# REVIEW AND COMMENTARY- 2017

2017 was a positive year for the SP TSX index as it posted a gain of just over 9% (total return). This compares unfavourably to the SP500 which returned over 21% (in US dollars). For Canadian investors who invested in the index, or other US denominated stocks, returns were muted by a strengthening Canadian currency; the SP500 in Canadian dollars returned 13.9% in 2017. While we have been positive on oil prices for the past few years, we were surprised that the SP/TSX Energy sector returns were negative for the year. The Integrated Oil and Gas sub-sector of the Energy Index was down 3% for the year, smaller Exploration and Production companies fared even worse. We certainly were surprised the price of the more senior oil companies had done so poorly relative to the price of crude oil (sweet) which was up approximately 12%. Gold shares were weaker as well losing 2% in 2017. Both Gold and Energy sectors hold influential weightings in the SPTSX (5.2% and 19.7% respectively as of the end of 2017).

Of the more influential SPTSX sectors Financial and Industrials were up nicely. Industrials with an index weighting of 9.5% were up just under 20% and financials (approximate weighting of a third of the index) posted gains of 13.3%. The Material sector representing 11% was up 7.7% for the year.

For 2017 we made the following predictions;

1) **The TSX SP Composite will hit new all-time highs in 2017.**
2) **Equities will again outperform medium and long term bonds.**
3) **Pullbacks in the equity market will be an opportunity for those under-invested in equities to increase their exposure.**

Despite stronger crude oil prices and relatively weak prices of publically traded Canadian oil companies the SPTSX index did hit new highs and continues to do so at the time of writing. While debates rage about the future price of crude oil prices, it wouldn't be hard to imagine that even if crude prices stabilized or even moderated, decent value remains in this sector. Obviously the influence of US equities was significant. All major US indices hit new highs in 2017. The US economy, prior to the Presidential Election, was gaining strength and continues to improve. U.S. employment statistics remain strong and the passing of a tax reduction policy prior to year- end had fulfilled one of President Trump's pre- election promises. While it would appear that the tax breaks for individuals may not be as wide spread it certainly will be beneficial for corporations. Lower taxes usually translate to higher profits which under most circumstances propel stock prices higher. *A rising tide….*

Again, our second prediction was accurate as well but not to the extent that we had thought. Canadian mid and long term bonds returned 1% and 7% respectively. Most of the return occurred in the fourth quarter of the year. Compared to the 9.1% return on the SPTSX index returns were less but we were surprised at the performance strength of long bond both in Canada and the United States markets given the Central Banks of both companies starting to increase base lending rates. With the prospects of inflation increasing in the upcoming year, it is unlikely that long bond returns will be equally compelling in 2018.

Finally our last prediction did prove sound. Those who were underinvested coming out of 2016 would have done well to increase their equity exposure throughout 2017 however there were few instances where the markets corrected significantly. Again, if we look at the US equity markets it would appear that not only the promise of a tax cut would be passed but the Republican Administration has verbally also been more big - company friendly than the previous administration. Obama and Clinton (if she had been elected) appeared determined to reign in big corporations in terms of their pricing, policy and procedures. The Trump administration appears to be far more indulging citing that they support less regulation than more which translates positively to almost every sector particularly finance, pharma and technology. While some consider the equity markets expensive, particularly in the US, we don't share this perspective. Instead we consider the US equity markets fairly valued. However, we are more than aware that the length of the bull market is above average but this is not an appropriate valuation metric when discussing relative value. It is when markets appear significantly under or over- valued that opportunities arise.

Our philosophy of investing in predominantly large cap dividend paying companies with a long term positive outlook continues to provide positive returns for long term investors. While it is tempting to look at high growth companies (re cannabis and bitcoin related companies) our experience is that quick returns are never sustainable over the long term. This doesn't undermine the potential of these investments both short and long term prospects, however as fiduciaries, it is important for us to be consistent in our philosophy and advice.

For 2018 here are our predictions;

1) **Market volatility will increase in 2018**. We would expect a correction in equities sometime this year in excess of 10%. While it is impossible to predict what and when might cause it, our concerns would be that the odds are increasing of a geo-political incident. It would also appear that with the release of recent books *Collusion* and *Fire and Fury*, the present US Administration may be distracted from constructive policy change. Of course, if present discussion lead regulators and politicians to further revelations of improprieties of President Trump's administration then this too will contribute. The important issue here is that market corrections are impossible to predict and even if we are correct, knowing when or at what level (it could be from much higher levels) is impossible.
2) **Long bonds will provide negative returns in 2018**. Barring a significant or severe geo-political fall-out in which Treasuries will be coveted as a source of safety, North American economies will continue to grow and prosper. Basic lending rates will increase throughout the year adding downward pressure on bond prices as will the inevitable return of inflation. While inflation expectations will increase, inflation should increase moderately.

3) **Equities will continue to outperform fixed income.**

Thank you for your continued confidence and all our best in 2018.