THE ABC PERSPECTIVE

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Common Stocks: Defying the Skeptics

As we entered 2019, common stocks were ready to defy the skeptics. For instance, during the final three months of 2018 North American equity markets suffered the worst quarterly investment performance since the 2008 financial crisis. Furthermore, there was enormous investment negativity overhanging common stocks as investors worried about every geopolitical, economic, and financial concern imaginable. But despite the pessimism, common stocks were trading at unusually low price earnings multiples, dividend yields of 3% - 5% were exceptionally attractive, corporate earnings were increasing, and the U.S. economy was growing at a respectable 2% - 2.5% rate. Nonetheless, investor sentiment was fearful, confused, and skeptical.

While it seemed equities had all the reason to continue their late 2018 descent, we remained optimistic. Closing out the year we concluded: *"it is our view that steady employment gains, continued consumer spending, and a more dovish 2019 U.S. Federal Reserve monetary stance should extend positive economic activity to at least the beginning of 2020".*

Within the first few months of 2019, investors finally recognized the overlooked equity valuations and by September 30th the major North American indices had soared 15% - 20% for the year. Surprisingly, this upturn occurred even with ongoing recession fears, an unresolved U.S./China trade dispute, presidential impeachment concerns, and inverted yield curve anxiety. In short, the market had "climbed a wall of worry".

Interestingly, notwithstanding the excellent 2019 market returns, there still remains a lingering uneasiness confronting the North American equity markets. We have, however, remained optimistic and fully invested. We do not anticipate recession and expect common stocks to continue to outperform. Furthermore, with $15 - 20 trillion of negative yielding fixed income European securities, U.S. interest rates remain the highest and most attractive alternative in the Western industrialized world. More importantly, it is our view that negative yielding securities are an extraordinary financial aberration and should provide the U.S. Federal Reserve considerable leeway to further reduce interest rates. By extension, these circumstances highlight the attraction of liquid, dividend-paying, high quality common stocks.

In conclusion, our present optimism is premised on the following factors: "money is cheap" with low interest rates and accommodating U.S. Federal Reserve and global central bank monetary policies; inflation is low, contained, and non-threatening; worldwide economic growth is still positive; corporate earnings are sound with numerous dividend increases; and rising employment is generating steady consumer spending.

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Economic Perspectives

Prolonging the Economic Cycle

Although the North American economies are now into their eleventh year of positive economic growth there are a number of factors which are prolonging the cycle. While the U.S. and global economies are currently experiencing decelerating growth, in the event that a U.S./China trade deal is consummated, in whole or in stages, and/or various geopolitical issues are clarified, we believe that the American economy will be revitalized.

In the meantime, we believe that low American interest rates, steady employment growth enabling healthy consumer spending, contained inflation, and sound corporate earnings prospects should extend economic activity even further in a low expectation environment.

Investment Perspectives

Money Market Funds: Potential Stock Market Driver

In a recent financial commentary Bank of America Merrill Lynch highlighted the fact that U.S. money market funds had grown to almost $3.5 trillion. More importantly, money market funds are now at their highest level since September 2009.

While not to suggest that all these funds are earmarked for a shift toward equity investment, we believe that they represent a potential stock market driver. For instance, any decline in money market rates from their average yield of 2% could precipitate a significant pivot toward S&P 500 common stocks where their 1.92% average dividend yield offers an attractive investment alternative.

Portfolio Perspectives

Gradually Shifting to Canada

Over the past, quarter we have gradually reduced our U.S. equity exposure by 3% - 5% and have shifted the proceeds to attractively valued, dividend paying Canadian common shares. These recent Canadian purchases appeared to be relatively better valued, possess lower betas, and offer higher yields than their American comparables.

A few of these new additions include: Brookfield Asset Management, First Capital Realty, and NorthWest Healthcare Properties.

Featured ABC Common Stocks Holdings:

Brookfield Asset Management: is a global alternative asset manager with diversified interests in real estate, power, and infrastructure. The company manages a wide range of public and private investment products for institutional clients such as pension funds and endowments with the intent of creating stable cash flows and long-term value. The company creates value for its shareholders by earning asset management fees and co-investing its funds along with its investor clients. We believe Brookfield offers an excellent investment opportunity for several reasons. Firstly, the company has a long runway for growth via its expanding asset management business and future fundraising. Moreover, due to low interest rates, alternative asset allocations are projected to rise significantly as institutional investors will need to earn their required returns beyond low-yielding fixed income securities. Consequently, Brookfield management contends that alternative asset allocations can rise from 40% to 60%. More importantly, the company is a defensive investment, with its assets being beneficiaries of low interest rates while providing steady, long-term cash flow and low volatility. Furthermore, the company has an extremely strong management team and there is excellent potential for large share buybacks in the future.

First Capital Realty: acquires, develops, owns, and manages retail-focused real estate properties in Canada. Additionally, the company is involved in the development of mixed-use properties that include residential assets. We believe that First Capital, while providing a 3.9% dividend yield, also offers untapped value in its portfolio. For instance, in Q2/19, the company identified 23.1 million square feet of incremental density in its portfolio, primarily above shopping centres and parking areas. Presently, only 15% of that density is recognized on its balance sheet, offering First Capital the opportunity to unlock additional value through future re-zoning and expanded development of its properties. Lastly, we believe that the company's deleveraging of its balance sheet and its transformation into a REIT by the end of 2019 should provide an upward revaluation of FCR's market capitalization.

Administrative Information

- There are units of the ABC North American Equity Fund & ABC Global Equity Fund available for purchase. Contact our office for more information.
- Purchase requests must reach our office by the last business day of the month and redemption requests (for our open funds) must reach our office no later than ten business days before the last business day of the month.
- Clients that are invested in our close-end funds are able to redeem their reinvested distribution units on a monthly basis. Also, you can participate in the annual 10% redemption right if you provide the completed form by November 30 for a December 31 transaction date. If you need assistance with either of these options, please do not hesitate to call our office.
- All cheques are to be made payable to RBC Investor Services.
- All client requests are to be directed to ABC Funds.
- We continue to request that clients assist in updating their "Know Your Client" forms. This information is a regulatory requirement to assess the suitability of our various ABC Funds to individual client needs.
- RBCITS is the custodian of the ABC Funds and is responsible for providing our clients with account statements, tax slips and requested funds. We ask that you retain all statements for your records as there may be additional costs for retrieving historical data.
- Please contact our office to inform us of any changes in mailing or email addresses. If we do not have your current contact information, you may not receive the information we are sending out.

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