned as it feels that the British banks are well capitalized and the Bank of England has in excess of $250 billion pounds in reserve to shore up the currency and provide liquidity should it be required.

So much remains unclear as to what the next few months will bring. In this communication, I wanted to attempt to explain what has transpired on Friday and over the weekend. The media, as I have always felt, picks the news bytes that catch one's attention as that is what they do. They provide catch-all numbers of stock indexes that most investors can relate to, which makes sense. To their credit, when they are reporting, they do capture the overall trend in the markets on which current market sentiment is related. Bear in mind that most investment portfolios, while owning some of the stocks that are part of the index, also are invested in other stocks, bonds and cash that provide the diversification and buffer when stock markets are volatile. Once again, quality and diversification along with a reasonable time horizon have a significant impact on the risk inherent in a balanced portfolio over the longer term.

Below is a link to a film clip from Philip Peturrson, Chief Investment Strategist for Manulife Investments who was on BNN this morning. His commentary relates to the Canadian markets and how they will be affected by the UK negotiations for leaving the EU.

Click here to hear more from Philip Peturrson

To summarize, the situation is still in the early innings so to speak. It is more a crisis of confidence and not a financial crisis as it was in 2008. Markets will continue to exhibit volatility in the short term. There could be concerns of other countries wishing to exercise their option to leave the EU and as before there will always be concerns of the economic issues with other EU countries such as Greece, Italy and Portugal. Our markets in North America will continue to be affected both negatively and positively by economic and political sentiment in not just the UK and European countries but all developed markets globally. These events only serve to reinforce the investment strategy of owning quality investments, diversification geographically and within asset classes and do not stray from one's investment mandates.

I will continue to monitor all portfolios and make any recommendations as required. In the meantime, please give me a call if you have any questions on this or in relation to your investment portfolio.

Take Care

Trevor

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