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ASSET MANAGEMENT

“Germane Thoughts”

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John Germain
Senior Portfolio Manager

Was it the seasonal effect of September historically being a weaker month for global equities or was it more related to macro and geopolitical headwinds that took markets down considerably in the month of September? Weaker U.S. payroll numbers and the European Central Bank’s decision to provide more stimulus to fight deflation definitely loomed over markets as did continuing conflicts in the Middle East, with a new enemy in ISIS. Questions about the survival of the United Kingdom after Scotland held an independence vote on September 18th that was narrowly won (~55%) by those wishing to remain part of the U.K. also weighed on markets.

The S&P/TSX Composite declined 4.3% for the month, led by the Materials and Energy sectors that were down 11.5% and 8.0 % respectively. A stronger U.S. dollar, with the US Dollar Index up 4.0% for the month, its highest level in four years, contributed to the weakness in commodities, as did mixed economic numbers out of many emerging markets.

Meanwhile, U.S. and European Indexes while mostly down, did fare better; the S&P 500 Index was down only 1.6%, the NASDAQ Index down 1.9%, the FTSE 100 (U.K.) down 2.9%, the DAX 30 (Germany) was flat, while the CAC 40 (France) up 0.8%. Small Caps were taken out to the proverbial woodshed during the month with the Russell 2000 and S&P/TSX Venture Indexes down 6.2% and 11.2% respectively.

Second quarter GDP for the U.S. continued to get ratcheted up in September with the third and final reading coming in at 4.6% versus the original reading in July at 4.0%. We expect 3rd quarter GDP will retrench somewhat from the strong 2nd quarter but with ISM Manufacturing Index still in expansion territory at 56.6 in September, we expect 3rd quarter GDP in the U.S. to come in around 2.7%.

Long-term interest rates backed up a bit in September on concerns the Fed may start raising rates earlier than the consensus of June, 2015. However, they still remain historically low and show no concerns of inflation with 10-year U.S. Treasury yields ending September at 2.51 % and Canadian 10-years at 2.16%. Euro country bonds continued to decline with German and French Government bonds ending September at 0.9% and 1.29% respectively, on expectations the ECB will provide more stimulus with quantitative easing.

The Health Care sector was the standout performer in Canada up 10.30%. Heavyweight Valeant Pharmaceuticals Intl. was up 15.2% during the month with most of the advance coming after potential target Allergan Inc., the maker of Botox, announced it was back in talks to acquire Salix Pharmaceuticals in an effort to fend off Valeant and its bidding partner Pershing Square Capital Management. As noted earlier, the Materials and Energy sectors were the laggards during the month due to a stronger U.S. dollar and slowing demand from China and emerging markets. Since July, we’ve reversed our call on Materials, mainly Gold stocks, and reduced our position to a significant underweight while we continue to have a slight underweight in Energy in our Funds. We have also been more active with our covered-call writing in these sectors due to our bearish view as well as the higher volatility exhibited by these sectors.

For the second consecutive month, Telecom Services was the best performing sector south of the border, up only 0.35% due to its defensive characteristics and high yield relative to other sectors.

Finally, volatility picked back up in September due mostly to the macro and geo-geopolitical factors outlined earlier. The CBOE Volatility Index (“VIX”) closed the month at 16.31 after trading as low as 11.52 on September 19, the same day the S&P 500 hit an intra-day record of 2,019 as shares of Alibaba Group Holding Ltd. started trading. Alibaba, the Chinese e-commerce company that rivals Amazon and E-bay became the biggest IPO ever, valued at $228 billion.

Our call writing program was very active during the month as we became tactically more cautious while the increase in volatility, mostly for our Materials, Energy and U.S. holdings, compensated us enough for selling away upside. Our view is that this is another correction in the 5% range and that we will be closing out the majority of our positions during October with an expectation that markets will resume their uptrend into the end of 2014.

Forward Looking Information and Disclaimer

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121 King Street West, Suite 2600
Standard Life Centre, P.O. Box 113
Toronto, ON
M5H 3T9

Tel: 416-681-3900
Toll free: 800-725-7172
Email: info@strathbridge.com
www.strathbridge.com