

DM Portfolio commentary

4th QUARTER 2017

Too far, too fast?

Stretched, overdone, long-in-the-tooth. *Unprecedented.* As gains pile up, such labels are being applied more frequently to stock markets and, with another strong year now in the books, they aren't likely to be put away anytime soon. Of course, underlying these descriptions is a nagging fear that things are going too well, that today's growth will eventually be reciprocated in tomorrow's crash. With the long shadow of the financial crisis still cast across investor memories, bouts of trepidation are understandable.

As we've related in the past, though, the fundamental analysis we conduct on individual companies doesn't have us overly worried about valuation and most of the conversations we've had with management teams suggest improving, not deteriorating, business conditions. As well, the economic backdrop is on an upswing around the globe, consumer and business confidence is strong and, though they've crept up from earlier lows, interest rates remain at historically stimulative levels, all of which should be generally supportive of equities. Still, even the most steely and unemotional portfolio manager can sometimes wonder if too much time in the trees is obscuring the view of an ominous forest. With that in mind, we decided to step back and take a look at past bull markets to see how the current run compares and just how vulnerable it might be.

Not including the one we may be enjoying at present, the past 70 or so years have provided two *secular* (or very long term) bull markets: roughly 1949 to 1969 and 1982 to 2000. During these periods, stocks delivered prodigious gains, with the S&P 500 generating an annual total return of approximately 14.7% through the first upswing and nearly 20% in the second. This isn't to say that these intervals were placid, linear uptrends. In fact, if the common definitions of interim bull and bear moves are 20% rallies and 20% declines, 13 of these "tactical" events occurred within the uptrend that began in the late 40's alone, while the second long term run included the crash of '87. Odds are, though, that virtually anyone trying to outguess these subordinate gyrations would have traded their way out of a significant portion of two of the most potent wealth creating episodes in history.

A couple of additional points worth noting:

- First, both of the long uptrends identified above were preceded by "lost" decades: major indices mostly treaded water through the Second World War and its immediate aftermath and they produced no return during the inflation addled 1970's. Similarly, the first decade of the third millennium was also lost to investors, with the dot-com crash and subprime crisis bookending a period when

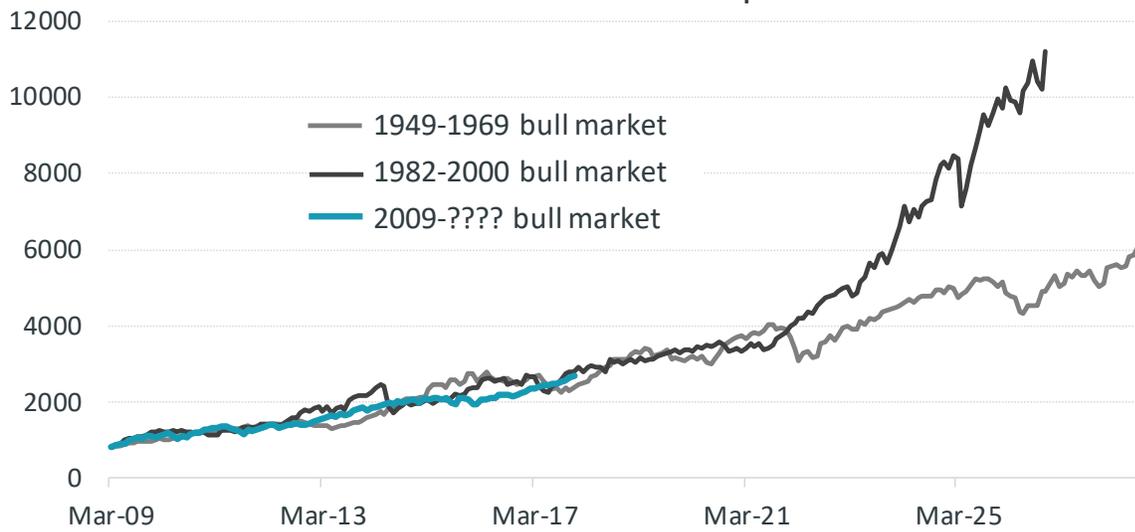
10-year stockholders earned nothing for their patience.

- Second, annual performance was extremely scattered throughout these periods, with the S&P never generating a calendar year return of between 8% and 10% during the years examined. In fact, the index has produced an annual total return within that range exactly zero times since 1928, the earliest date for which Standard & Poors provides data. Think about that: *the "average" return range that investors have come to associate with senior equity markets has never actually occurred in a calendar year!* If that doesn't underscore the axiom that expected stock performance only accrues to those who stick it out and let the good cancel out the bad, it's difficult to imagine what does.

March of 2009 and have also imagined that the 1949 and 1982 bull markets began at the same time.

As you can see, if history is at all relevant to current circumstances, the gains we've enjoyed since the nadir of the financial crisis are not extraordinary at all. In fact, if this is a secular bull market akin to the other two experienced since the War, the climb is barely at its midpoint and not in the least excessive in terms of magnitude. So, the next time you hear words like "unprecedented" or "dangerously over-extended", just refer back to the graph above. And when markets suffer a sharp drop, which they most certainly will, remember that such turbulence has always been part of equity investment, even when stocks are in the midst of assembling a prolific and extended ascent.

S&P 500 bull market comparisons



Source: Bloomberg

To get a sense of where we might currently stand, on the accompanying graph we've plotted the S&P 500 since it made its major bottom in

With these thoughts in mind, we remain fully invested in our equity mandates heading into 2018 and continue to believe that market

setbacks will represent opportunities to profitably reallocate portfolios, rather than significant shifts in trend. Though several predicted that a bear market in bonds would finally take hold in 2017, this never really came to pass: the yield on the 10-year Canada bond drifted up about 30 basis points during the year, while its US government counterpart actually saw its yield fall slightly. We

don't expect bonds to contribute much to return in the 12 months to come, but continue to view these assets as a risk management tool, dampening the natural volatility of equity allocations and providing reliable capital to meet unforeseen personal needs or changes in investment goals.