Portfolio Update and Commentary

November 2015

Market Outlook

In our experience, each economic cycle has one or two major drivers that set the tone. The last cycle (approximately 2000 to 2008) was commodities-driven, thanks largely to the growth of China's infrastructure. In recent years, we have been watching China's shift from a capital spending economy to a consumer-based one, and commodity prices, which topped out in 2008, have never really recovered. The price of oil had been around $120/barrel; it's now hovering around $40. Copper had traded at approximately $5/pound; currently, it's hovering near $2/pound.

The current cycle—like the technology-driven cycle of the late 1990s—is decidedly not resource-driven. Instead, it's largely being driven by the strength of the U.S. consumer, which impacts the consumer discretionary sector, as well as a number of other sectors, from automotive to technology to healthcare.

We are about three years (probably mid-way) into the current cycle: stock valuations are at reasonable levels given the interest rate environment; the majority of U.S. and Canadian securities currently at 52-week lows rather than highs – so there is still plenty of room for upward movement. While the Canadian economy is likely in for a rough ride in the coming year, and the Canadian dollar expected to remain weak, the U.S. economy is a different story. One area of the consumer-facing sector that has been lagging is housing in the U.S., and we are looking for that market to catch-up. We're seeing record rental rates in many U.S. locations, and believe that the pent-up housing demand will give the market a boost.

Monthly Pay Fund

We've made several changes to the portfolio to capitalize on these macroeconomic trends, allocating one third to financials, one third to consumer-related companies (such as Visa), and one third to technology—disruptive tech, primarily. We've increased U.S. exposure in the portfolio from approximately 17% to 22% and, given our stance on resources, we've sold off mining stocks and reduced our energy sector weighting from 13% to 8%. We've also implemented an options strategy in order to generate more income, and set some discipline for our buy and sell targets.

With a rate hike imminent, we wanted to ensure we're well positioned in financials, which fit nicely with the fund's income requirements. Canadian bank stocks, despite their mediocre returns, provide reasonably generous dividends. Similarly, we've tripled the fund's weighting in life insurance companies, adding Manulife and Sun Life, and purchased some U.S. financials, including JP Morgan, Citicorp and Capital One. We believe the Fed will raise interest rates soon, if not in December, then likely in the first quarter of 2016.

On the whole, we believe these strategic shifts leave the portfolio well-positioned for the next quarter.

Sub-Advisor - Front Street Capital (2004)

FRANK MERSCH
Chief Investment Officer and Senior Portfolio Manager

www.frontstreetcapital.com