July 2017

q2 report

Portfolios remain positioned to benefit from increased economic activity, as our models continue to point to US themes. This is supported by improving key economic indicators, combined with limited recessionary and inflationary indicators on the horizon.

Despite a short-lived pause in some bellwether technology stocks, the quarter resumed a positive tone. For the most part, the market has discounted Trump's delayed and derailed reforms as well as his other promised initiatives. Solid economic growth and robust earnings in the U.S. and Europe have taken over as the catalyst to buoy markets. Further, credit markets have continued to narrow, allowing companies to borrow and refinance at lower rates seen in years. This is indicative of the market confidence in lenders' low risk premiums.

While central banks outside the U.S. maintain easy monetary policies, the U.S. continues to move towards a normalized rate environment – migrating from extreme measures – which is supportive of a strengthening economic activity. Rate increases typically benefit US financials and industrials, as well as the US dollar. This increase coupled with strong leading economic indicators such as industrial production and ISM manufacturing numbers (Chart 1) point to continuing strength through the remainder of 2017.

With increases to the short end of the yield curve, pressure remains on long term rates from a persistently large US balance sheet. If this balance sheet begins to shrink, as alluded in the May Federal Open Market Committee (FOMC) minutes, a steeper yield curve will likely create further opportunities - we remain vigilant as some sectors will be challenged.

For Barometer clients, portfolios have been well positioned over this past quarter. With the continued improvement in US fundamentals, our themes - technology, financials, industrials and now healthcare - continue to show relative strength, while we have side stepped a persistent decline in energy and materials. Technology stocks have finally hit the levels of 2000, but this time with earnings and lower multiples – setting up further opportunities if earnings continue to expand. Traditional businesses continue to face disruption.

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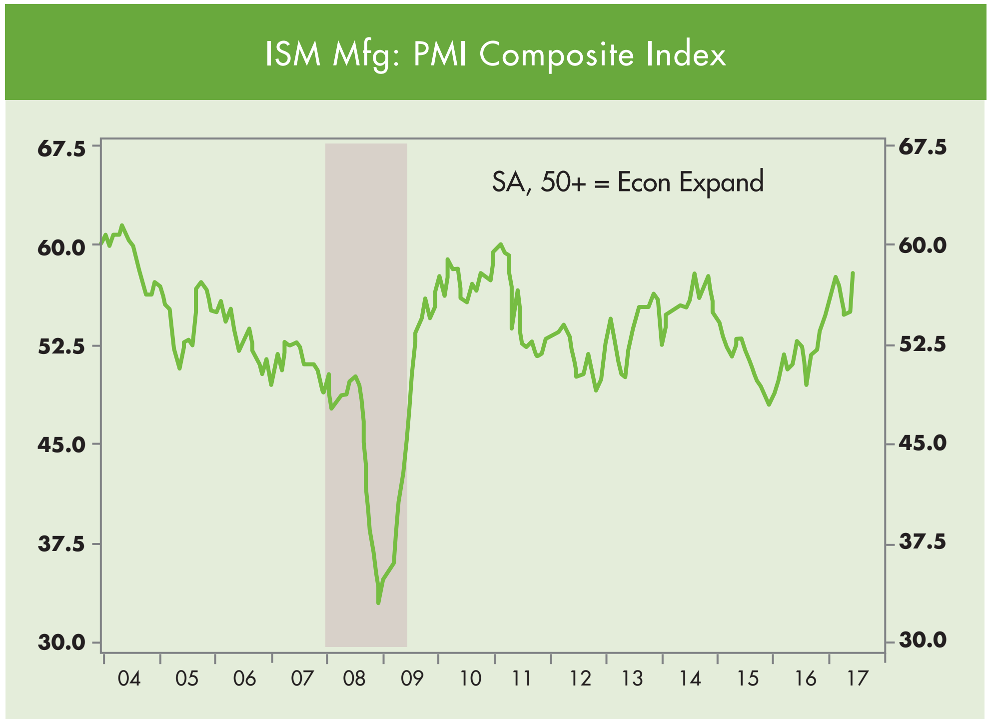

Source: Institute for Supply Management
PMI = Purchase Managers' Index
SA = Seasonally adjusted

Chart 1

Consumer discretionary companies like Amazon.com, Inc., that have straddled over to the technology world are changing the way the consumer purchases. This transformation is also being experienced within financials, with fintech companies providing further opportunities for consumers and banks. Traditional financials in the U.S. have also benefited from some rate normalization, low regulation and a strong domestic economy. Industrials, specifically defense companies, are seeing an increase in orders in the U.S. and around the world, as the geo-political climate remains on high alert. Healthcare has emerged as a leading sector, with companies like Johnson & Johnson experiencing profit growth, and bio tech firms are seeing robust product development. These growth themes continue to contribute to the portfolio.

The Barometer Tactical Equity Strategy has had a strong year of absolute performance by benefiting from the aforementioned themes. Technology, a large sector weighting in the portfolio, has contributed to performance with companies such as Shopify, Inc., which posted a strong quarter from their e-commerce platform. Technology names like Alphabet Inc. and Nvidia Corp. also performed well. Nvidia continues to be a crucial enabler of artificial intelligence. Another strong performer this year has been Amazon, and we expect this company to grow at a rapid pace as e-commerce, which represents 10% of US retail sales, will likely continue to expand.

The Strategy has avoided energy and materials, instead favouring US themes. Financials such as Citi were purchased. Healthcare positions were added, such as Regeneron Pharmaceuticals, Inc. US equities remain the overweight.

The Tactical Balanced Strategy's top holding reflects utilities, and for the most part they are preferred shares, which comprises of a portion of the targeted 25% fixed income exposure. This has provided stability and yield to the portfolio. Technology positions also contributed to performance with companies such as Apple Inc. and Visa Inc., while financials such as Bank of America Corp. and Citigroup Inc. were added over the quarter as the yield environment and regulatory climate became more favourable.

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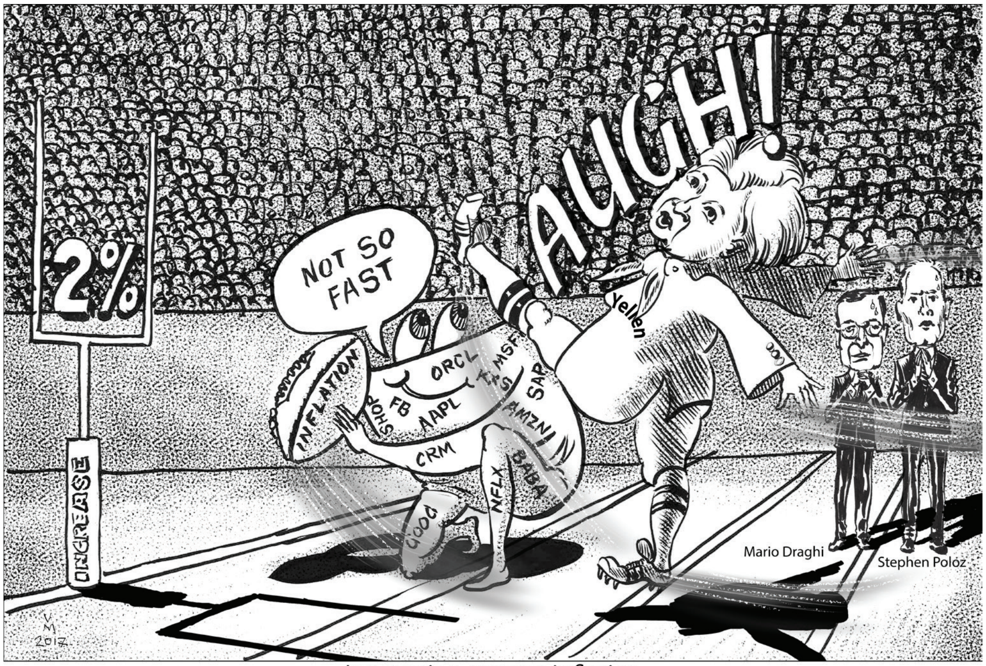

Innovation trumps inflation

The Tactical Income Strategy maintained a significant weighting in industrials with defense companies such as Raytheon and Northrop Grumman, which have benefited from the increase in military spending around the world. Within technology, Apple and Visa contributed, and financials such as Bank of America and Citigroup were added.

The Global Macro Strategy over the past quarter was long industrials with exposure to aerospace, defense and transports. Within financials, the Strategy has exposure to capital markets, brokers, insurance companies and regional banks following similar themes as our other strategies. The Strategy was short US fixed income, energy and precious metals.

The Long Short Strategy was long familiar themes such as technology, healthcare and financials, while also short US fixed income.

Looking Forward

Portfolios remain positioned to benefit from increased economic activity, as our models continue to point to US themes. This is supported by improving key economic indicators, combined with limited recessionary and inflationary indicators on the horizon. As the US economy will likely continue to expand, the Federal Reserve (the "Fed") may look to tighten monetary policy, while other major central banks are easing to boost economic activity. In addition, the Fed begun to speak of a strategy to shrink its balance sheet, which in theory could steepen the yield curve and consequently provide further opportunities for select sectors. Looking towards the remainder of the year, the backdrop for equities remains favourable, and our portfolios will continue to be focused on growth. As always, we monitor our portfolios daily and are prepared to make tactical adjustments as dictated by our risk assessment models.

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