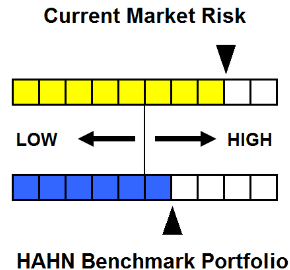

Current Portfolio Strategy

Financial markets continue to wage a "confidence face-off" with monetary policymakers. Equity and bond markets are wagering that monetary authorities (i.e. the U.S. Federal Reserve, Bank of Japan, the Bank of England ... etc.) must continue to provide accommodative monetary policies in order to sustain and spur economic growth. This view anticipates continued liquidity injections into the "financial circulation" (whether from overseas policymakers or here in North America), thus ultimately serving to boost financial valuations.

In recent months, this "confidence face-off" appears to have moved to high-stakes gamesmanship. Equity markets have raised the wager even further, speculating that central banks — having come this far in their unorthodox policy programs — can no longer reverse policies even if they wanted to. In effect, equity markets are now "all in" on their bet that central banks have no other choice but to further inflate financial markets.

We see a number of risks in this situation. Crucially, these all stem from the sporting notion that slow and disappointing economic growth is good for financial markets. Therefore, seen inversely, good economic news is bad for stock markets. Classical economists described this as the "financial circulation" of money becoming unlinked from the "industrial circulation." They saw this as a symptom of an unfolding financial bubble.

The current "gamesmanship" in theory can continue until one of the following happens: 1. Economic growth does finally speed up, even if only mildly. That would be "bad news" for inflated stock markets. No doubt, given enough unorthodox monetary injections, ultimately this would happen. 2. That increasing financial leverage and speculation results in financial instability. (Much speculative leverage has been built up over the past five-plus years due to interest rates being pushed down to the zero-bound); and 3. Financial participants come to the realization that future returns from this "confidence face-off" have been arbitraged to zero or less.

As stewards of our client's assets, we see it as our task to focus on long-term returns and to avoid risks that do not offer commensurate and sustainable returns. We would not resort to speculative gamesmanship. As such, we continue to focus on strategies that we believe will generate the best risk-adjusted returns over the long-term. That requires a dual emphasis upon income as well as growth.

In that endeavor, we anchor portfolio strategies in line with "Super Trends" (3 to 5 year outlook), as well as "Tactical Views" (applying to a 1-year outlook). Some current themes and strategies are as follows:

Emerging Markets – Selectivity Beckons. Sharp sell-offs in "emerging markets" over the past half-year have ushered in some attractive values on a selective basis. We have therefore added a modest exposure, preferring a diversified selection of higher-yielding equities. Also, we continue to maintain exposure to Eastern Europe and Russia.

Canada Stable But Commodity Sensitive. While Canada continues to possess one of the world's best-quality bond markets, it remains cyclically vulnerable. As well, its currency is likely still overvalued. We remain underweight in Canada's equity market, preferring international assets.

Multinationals and "Dividend Squatting". While we continue to favour the equities of multinationals over the longer-term, we have become tactically cautious due to a slowing earnings growth. Few companies are delivering robust top-line revenue growth at this juncture. Nonetheless, the dividend levels of this sector of the global stock market are attractive; and we expect them to remain stable.

Overall Income Focus. We continue to prefer investments that deliver underlying income ... i.e. dividends and distributions. In a world with an aging population and underfunded pension funds, income will ultimately prove its value. A global income crisis continues in our view. Since June of 2012, financial markets have become more driven by capital gains than income. We judge this to be an unsustainable trend. Overall, economies remain highly sensitive to interest rates and can be expected to slow in response to relatively modest rises in interest rate levels.

Diversified Asset Mix Posture. Our strategy team identifies four major scenarios that could possibly unfold over the intermediate term. These all have material probabilities, yet represent radically different outcomes. What to do? We continue to widely diversify our asset exposures ... no positions too extreme nor too small. As such, portfolios remain relatively balanced between equities and bonds, yet relying on a wider array of asset types that can offer insulation and insurance properties to client portfolios. These are described next.

Shifts in Opportunity Investments. We therefore continue to emphasize asset-types that can provide diversification benefits; superior growth in a continuing slow-economy environment; align with larger Super Trends; and anticipate shifts in investor sentiment. In this portfolio category, we have recently added a holding in "dim sum" bonds (government and corporate bonds, including those of large multinational companies in Yuan). Gold-related holdings (approximately 5% of most portfolios) have been re-oriented to senior gold miner equities to more efficiently position for an expected upside. Finally, over the past quarter, we have eliminated a holding in the biotech sector due to attaining full valuation.

Global Currency Tensions. One of the key features since 2008 has been the emergence of far more aggressive currency management by governments, classically referred to as "competitive devaluation." Recently, Canada's central bank has indicated a more accommodative monetary stance. We therefore have only hedged some assets in the yen and euro blocs back to the U.S. dollar.

Continuing Objective. The objective of our ETF Managed Portfolio strategies is to achieve stable, positive returns over the long-term without assuming excessive risk. More so than ever, the best approach for today's atypical investment climate remains building portfolios that are globally diversified across many asset types, informed by a concerted focus upon a variety of traditional and non-traditional risk factors.

Quarter 1, 2014 — Investment Stance

Net Asset Mix	Versus Benchmark			Change from
	Under	Neutral	Over	previous quarter
Cash		■		● Unchanged
Total Equity	■			↑ Increased
Total Fixed Income			■	↑ Increased
Opportunity			■	↓ Decreased
CDN Investments				
Bonds		■		● Unchanged
Stocks	■			● Unchanged
US Investments				
Bonds			■	● Unchanged
Stocks			■	● Unchanged
INTL Investments				
Bonds		■		● Unchanged
Stocks	■			● Unchanged

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