LEE, TURNER & ASSOCIATES INC.
INVESTMENT QUARTERLY

REVIEW April 2019

The very sharp reversal in investor sentiment over the first quarter of 2019 was emphatic. Global stock markets made on average double-digit rates of return while bond markets made mid-single digit rates of return, all in just three months. Whatever fears that had gripped investors over the latter part of 2018, threats of trade wars, rising interest rates and whatever ominous economic calamities, were quickly quelled in the first days of the new year. Optimism and confidence returned to the markets. There really wasn't any meaningful economic or political news that can outwardly account for the swift shift in investor sentiment. It looks to us that it was just a classic case of investors having a quick change of heart when their heads told them that their emotions had gotten the better of their investment decision making process. In returning to the stock markets, investors bid up prices aggressively. Widespread gains were evident across all industries and synchronized on all the North American exchanges. Over the first quarter, the Dow Jones Industrials Average jumped 13.1% while the S&P/TSX Composite Index bested that figure marginally with a 13.3% advance. Bond prices strengthened when the Central Bankers softened their tone in reference to their interest rate intentions for the balance of this year. Bond prices climbed across the entire maturity spectrum. The Canadian Bond Index came through with a 3.9% total rate of return.

FORECAST

North American economic growth has been slowing a touch since the fall of last year, but currently remain well inside positive territory of just about 2%. This moderation of growth might have been due to self-fulfilling worries of trade tariff wars or perhaps as result of some consumer spending fatigue. Regardless of cause, we are not overly concerned with this mild slowdown in economic growth because the other important measure of economic activity, inflation rate, is still very much pointing to a growing economy. We do not foresee a recession within the next year.

On a more local and topical issue, headlines of falling Canadian residential real estate prices have been prominent of late, stoking fears and forecasts of a precipitous rise in mortgage defaults to trigger a major banking crisis in Canada. Well, we don't agree with these prognostications. While we certainly have not forgotten how a seemingly similar set of events in the US a decade ago did in fact give the world an unparalleled financial crisis; we are certain that the current real estate travails in Canada are quite different and distinct from what the US had experienced. The main observation behind our assertion is that Canadian real estate prices have not been propped up by multiple mortgage loans on a single property nor by extremely high ratio mortgages on properties with little or no down payment made. As well, Canadian mortgages have not been packaged and resold into more loans with less collateral backing. Finally, Canadian banking executives are well prepared in their risk assessments for any downturn in residential real estate values to mitigate any impact of rising mortgage defaults on their banks' financial stability. So, no, we are not worried about falling Canadian real estate prices bringing on another banking crisis.

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INCOME STRATEGY

Bonds

Central bankers have turned gun-shy on their monetary policies. Over March, both the Federal Reserve and the Bank of Canada hinted that they will refrain from raising interest rates until sometime in early 2020. Both policy makers cited slower economic growth and trimmed inflation pressures as reasons to hold interest rates steady. Bond investors reacted by sending bond yields down by 20 basis points at the long maturity end and 30 basis points at the short maturity end. The greater yield decline in the short end means that the yield curve is once again completely flat. Bonds currently yield less than 2%, a rate of return that cannot serve most of our portfolios' investment objectives.

Income Trusts

Being interest rates sensitive securities, Real Estate Income Trusts (REIT's) performed rather well over the first quarter. Once again, they outperformed the S&P/TSX index in direct comparison. Given their strong performance over the past year, we are now dialing down our expectations of them somewhat. We see that their valuation metrics have now become elevated and are discounting a very healthy operating environment going forward. We feel that we should take a step back and, for now, observe this market from the sidelines.

EQUITY STRATEGY

A wide and considerable number of companies reported very positive 2018 yearend results in the first quarter, a fact that likely contributed to the stock market's strong performance. It appears that investors have returned to fundamentals, earnings and dividends, as the primary focus in their investment decision process. This is a welcoming change in light of the irrational selling spree that was so extensive just a quarter ago. Our portfolios have participated well in the recent market upturn. Fourteen companies amongst our holdings announced improvements to their profitability and, more importantly, raised their dividend rate. Of note, two of these companies extended their long and impressive track record of consecutive years of dividend raises, 47 for one and 30 for the other. Given the stronger reported fundamentals underlying the market, we are not alarmed by the strong rebound in stock prices. The market is merely returning to normal valuation levels. We are quite happy to maintain our equity positions over the near term.