21st ANNUAL EMPIRE CLUB
INVESTMENT OUTLOOK LUNCHEON

THURSDAY, JANUARY 8, 2015
Reception begins @ 11:30am, beside the Concert Hall @ Fairmont Royal York Hotel
Speeches begin at Noon Speech time: 10 minutes

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FOLLOW UP

- January 2013 talk Re: "Regulatory Strangulation".
- My prediction was exceeded.
- Since then 32 independent investment dealers have closed, not 20.
- Regs continue to explode in volume and implode in relevance.
- Investment advice and advisors are still being hammered by regulators, their lobby groups and media, ignoring all client satisfaction surveys.
- It is hard to imagine similar behaviour by the Law Society (eg. Trailers) or the CMA.
- Some advice to regulators: **Quantity** is no substitute for **quality**. This is not taught in law schools, the opposite is. Too much information is no information (prospectus example).
- Sadly, the trend of investors losing independent advice will continue.

FORECAST

A key part of my job (when not coping with regulatory demands) is to discern what is important within massive information overload.

- That means, I must filter and simplify

- 2014 had lots of geopolitical distractions. Although tragic and distressing on a human level, most, to quote Hyman Roth from Godfather 2, "had nothing to do with business".

Despite the rhetoric, hype and over-analysis, only a few factors were and are relevant to capital markets.

1. My first **filter** relates to the raw material for decision making. For example I am cynical about government statistics such as GDP growth, inflation, unemployment and quit rates etc. They are late, inaccurate and open to manipulation. The only numbers that count are corporate earnings. They are the only ones you go to jail for manipulating. They showed corporations and the economy growing all last year and into this year.

2. **Deflation** concerns (North America) are a scam. Yes, there will be downdrafts in economies and sectors, but anyone who bet on long term deflation over my 50 plus year career lost money.

3. The determining factor, for markets and economies, is still **interest rates**. Interest rates are the price of ownership of everything. Current rates are subsidizing ownership.

    - Yes, they will go up but when is actually irrelevant. When rates are raised it will be underpinned by a strong economy. Any increase will be both gradual and late. No central banker would risk cutting off a nascent economic recovery. They will want to be sure.

    - Low rates will continue to provide steam under the economy and markets through 2015.

    - The "Yellen bounce" at year end should not have been a surprise to anyone.

Oil prices are a combination of geopolitical (U.S. and Saudi trying to put pressure on Russia, Syria and Iran) and simple supply growth. U.S. self sufficiency has connotations for XL and Middle East.

- Overall, current oil pricing is a positive, equating to over an $800 tax cut for every U.S. family. More, if the ripple effect of industrial production costs are added in. A significant stimulus for many economies.

- Clearly, lower oil prices are not a positive for producing countries such as Canada. Impacts the dollar, our economy, anticipated government budget surpluses etc. It does, however, create bargains in Canada across a spectrum wider than oil.

- Forecast oil price range from $60 to 80 or $70 to 90. Everyone is more or less alright within these levels. Pricing is actually moving more into line with “normal” levels – whatever “normal” is.

- Another positive of this current pricing event is the increasing odds that the foreseeable future of energy will be hydrocarbons. Alternatives will require too much subsidization for some time.

<u>HOW WE WORK WITH THESE FACTORS AND VIEWS</u>

- We still hold large positions in major U.S. financials such as C, BAC, MS, CBOE. It is a bit like shorting oil by being out of the Canadian dollar.

    - The U.S. banks are approximately half the price of their Canadian counterparts as they are still being brutalized by regulators with record multi-billion dollar fines for everything and anything.

- Eventually this will ease and the major U.S. banks will be able to increase dividends and become more aggressive regarding share buy backs.

- In the interim, they are consolidating their operations and building better companies. Keep in mind that divisions and subsidiaries always fetch more in a sale that their recorded financial statement values.

- Our future thinking involves rolling some funds back into Canada on our reduced dollar. We recently purchased some SU and CNQ as starter positions. We would also anticipate buying some of the major Canadian banks, as the oil impact is felt, as we reduce U.S. dollar weightings, which are currently at 80% in the public investment pool I am directly responsible for.

- Remember, unlike the U.S. banks, Canadian banks are a protected and nurtured species in their home country and have good dividend yields.

- Regarding the raw material sector, China will surprise on the upside but not right away, so we are delaying positions in the metals sector (other than the gold stocks) until we have greater clarity. Keep in mind that China has no qualms about understating their economic performance in order to drive down metals or any other raw material prices.

The public pool I mentioned earlier is Urbana Corporation, listed on the TSE and CSE. Its website is urbanacorp.com. You can monitor our holdings, trades and strategies as the site is updated weekly.

FINALLY, THREE MACRO OR LONGER TERM TRENDS

Which will affect government policies, economic growth and capital market stability:

1. The massive disparity between the wealthy and everyone else in America. This underpins everything in the U.S. – civil unrest, rules and regulations. "Most people are not living the American Dream". The pressure to fund subprime housing loans resulted from this disparity.

2. Regulations of all varieties are exploding (Dodd Frank, SOX just to note the more visible over reactions). The dangerous side effect of regulatory self funding in the U.S. (not as extreme in Canada) is the plundering of the private sector in terms of insane fines and settlements levied against corporations, ie shareholders for management transgressions or mistakes. Eg. JPM.

   The Economist describes the process as "the world's most lucrative shakedown operation". This new taxation is becoming a major brake on the economy. Fiscal and monetary policies can be neutralized by regulatory or legal lock down.

3. Product complexity will probably precipitate our next financial crisis. Note the insured garbage bags filled with junk mortgages in 2007 - 8 is a case in point. My guess is the next crisis will come out of the ETF or derivative sectors. Remember, today's flavour du jour usually becomes tomorrow's crisis. There is a terrific media campaign in support of these products and their variants. ETFs are also massive money spinners for their sponsors in structuring and maintaining their "underlyings". ETF's, by their total size, now significantly distort share pricing. Just listen for the "bang" with this one.

   That is the typical outcome when people become, as the British say, "too clever by half".

   On balance, 2015 will be a good year for equities.