strathbridge ASSET MANAGEMENT

April 2014 Newsletter

What's Going On With The NASDAQ?

- Year-to-date the NASDAQ Composite Index is down 2.5% compared to a 1.6% increase in the S&P 500 Index and a 6.7% increase in the S&P/TSX Composite Index
- With the NASDAQ Composite returning 15.9% in 2012 and 37.2% in 2013, a little retrenchment is to be expected and opportunities sought
- Currently the NASDAQ Composite is trading at a forward P/E of 18.7 times compared to the ten year average of 20.1 times, combined with strong earnings growth, strong balance sheets and continuing share buybacks, valuations in our view do not appear stretched
- However, companies with high valuations such as Tesla which is up 21.7% YTD, but down 43% since its peak on Mar. 4 and which has no current earnings and Facebook which trades at a forward P/E of 39 times and which is down 20.8% from its YTD peak on Mar. 10 but still up 4.3% YTD are contributing to this more recent decline
- More recently, the pricing of Alibaba's IPO disappointed some analysts leading to a sell-off in Yahoo, which owns a stake in Alibaba, and corresponding a sell-off in other tech companies
- Keep in mind the NASDAQ is not all technology stocks; as of May 9, 2014 technology stocks comprised 43% of the NASDAQ Composite by market cap. while consumer services was 20.5% and healthcare stocks were 13.9%
- Think of this as a great opportunity to buy growth stocks at attractive valuations – you may consider a diversified approach through a closed-end fund, such as NDX Growth & Income fund (TSX: NGI.UN) which is oversold and trading around a 5% discount

PM Commentary - John Germain Senior Portfolio Manager

Global equity markets ended the month of April mixed, with the TSX Composite advancing 2.2%, the S&P 500 Index up only 0.6% while the NASDAQ declined 2.2% (see above) as momentum out of growth into value stocks continued on concerns regarding valuations.

- Markets were volatile for the month as the S&P 500 Index declined by 3% for the first 2 weeks only to rally back above break-even by the end of April
- Energy was the best performing sector in Canada during the month up 5.4% while Health Care lagged the group down 2.3%. The Energy sector is also the strongest performing sector in the TSX so far in 2014, up 14.6% vs. the TSX Composite up 7.6% after underperforming the broader market in 2012 and 2013 on strong earnings and attractive valuations.
- We have increased our Energy weight in Funds where we have exposure to overweight due to our positive view on valuations.
- South of the border, the S&P 500 Index has been led by the defensive Utilities sector due to strong power and gas prices in the first quarter impacted by the "Polar Vortex" along with demand for yield as bond yields have declined so far in 2014

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By The Way – Jack Way Vice President

China, according to the World Bank's International Comparison Program, will surpass the U.S. as the world's largest economy sometime within the next year. This measure is based on purchasing power parity and attempts to adjust for differences in price for the same goods in various countries. As such the analysis lends itself to much estimating; using the more common market exchange rate method, the U.S. is still considerably bigger. We take something of a jaundiced view of the World Bank report, but still the U.S. has held the title since 1862, and even if seen as not totally accurate, it is another example of the fast changing world in which we live and invest. Given the lack of creditability of the economic reports from the Chinese Central Government, it will be an interesting challenge to predict what impact the world's largest economy has on the rest of the globe. As an example, pundits point out that regional growth reports never add up to the national report. As it stands today, the government appears to have a dual mandate: to rein in inflation and excess risk and to transition from government investment to a more consumer-centric economy. The biggest risk to the success of these policies is generally perceived as the possibility of a downturn in the housing market. Cornerstone Macro, one of our favorite big picture firms, notes that the housing inventory in Beijing would take 16 years to clear.

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Investment Ideas:

Canadian Utilities & Telecom Income Fund (TSX: UTE.UN)

- Utility and telecom stocks are sought after for their high dividends while fears of imminently rising long term rates have subsided
- High monthly distribution of **7.0%** per annum based on the net asset value of the fund
- Trading at a slight discount of 1.0% makes it an attractive yield play

NDX Growth & Income Fund (TSX: NGI.UN)

- Top 20 yielding stocks in the NASDAQ 100 plus a basket allocation of up to 20% of the portfolio in other NASDAQ 100 stocks
- Beat the NASDAQ 100 Index on a NAV basis in the 5 months since inception by 2.3% as at May 9th
- Recent selling has pushed the market price down to around a 5% discount relative to the NAV per unit

PM Commentary - cont'd

- After ending 2013 at 3.01%, 10-year U.S. Treasury Bond yields continued to decline and ended April, 2014 at 2.65% due to weaker than anticipated first quarter economic numbers negatively impacted by harsh winter conditions
- Although we expect economic numbers to rebound in the 2nd quarter as the impact from the harsh winter has passed, we will be watching economic releases closely to see if other factors such as China's GDP slowing, the removal of Quantitative Easing by the Federal Reserve and also the tensions between Russia and the Ukraine are having an impact
- Nickel and coffee were the best performing commodities for the month, up 15.3% and 15.1% respectively in April on lower nickel inventories and drought weather conditions in Brazil
- We have become more cautious short-term in general and have increased our exposure to more defensive sectors while also increasing our call writing activity to generate some income for the Funds

By The Way - cont'd

The lack of widespread ownership of equities means real estate makes up the bulk of investment assets in China, and would be devastating to many people should a significant decline take place. In addition, local governments have borrowed extensively, and as the growth in the economy slows, land sales are becoming a larger portion of revenues with which to carry those debts. The consensus opinion of long term followers of China, especially those with "boots on the ground", predict a soft landing and we have no compelling reason to dispute that outlook. Nevertheless, the economies of China's Asian neighbors in particular, and indeed to varying degrees all global economies (not the least Canada) will be impacted.

U.S. first quarter GDP was estimated to be a disappointing 0.1%. In fact, after seeing the trade deficit most experts think the revision to be reported at the end of May will show the economy actually contracted. This is not the kind of improvement we have been waiting for. Conventional opinion, from Janet Yellen at the Fed to most every brokerage economist, blames the extremely adverse weather for the decline. Almost with the same unanimity the expectation is for a compensating rebound in the second quarter to a number near 4%. We have sympathy with that notion, but will be watching interim economic releases for signs of confirmation. There are a number of reasons to be optimistic; among them consumer spending and retail sales rose in February and March along with factory production, and employers added 288,000 jobs in April. On the policy and political front, all is quiet, which is a relief. Still this is the mid-term election year and the Republicans seemed to have put their nose ahead in the bid to control Congress. The question is will politicians keep their head down so as not to upset voters or will they harden their rhetoric as November nears? Stay tuned – it could impact financial markets.

We commented last month on the possibility that the European Central Bank might become more aggressive in its monetary policy. At the most recent meeting the ECB decided not to act, but in a press conference, ECB President Draghi was quite open that action would be taken at the June meeting should the outlook not show signs of improvement. The "elephant in the room" continues to be Mr. Putin and the situation in the Ukraine. As the window and door between Russia and Europe, an ongoing conflict in that region would be harmful to both economies. President Putin seems to be channeling Frank Underwood of "House of Cards" as he connives and dissembles and so far has accomplished his goals. Hopefully a lasting resolution can be found in the near future.

One of the great puzzles to many investors concerns the fact that 10 year U.S. Treasury Bonds continue to trade at such a low yield. If the above positive outlook for the U.S. economy is to come to fruition, one would expect the current yield to be significantly higher. But in fact, when April's positive employment numbers were reported, treasury yields actually edged down to the confusion of many, including ourselves. Explanations include; excess liquidity in financial market due to central banks easing is finding a home in the bond market, and perhaps more compelling, a flight to safety given the turmoil in the Ukraine. Whatever the reason, we believe the direction of 10 year yields will be upward to north of 3% once the economy improves and a more normal environment exists in fixed income markets.

As expected, stock markets have rebounded from the recent consolidation and the major trend remains positive. However, this rally has been narrower than others we have experienced over the past several years. Several bearish divergences have developed that have not changed our longer term bullishness, but still need to be watched closely. For example, while the NYSE 1500 made a new high, the advance/decline line did not. This indicates a lack of breadth and internal market strength as fewer stocks are participating in the rally. There has also been weaker momentum during this move, given that less than 50% of S&P 500 stocks are above their 50 day average. At this point, these are not significant negatives, but should not be ignored. We would expect improvement that would confirm the rally and we will move to new highs.

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