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An employee works in a textile factory in Huaibei, in east China's Anhui province. Though growth has slowed in China, the size of its economy makes the drop less significant, analysts say.

For 2014, the outlook is liquid

THERE'S BEEN MOMENTUM and 'a heck of a lot still can potentially flow into this market,' but questions linger about gold and oil

Equity markets in Canada and around the world confounded forecasters and posted significant gains this year. The Toronto Stock Exchange topped 10 per cent while the S&P 500 in the U.S. more than doubled that. What made 2013 such a banner year for investors and what lies ahead for 2014? For answers, Gazette business reporter Paul Delean convened three local investment professionals: portfolio manager Marc Dalpé of DalpéMilette, Willem Hanskamp, chief investment officer of Heuward Investment Management Ltd., and Lorne Steinberg, president of Lorne Steinberg Wealth Management. Here's an edited transcript of the conversation.

GAZETTE: To the surprise of many, it has turned out to be a solid year for stock markets, not just here but around the world. To what do you attribute this development?

DALPÉ: There was a strong advance in most markets around the world, but what's different this year is there were also big differences in performance from one market to another. The correlation between markets was less than it has been in past years. What happened is a result of the pressure created in 2008-09 ... the deleveraging process, will Europe stay Europe, pressure on the budget in the U.S. The pressure was less this year than last and it gave more confidence to markets that we're on the right track in terms of improving the situation. This contributed to an increase in interest rates, which created a loss in bond markets, so you had a flow of money out of bonds and into the stock market. This all came together at the same time and created a climate for a good performance in stock markets.

STEINBERG: Another huge theme was Europe coming out of recession. After several years of austerity programs, bringing deficits down, Europe is ready to grow again, and governments have room to spend a little

money going forward. And underpinning everything is the ongoing very low interest rates, fuelled in part by the so-called forward guidance by central banks. For us, the big thing — because our largest weighting is in Japan — was the emergence of Japan after 20-odd years of horrible stock market. Its central bank and PM are setting Japan on a different path. Some things may be successful, some not, but we think the Japan story is a real story going forward. On the negative side, comfort that the world is getting back to some level of normalcy has led to gold declining, which I think is a significant thing.

HANSKAMP: When we went into this year, there was a fear about another fall off in global economic growth, doubts about countries like China, on whom the world has become dependent for global growth. China found itself, admittedly at a lower level of growth than before, but still about 7.5 per cent, and globally we were actually pretty happy with that. There were also real improvements in peripheral Europe. That took a lot of pressure off the European economy and global concerns of a potential breaking down of the currency system. Those two items are additional contributory reasons for what happened

last year. You mentioned the flow of funds from fixed-income to equities ... sure it has taken place to some extent, but there hasn't really been a huge move just yet. If it does continue, a heck of a lot of liquidity still can potentially flow into this market.

GAZETTE: There's been forward momentum in markets for four or five years now. Can that continue?

HANSKAMP: Five years? I don't think you can say that. You've got to look at it globally. The U.S. really is the only market that's been five years. Europe, it's a year and a half. With Japan, it's just one year. Emerging markets haven't even had it yet, because they've been coming down for the last two years.

"For us the big thing ... was the emergence of Japan after 20-odd years of horrible stock market."

LORNE STEINBERG, PRESIDENT, LORNE STEINBERG WEALTH MANAGEMENT

What has happened over the last five years, economically speaking, is the U.S. has basically bought itself or spent itself through a cycle that should have been a down cycle and ended up not being one. The rest of the world has gone through a two-year down cycle, starting in 2011, from the highs, and is only now just coming out of it. Globally, you really see the turnaround coming now. Markets have sort of followed that pattern, but one market at a time.

STEINBERG: The U.S. kind of led the world into recession and it led the world out of recession.

DALPÉ: The U.S. market is

the only market, to my recollection, that managed to reach the level it was prior to 2008. Others are 15, 20, 25, 30 per cent lower. And even the U.S. isn't far from the level it was at in 1999. It hasn't been a huge performer. We were zero per cent invested in the U.S. from 2003 until about two years ago. We're more optimistic about the U.S. market than we were, looking for the next five to 10 years, but even then we have some concerns. We think the economies of Europe and Asia will perform better than the U.S. from this point on for the next couple of years, and the U.S. market is 30-40 per cent higher in terms of valuation than the other countries. You'll probably make more money in Europe

over two years than you will in the U.S.

STEINBERG: We've been very bullish on Japan the past few years and we believe Japan, in the developed world, will be the best-performing market in 2014 by a wide margin. The reason is, Japanese stocks remain, on average, extremely cheap. With the yen poised to show some weakness in 2014, I think we'll again see significant earnings growth in Japan. It's really catch up to more normalized levels, a reversion to the mean. At our firm, we think Canada will be an underperformer in 2014. We're quite negative on the gold sector — we still think it

has a long way to fall — and a bit negative on oil. And if this housing market ever slows down, the banks won't suffer horribly, but earnings will probably flatten out a little bit. Canadian banks deserve to sell at premium valuations to the rest of the world, there's no question, but it's hard to see the banks doing a lot better from here. The U.S. market has had a great run and a lot of that is PE-multiple inflation. We're looking for the U.S. to have positive performance in 2014, but it'll be tougher to have a great year in 2014 than it was in 2013. So we're kind of downplaying expectations a little bit to clients.

HANSKAMP: Since 2003, we hardly had any foreign exposure at all, a little bit in emerging markets here and there and specific stocks. Two and a half years ago, we started really buying more aggressively in the U.S. In 2011, we were maybe 90 per cent invested in Canada, but by the beginning of this year, we had about 35 per cent of our equities in the U.S. As of the start of this year, we started really investing in Europe more aggressively and we still like it. We still think it has some time left and some valuation space it can grow into. Europe is still very much in the forefront for us. We didn't really invest in Japan because of the yen coming under pressure. It's hard to hedge that risk off in individual portfolios. If you look at the volatility of the Japanese market, and of the currency, you could have been really whiplashed in that market over the past year, depending on your entry point. Most of our cli-

ents aren't comfortable with a market where stocks can drop 6-7 per cent one day and rise 8 per cent the next. We paid a bit of a price for that decision because Japan did well, but by overweighting the U.S. and later on Europe, we didn't underperform relative to the Morgan Stanley World Index. We're looking at Japan for sure but we still think currency is an issue. We have taken money out of the U.S. and started to buy more in foreign markets. As a group, it's quite likely emerging markets could shape up as being the winners of it all in 2014. They are still very much on a downtrend. They haven't really performed this year at all. If global growth comes back, it'll definitely rub off on emerging markets, and there are some extraordinary valuations in there. For Canada, we actually think that with the Canadian dollar at 93 cents, maybe going even lower, Canada might surprise. If global growth comes back, part of the commodity market — not gold — might have a chance of performing better, maybe even including oil. There are still a lot of companies in the Canadian market that we like. We still like the banks. They're not cheap, but in valuation comparisons we run with U.S. banks. There's really not much difference at this point, given what the expectations are, and if they deserve a premium, then there is some room left in the Canadian banks as well.

GAZETTE: Mark, what's your feeling about the Canadian market in 2014?

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PHOTOS: DAVE SIDAWAY/THE GAZETTE

Weighing in on the issues are, from left, Marc Dalpé of DalpéMilette, Lorne Steinberg of Lorne Steinberg Wealth Management, and Willem Hanskamp of Heward Investment Management.

OUTLOOK Still a good time for investors to get into the market

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DALPÉ: One of the themes of this market is people are bearish on Canada, bearish on resources. We hear "the resource story is over" after 10 years. If it's incorrect, there's an opportunity to make a good profit. I'm of the opinion the market is mistaken (about Canada). The world economy could surprise on the upside the next three years ... and my feeling is the demand for resources will be higher than the market expects. People look at China, they say it was growing at 12 per cent 10 years ago, now it's seven or eight per cent and it'll only be growing at six per cent on average over the next 10 years. Yes, it's less, but what people don't realize is that 6 per cent growth in China means more than before because it's a much bigger economy. The demand for copper in China today is 40 per cent higher than it was last year. Forty per cent! In what's supposed to be a down year, with the world economy not growing a lot and China slowing down. My feeling is demand for resources will be much higher than the market anticipates. You have stocks at 40, 50, 60 per cent of the valuations they were a year or two ago. A company like Teck Resources, which is like a mutual fund of different resources, could be 50 per cent higher than it is today in the next 12 to 18 months. If I think that of a resource stock, I have to think that of the Canadian market in general, because a large portion of our market is the resource sector. I'm very bullish on China, have been for a while. All the restructuring they're doing in the economy will, over time, make markets more comfortable investing in China. It too may soon find its market 50 per cent higher than it is today in the next year or two.

HANSKAMP: In Canada, important strides are being made with the pipeline system and transportation bottlenecks for oil. Approval of these pipelines will come through and what you then get in Canada is deliverability of the energy being easier, opening up a bigger market. On top of that, at the initial stages, you get a huge investment program linked to this, which will be a real boom for the Canadian economy in terms of growth, particularly Western Canada. There's a lot of demand from China for all commodities. It's just become more difficult from Canada to actually get it there. If you open up more channels, that growth in China is going to have a very big impact on the Canadian economy.

GAZETTE: Lorne, what sectors of the market do you like in Canada?

STEINBERG: We like the insurance companies, because it looks like bond yields are starting to rise. While the five-year mortgage rate in Canada already has come off its incredibly low levels. Rates are still at levels we probably never thought we'd see 10 years ago, but mortgage activity for the banks has probably peaked. We've seen an explosion of condo building all over the country. How long can this continue? I personally thought it would end two years ago, but I was totally wrong. At same point in time,



NAVNEET PALL/THE GAZETTE

The Gazette's panel of analysts don't see a housing disaster anywhere close in 2014 but do think the market has likely peaked.



MARK LENNIHAN/THE ASSOCIATED PRESS

Housing-related debt levels are a worry but certainly not to the extent seen south of the border.

lems in 2014 and perhaps further down the road is the lack of inflation. We almost don't have enough inflation. No one wants to fall into a Japanese-type deflation trap. Europe is very close to that. They really have to watch out. In Canada, high rates and inflation is not really the issue, it's actually low rates of inflation and with that, the chance of a real jump in interest rates is remote. Rates shouldn't be a real negative issue for the housing market, but debt levels are. Fortunately, we're still way better off than they were in the U.S. in the sense

from the last four or five years of underinvestment in the U.S. They will get increases in earnings and continue to have growth and profits. We also have the Canadian banks and they're still a pretty safe bet with return on equity of 18-19 per cent this year and a 4 per cent dividend.

STEINBERG: In Canada, we're bullish on insurance companies like Manulife and Sun Life which had a lot of trouble with low interest rates. They're both global players so they give Canadians a chance to partici-

they're not paying out a huge amount. To me, it's a lower-risk, incredibly well-run company. In Europe, I'll mention a European insurance company called Aegon, which also owns a North American insurance company, Trans-America. It's trading at a 40 per cent discount to tangible book value, has a dividend yield of 3.3 per cent and plenty of room to grow. ING as well, which we've owned for a few years. It took a big loan from the Dutch government, will pay it back probably in 2014 and be allowed to

panies that haven't gone to extremes in terms of valuation and price. That's why it fits. On the U.S. side, one of the companies we've built up over the past year is Quanta Services, which does infrastructure work for pipelines and power transmission and transportation systems. The grid in the U.S. is very, very bad. Hasn't been a lot invested because governments didn't have money. Quanta builds and maintains pipelines and power lines. It's a very segmented market, many small companies. They're actually one of the bigger ones with

should people get in today or at 3 o'clock Monday, I don't know. Obviously, it would have been better two years ago, but I think now is better than two years from now, if you've got a horizon of 3-5 years. What are the alternatives for your money? Most of the alternatives to the stock market were at or near their peak price a year or two ago: precious metals, resources, bond market, real estate. Every asset you could have purchased had the highest level it's achieved; meanwhile, the stock market is still at the same level it was 12 years ago. If you look at the next five to 10 years from the standpoint of reversion to the mean, I believe the stock market in general will be one of the best, if not the best-performing asset classes. I thought it three or four years ago and I still do today, though some of it has been achieved. That doesn't mean markets will be doing 15 per cent a year, but I think the stock market will be the best performing.

STEINBERG: My thinking is along the same lines. For the last 30 years, one of the big boosts for real estate has been declining interest rates, and that game is over today. Government bonds, high-quality bonds, offer basically zero returns to investors. On that basis, we are therefore bullish on equities, even if the returns of 2013 aren't likely to be repeated for the next two or three years.

HANSKAMP: This whole deleveraging process, happening since the crisis of 2008-09, if you go back in the past, you see that it can take up to 10 years to get through that. That means we're only about half way. There's another four-five years to come. Some of the issues can still come back and start hitting us again, but it usually

housing prices will at least flatten out, and construction activity which has provided a bunch of fantastic jobs probably will slow down a little bit. We're not negative on the Canadian banks but will we see a big bump in earnings in the next couple of years? Possibly not. And if 10-year bond yields keep on rising, it won't be good for utilities, pipelines and REITs, and in the grand scheme of things they're likely to underperform. We're not predicting a Canadian housing disaster, but would I be rushing out to buy a condo today? Probably not. Since 1997, housing prices in Canada have been a one-way street up, with a minor blip here and there, but everything is somewhat cyclical.

HANSKAMP: I still think we'll see reasonably low (interest) rates for a longer period. One of the main prob-

lem is that most of ours is linked to housing. What you may see is an extended period of time, maybe a couple of years, when (housing) prices will not move, or maybe go down a little. But I don't see a disaster happening here.

GAZETTE: What are some of the individual names you like at this stage?

DALPÉ: I like companies that are cyclical, not defensive. REITs and public utilities did well over the last five to 10 years with little economic growth, providing a fixed income. Fixed income with interest rates going up doesn't work too well. It's like bonds. I think they'll underperform. Now's the time to push the envelope a bit and go into more cyclical investments. If the economy holds up or increases, I think there's significant upside there ... some resource stocks, U.S. techs, industrials, all stuff that hasn't benefited

"One of the main problems in 2014 and perhaps further down the road is the lack of inflation."

WILLEM HANSKAMP, HEWARD INVESTMENT MANAGEMENT

ate in places like India and parts of Asia. We also like (U.S. aluminum producer) Alcoa. Aluminum has been one of the worst-performing commodities in the world, but it remains a growth metal. I think it's a great time (to buy in). That being said, I've owned it for three years and it hasn't moved. One unloved U.S. company we like is Cisco. From a valuation standpoint it's compellingly cheap and you need to own it. It's sitting with about \$32 billion in net cash, trading at 10 to 11 times earnings and they're No. 1 in the world in several growth areas. The dividend yield will be rising for years because

start paying dividends again by 2015.

HANSKAMP: We own Teck. Alcoa is a recent addition. A name we like in the Far East is Jardine Matheson, a conglomerate that's all over Asia, really a Southeast Asian story. It's affected by what happens in China, Indonesia ... it's very broad, like its own mutual fund almost in terms of its holdings. Valuation is relatively low, about 10 or 11 times earnings. It's a big company — \$16 billion market cap. It hasn't really done well lately because there's still some weakness in that economy but I like that story for 2014. It's hard to find com-

panies with a market cap of \$4-5 billion. They don't pay a dividend because they know they need the money going forward to build their business once these projects come online. In Canada, again on the infrastructure side, there's Financing Transport, a distributor of Caterpillar equipment. They do big business in Alberta. Hasn't done very well lately because there's been a lot of issues with mining and the oilsands, but it pays a nice dividend. We also own Canadian Western Bank, which has a better growth profile than the big banks because it's really only active in the west. It's had lower-growth periods, but all in all, it's done better than most of the banks over a period of time.

GAZETTE: Is it a good time for investors to get into the market now, or is that train already past?

DALPÉ: If the question is

means the global economic cycle is just coming out of a bottom formation and starting to move back up. When you have that, you cannot predict a bear market. I've never seen that. That would really be a big surprise at this point. However, the cycle may be shorter. Maybe by the end of next year, we'll start to see some topping out. Europe and the U.S. aren't through all their problems yet. This cycle might be cut short at one point, and we have to look out for that. But at this point, we're still overweight equities relative to fixed-income and cash, because cash brings you absolutely nothing. We might even bring (equities) up further in the next little while. So yes, we think it's still time to be in equities.

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