Seymour Investment Management

October 14, 2016

Equity markets performed well in the third quarter, as markets continued to recover from their lows earlier in the year. In Canada, the TSX was up 5.5% in the quarter, bringing its year-to-date return to 15.8%. In the US, the S&P 500 was up 3.9%, and year-to-date the S&P is up 7.8%. Overseas, markets were also strong with the MSCI EAFE Index up 5.8% in the quarter but down -0.8% for the year, which in part reflects the fallout from the UK's vote to leave the European Union ('Brexit').

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The strong performance of the TSX in 2016 is mostly attributable to gains in the resource sector. Oil and gas, base metal and gold stocks contributed to almost 70% of the gain in the TSX since the beginning of the year. Historically, these sectors have been very volatile. While the year-to-date gains are impressive, we caution investors that these sectors generally do not provide investors with sustainable long term capital appreciation.

The primary reason for the strength in global equity markets has been the continuing low interest rate environment. Companies are able to borrow money at extremely favorable interest rates. Even companies that operate in more cyclical areas of the economy are able to borrow at historically low rates. Suncor Energy Inc. recently was able to borrow money for 30 years at just over 4%. Even more remarkable, was that CIBC was able to borrow 1.25 billion euros over 6 years at a rate of negative .009%!

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We have commented on negative rates in previous letters, noting that almost one third of the global government bond market trades with negative yields. The recent CIBC bond issue indicates that some companies now have the ability to essentially borrow money for free. Negative interest rates are a new phenomenon, and it is not clear what the long term implications of such a low rate environment will be to capital markets. However, one thing is clear and that is that the cost of capital for companies has never been lower and this is very beneficial for any company with borrowing requirements.

While companies and equity markets are benefitting from low interest rates, fixed income investors find low interest rates to be much more challenging. The low interest rate environment means that bond investors get paid very little for holding bonds. In fact, if interest rates rise to more normal levels, bond investors likely will incur negative returns.

How Investors Can Benefit From "Thinking Slow"

In 2002, Princeton University professor Daniel Kahneman was awarded the Nobel Prize in Economic Studies for a series of studies popularized in his book "Thinking, Fast and Slow". His conclusions have profound implications for investors.

Kahneman surmised that most of the time we are "thinking fast", using rules of thumb that simplify problems allowing for quick solutions. An example of "thinking fast" is the human tendency to feel safer in groups. This simple rule of thumb or tendency can manifest itself into behavior where investors will chase market rallies or sell at the bottom of market corrections. Investors will feel more comfortable doing what everyone else is doing when they are "thinking fast". Unfortunately, this type of behavior can result in poor investment results.

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Another example of "thinking fast" is when investors go with their "gut" feel. This may lead investors to irrational decision making, when a more careful analysis of facts would yield a different conclusion.

"Thinking slow" requires investors to use higher analytical functions such as mathematic or accounting skills. Thinking slow takes a lot more effort, both in terms of intelligence and concentration. The investing benefits of thinking slow are relatively obvious. The careful analysis of economic, financial, and corporate factors that drive equity markets is the best way to manage risk and generate returns. However, for many investors, thinking slow is much more difficult than thinking fast!

"Thinking slow" has obvious benefits for investors, but is much more difficult than "thinking fast."

Market noise is the day to day news that can have a short term impact on equity markets. It can lead to investors making short term decisions that will impair long term investment results. We have counselled our clients to try and ignore market noise. However, more connectivity to news sources makes tuning out market noise increasingly difficult.

"Thinking fast" is very susceptible to market noise. One of the most helpful pieces of advice in Kahneman's book highlights the compelling research showing that checking individual investments on a frequent basis will lead to poor decision making. He says,

"Closely following daily fluctuations is a losing proposition, because the pain of the frequent small losses exceeds the pleasure of the equally frequent small gains. Once a quarter (looking at investment results) is enough for individual investors. In addition to improving the emotional quality of life, the deliberate avoidance of exposure to short-term outcomes improves the quality of both decisions and outcomes."

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If investors can learn to incorporate "thinking slow" into their investment behavior, they will increase the likelihood of successful investment results. Learning to ignore market noise, and learning to place a higher value on longer term trends and analysis can serve as building blocks to becoming a better investor.

Investment Strategy and Outlook

Equity markets have managed to recover since hitting their lows at the beginning of the year. The market correction, which began in the spring of 2015, ended in January 2016 with the TSX down 25% and the S&P down 15%. Today, the TSX is within 6% of its former high, and the S&P trades near record levels.

Stock market valuations have now recovered to where stocks are no longer considered "cheap" and in fact some sectors are fully valued. However, while stocks may be somewhat expensive, they appear more attractive when valued in the context of today's historically low interest rates.

Traditionally, large allocators of capital such as pension funds, endowments, and sovereign funds have invested in three primary asset classes: stocks, bonds, and real estate. ***The valuation of both bonds and***

real estate (global) is now well above what would be considered normal. This makes it very difficult for investors to feel comfortable investing in bonds or real estate. Stock valuations are supported by earnings which continue to grow, albeit slowly. Capital allocators can have much more confidence in equity valuations that exist today compared to valuations in real estate and bonds.

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We continue to be very much in favor of equities versus bonds. We try to de-emphasize some of the "thinking fast" themes such as the US election results, and concentrate more on "thinking slow" themes such as the benefit of a low and stable interest rate environment on corporate entities.

Another example of "thinking slow" can be found in our appendix. We have included a chart from Statistics Canada which outlines three different growth scenarios for Canada's population over the next 45 years. It suggests that Canada's population will likely be over 50 million by 2061, and could be as high as 60 million. Even if we reduce the time line to 5 years from now, it is likely that Canada's population grows by almost 2 million people. This has very positive implications for corporate Canada. It is hard to imagine that institutions such as the TD Bank won't be significant beneficiaries of both the medium and long term growth in the Canadian population. "Thinking slow" would suggest that Canadian equities should continue to grow profits in such an environment.

We will be contacting you soon to review your portfolio. If you have any questions in the meantime, please give us a call.

Warm regards,

The Seymour Team

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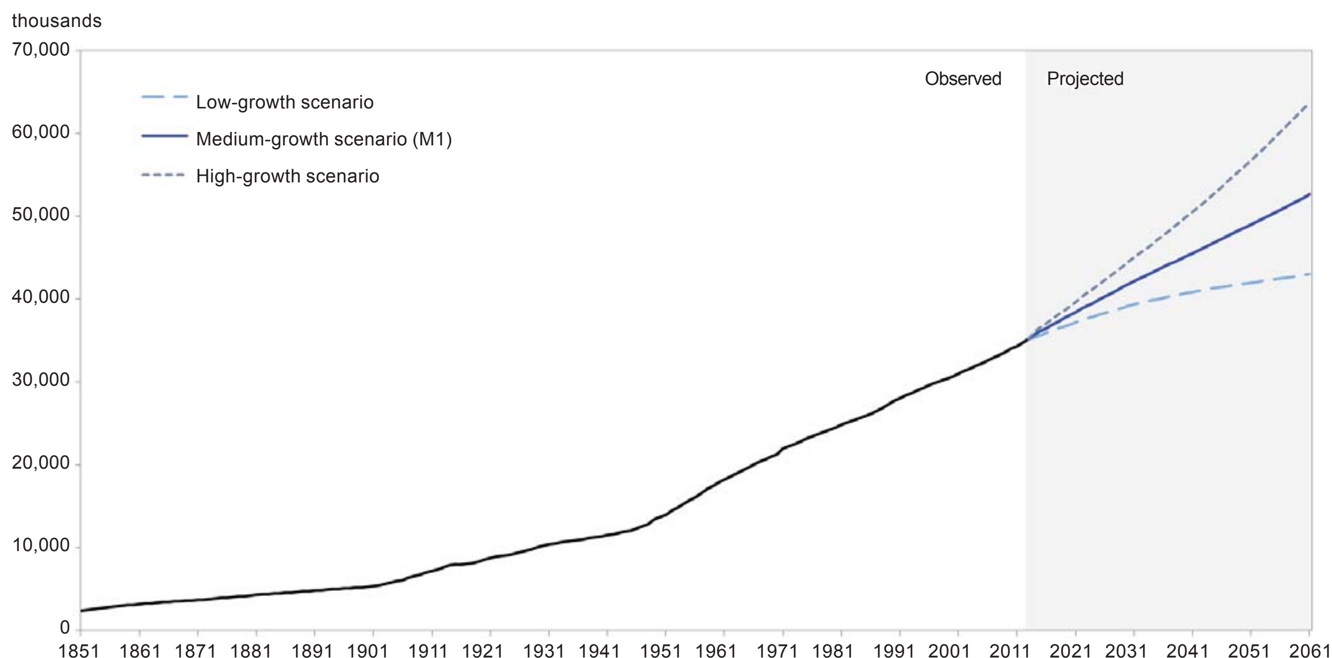
Approximately 52.6 million Canadians in 2061

- Over the past 150 years, the population of Canada has grown steadily. At the time of confederation, in 1867, the nation's population was about 3.5 million. In the last four decades of the 19th Century, growth was slowed by negative migratory increase, when more people left Canada than arrived.
- Population growth was especially robust during the first decade of the 20th Century and during the baby boom (1946 to 1965) when there was strong natural and migratory increase. By the peak of the baby boom, in 1959, the population of the country had increased to close to 17.5 million.
- On July 1, 2013, Canada's population was estimated at 35.2 million, and population growth has gradually slowed in recent decades. In the one year period between July 1, 2012 and June 30, 2013, Canada's population grew by a rate of 1.2%, mainly due to immigration.
- In the coming decades, the population of Canada is expected to continue to increase. According to the medium-growth scenario of the most recent population projections, Canada's population could reach 52.6 million by 2061. However, population growth could continue to slow as a result of declining natural increase, since the number of deaths is expected to gradually approach the number of births.

Figure 1
Population of Canada, 1851 to 2061



Sources: Statistics Canada. 2010. *Population Projections for Canada, Provinces and Territories 2009 to 2036*, catalogue no. 91-520-XPE, low-growth scenario, medium-growth scenario (M1) and high-growth scenario, censuses of population, 1851, 1861 and 1871, Demography Division, Population Estimates Program.