2015 – A Year of Volatility and Unpredictability …. As expected

QAM Perspectives – January 2016

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

At the beginning of each New Year, we at QAM like to look back at the previous one and try to make sense of what happened, as well as look forward to what the upcoming year may bring. This year was certainly a mix of highs and lows as well as many market surprises.

In the past year, QAM has discussed the ways in which the reactions of investors to market movements can hurt them (see "Human Nature Can Hurt Your Portfolio"), as well as the various ways to measure that performance (see "Real Returns"). The larger trends which buffeted the financial markets in 2015 were, however, not new to the minds of investors. Names such as Greece, China and, above all for Canada, oil, were never far out of the headlines in 2015. The impact of declines in both the energy and commodity prices, and the corresponding rise of the U.S. dollar, all affected the investment landscape.

"If you aren't confused [about the current state of the economy], you don't understand things very well."
Charles Munger, Vice Chairman of Berkshire Hathaway.

Broad equity markets rose in 2015 but increasingly few names drove the major equity indices higher, while the majority of stocks in those indices declined. In the U.S., equity markets were flat for the year in local currency even as the average stock in the S&P 500 fell into correction territory (10% decline). A group of stocks labelled within the industry as the "Nifty Nine" advanced enough to mask this broader weakness in the market. Canada was not immune from this phenomenon either, as a single holding (Valeant) led the TSX higher in the first half of 2015 before negative news sent the stock reeling and, with its main support pillar gone, the Canadian index declined, finishing the year off in a loss position.

Equity Market Total Returns (in CAD dollars)	Q4 - 2015	2015
Canada (S&P/TSX Composite)	-1.40%	-8.33%
S&P/TSX Capped REIT Index	-3.73%	-4.74%
U.S. Large Caps (S&P 500)	10.45%	20.69%
U.S. Small Caps (Russell 2000)	6.92%	13.80%
MSCI EAFE	8.15%	18.80%
Germany (DAX)	12.49%	17.69%
MSCI Emerging Markets	3.75%	1.40%

Fixed Income Total Returns (in CAD dollars)	Q4 - 2015	2015
Canada Universe Bond Index	0.97%	3.30%
Canada Real Return Bond Index	1.15%	2.10%
US Investment Grade Index	2.65%	19.63%
US High Yield Bond Index	0.23%	10.99%
US Treasury Inflation Protected Index	2.26%	16.09%

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ASSET MANAGEMENT

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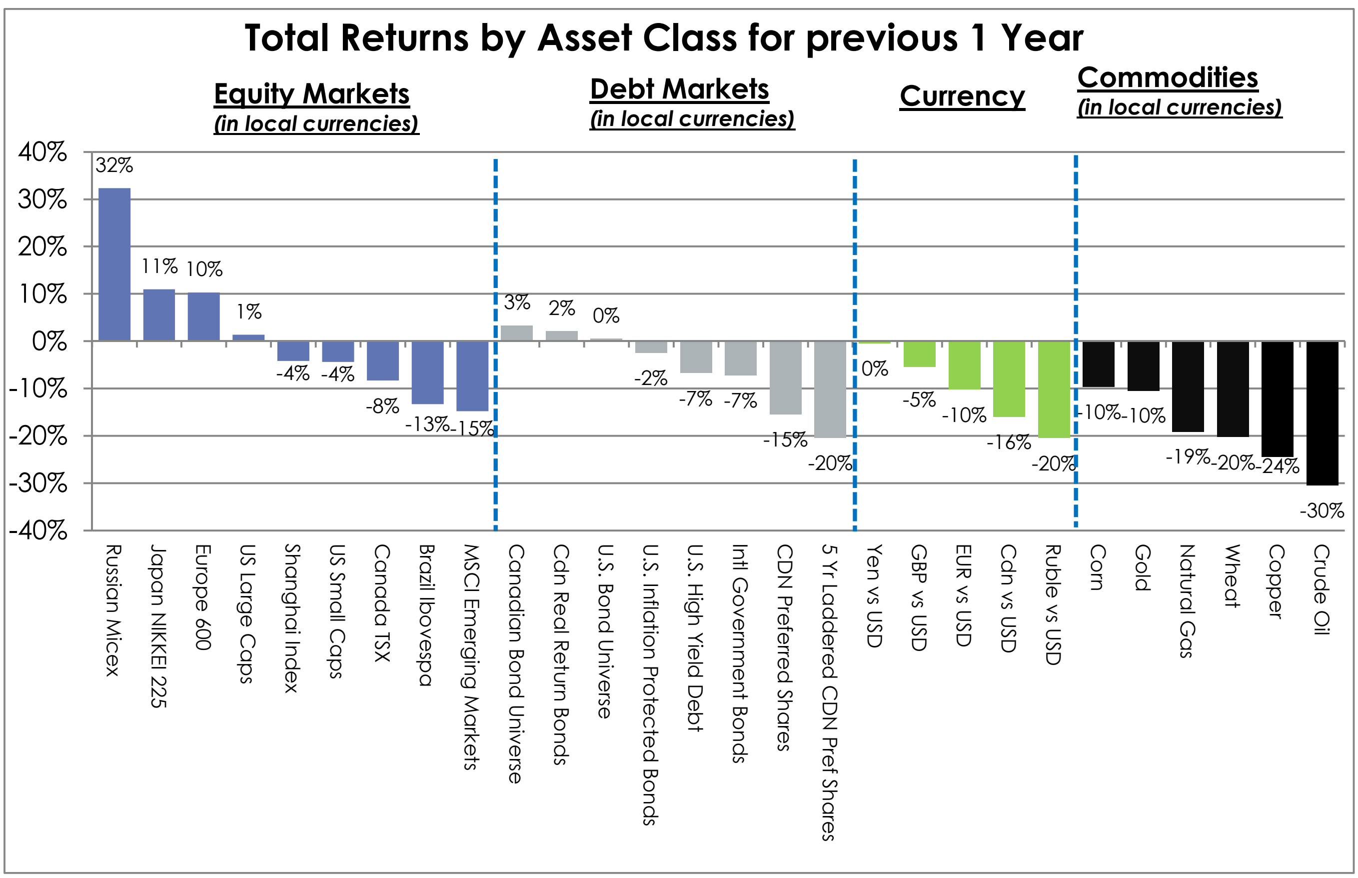
Weakness in commodity and energy prices spread into the wider Canadian economy in 2015, leading Canada to fall into technical recession in the first half of the year. In an effort to use monetary policy to help stimulate the economy, the Bank of Canada cut its benchmark interest rate twice. These declines in Canadian rates combined with the fall in the price of oil led the loonie even lower in 2015. The loonie depreciated 16% in total over the year ending at .72 cents US (the lowest level seen in 12 years). The loonie's fall highlights the importance of being internationally diversified since it limits the investor's exposure to any one country or currency. Just as important for Canadian investors is the sector diversification benefits which international holdings bring. The Canadian market has long been exposed to the energy and materials sectors, so by holding U.S. and international stocks, investors reduce their exposure to these volatile sectors.

In 2016 we see divergent expectations for interest rates in Canada vs the U.S. In Canada where the economy continues to be buffeted by low oil prices, the expectations are for the Bank of Canada to stand pat on rates or to even cut them again. Meanwhile, in the United States, the Fed began the process of normalizing interest rates by raising the Fed funds rate which has been near zero since the financial crisis of 2008. Expectations are that the Fed will continue to raise interest rates over 2016, albeit at a slow pace. Surprisingly, inflation has yet to rear its head despite the massive amount of currency printed by the Fed and other central banks over the previous few years.



Globally, 2015 was a story of a strengthening US economy and weakening commodities. Fears of a slowdown in global growth, as the Eurozone went through yet another "Greece " chapter and as China continued to transform its economy from one based on exports to one based on consumer spending, had ripple effects on commodity prices. The growth rate of China is virtually impossible to know. The Chinese government claims its economy is growing at high single digit rates, however, electricity production and other data tell a much different story. Expectations over the year of the Fed finally beginning to normalize rates had an effect of strengthening the US dollar against all other major currencies.

Looking forward to 2016, one macro trend which will continue is the spread of the effects associated with the decline in the price of oil. Low oil prices have already been in effect for a year now and the longer prices continue to remain low the more these effects will spread into the wider economy. Various producer countries around the world such as Iran, Russia and Venezuela are all dependent on high oil prices in order to manage their budgets and ensure domestic tranquility. How these countries will react to the fall in the price of oil will continue to vary.

In the very last update of 2015, we talked about what ultimately matters most for investors in the long term. That is being disciplined and sticking to a properly diversified portfolio. Portfolios should be designed to ensure that they strike the proper balance of risk and reward for the long term and are able to ride out the short term volatility which is inherent in the financial markets. We at QAM are constantly monitoring our portfolios to improve insulation from market gyrations. For investors with a long investment horizons years such as 2015 can be helpful to their portfolios as it allows investors to buy good companies when they are momentarily out of favor and, therefore "on sale".