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First Quarter 2016

In the first quarter stocks made a V: plunging until mid-February then soaring for six weeks until quarter end. The Canadian stock market, which had been about the worst in the world for a year or more, was among the best in the world in the month of March. The S&PTSX returned 5.3% in March and 4.5% in the first quarter. By contrast the MSCI World Index had a price return of negative 6.8% in the first quarter.

After peaking in May 2015, the S&P 500 has now gone 10 months without making a fresh high, an unusually long stretch. Volatility has picked up noticeably, on a daily and monthly basis. US stocks fell 10.5% from the start of the year until February 11, and then rallied 12.6% into quarter-end. Measured in Canadian dollars, the S&P 500 returned 2.6% in March and lost 4.7% in the 1st quarter. In US dollars, the S&P was up 6.8% in March, 1.3% in the first quarter.

The stomach churning slump into mid-February and the bounce back, to me, is a reminder of the benefit of diversification. The unusual volatility of the last 12 months has spawned any number of predictions and punditry. The more sensational it is the more attention it gets (and I don't mean to discuss politics).

Some five years ago I was asked to advise a recently bereaved and emotional investor. On the advice of an internet seer she had invested substantially all her inheritance into silver bullion after it had had a multi-year run. I don't know how that story ends but I do know that at the time I was unsuccessful in persuading her to diversify by, among other things, buying some dividend paying common stocks (did I mention that this was in 2011). Recalling that prognosticator's advice, and, seeing Raoul Castro on TV last week and reminisces about the Cuban Missile Crisis of 1962, when we all almost died, brought to mind a vignette from a book that I stumbled across a few years ago. Robert F. Kennedy's Thirteen Days a memoir of the Cuban missile crisis was published in 1969 after he had been assassinated. Bobby Kennedy had been charged by his brother John F. Kennedy to



coordinate US tactics and strategy in response to Russia's nuclear armed missiles in Cuba. About one pivotal meeting, Kennedy wrote:

Bob McNamara [Secretary of State] presented the arguments for the blockade; others presented the arguments for the military attack [...] One member of the Joint Chiefs of Staff, for example, argued that we could use nuclear weapons, on the basis that our adversaries would use theirs against us in an attack. I thought, as I listened, of the many times that I heard the military take positions which, if wrong, had the advantage that no one would be around at the end to know. (Norton, 1969, p.48)

That investment guru that may've offered ruinous advice electronically likely didn't have to deal with the emotional consequences. The bank economist who said to 'sell everything ahead of stock market crash' as The Guardian (Jan. 12, 2016) headline read might be right but in investing there is little difference between being very early and being wrong. It is like a hedge fund manager, paid for performance, who has every incentive to swing for the fences. When placing winning bets they get to share in the profits. When they lose big (in the investment business the technical jargon is blowing your client out of the water) they close the fund, hit the beach for a couple of years, then start a new fund and try again.

Investors who've been the victim of disastrous advice might not get a second life's savings. I take my responsibility seriously, and I stay diversified to avoid financial Armageddon.

You know of the Warren and Charlie show, the Berkshire Hathaway Annual Meeting, the Woodstock for capitalists, (this year for the first time it will be webcast, on April 30th). Hardcore fans know that 92 year old Berkshire Vice-Chairman Munger (who doesn't say much at Berkshire meetings) is Chairman of the Daily Journal Corporation, a legal publisher based in Los Angeles. At the Daily Journal meeting Charlie holds court. In March 2015, according to "not a transcript, just detailed notes" published by Forbes (Google it; Munger Daily Journal – please, they're great) Munger was asked about any unintended consequences of ultra-low and negative interest rates; Munger said that in his whole life he'd never seen anything like it, and answered; "Anybody who is intelligent who is not confused doesn't understand the situation very well. If you find it puzzling, your brain is working correctly."



I'll go out on a limb and say that one consequence of low interest rates has been cheap financing. For a number of years corporations have been hoarding cash but recently some interesting corporate mergers have been announced. Here is a sampling from 2016's first quarter:

Algonquin Power and Utilities Corp. (AQN) in January closed the purchase of Park Water (three small water utilities in Southern California and Western Montana) for US\$327 million and, in March proposed the acquisition of Empire District Electric for US\$2.4 Billion. EDE is a regulated utility with electric, gas, and water distribution businesses mostly in Missouri but also in Arkansas, Kansas, and Oklahoma. AQN will be 85% in the US after this transaction.

CCL Industries in March announced its intention to buy Checkpoint Systems Inc., which makes anti-theft tags, for US\$400 million, the largest of a string of acquisitions that CCL has done in recent years.

Fortis Inc. in February announced the purchase of ITC for US\$11.3 billion. ITC is an electric transmission utility in Michigan, Iowa, Minnesota, Illinois, Missouri, Kansas and Oklahoma.

Johnson Controls has made plans to spin-off their car parts business and to merge their building efficiency business with Tyco, which is headquartered in Ireland. At the moment it doesn't appear that the Treasury Department's new tax inversion rules, which are designed to discourage companies from moving to countries with lower tax rates, will greatly affect their plans.

McCormick & Co. in March disclosed that they had offered to buy the British company Premier Foods plc, the maker of Oxo cubes and Mr. Kipling cakes, for 537 million pounds, US\$762 million. Talks continue.

Progressive Waste Solutions put itself for sale late last year and in January received a takeover offer from Texas based Waste Connections. Waste Connections intends to keep the combined company's headquarters in Toronto to take advantage of Canada's low corporate tax rates. The combined company will be generating 75% of its revenue in the US.

TransCanada Corp. in March announced its plan to buy Columbia Pipeline for US\$13 billion. Columbia's assets will give TransCanada a strategic foothold in the US Northeast.



The deal will be financed in part by the sale of TransCanada's Mexican operations and by the sale of their US power assets.

We'll see how these deals progress over the summer.

Sincerely,

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