RICHARDSON GMP

Global Trade Negotiation Helps Smaller US Stocks

Trade negotiations and tariffs are positive for smaller US companies that sell most of their goods domestically. The US stock market has been one of the few things that has made investors money this year. Companies in exporting nations are in a weak position during these trade disputes.

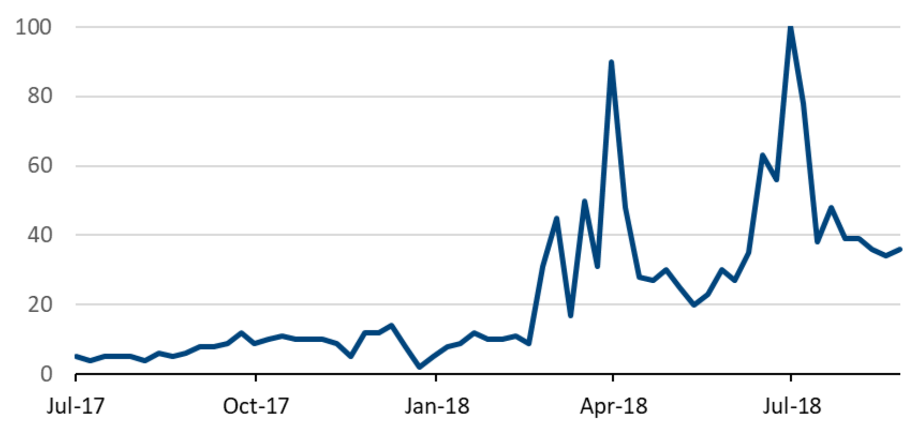
Global protectionism contributed to inflation and interest rates moving upward, off uncomfortably low yields. Inflation and price growth are frequently positive for owning stocks and physical assets (commodities, land) while being troublesome for fixed income and yield products.

Earnings in the United States have been fantastic this year. Underlying fundamental growth has been a solid foundation for US stock gains. Valuations tend to be expensive, but not excessively so.

Market volatility has increased in 2018. Having a modest cash buffer can allow some active trading while investments have larger price movements.

Uncertainty helps investors get their risk tolerance right.

Prevalence of "Trade War" in Financial News Articles



Note: Worldwide news searches in all categories; Numbers represent search interest relative to the highest point in the past 12 months.
Source: Google Trends (www.google.com/trends), Credit Suisse, MRB

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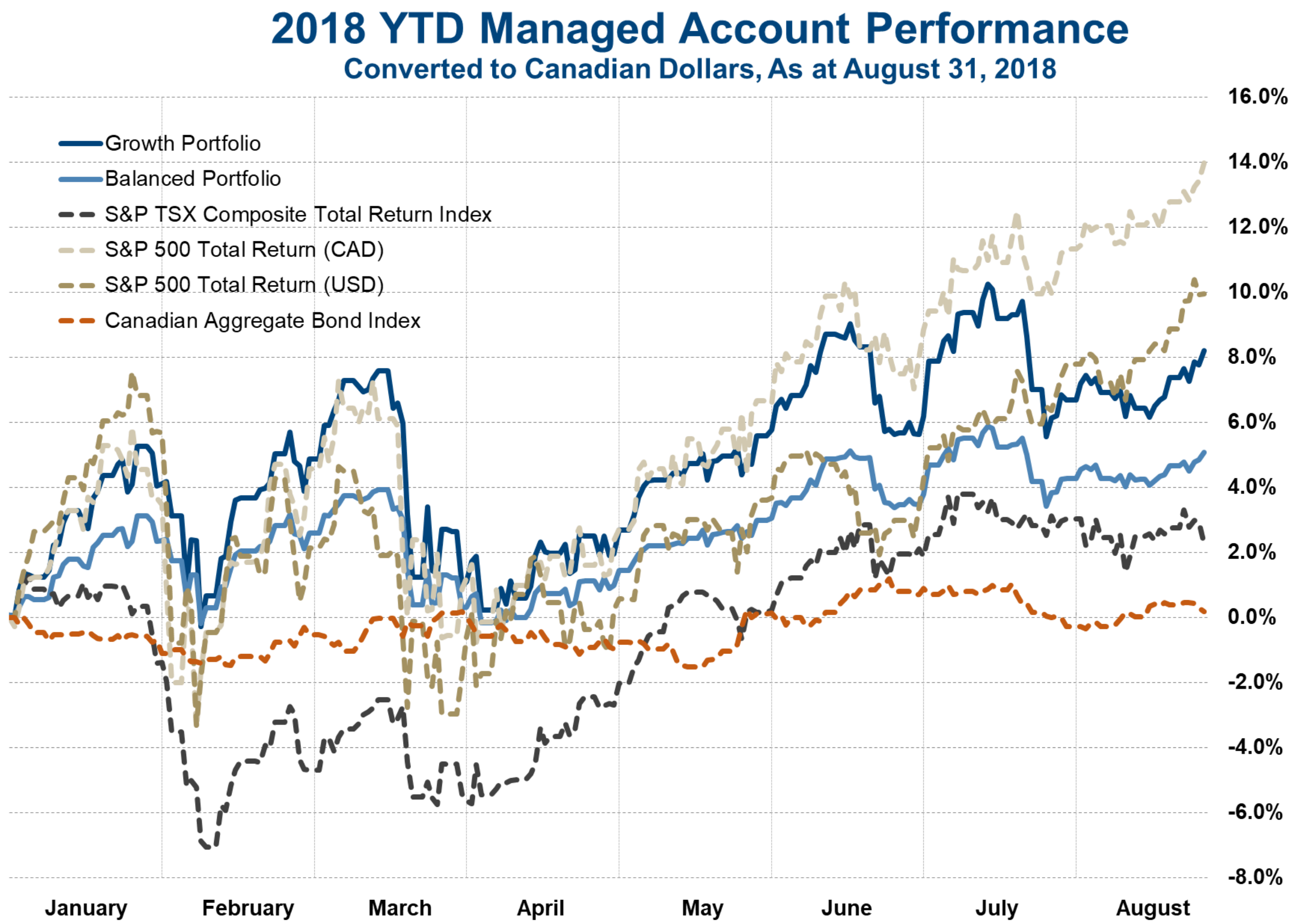


Growth Portfolio is one specific growth-oriented managed account. The asset mix was approximately 80% equity, 5% fixed income, 13% alternatives, and 2% cash.

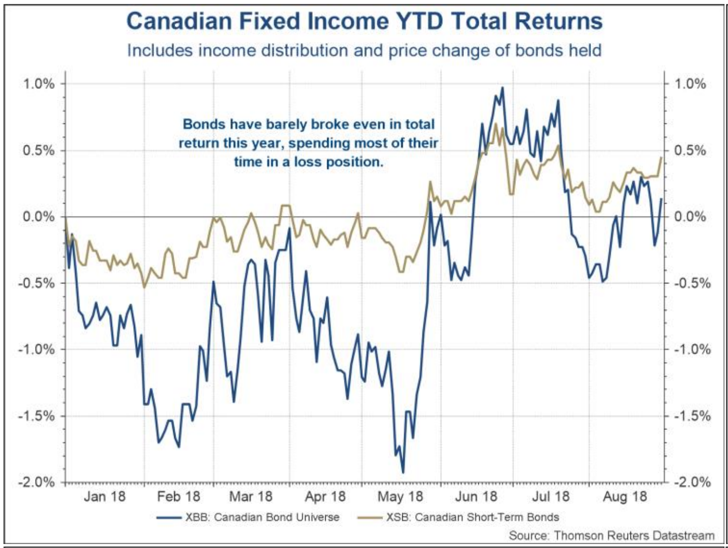
Balanced Portfolio is one specific balanced managed account. The asset mix was approximately 47% equity, 35% fixed income, 15% alternatives, and 3% cash.

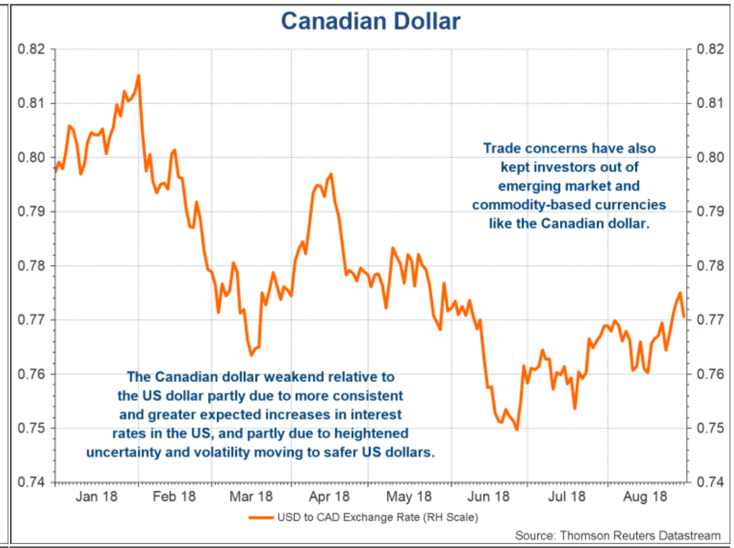
Selected accounts are considered representative of growth and balanced portfolios across most managed client accounts. The level of cash varied throughout the quarter. Individual managed accounts vary in results due to customization. Deposits or withdrawals to portfolios, and the resulting implementation of changes in securities held represents the largest cause for differences in accounts. Client-directed and non-model securities held in managed accounts can also result in a significant performance difference from the average experience.

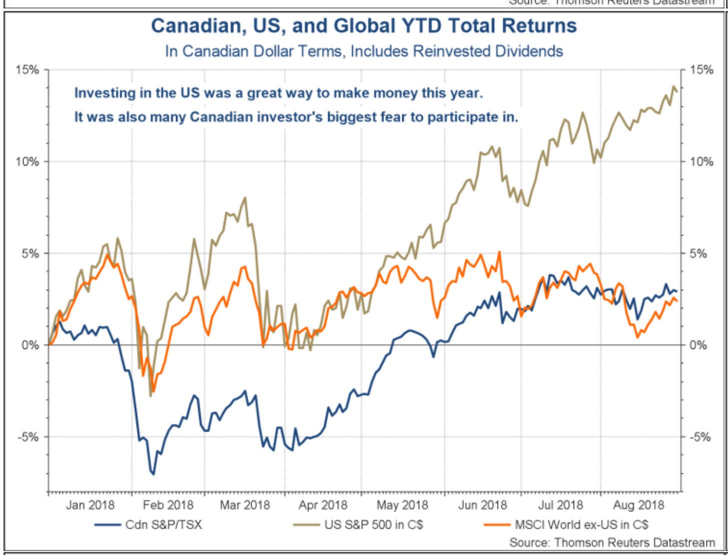
Owning a global portfolio and investing in corporate bonds rather than government ones has made a significant impact this year. The managed growth portfolio has earned close to quadruple the Canadian benchmark (after fees), while the managed balanced portfolio has achieved well over (~4% above) what a balanced Canadian equity and bond portfolio has earned.

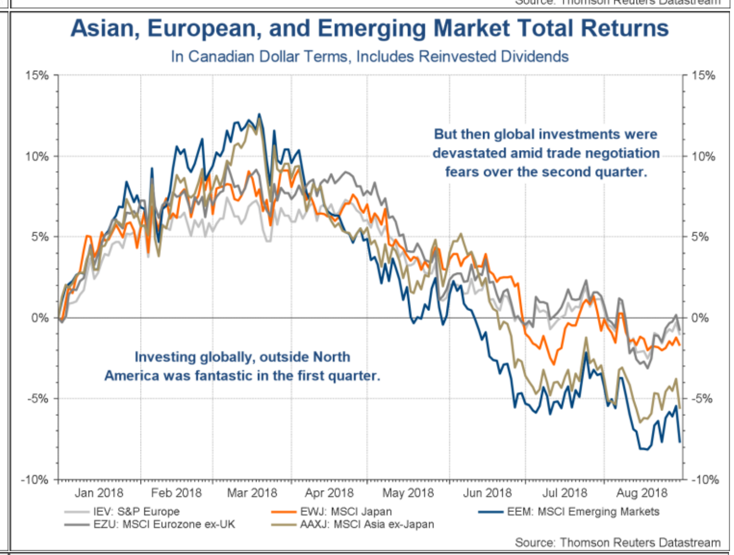
It seems easy in hindsight that owning US securities made a lot of sense. Many Canadian investors seem reluctant to invest in US companies because of politics, trade negotiations, and media coverage. They also express concern over owning stocks when they are around their highs. A large part of the value we add is to keep investors on track with their financial plan, their investment policy, and focused on the underlying earnings and economic situations of markets. Disciplined investing with less emotional distraction leads to consistency.

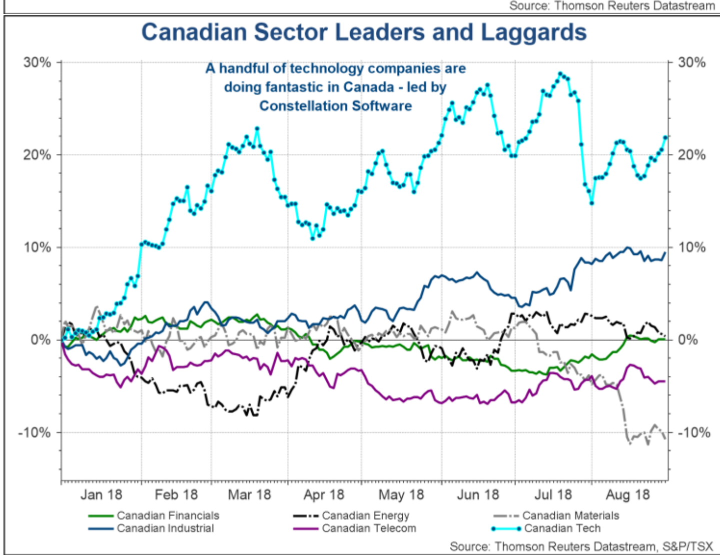
2018 Year-To-Date Key Markets Perfomance

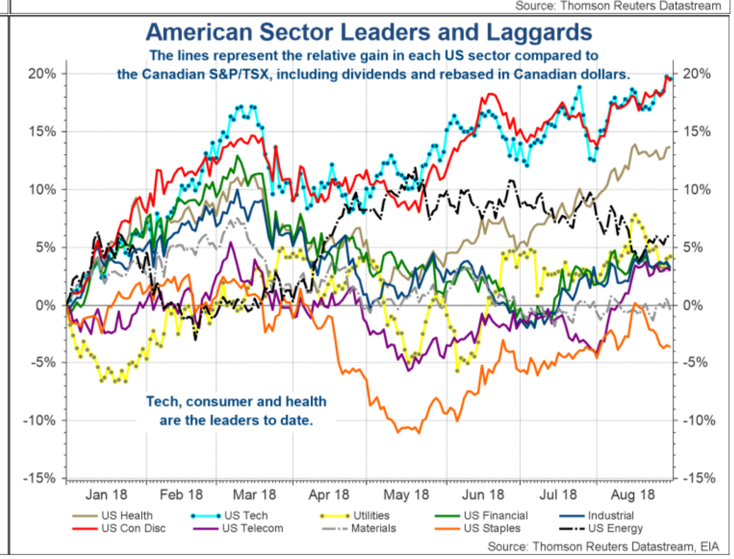










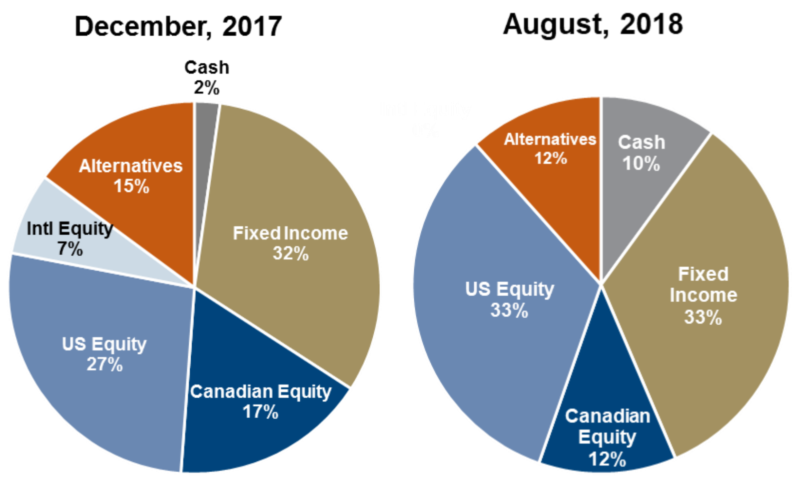


Positioning in Managed Portfolios

Money came off the table. Stock market volatility in 2018 has been double that of the prior year. There have been fewer areas of consistent market leadership. Our tactical model owns a few themes (discussed below) but also suggests holding some cash because of greater uncertainty.

Fixed income remains at a low weighting. The balanced sample client portfolio depicted to the right targets 45% invested in fixed income, but currently holds only 33%. Interest rates still have a bias of increasing over the next several months in North America, but at a fairly slow pace. The "premium" for investing in corporate and riskier bonds is becoming fairly narrow. Investors need to be selective in taking credit risks associated with owning corporate bonds, and ensure they are sufficiently compensated.

Balanced Account Managed Portfolio
Asset Mix

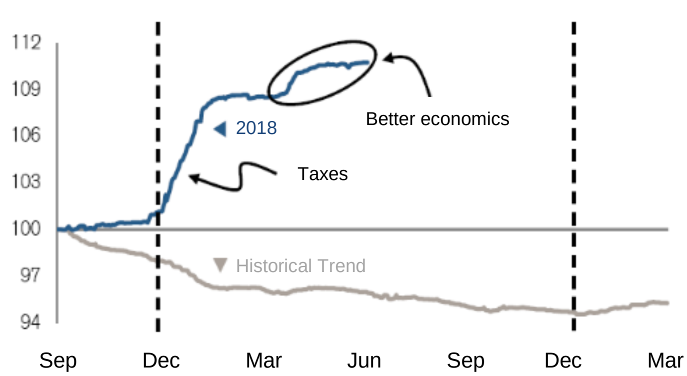


Source: Richardson GMP, sample client account, balanced portfolio

Canadian equity was reduced further, now representing around a quarter of the equity portion of investments. The Canadian stock market's largest listed companies are predominantly interest sensitive – banks, telcos, and utilities. With rates moving upwards, these dividend payers have had challenges with their stock prices stagnating. Oil prices have been very strong, and one might expect the large Canadian energy component of the index to do very well. However, carbon taxes, environmental regulation, and lack of pipelines have caused the Canadian energy sector to be significantly less profitable than in the United States and elsewhere.

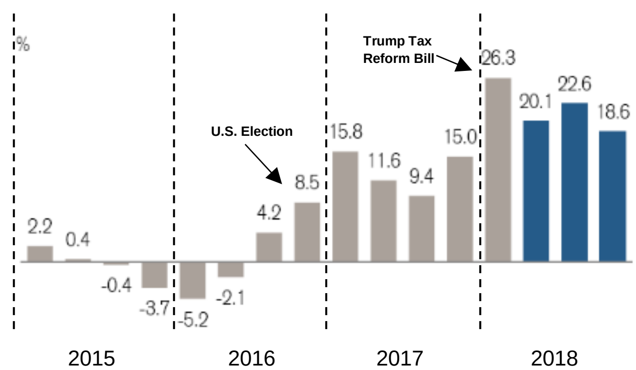
Investment in the United States continues to be very significant in the portfolio and was increased over the year. Earnings estimates for 2018 at the beginning of the year were for 8-10% growth for American companies. In most years, earnings estimates at the beginning of the year erode as actual results throughout the year come in. Instead, this year's estimates for the S&P 500 index have soared.

Annual Earnings Per Share (EPS) Revisions



Note: Indexed to 100 on 9/30 of prior year
Source: Standard & Poor's, Thomson Financial, FactSet, Credit Suisse, MRB

Historical %EPS Growth with Consensus Estimates



Note: Represents year-over-year earnings growth by quarter
Source: Standard Poor's, Thomson Financial, FactSet, Credit Suisse, MRB

Many investors seem afraid of investing in stocks because of global trade negotiations and the potential impact of tariffs. Global trade has brought lower prices and prosperity to many. It has also pushed manufacturing out of developed countries to regions with cheap labour. Global migration from poorer regions to wealthier ones is putting pressure on job markets. Around the globe, voting citizens are telling politicians that they would rather have work around their homes instead of the lowest price for already inexpensive goods.

Protectionism and the potential for tariffs has been part of the Republican/Trump mandate from the start – it should be no surprise. Longer-term rates jumped immediately at the November 2016 election and have been moving upward ever since. Zero (and potentially negative) interest rates were a problem. Global protectionism has led to mild reflation. Global trade practices have undergone greater scrutiny, and we are learning how there are inequities and problems with the existing system. Protection of intellectual property, protectionism of domestic workers, and the ability to bypass trade terms by routing goods through various complicit countries are important issues political leaders are currently attempting to solve. It will take time. Not addressing these issues wouldn't be much of a solution.

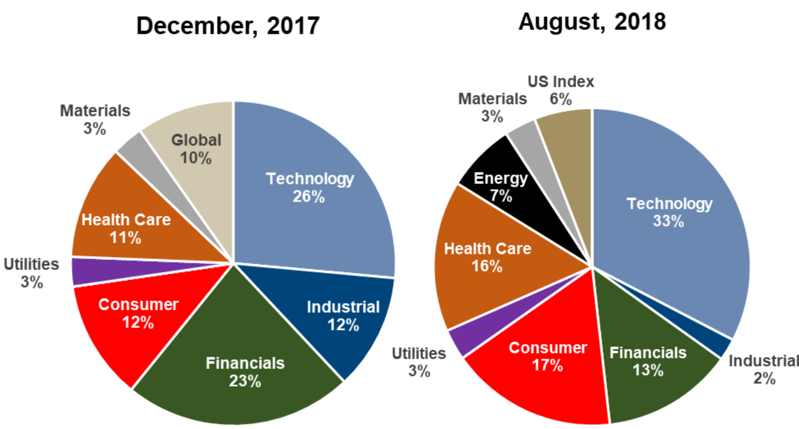
The small company selling domestically within the United States is the biggest winner as American policy becomes more protectionist. The United States is the largest market in the world and currently imports 15-20% of what they consume. Trade barriers make it harder for foreign companies to compete while non-exporting domestic companies may get a windfall. Earnings for American companies focusing on internal markets continues to be very strong.

Export economies are the biggest losers from tariffs. Companies in countries that produce more goods than they consume internally will struggle with tariffs that reduce their foreign appeal. They will likely produce, sell, and earn less.

Our managed portfolios eliminated all Asian, emerging markets, and European positions in 2018. Each of these areas has been struggling with stagnating growth. Trade tariffs, quotas, labour rights, and intellectual property rights are making it harder to make money in countries that don't have enough internal demand.

When trade agreements are reached, there tends to be a quick rally in whatever country's stock market successfully concluded negotiations. Recently, the bilateral deal with Mexico caused that market to recover somewhat. Emerging market and European companies trade at very attractive valuations relative to American counterparts. Investors should keep in mind that a global resolution to trade negotiations likely will mean a slowing or selling of the US market, while funds may quickly flow to currently depressed companies outside the US. When will trade be settled globally? Brexit, China, and perhaps Canada are three key participants to watch for. I think it will take months or years, although I hope Canada can enter a new arrangement with the US much more quickly.

Equity Sector Allocation



Source: Richardson GMP, sample client account, balanced portfolio

Technology exposure increased to one-third of equities. A significant portion of this exposure is through the tactical models which emphasize leadership. Holdings include a basket of Amazon, Google, Netflix, eBay, Facebook, PayPal, and a handful of similar market leaders.

Exposure to financials and industrials was cut significantly. Not much further change in relaxing banking rules is expected, although the sector remains attractively valued. Military defense and aerospace (the industrial sector) was removed from the tactical model. Portfolios did well owning it but valuation became stretched and performance flattened out after tensions subsided with North Korea.

Health care and energy are two areas with significant increase in exposure this year. Biotechnology in particular has been very positive since Republicans haven't been able to change the existing health care plan after several attempts. This highlights how hard it is to bring any meaningful change to health services with so many diverse and passionate views. Trump recently suggested potentially fast tracking new drugs, which has added to demand for biotech companies.

Utilities, telecommunication, and consumer staples stocks are notably absent or significantly underweight in the portfolio. These stocks tend to have very low earnings growth rates and be high dividend payers. While global earnings growth is strong and interest rates move upward, investment flows tend to neglect these defensive sectors.

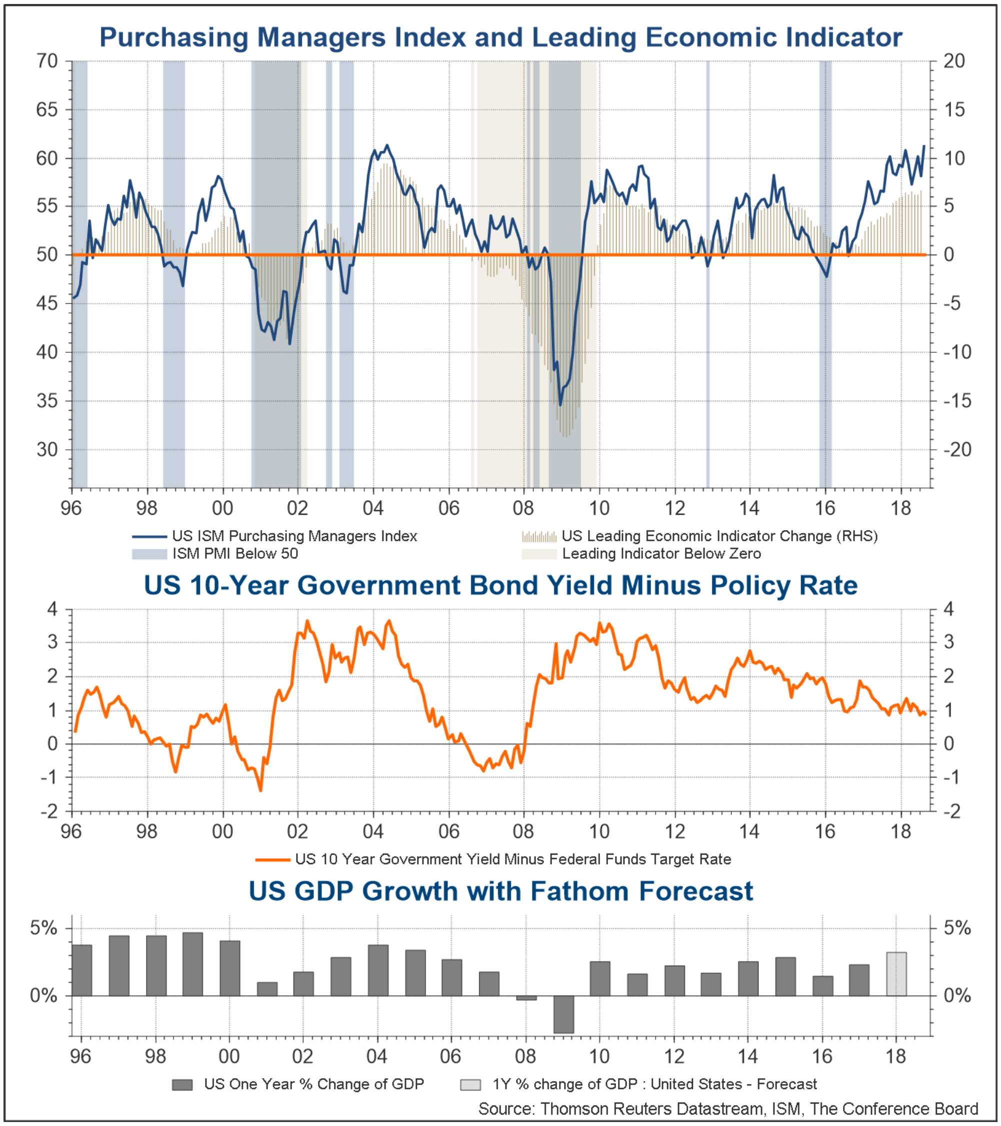
Make Investment Decisions Using Economic Indicators, Not Emotions

The media's role is entertainment. Many clients watch Trump and political news and somehow think it is a primary driver of investment portfolios.

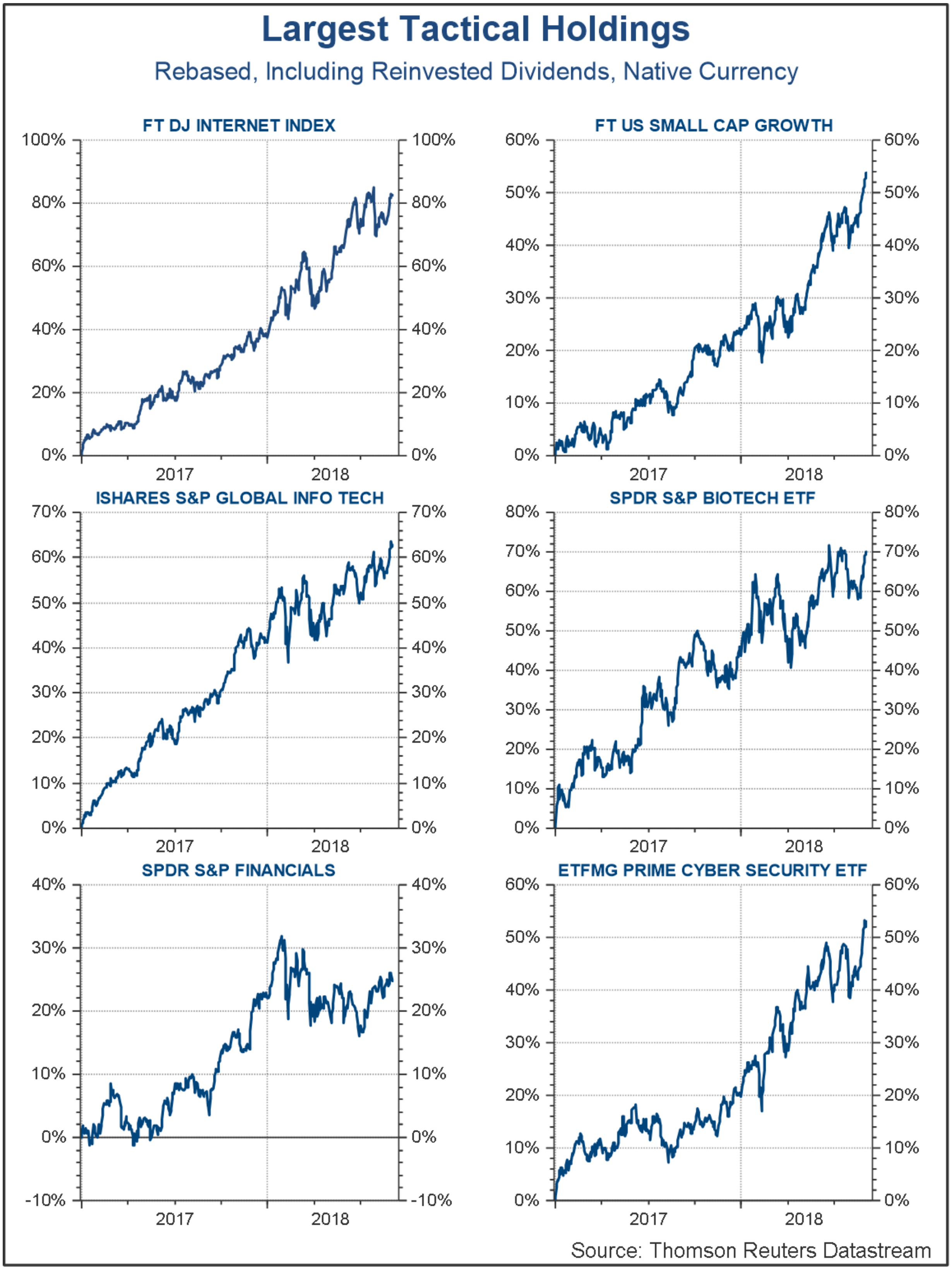
On a day-to-day basis, political news and careless tweets do seem to have an impact on the market. But this influence is short-lived. I'd call it random noise.

Pension managers and investors responsible for large sums of money don't trade off political news headlines and tweets alone. Media coverage of financial news seems to suggest that hundreds of millions of individual trades by diverse individuals all over the world on thousands of different securities are all happening because of the same news headline. They're not.

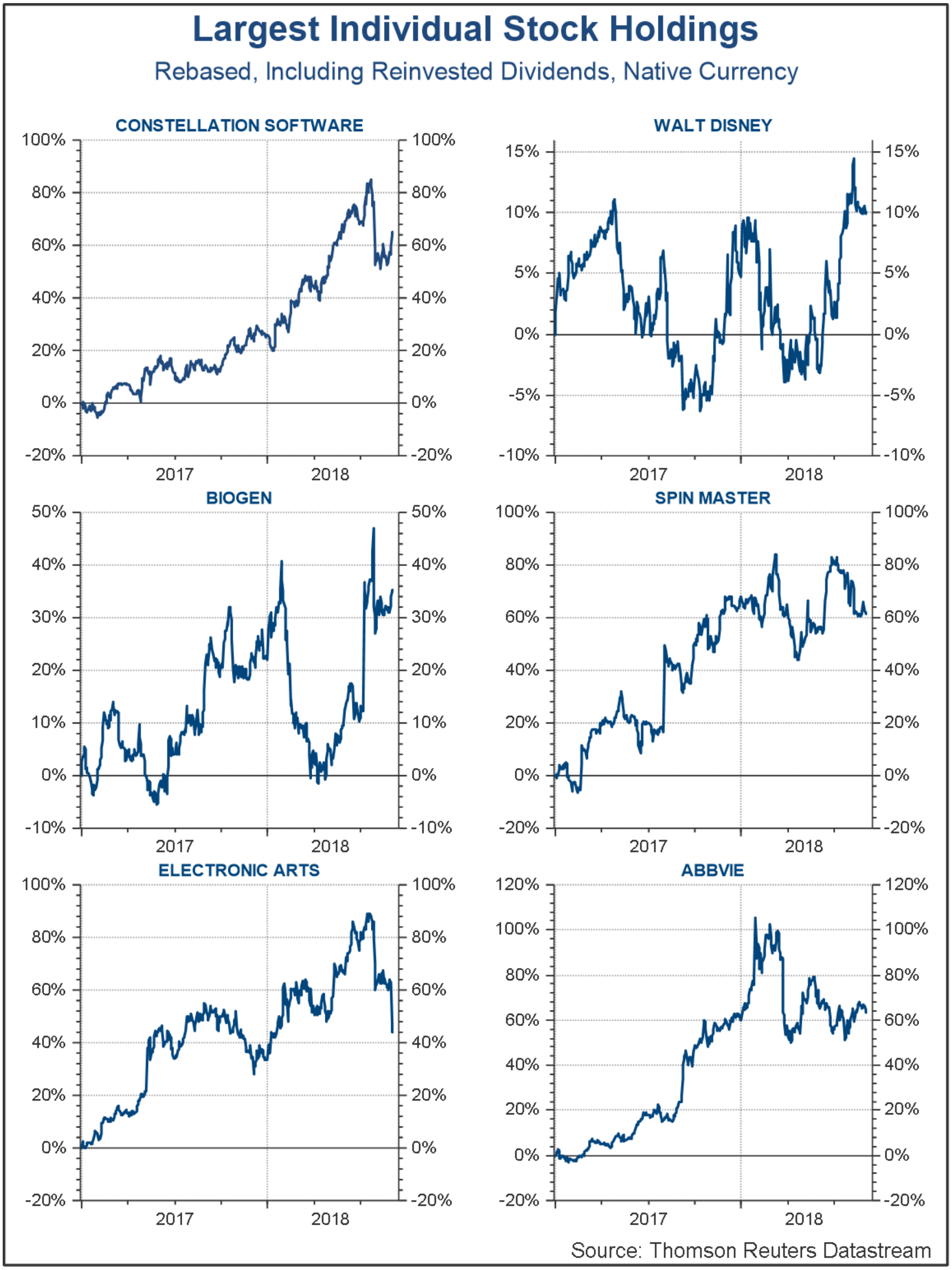
Earnings are created on the ground level by hardworking people. Decisions made by management have a massive influence on results. Stocks in companies that make money are worth progressively more.



Change in the earnings levels of companies are one of the more significant drivers of stock prices. Acceleration and deceleration are as important as overall growth and stability. Economic indicators that aggregate a large group of companies help identify larger trends. Forget the emotion of the media. Stick with financial information like shown above.



Represents the six largest tactical positions held in managed accounts. They are all exchange traded funds.



Represents the six largest individual stocks held in managed accounts.

Summary

This year can be characterized by sustained strength in the US economy. Leading growth indicators continue to trend higher, despite all the negative headlines about rising interest rates, market volatility, and tariffs. We continue to view the US as the most favorable investment environment in the world. As long as corporate earnings continue to rise, we remain positive on US equities.

Being near all-time highs isn’t a reason on its own to exit markets. Investors need to dig deeper into the underlying reasons individual markets are performing or not. Managed investment portfolios are well diversified and built with long-term objectives in mind. Managing a tactical portion of portfolios has allowed us to adapt more quickly and take advantage of opportunities in the current more volatile market.

We encourage our clients to reach out at any time to discuss our strategy and their individual circumstances.

I sincerely appreciate your business. I strive to earn your trust. I appreciate introductions you could make for me to any family or friends that might benefit from our services.

Regards,

Connect with me on LinkedIn

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