Winter 2015

At least stateside, we're being dealt too many aces for even the biggest naysayers to suggest we pick up whatever remaining chips we have on the table, cash out, and head for the door. The economy created another 252,000 jobs in December, a record 58th straight month of private sector gains. The jobless rate dropped to 5.6 percent, nearly back to normal after peaking at 10 percent in October of 2009, and consumers have returned, in spite of the recent December report of a decline in consumer spending that was largely impacted by a 19% drop in gasoline prices (figures that aren't adjusted for in the government's release). And the economy turned in a robust 5 percent growth rate in the third quarter of last year. More broadly, for six years the North American equity markets have moved in one direction – up! It has seen the S&P 500 index rise by over 145% and the S&P TSX Composite Index increase by over 85%. The US economy is leading the way, but Canada's, which suffered a little slow down due to the weakness in commodity prices, has also remained strong. Interest rates remain at historically low levels and inflation seems to be taking a long winter's nap.

While we, ever the optimists, continually find ourselves opposing the advice of those who panic when the cards aren't going our way, now seems a good time to remind our clients that a great many hot streaks have been ended by trusting mere luck and impulsively going all-in without considering the odds.

What lies beneath all the good news is a more complex market. While large North American companies have enjoyed a stellar year (the S&P rose 13%, the US dollar continues to get stronger), small company stock lagged far behind, their indices up only around 4.5% (using the Russell 2000 index as proxy). Small Canadian companies actually lost money on average- to the tune of around 2.3% (using the S&P/TSE Small cap Index as proxy). International markets also struggled, with returns ranging between 5% (S&P Global 1200 Index) and -1.9% (MSCI Emerging Markets Index). Investors that followed the time-honored and proven method of diversification (guilty as charged!) may be surprised their portfolios didn't match the much-published equity market indices of the S&P 500 or Dow Jones Industrial Average. (It's important to remember one of the five investment principles: Effective diversification means that investments won't all work at the same time – nor do they all fail at the same time.)

Factors that led to the varying markets include the plunge in oil prices, a drop of 46% in 2014. While this should have a stimulative effect in the longer-term, it has caused a lot of near-term uncertainty, as many energy-based economies struggle to adapt to their changing situations. Russia is at the top of the list of those most seriously affected. In fact, the drop in oil prices has done far more to wake up Russia than the sanctions imposed after their aggressive actions toward Ukraine. The slowdown of the Chinese economy and their attempt to control their shadow banking has rippled out to mining- and commodity-based economies, causing their companies to drop in value as 2014 unfolded. Europe is still struggling to fully emerge from the long recession and their austerity programs offer little room for the stimulus spending needed to kick-start economies.

Given all this, would those who diversified seen a bigger return had they concentrated their investments in the North American markets? In a word, yes. But, sadly, when investing we don't have the benefit of acting after the fact. (We'd all be fabulously wealthy if we did.) But history tells us to expect the unexpected when it comes to predicting what to do next.

Think of diversifying as counting cards in black jack. For those unfamiliar with the strategy, it involves keeping a running tally of all the high- and low-valued cards seen by a player, and allowing them to bet with less risk when the count gives an advantage, and minimize losses during an unfavorable count. (And, provides the ability to alter playing decisions based on the composition of remaining cards.) Even the most expert cardcounter will lose hands (or win smaller amounts). And they'll likely watch a few fellow players win an occasional big (or bigger) amount on nothing more than a hunch, and Lady Luck. But if the player sticks to their system-betting more when a clear statistical advantage is evident and less when it's not-they're far more likely to be continually cashing out at the end of the night.

We're being dealt a lot of aces right now, and that's good news for all investors. But every ace laid on the table means fewer exist in the deck. Keeping note of such things puts us in a better position to stay at the table and continue to grow our stack of chips.

We wish you a healthy and prosperous 2015.