July 2017 / Second Report

Volume 41, Issue No. 14

THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

MARKET WISDOM

The Right Strategy?

"DIVERSIFY," HE WROTE.

Keith Richards

THE RECENT QUARTER, AND indeed the first half of the year, has been punctuated by a very significant move by the loonie. At the time of writing, our dollar has risen some 6 per cent against the U.S. greenback since May. What this means to most investors is that your U.S. dollar-denominated stocks have been swimming against the tide against due to the exchange-rate change.

We reduced our exposure to U.S. stocks a few months ago against this potential. However, it is imprudent to hold a Canada-only stock portfolio and expect to earn a respectable risk-adjusted return. There is just too much concentration within the TSX in resources and financials, which have been losing sectors this year. Moreover, returns on the Canadian stock exchange have been poor for the better part of a decade.

Diversification

Diversifying to other geographical regions makes sense, despite the momentary strength of the loonie. We believe that the ultimate top for the loonie is somewhere around its current levels, perhaps $0.79 -$0.80 USD or so. The primary trend for the loonie, and commodities (which Canada's economy is tied to), has been negative since 2011. Thus, we continue to want exposure to currencies outside of Canada, despite what we view as a temporary counter-trend rally for our dollar. We gave our opinion on the outlook for the loonie on the website valuetrend.ca. Look for a post entitled "Follow the big red line."

The loonie's downtrend, as noted above, coincides with the 2011 commodity peak and its steady decline. As most of you are probably aware, the loonie has a very positive correlation to oil in particular, and other major commodities that we export.

Until oil breaks out of its rather contained $42-$55 range, we shouldn't expect too much out of the loonie. As I've noted in my past articles on this subject, the relationship is tight.

There is no doubt in my mind that oil will break out past $55 eventually, but it may be a few years. Whatever time it takes, that day is not here yet.

Near-term picture

The Canadian dollar has broken out of the near-term price channel. This breakout provides a temporary bullish target for the loonie, back to its old, major point of support of around $0.79 or so. This now represents its major point of resistance. That support, originally established in the 2008/2009-oil crash, was tested successfully one last time in early 2015.

My target for the loonie is for a revisit of the $0.79 – $0.80 area. I would be willing to bet that we

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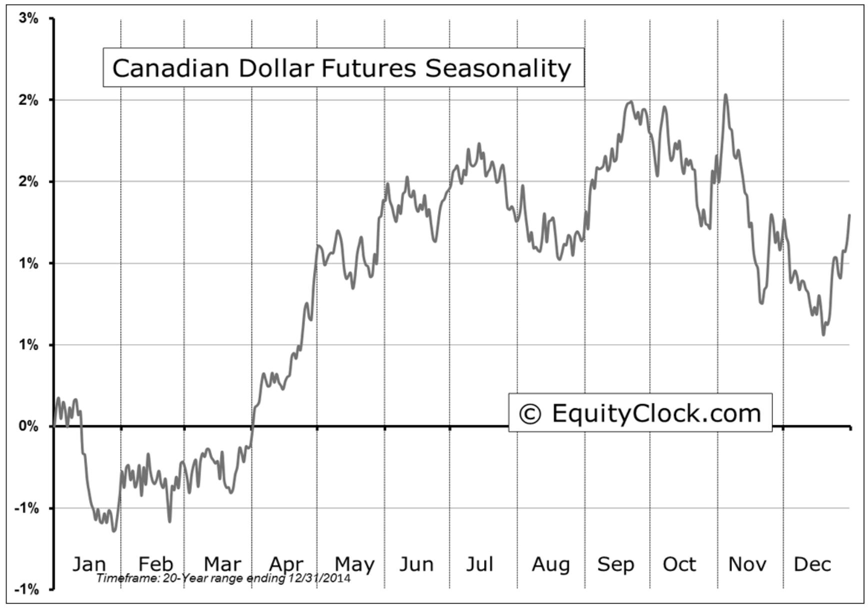

will not see a test of $0.84 resistance as noted on the horizontal dashed line on the chart. If you held a gun to my head and made me guess, I would suggest that after a brief test in the $0.79 area, we will see a return to the dominant downtrend.

Further pressure on our economy via our growing debt will be felt by the dollar, despite the temporary reprieve provided by the BOC's recent rate rise, and probable follow-up rate rise later in the year. The ratio of private sector to GDP is the highest of any developed nation in the world. But it's not just ordinary Canadians who are on the "spend now, worry later" path. Our government is on a spending spree – not all of which (to put it mildly) is accretive to the economy.

As Alexandre Laurin Research Director of CD Howe Institute said in an interview last year: "Trudeau took out the credit card and spent. But is this really affordable? It's endless deficits. It's probably not affordable. Something will have to be done at some point. The minister will have to put his credit card back in his pocket and start paying back. If there's not a huge, surprising growth in the economy…then we will have to pay for this. How are we going to pay for this? Through tax increases and cuts in spending – spending we have become accustomed to. So it's going to be painful".

Whither the loonie?

As I noted in a past article, TD Bank has forecast that Ottawa is headed for a $150B deficit over next 5 years! I've also quoted ACG Analytics Research and its bearish view on the Canadian markets on my blog at www.valuetrend.ca.

None of these institutes are known to be extremists, nor are they considered overly political when presenting any countries outlook. I consider them fairly unbiased and neutral in their analysis towards our market. So it's worth heeding their words.

It is my strong opinion that the current rally in the loonie is a counter-trend rally, and not a new beginning for our currency.

Again, with the gun to my

head, I would guess that the loonie will hit and maintain a peak price into early fall. Note on the seasonal chart below (equityclock.com) that most of the strength for the loonie is in the spring, with a brief last hurrah possible into the September – November time period.

For those considering a move into the U.S. greenback, the next little while might be the right time to make that move. I'm putting my money where my mouth is. I expect to convert some personal capital to USD for a property I'm building in Florida as/if/when we see around $0.79. It's my belief that the potential for a move beyond $0.80 is low – and the potential for a breakdown from $0.79 - $0.80 will be significant. ▼

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