January 2017

Uncertainty remains a theme in 2017

By Alfred Lam, CFA
Senior Vice-President and Portfolio Manager, Multi-Asset Management

Happy new year to all of our readers!

Last year was full of surprises – Britain's decision to leave the European Union, OPEC's decision to cut oil production, Donald Trump winning the U.S. presidential election and the subsequent sell-off of sovereign bonds on higher inflation expectations, to name a few. All of these events led to changes in asset prices. Some benefited our portfolios while some did not. We invested diversely and generally defensively, and our portfolios finished the year with positive returns and low volatility, especially when compared to the changes in individual asset classes in response to these events.

The Canadian stock market was the world's best-performing developed equity market in 2016, partly because of the strong rebound in energy and other resource sectors. We did not fully participate in the downside of the market in previous years when commodity prices were correcting aggressively and in 2016, we did not fully capture the upside. We continue to benefit from not owning Valeant Pharmaceuticals, a former top-performing company in the Canadian market whose share price has fallen consistently for another year. Our balanced and equity-centric portfolios reached new highs at year-end while the income-centric portfolios were moderately lower compared to the peak values reached during the fall of 2016.

Going into 2017, we remain defensive as stock valuations are above fair value and the "Trump effect," which has pushed valuations higher since the election, is still largely an unknown. We recognize that change can lead to a positive or negative outcome, but the markets seem to be putting too much weight on the bright side. No one knows whether new governments and their policies will result in inflation or deflation, or economic growth or contraction. Furthermore, holding cash may not offer the best protection in a world filled with uncertainties. For example, U.K. residents who held cash to protect against uncertainty from Brexit did not achieve their intended result. While the face value of the cash (sterling) has not changed, its purchasing power has decreased as a result of the depreciation of the currency.

We expect only modest growth from the stock markets, and some downside pressure if Trump fails to deliver on his growth promise. The good news is that the opposite outcome – lower-than-expected growth – likely will lead to lower inflation expectations and higher bond prices. Investors should pay equal attention to both asset classes and consider the upside and downside of "Trumponomics." News headlines may convince investors to favour the upside but the risk of under-delivery should not be ignored. Until there is more clarity and valuations become compelling, our portfolio positioning will be "boring" based on our decision to protect capital, backed by our process aimed at buying low and selling high.

Combined top 15 equity holdings as of December 31, 2016 of a representative balanced Private Client Managed Portfolio with alpha-style equity exposure*

1. Altagas	6. SNC Group	11. AT&T
2. Wells Fargo	7. Loblaw Companies	12. ICICI Bank
3. Atco	8. E-L Financial	13. Accor
4. CIBC	9. Toronto-Dominion Bank	14. Canadian Natural Resources
5. Suncor Energy	10. Mullen Group	15. Cap Gemini

Combined top 15 equity holdings as of December 31, 2016 of a representative balanced Private Client Managed Portfolio with value-style equity exposure*

1. Royal Bank of Canada	6. CCL Industries	11. UnitedHealth Group
2. Toronto-Dominion Bank	7. Alphabet	12. Suncor Energy
3. Bank of Nova Scotia	8. Apple	13. American International
4. Microsoft	9. Manulife Financial	14. Mitsubishi
5. Chubb	10. Canadian National Railway	15. Keyera

*Approximately 37% fixed-income, 7% enhanced income, 49% equities and 7% global real estate.

To see the top 15 holdings of the individual United Pools or of the United equity Alpha mandates, please contact us.