Quadrant
ASSET MANAGEMENT

Moody Markets

QAM Perspectives – April 2016

Quadrant's regular newsletter that highlights topics we believe will affect markets or are important in understanding them.

¨With every new wave of optimism or pessimism, we are ready to abandon history and time-tested principles, but we cling tenaciously and unquestioningly to our prejudices."
Benjamin Graham, The Intelligent Investor

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Q1 2016 in Review

The first quarter of 2016 was a rollercoaster ride as equity markets came out of the gate with a steep descent followed by a steady upwards climb. The New-Year-Selloff began with resurfaced concerns about slowing growth in China and the decline of oil prices. Many investors grew even more fearful as talk of a global recession, banking instability, and deflation came to the forefront.

The second half of the quarter essentially reversed the loss of the first half and resulted in global markets finishing relatively flat for the quarter (give or take). An apparent bottom in the price of oil and a resurgence of global central bank support appeared to be the basis of the rally.

This V-Shaped trajectory over the period shows us how fickle investor sentiment can be. The market correction activity at the beginning of the year was reminiscent of the correction that occurred at the end of August 2015. Both instances saw fairly significant drawdowns followed by a relatively quick reversal. One could argue that we are currently in a "sideways" market with no clear upward or downward trend. Market swings are seemingly driven by sentiment as opposed to fundamentals.

The S&P/TSX Composite Index in Canada returned 4.54% over the quarter. The Energy and Materials sectors led the charge as the price of oil pushed up above $40 and gold experienced its strongest rally in 25 years. Valeant Pharmaceuticals dominated headlines in Canada for the third consecutive quarter as it fell by over 70% following a slash in revenue forecasts and concerns that the company wouldn't meet some debt covenants.

The S&P 500 Index returned 1.35% in USD terms, but after the CAD currency conversion it translated into a loss of 4.90%. The currency translation benefitted Canadian investors with US holdings as the Loonie declined during 2015, but it worked in the opposite direction this quarter as the Canadian dollar appreciated alongside the price of oil.

The MSCI EAFE Index finished the quarter lower by about 8.84% in CAD terms. The appreciation of the Loonie was a factor in the negative performance, but the fundamental factors arose from the Eurozone which faced a number of problems including non-existent inflation, negative interest rates that put pressure on banks' profitability, and security concerns over the March terrorist attack in Brussels.

Equity Market Total Returns (in CAD dollars)	Q1 - 2016	1 Yr	3 Yr	5 Yr
Canada (S&P/TSX Composite)	4.54%	-6.58%	5.02%	2.09%
S&P/TSX Capped REIT Index	10.68%	-2.34%	2.61%	6.35%
U.S. Large Caps (S&P 500)	-4.90%	4.17%	21.29%	18.26%
U.S. Small Caps (Russell 2000)	-7.60%	-7.65%	15.90%	13.64%
MSCI EAFE	-8.84%	-5.65%	11.48%	9.03%
Germany (DAX)	-9.60%	-9.57%	13.15%	8.72%
MSCI Emerging Markets	-0.83%	-9.64%	3.91%	1.96%

Fixed Income Total Returns (in CAD dollars)	Q1 - 2016	1 Yr	3 Yr	5 Yr
Canada Universe Bond Index	1.19%	0.29%	3.54%	4.80%
Canada Real Return Bond Index	1.61%	-2.70%	1.23%	4.08%
US Investment Grade Index	-3.30%	4.37%	11.12%	9.97%
US High Yield Bond Index	-4.16%	-4.99%	8.30%	9.42%
US Treasury Inflation Protected Index	-1.45%	3.51%	7.60%	9.15%

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The two very distinct and dissimilar halves of Q1 2016 illustrates the temperamental behaviour of the markets. In January, investors were battening down the hatches and preparing for a seemingly imminent crisis. Oil was below $30, the Loonie traded at 68 cents to the US dollar, high yield debt was being abandoned, and China was going to spark a global depression. Fast forward to March and oil was trading above $40, the Loonie jumped to 77 cents on the US dollar, high yield debt was popular again, and China was back to a steady growth outlook.

What are we supposed to make of this? Do we heed the warnings of the January market or do we embrace the confidence of the March market? The answer is somewhere in the middle. When valuations on the aggregate appear to be more fairly valued as opposed to inexpensive, risk management becomes the main priority.

As a result of the relatively weak earnings outlook, most strategists expect modest stock market returns over the balance of the year. We are making sure portfolios are rebalanced to the long-term asset mix for each particular client. We at Quadrant believe that most of the negative impact from lower oil prices may have already occurred, but are also cognizant of the complexities of this commodity - too complex and too lacking in transparency to be discussed intelligently when it comes to short-term price movements. What we do know is that the energy sector makes up a smaller weight in the overall indices and the S&P/TSX has the potential to outperform the S&P 500 after five years of lagging it.

The emotional and psychological discipline required to stay calm and make rational decisions in turbulent environments is often overlooked. We continue to believe that long-term investors are going to be well served by investing in a well-diversified portfolio that reflects their risk tolerance, time horizon, and income & liquidity needs.