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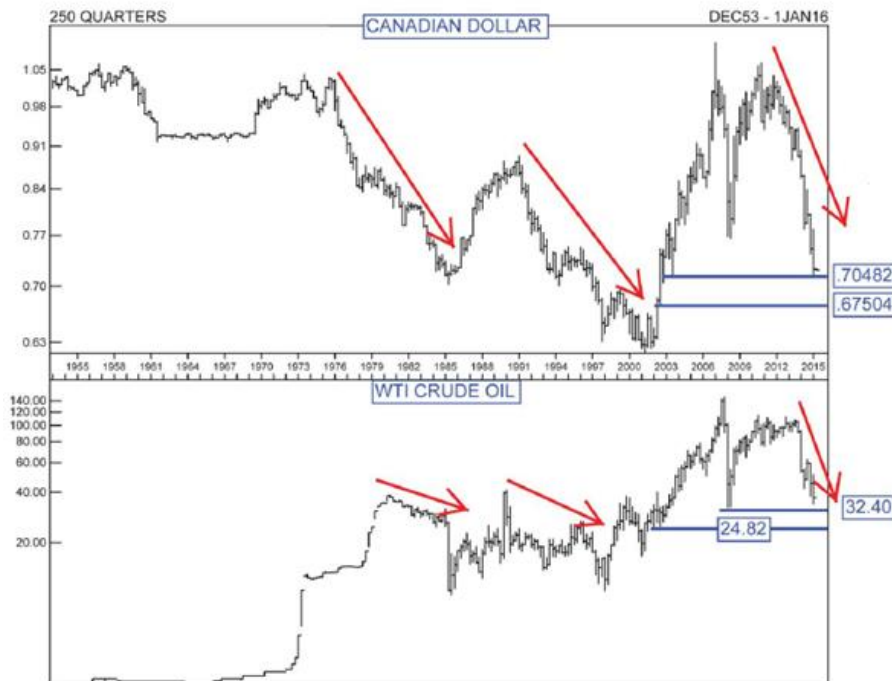
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### Year End 2015

This past year could be summarized as all about energy. Caught between falling demand from China and elsewhere and rising supply from the United States and elsewhere, the price of oil declined 30.5% to US\$37.04. The Toronto stock market index declined by 8.3%, and the Canadian dollar fell 19.1% versus the US dollar. The chart below illustrates that the Canadian currency remains a petro-dollar.



Source: RBC Capital Markets Trend & Cycle – 2016 Canadian Technical Outlook – Jan 6, 2016

Stocks in 2015 have had to cope with weak corporate earnings, declining commodity prices and slow global growth. After a horrible start to 2016, as this letter was in production the S&P TSX is in bear market territory, down 20% from its high in August 2014, not including dividends. Joining energy stocks in the tank were mining companies which were trounced in 2015. Dividend stalwarts like Canadian banks and pipelines were also influenced by energy's

rout. The S&P TSX has now underperformed the S&P 500 for 5 years running. Hard assets (the TSX) have underperformed paper assets (the S&P 500). This is a kind of trend that has persisted for years.

### S&P TSX Versus S&P 500 from 1965 to 2015



Source: RBC Capital Markets Trend & Cycle – 2016 Canadian Technical Outlook – Jan 6, 2016

In 2015 the US stock market (S&P 500) was up 1.4% including dividends and measured in US dollars but up 20.7% when measured in Canadian dollars. After the first few days of January, the S&P 500 is close to a typical correction zone, almost 10% below its peak of February 2015. The stocks that went up the most in 2015 were the ones that went up the most in 2014, which is a pretty good definition of momentum stocks. And so a new acronym was born. In 2015 investors did well who owned FANG (Facebook, Amazon, Netflix and the company formerly known as Google, now Alphabet). Those internet behemoths' large market capitalizations heavily influenced the S&P 500, a cap weighted index. According to Barron's (January 2, 2016) the average stock in the S&P 500 lost almost 4% in 2015. The stock market's breath, as we say, stank.



Of the four FANG stocks only one, Google, has much in the way of profits at the moment. Incidentally, when Wall Street popularizes a new abbreviation things may be due to change. Who remembers PIIGS (Portugal Ireland Italy Greece Spain) that were considered basket cases when that acronym was coined or, BRICs (Brazil Russia India China) that were considered economic stars when that abbreviation was popularized? In 2015 Emerging Markets were down 17% in US dollars.

Fixed income markets were unusually exciting in 2015. In Canada the Bank of Canada cut short term interest rates, twice, to 0.50% and in the US the Federal Reserve raised rates, for the first time since the financial crisis, to 0.25%. According to RBC, at this writing (January 6, 2016), futures markets are putting a 34.7% probability that The Bank of Canada will cut rates on March 9 and by contrast a 44.2% probability that the Federal Open Market Committee will hike rates at their meeting on March 16.

Canadian Government ten year bond yields went down and high yield corporate bond yields went up, in part because of the distress felt by energy and mining firms. Rate-reset preferred shares, many of which were issued after the financial crisis, plunged as holders realized that their dividend rates were resetting lower, not higher, as had been expected.

New international rules requiring banks to hold more collateral capital have had two interesting effects in the fixed income markets. Banks get extra credit for holding collateral in the form of retail deposits so Guaranteed Investment Certificates (GICs) with terms from one to five years yield considerably more than government bonds yet GICs carry Canada Deposit Insurance Corporation coverage up to \$100,000. Secondly, banks will be issuing preferred shares to meet the new regulatory requirements. These new preferreds will be “non-cumulative” and are “contingent”: that is they can be forced to convert into common shares if the bank gets into financial difficulty. These new bank preferreds will replace older issues and will be a challenge for the preferred share market overall. When it comes to fixed income investments, GICs and preferred shares will remain a focus in 2016.

In the stock market we will continue our longstanding emphasis on reliable dividends and, we will seek to invest ahead of social trends that we think will be valid for a long time. I like to think of those long term trends, in sail boat racing terms, as staying on the lifted tack. Sailors recognize that winds are constantly oscillating and they try to head in a direction that is favored by longer lasting shifts.

An unfavorable shift whose persistence I clearly underestimated last year was the crash in the price of oil and its ramifications for other parts of the Canadian economy and stock market. The Energy sector accounted for fully 51% of the TSX Index decline in 2015.



A recent selection is Corning Inc. I have been invested in Corning several times over the years which makes it an old friend. Corning Glass Works was founded 160 years ago and Corning's specialty glass is used in display technologies, fiber optics and environmental technologies. Corning trades at 12 times earnings and with a dividend yield of 2.7%. The winds of change are I think mostly in Corning's favor. For example, a few days ago Corning announced that the Ford GT supercar is the first production vehicle to use lightweight and strong Corning Gorilla glass in a windshield. There is a lot more glass in a windshield than in a smart phone. I hope to use periods of market weakness to build up a position in Corning Inc. this year. For those seeking good infotainment, I'd recommend Corning's presentation at this year's Consumer Electronic Show – The Glass Age. It is available on Corning's website: <http://www.corning.com/worldwide/en/innovation/the-glass-age/the-glass-age-today/ces-2016.html>.

Isabelle, Kristin and Margarita join me in wishing you all the best for the upcoming New Year!

Sincerely,

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Portfolio Manager, Vice-President  
*Please visit us at [www.georgestedman.com](http://www.georgestedman.com)*