GESTION DE PORTEFEUILLE LANDRY

Market Review
Third quarter 2014

The stock markets underwent a slight correction in the summer but then recovered. We continue to believe we are in a bull market even though valuations exceed the historic average.

Performance in Canadian currency		
	3 months	**9 months**
Canadian equities	-0.6%	12.2%
U.S. equities	6.3%	14.3%
Europe and Pacific equities	-1.1%	4.0%
Emerging market equities	1.4%	8.0%
Bonds	0.8%	5.7%
REITs	-1.1%	8.7%
Canadian/U.S. dollar	-4.7%	-5.1%

Source: Bloomberg, September 30, 2014

Looking at economic indicators from around the world, we can see clearly that the United States stands out from the other countries: it has definitely emerged from the Great Recession. But Europe is sliding into a triple-dip recession, Japan is unable to achieve a satisfactory growth rate and the developing countries are signalling ever more strongly that they cannot return to their high growth rates of the 2000s. In this context, it is not surprising that the U.S. stock market is outperforming the other markets.

We have entered a world of slow growth where global supply exceeds global demand. Demand is weakening in the developed countries as a result of the accelerated aging of the population and the need to reduce overall debt, which is still at record levels as a percentage of GDP six years after the global Great Recession of 2008-2009.

As for supply, it is being buoyed by the large numbers of young people arriving on the job market in developing countries and by technological advances. In this context, the rate of inflation will remain low for a very long time. This scenario affects all investment vehicles.

INTEREST RATES

John Maynard Keynes pointed out that interest rates seem to remain at a certain level for long periods. It can also be seen that interest rates take a long time to adjust to a new economic environment. For example, interest rates have been falling for 30 years, and we must ask ourselves whether they have overshot their equilibrium level on the downside. This seems to be the case for Germany's 10-year Bonds, which are yielding only 1%.

Are we about to begin a long period of rising interest rates that will last several decades? That outcome appears rather unlikely in a scenario where global supply constantly exceeds demand. Rates should instead stabilize and remain at a fairly low level, perhaps in the range of 2% to 4% for 10-year U.S. Treasury bonds.

EQUITIES OVER THE LONG TERM

What is the value of publicly traded equities in such a context? Like interest rates, equity valuations tend to remain at a certain level for a long time, depending on the regime. For example, inflationary periods, such as the 1970s, come with very low price-earnings ratios that are typically less than 10. In contrast, during the euphoria of the technology bubble we saw periods when the ratio exceeded 30 times. For that reason, a ratio should not be compared to its average over a century because economic conditions change. The price-earnings ratio is currently 18 for the U.S. stock market. It is high in comparison with the average of the past 100 years but it is below average when compared with the past 25 years.

A NEW ERA?

We are in an era characterized by very low interest rates as a result of abundant liquidity on the markets, but without the risk that it will cause inflation in the developed countries. Moreover, we live in an era dominated by corporations. What is the price-earnings ratio of equities in such a context? The characteristics of this new era began to appear at the start of the 1990s. Since then, the price-earnings ratio has evolved in the following way: (1) the minimum ratio has been about 15; and (2) the ratio has become extremely volatile, recording two peaks of more than 30 over the past 25 years. The current ratio of 18 seems to be at the low end of this era's range.

COMMODITIES

Malthus thought that the real price of food and commodities had to rise over the long term because the population constantly increases, but the surface of the Earth remains the same. In fact, the real price of food and commodities has been going down for centuries because of technological change. Even so, commodity prices may rise suddenly and remain high for periods as long as a decade or two, as has been the case since 2000, a period during which commodity prices tripled.

Did this increase mark the start of a long cycle? It appears that the upward cycle has ended, because commodities have not been rising in the past three years. In a context of slow global economic growth, these prices will probably continue to fall in real terms.

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EMERGING MARKETS

For about 20 years, emerging markets have grown much faster than the developed countries, and their stock markets have often recorded impressive gains. These countries have been making up for lost time, with China leading the pack. This catch-up process has lasted so long that people have come to think it is natural for developing countries to grow more quickly than the advanced economies.

The phenomenon of the convergence of living standards in various countries exists but it is taking place far more slowly than in recent experience and, moreover, it does not extend to all countries. The stock markets of emerging markets have underperformed in recent years as investors adjust to this new reality, and it appears that the adjustment is not yet complete.

CANADIAN DOLLAR

Canada and Australia are the two countries that are affected the most by commodity prices, and because these prices have been weak since the start of the year, the Canadian dollar is down 5% against the U.S. dollar on a year-to-date basis. It should be noted that the U.S. dollar has strengthened against all currencies recently. It is not necessary to know which of these two factors has contributed more to the drop of the Canadian dollar; both factors will continue to put downward pressure on it.

DASHBOARD

	September 30, 2014
Canada	
Canadian dollar versus U.S. dollar	-
Corporate bonds	+
Long-term government bonds	=
S&P/TSX 60	=
Small caps	=
REITs	+
United States	
U.S. dollar versus euro	+
Long-term Treasury Bonds	=
S&P 500	+
Nasdaq	+
Europe	
Euro versus U.S. dollar	-
MSCI Europe	+
Asia	
Yen versus U.S. dollar	=
MSCI Japan Index	+
Emerging markets	
MSCI Emerging Markets	0

=: Neutral +: Overweighted –: Underweighted