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The Bigger Picture

A weekly snapshot of the markets

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James Grant warns about risks posed by central banks' monetary policies at CFA Vancouver's 37th Annual Forecast Dinner

Elvis Picardo, CFA

CFA Vancouver's 37th Annual Forecast Dinner held on January 13 featured three speakers – James Grant of *Grant's Interest Rate Observer*, John Thiessen of Vertex One, and Brad Dunkley of Waratah Capital Advisors. Grant's dire warnings about the risks posed by unconventional monetary policies, and some interesting equity ideas on the long and short side by Thiessen and Dunkley, were key takeaways from the event.

Grant heaped scorn on the monetary policies now being pursued by central banks around the world. Grant noted that with central banks having conjured more than $10 trillion of "digital wampum" over the past seven years, the business model of the modern central bank has become "something for nothing." Referring to the negative rates of return offered on short-term euro deposits, he said (with only a hint of sarcasm) that such "negative payback" instruments may represent a new asset class!

Grant expressed astonishment that as many as six countries currently have 30-year bond yields below 1%, led by Switzerland, where the 30-year bond yield is below 0.5%. Echoing the views he expressed in a recent piece in the *Financial Times*, Grant said that many years from now, investors will marvel that today's bondholders are willing to lend to "feckless" governments at barely positive rates of interest, or at literally negative rates in the case of countries like Switzerland, Germany and Japan. Grant concluded by questioning how central banks would respond to the next recession and bear market, which will inevitably occur sooner or later.

Brad Dunkley noted that funds flows into Canadian non-resource sectors rose 31% in 2014. He also said that he expects a significant decline in Canadian housing, and anticipates a flurry of M&A activity because debt is so cheap at present.

John Thiessen expects US Treasuries to continue to rally, as their yields are higher than those offered by bonds from some European countries like France. He expects that the Treasury rally will pull the S&P 500 along on a relative-yield basis. Thiessen also said that he expects the Canadian dollar to decline markedly.

Table 1 summarizes some of the long-short ideas offered by the presenters.

Table 1: Long-short ideas by presenters at the 2015 CFA Forecast Dinner

	Grant	Dunkley	Thiessen
LONG	***Sberbank of Russia ADR*** *(OTC: SBRCY, $4.23)* ***Gold*** ***Franco Nevada*** *(TSX: FNV, $65.94)*	***CCL Industries*** *(TSX: CCL/B, $120.69)*	***Fiat Chrysler*** *(NYSE: FCAU, $12.10)* *European banks –* ***Barclays PLC*** *(NYSE: BCS, $13.63)* ***Royal Bank of Scotland*** *(NYSE: RBS, $11.03)*
SHORT	*Not mentioned*	***Finning Intl.*** *(TSX: FTT, $21.52)* ***SAP SE ADR*** *(NYSE: SAP, $67.11)* ***MacDonald Dettwiler*** *(TSX:MDA, $91.32)*	*Leveraged ETFs*

*Prices as of January 19, 2015

In outlining the rationale for their picks, Dunkley said that his three short ideas have levered balance sheets, stretched valuations and downward earnings revisions, while Grant said that Sberbank trades at a single-digit P/E and has a rich dividend yield. Thiessen warned that Canadian insurers may get stressed if interest rates stay low.

How did the forecasts from last year's panel – Avery Shenfeld of CIBC World Markets, Jim Gilliland of Leith Wheeler Investment Counsel, and John Mauldin of Millennium Wave Advisors – pan out? With mixed success, as it turned out. The highlighted items (in yellow) in Tables 2 and 3 show the closest forecast or successful idea. Items highlighted in red in Table 3 missed by a mile.

Table 2: End-2014 forecasts by presenters at the 2014 CFA Forecast Dinner

	Levels (Dec.31,'14)	Gilliland	Mauldin	Shenfeld
TSX Composite	14,632.44	*14,500*	*Not Provided*	*+10%*
S&P 500	2,058.90	*1,935*	*+10%*	*+5%*
10-year yields – GoC **US Treasury**	1.79% 2.17%	*2.75%* *3.00%*	*Not Provided* *2.50%*	*3.00%* *3.25%*
Gold	US$ 1,184.86	*US$ 1,200*	*US$ 1,240*	*US$1,150*
C$	US$ 0.8605	*US$ 0.88*	*US$ 0.95*	*US$ 0.92*

Table 3: Long-short ideas by presenters at the 2014 CFA Forecast Dinner

	Gilliland	Mauldin	Shenfeld
LONG	*Capital Power Series 5 Preferred (TSX: CPX E, $22.20)*	*Robo-Stox Global Robotics & Automation Index ETF (NASDAQ: ROBO, $24.92)*	*Canadian forestry stocks index*
SHORT	*Emera (TSX: EMA, $40.57)*	*Japanese Yen* *France bonds*	*US Utilities*

* Prices as of January 19, 2015

The Week Ahead

U.S. earnings season kicks into high gear this week, with a number of bellwethers – including Johnson & Johnson, IBM, Verizon, GE and McDonald's – set to report Q4 numbers. On the Canadian side, only Celestica and Canadian Pacific are scheduled to report this week. Corporate earnings are likely to be upstaged in the week ahead by economic forecasts from the IMF and Bank of Canada, as well as news from the World Economic Forum at Davos, Switzerland.

Tuesday, January 20, 2015: The IMF releases an update to its *World Economic Outlook (WEO)* tomorrow. While the October 7 edition of the WEO had predicted global growth of 3.8% in 2015, the amount of economic turmoil since then may result in a lowered forecast. Note that the World Bank last week forecast that global growth may rise moderately to 3.0% in 2015 (from 2.6% in 2014 and 2.5% in 2013), and average about 3.3% thorough 2017. Separately, China will tomorrow release Q4 GDP data, which may show that the economy grew at a 7.2% rate, the slowest pace since 2009.

Wednesday, January 21, 2015: The Bank of Canada announces its rate decision and issues its *Monetary Policy Report (MPR)* on Wednesday. While the Bank is widely expected to leave its benchmark overnight rate target unchanged at 1%, the growth forecasts in its MPR will come under a great deal of scrutiny, given that the Bank had forecast domestic growth of close to 2.5% this year in the October 2014 MPR. The economic landscape has changed dramatically since then, as crude oil prices have plunged 40% and the loonie has depreciated 6% versus the greenback. There is growing evidence that 2015 will be a challenging year for the Canadian economy. At least $12 billion in capital spending cuts have been announced by Canadian energy companies since November; Target's departure from Canada announced last week will result in the loss of almost 18,000 jobs; and home sales in Calgary plunged 24.6% in December from the previous month. According to a recent Bloomberg survey, economists have reduced their growth projections for Canada in the first half of 2015 to 1.9% in Q1 (down from 2.2% forecast in December), and 2.0% in Q2 (compared with a December forecast of 2.4%). Futures trading is now pricing in a 17% chance of a rate hike by the Bank of Canada in 2015, compared with 48% at the beginning of January.

Thursday, January 22, 2015: European Central Bank policy decision, with the ECB likely to announce a historic 550 billion-euro bond-purchase program.

Market Snapshot

At close today

S&P TSX	14312.50	+3.09	Commodities			Yields (%)	Can.	US
TSX Venture	673.16	+5.85	Canadian $ (US cents)	83.75	+0.31	90 Day T-Bill	0.92	0.01
DJIA	17511.57	Closed	Gold (Spot)-US$	1275.65	-4.80	2-Year Bond	0.92	0.54
S&P 500	2019.42	Closed	Oil (WTI-Feb.)	47.52	-1.17	10-Yr.Bond	1.60	1.90
NASDAQ	4634.38	Closed	CRB Index	224.24	Closed	30-Yr. Bond	2.17	2.49

Thought for the Day

"In great attempts it is glorious even to fail." – Vince Lombardi

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