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THE SUBARU VANCOUVER TRIATHLON

By Cameron Ho

Several years ago, I was inspired to do a triathlon after watching the Ironman World Championships on TV. The idea of pushing myself to the limit - combining open water swimming, biking, and running – appealed to me. Indeed, it seems that above all else, passion for extreme exertion is the strongest pull that brings people into the world of triathlon. On forums online, veterans share stories of their experience in the "dark place", the point at which the mind and body start begging you to slow down, or to quit. Coaches cite the most recent research on how pain can be ignored to allow an athlete to push until complete body failure. One tri expert ended his description of the "perfect race" with a picture of a triathlete collapsing across the finish line.

I completed my first Olympic-distance triathlon on a warm, sunny morning in mid-July, at the Subaru Vancouver Triathlon. The event was of the most grueling activities in which I have participated, next to cross-country ski racing and rowing. While the physical rigor of the sport may seem daunting, I was encouraged to learn that triathlon draws athletes of all ages, shapes, and sizes. There were professionals with shaved legs and $15,000 bikes, beginners like myself, and everything in between. I spoke to a man whose 48 year old son, a former two-pack-a-day smoker, had travelled from Alberta to race. Competing with such a diverse group of athletes, along with the event's beautiful location around Spanish Banks and UBC, made the triathlon a memorable one. The swim for my category started at 7am, with dozens of us jostling to get from the beach to the first buoy. With adrenalin flowing, I barely remember how I finished the 1.5km swim. Before I knew it, I had completed 40km on the bike with two loops up and around UBC, and was steadily running along Spanish Banks. I eventually entered the fabled "dark place" at the 7k point, but I mustered enough energy to run to the end and sprint through the finish.

My mum was surprised to see a medal around my neck when I came in the front door later that morning. I clarified that it was only a finisher's medal, given to everyone after they cross the line. Still, it was a satisfying personal victory. Time to start training for my next tri!

About Cameron:
Cameron is a final-year undergraduate at the University of Exeter in the UK. He is completing a degree in Middle Eastern Studies, and plans on pursuing a career in asset management.

Originally from Vancouver, Cameron is spending the summer as an intern with the Jefferson|Steele team.

OUR PARTNERS

Dwight Jefferson, CIMA ®
Senior Vice President,
Portfolio Manager
T: 604 640 0555
dwight.jefferson@richardsongmp.com

Tyler Steele, CFA
Senior Vice President,
Portfolio Manager
T: 604 640 0554
tyler.steele@richardsongmp.com

Neil Kumar
Associate Investment Advisor
T: 604 640 0406
neil.kumar@richardsongmp.com

Paul Rietkerk, CIM, FMA
Associate Portfolio Manager
T: 604 640 0562
paul.rietkerk@richardsongmp.com

Wendy Lloyd
Associate
T: 604 640 0556
wendy.lloyd@richardsongmp.com

Jessica Dewey, BA
Associate
T: 604 640 0405
jessica.dewey@richardsongmp.com

Brenda Geib, BA
Associate
T: 604 640 0559
brenda.geib@richardsongmp.com

RICHARDSON GMP
550 Burrard Street, Suite 500
Vancouver, BC V6C 2B5
TF: 1 866 640 0400
F: 604 640 0300
www.richardsongmp.com

FIXED INCOME COMMENTARY

What We Think - Lorica Investment Counsel Inc.

By Gary Morris CFA, President – Lorica Investment Counsel Inc.

The Second Half…

Now that we have gotten through the first half of the year, it is time to let go of the weather distortions and the geopolitical crises that have dominated investor psyche, and look forward to the economic reality that will ultimately dominate markets. Of course, the other dominant factor – the Fed – is still alive and kicking in, some might argue, even better playing form, with a newly ensconced captain and updated roster. Although Janet Yellen has been around the Eccles Building (where the Fed meets) for some time, she does not carry the baggage of being the lead architect of the QE program nor the author of controversial procedural changes. In many ways, Yellen is freer to direct the Fed than Bernanke would be at this point, although it still remains to be seen when she will begin to chart a substantially new course.

We think the economic data is pointing to a stronger US economy and, perhaps more importantly, tighter labour markets. Job growth has averaged 272,000 for the last three months, and although not stellar in the context of past recoveries, the trend is clear and stable. The unemployment rate, now at 6.1%, has been declining consistently, edging closer to conventional levels of full employment – somewhere around 5.5%. Janet Yellen has continued to emphasize the decline in the participation rate as evidence that there is more slack than the headline unemployment numbers reveal. However, there is reasonable evidence that a meaningful portion of the participation rate decline is related to the ageing workforce and retirement, as well as other structural impediments, such as skills mismatch and less workforce mobility. Our take is that as long as the unemployment rate continues to decline, even modestly, wage pressures, in at least specific pockets, will not be that far off. Currently the YoY change in average hourly earnings is not yet a concern at 2.0% YoY as at June, compared to 2.2% this time last year and 2.0% two years ago.

Admittedly, current US economic growth appears lackluster – likely to average no more than 2% for 2014, but one has to look beyond the first half of the year. The most recent data suggests economic growth could average between 3-4% in the second half, led by improvement in manufacturing and housing. The recent manufacturing reports including the national and regional ISM's all point to significant contribution from manufacturing with steady improvement since December. Notably, transportation is leading the way with the most significant contributions coming from autos followed by aerospace. In terms of housing, starts stayed above one million in May, continuing the mark set in April, after the poor first quarter when starts averaged just 925,000. The growing number of starts combined with the continued pace of permits (just under one million) should greatly benefit domestic growth in the second half of 2014.

We believe that the inflation picture is changing. That's not to suggest we think inflation is poised for uncontrollable acceleration, but rather, we expect to see a visible increase from the sub-Fed target levels experienced during the last twelve months. The US CPI came in at 2.1% in May, the highest reading since October 2012, and the Core CPI came in at 2.0%, which is at the higher end of the range that has held since June 2012. Given the improved outlook and pockets of wage pressures, these levels should increase further. We note that the Fed, Yellen in particular, seems unfazed by the inflation numbers, with the Chairwoman responding that there is much "*noise in the current data*" when asked to comment about rising CPI, during the recent post-FOMC meeting press conference. It should be noted however, that the Fed pays more attention to the Core PCE Deflator which has only just begun to turn up, but based on historical behavior can be counted on to follow the CPI moves.

To this point in 2014, the bond market has pretty much ignored the growth story and only begrudgingly paid attention to inflation. But then, that should not be a surprise as the Fed largely "owns" the yield curve and Yellen and team have not been shy about their intentions to keep it low, despite tapering its QE program. The Fed's other "program" of lowering *threshold guidance* has effectively kept a ceiling on longer term yields, and there are no signs of an imminent change in course. We can only surmise that, for the time being, the Fed, on the whole, would be comfortable with core inflation rising to 2.5%, while continuing to focus on the low participation and high underemployment rates, thereby keeping monetary policy easy until they are absolutely ready for a tightening.

While the US economy is looking healthier, the same cannot be said for most developed economies around the world. Europe is clearly struggling, which has forced the ECB on a path of increasing accommodation, and Japan has shown only an erratic response to the over-zealous policies of the BoJ. It should therefore, be no surprise that developed country sovereign yields have fallen precipitously, such that even 10-year Spanish yields have now fallen below 10-year US yields. Correspondingly, attractive US yields have encouraged foreign flows into the US bond market, which in turn has had a dampening effect on the rise of US yields.

International investment has not been the only flow of funds supporting the US bond market. Financial institutions (which includes banks, brokers, and asset managers), who had been net sellers of bonds in 2013, have been one of the biggest sources of investment so far this year. As for the Fed, though it is steadily diminishing its asset purchase program, it is still reinvesting the coupons and maturities from its vast holdings. Households appear to be the most significant investor base disinterested in bonds, representing a major source of Treasury sales – on pace to be about $350 billion in 2014.

Into Extra-Time…

We are going through a period where we believe underlying economic factors warrant a rise in yields but financial flows into the bond market and monetary policy have not yet been supportive of this view. The dynamics for bond market flows are less certain in the short term – there are a variety of sources, such as sovereign yield spreads, asset prices, and investor sentiment, which are less influenced by domestic US fundamentals. However, in the medium term, assuming economic conditions remain positive, we expect monetary policy to reluctantly come into line, which will eventually impact flows to the bond market. It is this dynamic, stemming from even a subtle change in monetary policy, which has the potential to increase bond yields quickly.

We expect the longer end of the Canadian bond market to follow the direction of the longer end of the US bond market. However, the Canadian yield curve will likely remain flatter than the US yield curve as investors are forced to factor in the Bank of Canada's current dovish messaging. The fairly resilient Canadian housing market, improved manufacturing on the back of last years weaker Loonie, and the surprising rise in Canadian inflation will make it difficult for the Bank to continue to suggest its next move will be lower. The market has already priced some policy change into the front end of the Canadian yield curve and the Canadian dollar, and as the US economy continues to improve with some benefit to the Canadian economy, we would expect more to follow.

Source:
http://loricaic.ca/pdf/2014/LoricaInvestmentCounselIncWhatWeThinkQ32014.pdf

MARKET COMMENTARY

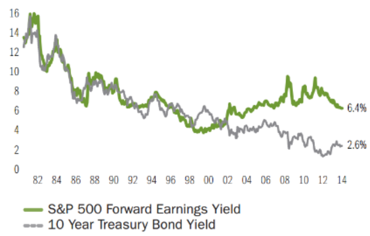
Equity Market Outlook – Sentry Investments

By James Dutkiewicz CFA, Chief Investment Strategist and Senior Portfolio Manager at Sentry Investments

Value in equity land

At the start of 2012, investors were willing to pay $12.90 for one dollar of future market earnings, represented by the S&P 500 Index P/E ratio. Fast-forward to June 2014, and for the same one dollar of earnings, investors are willing to pay $18.20. It does not take an expert to recognize that the equity market is no longer as cheap as it was over two years ago; however, it does take conviction in a portfolio to remain invested. On a relative basis, comparing equities' earnings yield of 6.4% (S&P 500 forward 12-months earnings yield) to a bond yield of 2.6% (10-year U.S. Treasury government bond yield), equities remain a more attractive proposition with an approximately 2.5x higher yield. As long as the global economy continues to improve, we do not believe stocks are expensive enough to undergo a significant correction without a negative catalyst.

S&P 500 forward earnings yield vs.
10-year U.S. Treasury government bond yield

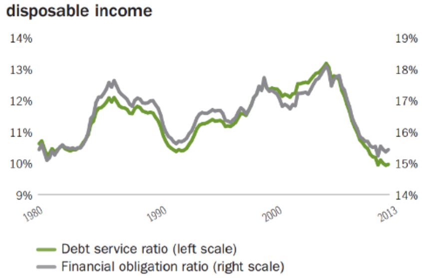


Source: TD Securities, data as at June 30, 2014

Improving economy

Global economic data is continuing to improve, and one of the positive tailwinds is the U.S. consumer's better financial position and consequent ability to maintain and increase consumption. The chart below highlights the magnitude of deleveraging in the U.S.; debt service and financial obligations as a percentage of disposable income have approached 30-year lows. A low interest rate environment, built up savings and debt reduction have enabled the U.S. consumer to be better positioned to contribute to the U.S. economic growth rate. The U.S. economy may not grow at a 4% GDP growth rate; but a 3% GDP growth rate in the second quarter and for the remainder of 2014 is probable, and we believe this will make a material contribution to global economic growth.

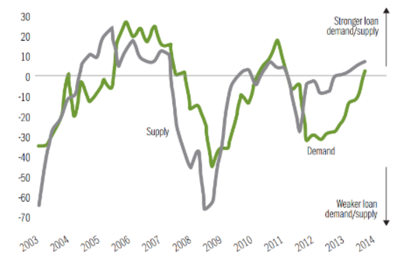
Low rates support U.S. consumption
Household debt ratios as a percentage of disposable income



Source: Federal Reserve Board, as at December 31, 2013

In Europe, the economy is on firm footing as well. For the first time since the European peripheral credit crisis, banks have reported positive net loan demand and supply. However, we do not believe that Europe is on the cusp of a roaring rally: the recent announcement by the European Central Bank (ECB) to embark on the most aggressive monetary stimulus program yet suggests that Europe is still in the process of resolving structural issues. The ECB is studying methods to buy asset-backed securities outright and has extended its four-year, targeted long-term refinancing operation – which basically means that the ECB is attempting to find ways for continental banks to create loans and increase the money supply. We believe this on-going expansionary policy will be incrementally positive to the global economic recovery.

Loan demand shows the first sign of life
ECB bank lending survey



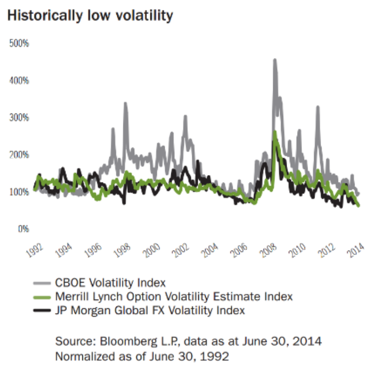
Source: Credit Suisse, data as at February 28, 2014

Complacent market sentiment

Over the last six months, a sense of optimism has reverberated throughout various capital markets with volatility reaching a historic low. It is a rare moment for the foreign exchange market (JP Morgan Global FX Index), bond market (Merrill Lynch Option Volatility Estimate Index) and equity market (CBOE Volatility Index) to experience low volatility at the same time. Year to date, U.S. Treasury yields have decreased, delivering a positive return to bond holders; credit spreads have narrowed for a positive return in the investment-grade and the high-yield bonds sectors; and Canadian (S&P/TSX Composite Index), U.S. (S&P 500 Index, CAD), and global equity markets (MSCI ACWI, CAD) are all up more than 6%. Central bank policies continue to be supportive, and government fiscal restraint, both in Europe and U.S., is declining. All of which is lulling investors into complacency.

"Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning" – Winston Churchill

We may have transitioned from the initial five-year period of skepticism about the recovery to one where grudgingly more and more investors are starting to accept the new era of improvement. We acknowledge the current market enthusiasm, and while we are not significantly changing the composition of our portfolios, we are aware that any one of these markets has the potential to experience a temporary pullback.



Source:
http://sentry.ca/en/documents/3/2014-07-14_1405353412_Market_out_Commentaries_en.pdf

EDUCATIONAL TIDBIT

Bitcoin 101

By Neil Kumar

From the volatility in their value, to use in the Web's notorious black market, to a recent string of cyber-heists, there has been no shortage of news involving Bitcoin in the past year. Like many, I was introduced to the world of digital-currencies in the late summer of 2013 when the value of 1 Bitcoin spiked from under USD100 to over USD1,000 in three months. Like most bubbles, the Bitcoin bubble eventually burst too, with a 60%+ decline from peak to trough. Today the value of a Bitcoin flutters between USD400 and USD650 on different exchanges.

Why are we writing about Bitcoin now?
Despite the controversy and the decline in their value, it seems that Bitcoin is emerging out of its brash adolescence into a more mature, adult form. The Bitcoin ecosystem is growing more robust, and today more people and companies are embracing the digital-currency than ever before. Announced earlier this month, PC behemoth Dell, is the latest in a string of retailers including Expedia and Overstock.com to begin accepting Bitcoin as payment online. With annual revenue of around USD57 billion, Dell is by far the largest company to have made the move to adopt Bitcoin, and adds further credibility and legitimacy towards potential mainstream use.

What are Bitcoins?
The short (and overly simplistic) answer to this question is that Bitcoin is a currency, which enables individual to anonymously send instant payments to anyone, anywhere in the World at a very low cost relative to more traditional methods. Like all currencies, Bitcoins can be used as a payment for goods or services and the repayment of debts. But unlike the "Loonies" that we carry around in our pockets, there are several key features that make Bitcoins very different from traditional currency. Bitcoins are a decentralized, digital currency: it is decentralized, meaning that there is no central bank or hub where Bitcoins are created; and Bitcoins are purely digital, meaning that there is no physical representation of the currency.

Where do Bitcoins come from?
The idea of Bitcoin originated with a paper published by Satoshi Nakamoto in 2008. In the paper, Nakamoto outlined the use of cryptography to control the creation of and transfer of currency, rather than relying on a central authority or government body. With physical/paper currency, a central banker or government official decides when and how much cash to print and distribute. Bitcoin, by contrast, do not rely on a central bank or government, instead people create Bitcoins through "mining."

Mining is the process of solving difficult mathematical problems using computers running Bitcoin software. The amount of computing power necessary to mine is far greater than the ability of regular PCs. So people interested in mining buy specialized Bitcoin machines or form groups that link multiple computers together to solve the complex equations. When a program solves one of these problems, it creates "blocks" and you (or the group) are rewarded with Bitcoins.

Every new block created by the mining process is recorded in the Bitcoin ecosystem, and it is currently estimated that a new block is added every 10 minutes. To prevent rapid inflation, the Bitcoin system is programmed to generate a fixed number of Bitcoins per unit of computing time. Unlike a central bank that can increase the dollars in circulation by printing more money, the supply of Bitcoins is regulated by software that limits the total supply and the rate at which they enter circulation.

The debate around Bitcoin

As public awareness and use of Bitcoin grows, more questions arise as well. Bitcoin is commonly referred to as digital-currency, digital cash, virtual currency, electronic currency, or crypto-currency. But there seems to be no consensus on its classification as being money, a currency, or a commodity.

Money is defined as being a store of value, a medium of exchange, and a unit of account. The topic of money versus currency is controversial, but under the above definition, most economists agree that Bitcoin still has some way to go to meet all the criteria of being classified as money. While most economists agree that Bitcoins work well as currency (as a medium of exchange and unit of account), some argue that the extreme volatility limit their ability to act as a store of value. However, it is interesting to note that the purchase of Bitcoins seem to rise during periods of financial turbulence.

It is too early to say whether the crypto-currency revolution is a short-term fad, or that one day it will be seen as an alternative to official currency. One of the most constructive opinions about Bitcoin I have read was a comment by David Andolfatto, a Vice President at the Federal Reserve Bank of St. Louis. According to Andolfatto, Bitcoin is a threat to the establishment, which he argues is a good thing for the Federal Reserve System and other central banks because it prompts these institutions to operate sound policies. And in my view, this would be a positive outcome for everyone.

Sources:
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SUPPORTING OUR OLYMPIC ATHLETES

The Jefferson|Steele team is proud to support Nikola Girke, a three-time Canadian Olympic sailor and Rio 2016 hopeful. Nikola has been a talented competitor since she learned to sail in West Vancouver as a child, winning three national youth championships and the women's title at the world championships sailing for Canada at Athens 2004, Beijing 2008, and London 2012. In the final days of London 2012, Nikola, then competing in the RS:X windsurfing class, decided to pair up with Olympic teammate Luke Ramsay (a former Youth World Champion, also from Vancouver), to campaign for Rio 2016 in the brand new Nacra 17 catamaran class.

The Nacra is one of the most exciting boats in the Olympics. Its powerful, state-of-the-art design makes it a very demanding catamaran to sail, both physically and technically. Unlike other age-old Olympic classes such as the Laser dinghy, in which the top teams benefit from decades of sailing experience, research and testing, the Nacra 17 class has only existed for two years. Olympic hopefuls from around the world are all on equal footing as they race to learn as much as possible about the new catamaran, making it a particularly interesting and competitive boat to watch.

Our team is committed to supporting local Olympic athletes. Unfortunately, some of the same tensions that affect national politics are also seen in Canadian Olympic sailing; while over half of the Olympic sailing team is consistently made up of Vancouver-based athletes, money is not always distributed in appropriate proportions, leaving talented sailors such as Nikola and Luke with a significant funding gap to fill.

Jefferson|Steele believes that the team has tremendous potential, and hopes that our contribution will help propel them one step closer to bringing home gold medals in 2016. We encourage you to check out their website, www.nikandluke.com, to follow their campaign and watch great footage of the team in action.