Market Commentary

Digital Roadshow 2017

Investing in the real world

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- We invest based on reality, as opposed to hope – of which there is a lot following Donald Trump's presidential election victory in November. It also is important to be mindful of the near-term uncertainties that can lead to volatility – but that also can produce investment opportunities. Although some of the excitement of the "Trump bump" has subsided, there remains a lot of hope priced into all asset areas. But we will continue to invest based on fundamentals, valuations and correlations between assets.

- Trump's election and other populist movements in Europe, with elections in France and Germany to come this year, are potentially destabilizing for growth. Globalization has helped economies grow during the past three to four decades, and policies that backtrack on this are not constructive. We need to be mindful of the new trade policies that will unfold, and of excessive debt levels. As well, the political reality in China is a deterrent to sustained growth, as you need an environment that fosters creativity to achieve technological breakthroughs.

- The current price of oil appears to be based on optimism following agreements to curtail production, but full compliance is far from certain. Meanwhile, there have been technological improvements in oil production, notably in U.S. shale extraction, helping to lower the marginal cost of production. This has implications for the Canadian dollar and thus to our investors. As we continue to invest outside the country, currency management will continue to be a very important tool.

- CI Multi-Asset Management sees three structural realities in the markets to consider this year:
  1. Technological progress that enhances productivity, albeit at a slower pace than we've seen in prior decades. Such progress is a disinflationary force and also leads to a widening of wealth gaps, which could also hurt overall consumption down the road.
  2. Aging demographics is a serious threat to GDP growth. Population has started to decline in Japan, is flat-lining in Europe and is rising at less than 1% in North America (mostly through immigration).
  3. Higher debt levels eventually impact growth. Cutting taxes means government debts must rise. With bond yields on the rise, governments will have higher debt-servicing costs, and ultimately future generations will face higher taxes.

- There is still a lot of momentum in stock markets, and volatility as well. To offset equity down-drafts, we continue to use safe havens like long-duration bonds and foreign

currencies, particularly the U.S. dollar. In our income portfolio, we are seeing increasing risks in stocks over the near to medium term, and have lower equity weights (11% vs our typical 20%). To generate consistent returns, we need to hold fixed-income assets and take on some interest-rate risk. But our bond duration is 5.5 years, compared with 7.5 for the Canadian bond universe, and thus our rate risk is about 20% less. We hold equities for inflation protection and to offset bond duration, although we continue to take a somewhat defensive approach.

- In this environment, a diversified approach has never been more necessary, and we hold assets that are negatively correlated.

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