Avenue
Investment Management

47 Colborne Street, Suite 300
Toronto, Ontario, Canada M5E 1P8
T 416.482.2004 • 888.482.2007 F 416.482.0007
www.avenueinvestment.com

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There is no dramatic difference between the strength of the US economy and that of a core European economy like Germany. However, ultra-low interest rates are magnifying the subtle differences and we are now seeing a large flow of money from Euros to the US dollar as well as the continued rise of asset prices. Avenue has started to incrementally move investments back to Canada.

We have argued for five years now that interest rates will be low for much longer than what the majority of investors have anticipated. However, we are now in a world where we compare one country's low interest rates to another's. At present, the US economy is doing relatively well; therefore, the US Federal Reserve would like to start raising short term interest rates.

However the 10 year US Government Bond yield is 1.96% and the 10 year German Government Bond yield is 0.16%. The US return of 1.96% is not ideal, but it is more attractive than the arguably punitive German return of 0.16%. We have seen a massive flow of money and consequently a 23% rise in the US dollar since mid-2014. When money flows rapidly to the US, the Canadian dollar can be marginalized. The Canadian dollar has also suffered due to the drop in oil price and the fact that our 10 year Government bonds, which yield 1.37%, are now well below US rates.

The knock-on effect from a stronger US dollar is that US corporate earnings will not grow in 2015 for the first time in five years. Almost 40% of public company earnings in the US come from global operations. Any earnings growth will be offset by the strength of the US dollar.

As Canadian investors, we now have the stimulative effects of a much lower currency compared to our major trading partner. In addition, a lower oil price benefits those who use energy on a daily basis compared to the fewer people, mostly in Alberta, who are in the business of producing it. The resulting positive impact will take time to flow through the system, and it may be a year before it can be measured through statistical analysis. This argument can be read thoroughly in the article written by Paul Gardner for the Globe and Mail on March 11, 2015 (see our website).

Paul Harris, CFA
Partner
pharris@avenueinvestment.com

Paul Gardner, CFA
Partner
pgardner@avenueinvestment.com

Bill Harris, CFA
Partner
bharris@avenueinvestment.com

The fundamental issue remains that there is no inflation of either type. Demand pull inflation is described as when too much money is chasing too few goods. The problem is that we have too many goods and the capacity to make everything we need. Alternatively, cost push inflation is described as when the swelling of input costs results in overall price level increases. However, the input costs of wages have not gone up and the input costs of raw materials are in steep decline. Ultra-low interest rates are meant to encourage the virtuous cycle of borrowing and investment for growth, but it remains that we don't need any more debt and there is excess capacity in almost every industry.

Asset price increases and even potential asset price bubbles are now common investor worries, but we do not believe we have reached this point yet. The prices of Canadian houses are quite rational given the low level of interest rates. Where borrowing $350,000 at 8% in 1990 cost $28,000 per year in interest, borrowing $1,000,000 in 2015 at 2% will cost $20,000 per year in interest. A drop in interest rates by 6% may have the effect of house prices increasing by 200%. This is not a bubble. A bubble is created if the house price increases beyond what people can afford to cover in interest costs. The cost of Canadian housing is quite rational, with perhaps the exception of Vancouver, which is dealing with limited supply and a hot Asian buyer's market.

We would also use this same argument to view price earnings (PE) multiple expansion in the stock market. A few years ago when stocks were trading at 14 times earnings, we made the case that in this low interest environment stocks should trade at a PE of 18 times. This is where we are today. However, the pressure for investment returns is only increasing. A recent survey by State Street of large institutional money managers in 15 countries found that "plan sponsors will increase their risk appetite over the next three years". This has only recently occurred and is a polite way of expressing that large investors are finally acknowledging that they cannot meet their return expectations from large weightings in bonds.

A great example is our investment in Royal Bank. The stock currently has a dividend yield of 4.1% which compares favorably to a 10 year Canadian Government bond yield of 1.3%. Royal Bank only pays out 45% of earnings in the form of dividends. Barring a major financial disruption, it is unlikely that the stock will fall in price. However, we have also just demonstrated that there is not a housing bubble, and the high prices are really a rational appreciation given low interest rates. We believe it is more likely that the stock will go up regardless of earnings or dividend growth. Investors need the income. At the overall stock market index level, the current PE multiple of 18 times could easily go to 20 or 22 times.

At Avenue, one of our core beliefs is that we have to stay invested and capture the long term compounding offered by owning a variety of stable income streams through investing in public companies. The case study this month is a discussion based on an excerpt from this year's Berkshire Hathaway annual report, authored by Warren Buffett. His argument is that being a long term shareholder in a good company is much less risky compared to treating cash or bonds as long term investments. The tradeoff is that in the short term, cash and bonds can be necessary to reduce volatility but volatility is not an ideal way of measuring risk for investments over decades.

Bringing this all back to Avenue, our bond portfolio is committed to getting the best return we can out of the bond market for those clients that need income and stability. The largest part of the return is coming from our investments in medium term Canadian corporate bonds.

Our equity portfolio is committed to staying invested but being careful about inevitable valuation increase. This quarter we have shifted our exposure within the energy sector to two companies that are better positioned to get through the downturn and hopefully we will take advantage of today's lower energy prices.

Measured by asset exposure, the Avenue equity portfolio has benefitted by being over 50% invested outside of Canada. Most of these investments are in the US through direct investments like Bank of America, Deer and Amgen. However, we also have to factor in that our investments in Canadian listed companies, such as Brookfield Asset Management, have most of their assets in the US. In addition, TD Bank and Royal Bank now have a third of their operations in the US. With the Canadian dollar now at this $0.80 level we will be looking to incrementally sell some of our US investments and bring the money back to Canadian opportunities.