alizé capital

Gestion de portefeuilles / Portfolio management

La voie des Alizés

Navigating the Trade Winds

July 2016

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Dear friends,

		Closing	Change	
		30-Jun-16	Quarter	2016
Stock Indices				
S&P/TSX		14,065	4.2%	8.1%
S&P 500		2,099	1.9%	2.7%
MSCI EAFE*		922	-1.9%	-9.0%
Currencies				
CAN$ (US$ / C$)		0.7737	0.6%	7.1%
Euro (US$ / EUR)		1.1106	-2.4%	2.3%
Commodities				
Oil (WTI)	$	48.27	25.8%	30.0%
Gold	$	1,321	7.0%	24.3%
Volatility index				
VIX		15.63	12.0%	-14.2%

** MSCI Europe, Australiasia and Far East*

While Quebecers were getting ready to celebrate the National Holiday, the British parliament was expecting every citizen to do his duty on June 23rd in a national referendum. The financial markets were clearly outguessed and outmaneuvered by the final outcome. The Prime Minister David Cameron was not in a festive mood after his unexpected defeat in the face of the Brexit's "Leave" camp. The aftershocks of the vote were immediate, European capital markets were in a free fall at the onset on June 24th. In two trading sessions, the FTSE 250 plunged 7.2%, the biggest drop since the 1987 crash, and the British Pound tumbled by 11%, an event not seen in four decades. Even though the Brexit victory increased the risk level for the international financial markets, we do not believe that it constitutes a major setback for the world economy. Not to diminish the importance of the Old Continent, but relatively speaking, India and China respectively account for twice and seven times more in terms of growth of the world GDP.

During the second quarter, what stands out is the best performance in two years of the Canadian market (4.2%). Also, the stabilization in the prices of oil that began early in the year ran unabated, as we mentioned back in April. For Q2, the WTI clocks in at $48.27. Obviously, the 8.6% return of the Energy sector, contributed to the S&P/TSX performance, as did the rest of the commodity complex. The S&P500 ended the quarter in the black with a 2.7% return, while the MSCI EAEO, finished down 1.9%, losing most of its gains in the final days of June in Europe for the reasons we already know.

The impact of Brexit on our investment strategy

What was really whispered in the backrooms and corridors of power in regards to Brexit. We shall only know for sure in a distant future. The polls going into the last stretch were giving a slight advantage to the "Remain" vote, but as for the Scottish referendum, most experts were convinced that a final ground swell would convincingly preserve the status quo. The favoured outcome obviously did not materialize. It was a complete surprise for 48% of the British voters and a total shock for 100% of the Golden Boys.

In the short term, the damage on North American exchanges was well contained, the reversal after the vote result, was swift, impressive and complete. In the two weeks leading to the referendum, the S&P500 was hesitant, almost gasping for air, it was getting closer to that ultimate resistance level that was encountered several times but never overtaken. The Brexit win provided the impetus for the correction. In the longer term, we believe that the Brexit will have a positive impact on the European Union and no major repercussions for the markets. This apparent break was in the cards for quite a while. The United Kingdom is by far the member country that voted the most often against Germany, its voting profile was closely aligned with the Swedes and the Dutch. Most importantly, the UK was the member that ended up on the losing side of a vote the most often. We expect an increase of acrimonious declarations as all parties will want to position themselves for future negotiations. But in the end, we believe that the British people will manage to pull out a deal that is quite similar to the Norwegian status. Furthermore, we believe that global trades will not be affected by this event.

Our intention is not to underestimate the importance of the Brexit, but for the time being the EcB and other central banks have a clear path for accommodative policies. Any austerity measures that may remain will surely be alleviated. Weaker European currencies will also act as a natural buffer and countervail partially the negative impacts on export driven economies. Finally, the Fed, in a precautionary stance, should pause the current rate hike cycle. What appeared initially as a negative framework could possibly offer a very good environment for the S&P500 to punch through that important ceiling at 2 135.

For the Golds, just stay the course
Our decision to increase the exposure to the gold sector during the quarter was for now a sensible move. Gold stormed out of the gates on the very first trading day of the year and basically has seen no important retracement. At midyear, it is one of best performing asset classes with a 24% return. What about the second semester? On a technical basis, the precious metal came out of a very sinuous and elongated consolidation pattern that stretched out for three long years. We could be at the very first stage of a new upward cycle. After the Brexit result, gold bolted upwards 8% and we think that at the very least, Gold will maintain the present levels. Moreover, in these uncertain times, the Golds could act as an indirect insurance policy against geopolitical dislocations.

Conclusions and perspectives
Despite our relative optimism for the rest of the year we are not blind to certain risk factors that could alter our current scenario. A stronger than expected advance in the US dollar – the other world safe haven with gold – could cap any upside for economic growth and impact negatively on stock markets. For now, we are satisfied that current actions telegraphed by central banks will maintain robust confidence levels among investors. A low interest rate environment in Europe and a Fed pause will contain the advance of the greenback. Also, we find solace in the still healthy trend of leading economic indicators. All is almost well for now.

The Alizé Capital Team