THE MACKIE WEALTH GROUP

FOURTH QUARTER 2014 REVIEW
JANUARY 2015

2014 INVESTMENT REVIEW AND A LOOK AHEAD AT 2015

INDEX RETURNS (LOCAL CURRENCY)	4TH QUARTER	2014	3 YR. ANNUALIZED
S&P/TSX	-2.2%	7.4%	7.0%
S&P/TSX Venture (small cap)	-23.5%	-25.4%	-23.4%
S&P/TSX Materials	-7.4%	-4.5%	-14.2%
S&P/TSX Capped Energy (XEG)	-24.0%	-18.2%	-9.0%
S&P/TSX REIT	8.5%	10.0%	3.1%
S&P/TSX Financials	0.3%	9.8%	12.0%
S&P 500	4.4%	11.4%	17.9%
Euro Stoxx 50	-2.5%	1.2%	10.7%
England (FTSE)	-0.9%	-2.7%	5.6%
MSCI Emerging Markets	-4.9%	-4.6%	1.4%
TMX Universe Bond	2.7%	8.8%	3.7%

COMMODITIES		DEC. 31 PRICE
Natural Gas (NYMEX)	-33.8%	$2.89
WTI Crude	-41.6%	$53.27
Gold	-1.9%	$1,184
Silver	-20.2%	$15.60

CURRENT YIELDS		ONE YEAR AGO
2-yr Gov Cda	1.01%	1.14%
5-yr Gov Cda	1.34%	1.94%
10-yr Gov Cda	1.79%	2.76%
2-yr Treasury US	0.66%	0.38%
5-yr Treasury US	1.65%	1.74%
10-yr Treasury US	2.17%	3.03%
CAD spot	**1.1621**	**1.0623**

Source: Richardson GMP, spindices.com

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RICHARDSON GMP

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The U.S. markets led global equity markets, with each of the Dow Jones Industrials, the S&P 500, and the NASDAQ all making several new 10 year highs at points during the year. Note the NASDAQ this past year regained the price level it made in April 2000, 14 years after the tech bust. The TSX lagged, owing largely to commodity prices weakening significantly through the last four months of the year, but still up 7.4%. Large-cap Dow and S&P stocks remained the focus as investors stuck with quality, liquidity and more attractive dividends than can be had in investment grade debt.

Volatility came back to markets in the last quarter, with strong "V" shaped recoveries back from the 4.3% drop in the S&P 500 in October which was then followed by a 4.5% peak to trough drop in December. But the TSX never fully recovered its value from where it was trading at the beginning of the fourth quarter owing mainly to the continued drop in oil and natural gas prices and the index weighting to oil related stocks. Energy stocks now represent 22% of the TSX index (down from closer to 30% in previous years). Central bank maneuvering has still been the driver of the risk on/risk off moves in the market, and we are feeling increasingly that volatility will be the theme of 2015. Central banks are diverging in their strategies, unlike a few years ago. The U.S. would like to tighten monetary policy, but is unlikely to go far with interest rate hikes with the U.S. Dollar so buoyant. Europe and Japan are looking to promote quantitative easing policies. This week's surprise move by the Swiss to unpeg their currency to the Euro, and cut interest rates again (to NEGATIVE 0.75%!) was the latest central bank move that caused global volatility in stock and bond prices.

We maintained or increased cash positions in the fourth quarter, and harvested some gains in the energy infrastructure space particularly, as we feel this sector (among the best performing of the last three years) is going to continue to be vulnerable to repricing, i.e., these stocks we feel are overvalued relative to their future growth environment given they are still trading at 20 – 30x P/E multiples. We were generally underweight energy going into the fall compared to the index, but any exposure at all led to a drag on fourth quarter performance.

The three most significant events that shook markets in 2014 were broadly unexpected:

Interest Rates went DOWN

- Interest rates behaved the opposite of nearly all expectations at the beginning of 2014
- Interest Rates went DOWN over the year: U.S. 10 year treasuries are a full percent lower than they were last year.
- Long U.S. Treasury bonds were among the best investment class, up 25% in 2014, to the contrary of nearly all prognostications at the beginning of the year, when it seemed universally expected that long bonds would be the riskiest and worst performing asset class.
- Bond prices rose (and yields fell) owing to: risk aversion for other asset classes and looking for safety in German, Swiss, U.S. bonds; a forecast that low inflation will be the theme for many years; and low yields are a reflection of future global growth expectations. It is worth noting that the U.S. 10 year Treasury at 1.8% yield today, is still more attractive than German, Swiss, Japanese yields, one reason why investors have been flocking to US dollars.

The U.S. Dollar had its most dramatic rally in years

- The Trade Weighted Dollar index, which measures the USD against a basket of currencies, moved from valuing the 80.04 at the beginning of 2014 to 90.27 at the end, and continued its rally into 2015. The USD gained against all 31 of its major counterparts in 2014 for the first time in 25 years (Mauldineconomics.com).
- Canadians certainly noticed our purchasing power decline when travelling to U.S. over the last year, as the loonie dropped by 8.5% over the year against the USD, and further into 2015, with the CAD trading at a multi-year low of 83 cents, versus the USD. Our US and International positions benefitted.
- The USD has gained on the view that the U.S. economy will outperform in 2015, alongside the desire to seek out safe havens. This trade is becoming crowded and could cause volatility if sentiment shifts. The USD will likely see some price volatility at these levels.

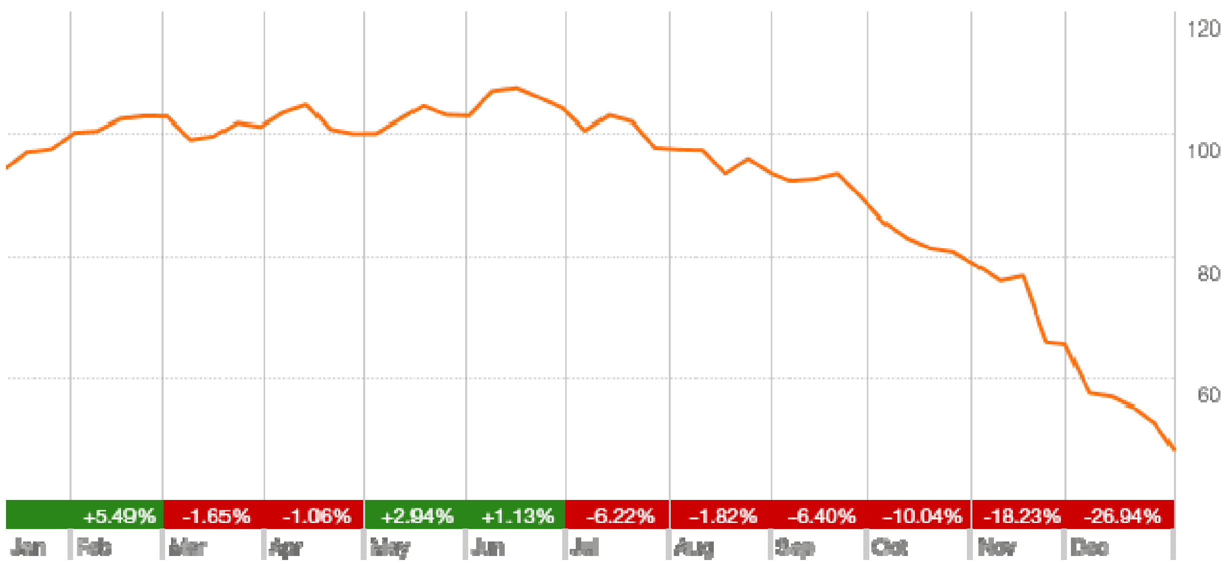
Trade Weighted US Dollar Index:

Stlouisfed.org

The price of oil crashed

Oil price had its fastest and most precipitous price decline in recent memory, including the Great Financial Crisis, and is now trading back near levels last seen when the world was in a state of financial crisis. While many thought $100-plus oil price was unsustainable given fundamentals last summer, the 60% drop in WTI price was a shock to all.

2014 Light Sweet Crude front month



10 year performance Light Sweet Crude front month

Globeandmail.com

Why did the price fall?

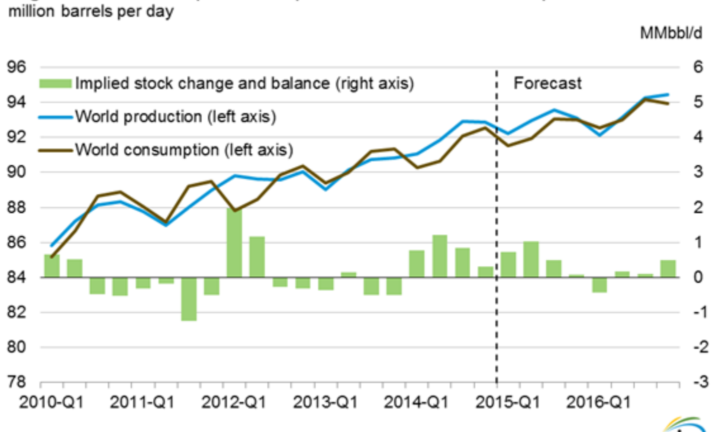
Bearish supply/demand fundamentals. They hit a tipping point this summer due to the run up in US production. US output expanded to 9.14 million barrels a day by December, 2014 (up one million barrels per day from 2013). When you include Canada's and other nations contribution, Non-OPEC production grew by 2 million barrels a day in 2014, while OPEC production remained stable, and demand was in decline.

Ongoing risks:

- The supply/demand balance is off by an estimated 1 – 1.5 million barrels of daily oversupply. At writing, we still haven't seen shut-ins of production. Most Canadian company budgets are still projecting at least flat, if not modest growth production compared with last year. *The Calgary Herald* reported on January 14 that the oil sands will still add 300,000 barrels a day over the next two years. ("Delayed oil supply response expected to slow price rebound." *Calgary Herald*, January 15, 2015). Oil and gas producers have on average announced 20% - 25% spending cuts for 2015.
- It is still uncertain how U.S. shale oil production, the other major source of global growth, will change. On the one hand, some companies are extremely vulnerable to the price change owing to high leverage on their balance sheets. The energy sector represents 15% of the high yield bond market in the U.S., with much of that debt raised at above $90 oil prices. This element of the high yield market risks falling into distress, which could lead to a quick curtail of production. An important side note – we are at risk of a wave of defaults in this space with it being unclear how deep that contagion could spread. Junk bond ETFs have reflected these concerns with mass capital outflows in the last several months. On the other hand, stronger companies like Conoco say that they will still grow production by 3% in 2015 even with a 23% spending cut, and will focus drilling on Bakken shale in North Dakota and the Eagle Ford in Texas ("Conoco slashes investment after oil slump," *FT.com*, December 8, 2014)
- The breakdown within OPEC/ Saudi Arabia's willingness to take lower prices to protect market share – Saudi is continuing to talk down the oil price through the last two months of 2014.
- The run up in the USD contributed to the fall – commodities are priced in USD –and the USD is still rising and could stay relatively strong through 2015.

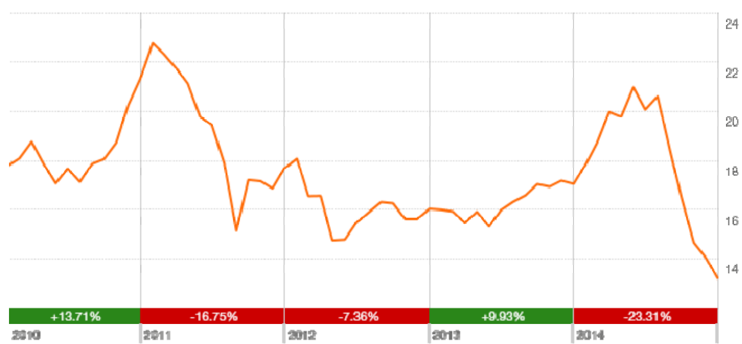
- Concerns about global growth remain – low global growth means that consumption is not picking up to meet supply growth.

Figure 2. World liquid fuels production and consumption balance
million barrels per day



Source: Short-Term Energy Outlook, January 2015.

TSX Capped Energy Index 5 Year Performance



Globeandmail.com

What does all this mean for 2015? Investment Strategy

U.S. is still the strongest global economy:

- 2014 GDP growth will ring in at around 2.5%, which while below long term averages, is still real growth. 2015 growth is expected to be 3% (*WSJ.com*, January 15, 2015).
- Outside of the oil patch, U.S. corporate balance sheets remain strong.
- Unemployment rate back down to its long term average of 5.8%, although we discount that statistic somewhat as the participation rate, those looking for work is at its lowest in forty level years, at 62.7%. Still, the U.S. consumer is in far better shape than in 2007, and in better shape than the Canadian consumer.
- However, caution will be used when buying as equity valuations may have already priced in growth expectations for the 2015 U.S. economy. So we will be looking to be buyers on the pullbacks that we expect to continue to see. Gains in the U.S. stock market will be more company specific versus broad based. We are looking specifically at companies who benefit from the cheap energy dividend, those that have large floating cost exposure to energy prices; and companies that will benefit from increased U.S. domestic consumption, like Walgreen's.

- Note the Federal Reserve is trying to back away from market support – this will lead to volatility as market participants adjust. Risks include foreign market carry or trades being unwound and short covering rallies.

U.S.Dollar: keep a large weighting in this currency:

- We will hold our USD and would even look to use meaningful pullbacks in the USD to add to our U.S. dollar holdings. We are not optimistic there will be meaningful strength in the CAD over the coming year.
- It is possible that the USD could run more from here: the USD remains the main reserve currency that markets turn to when they feel risk averse. The Euro and Yen have been sliding as those currencies are battling deflation, and recessionary forces could take hold in parts of Europe; U.S. growth is easily outpacing them. Easy monetary policy is likely to continue in Europe and Japan, whereas the U.S. Fed is at least talking up an attempt to tighten monetary policy. This keeps investment dollars flowing to the U.S.. Second, if capital continues to leave emerging markets (think Brazil, Russia, etc.), the USD will keep rising.
- U.S. equities are still perceived as the best place to make a return on capital, and can provide better income than bonds.
- Below is a technical analysis chart, courtesy of Mauldin economics, that posits that the definitive breaking out above the resistance line above 90 is a powerful indicator that the dollar could move higher. A rapid capital move out of emerging markets would not only move the USD higher, but likely precipitate extreme volatility in markets.

Interest rates will start to rise modestly this year in the U.S. (we think); stay flat in Canada

The consensus right now seems to be a June hike in rates in the U.S. – but we think any raises will be modest, as the Fed is aiming to ease out of ZIRP (zero interest rate policy) without causing catastrophic repercussions in markets. The attempts to normalize rates will cause disruptions to the market as this causes asset class re-pricing, especially fixed income and utility stocks.

Volatility will increase:

We are still advocating a meaningful percentage of accounts invest in alternative strategies/ hedge funds that take advantage of stock market volatility: market neutral strategies that have low correlation to the market; that can go short stocks; arbitrage strategies. 20 to 25% of accounts could be exposed to these strategies. We are always interviewing and performing due diligence on prospective and current managers to seek out best in class in this hedge fund sector.

Canada will struggle:

The core index sectors of Canadian banks, Energy and Materials will be volatile or just muddle through performance in 2015

Lower oil prices are a tax cut for some, but very painful for Canada.

- In Canada, 37% of all private sector capital expenditures (outside of housing) was spent in the oil patch the last several years. This will be radically reduced in 2015, meaning a real slowdown in economic activity in oil producing regions of Canada – Alberta and Saskatchewan especially.
- Consumers are going into the slowdown highly indebted as we have noted previously. Bank earnings will decline as consumer and corporate loan growth will slow, defaults could rise in consumer and oil patch related debt.
- The U.S. will likely be one of the net beneficiaries of lower oil prices. In the U.S. capital spending driven by oil investment is significant but it only represents 7% of all CAPEX in the U.S., meaning that for the bulk of the U.S. economy, lower oil prices is a boon. Certainly, jobs growth in the oil producing states North Dakota and Texas was significant, increasing by 19% since 2003, versus 7% broadly across the nation (*Gavekal*, January 14, 2015). But if history repeats, we should see a surge in in consumption and investment by those who use energy. Traditionally, six to seven months out from a large drop in oil prices (they have been falling for six months) we see consumer consumption pick up and business investment later expand to meet demand. This could mean that the U.S. is again the best performing market, as we could see a pick-up in sales and CAPEX in other sectors that will compensate for the loss of oil industry spending.

We expect oil to trade in a much lower band for 2015, and perhaps well beyond 2015, then where it was trading the last four years.

- Canada had adjusted and assumed a normal range of $70 - $90 WTI price band following the GFC. At writing, we don't know if $50 - $55 will be the floor or the ceiling for 2015. Most oil producers that revised budgets for 2015 are assuming $65 average WTI for 2015, based on December revisions.
- Supply disruption has been far less than expected owing to Middle East strife.
- Uncertain how U.S. producers will react to lower prices – and the cost of production keeps coming down, allowing supply to keep growing.
- Global demand growth uncertain: Europe's economy slowing and flirting with recession.
- Waning demand in China: China's GDP has been slowing and will probably stabilize around the 6-7% growth level of the last two years, versus the 12% growth 5 years ago. Oil intensity is falling as the economy develops away from heavy industry focus.

Best regards,

Tricia Leadbeater
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