# Luft Financial Model Portfolios

**Q1 2019 Review**

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HollisWealth®

Your Vision

Our Goal

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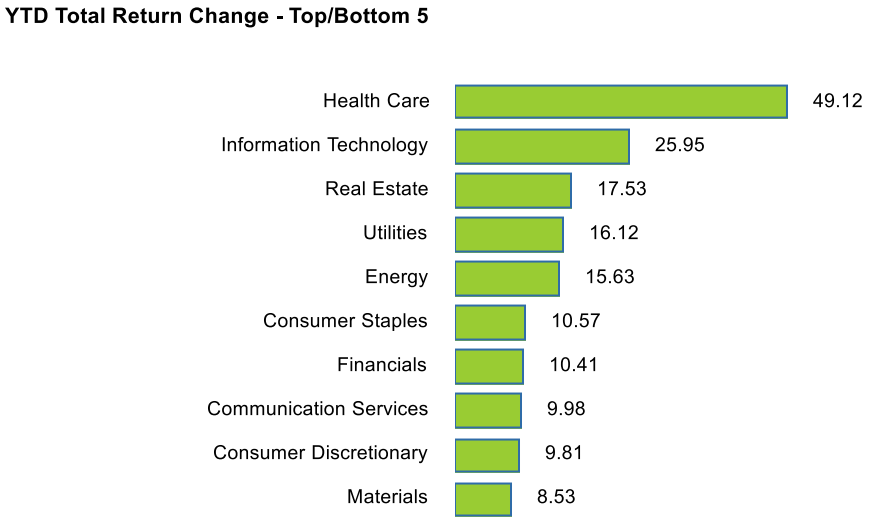
## Market Review – Best Q1 in Almost Two Decades

Global equities rebounded from their worst year in a decade with their best showing in years in the first quarter, as a turnaround in monetary policy at the Federal Reserve and optimism for an imminent easing of trade tensions between the U.S. and China boosted risk appetite. The TSX Composite's 12.4% rebound in Q1 effectively erased its 11.6% tumble in 2018, with the index's end-Q1 level of 16,102 only 3% away from the record high reached in July 2018. This was the largest quarterly gain for the TSX since Q2 of 2009 and its best Q1 performance since 2000. Likewise, the S&P 500's 13.1% advance in Q1 was its best quarterly print since Q3 of 2009 and its best Q1 since 1998. In a quarter when almost all major equity indices advanced, with many bourses posting double-digit gains, China's Shanghai Composite was the top performer with a 23.9% surge (Source: FactSet).

On a total returns basis (price change plus dividends), the TSX had a return of 13.3% in Q1, compared with -8.9% in the preceding quarter. TSX gains were broad-based, with all of the index's 11 sectors posting positive returns in the quarter (Figure 1). The best-performing sectors on the TSX were two of its smallest groups – Health Care returned 49.1% thanks to huge gains in marijuana stocks, and Information Technology had a 26% return. Interest-rate sensitive sectors such as Real Estate (+17.5%) and Utilities (+16.1%) also generated solid returns in Q1.

Four sectors on the TSX now account for 72% of the index – Financials (31.9% weight), Energy (18.2%), Materials (11.2%) and Industrials (10.9%). Energy (+15.6%) posted the best return of these four heavyweight groups as crude oil (WTI) recovered from its 25% plunge in 2018 with a 33% surge in Q1 and the local benchmark Western Canada Select (WCS) traded at a much smaller discount to global oil prices due to output curbs in Alberta. The Industrials sector had a Q1 return of 15.3%, while the Financials and Materials groups lagged the index, with returns of 10.4% and 8.5% respectively.

**Figure 1: TSX Composite Top / Bottom Five Sectors – Q1 2019 (Total Returns)**




**Source: FactSet**

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## Portfolio Constituents – Major Movers

- As many as 16 of our portfolio constituents posted double-digit total returns In Q1. The top three performers (based on total returns in Canadian dollar terms) were: **General Electric** (NYSE: GE, +29.3%), **Pembina Pipeline** (TSX: PPL, +22.7%) and **Restaurant Brands International** (TSX: QSR, +22.6%). The bottom three performers were: **SNC-Lavalin Group** (TSX: SNC, -26.0%), **Berkshire Hathaway** (NYSE: BRK.B, -3.7%) and **Westshore Terminals** (TSX: WTE, -2.0%). Five other securities had marginally negative returns (0% to -1%) in the quarter. (Source: SIACharts.com).

## Q1 Portfolio Changes and Rationale

- There were significantly fewer rebalances in Q1, compared with the flurry of portfolio rebalances undertaken around key events in Q4 of 2018.

- On February 13, we added to positions in **SNC-Lavalin Group**. As value-oriented investors, we chose to look past the political firestorm that has engulfed SNC in recent months and invested in the stock based on its heavily discounted valuation compared to its peers.
    - Analysts had estimated SNC's 16.77% stake in the 407 Express Toll Route across the Greater Toronto Area, plus its other concessions, to be worth well over $30 per share. Based on a "sum-of-the-parts" valuation, a stock price in the mid-$30s implies that there is very little value ascribed to SNC's core Engineering & Consulting business, which has $15 billion in backlog.
    - Note that on April 5, SNC announced the sale of most of its stake in the 407 ETR to Canadian pension giant OMERS for up to $3.25 billion. SNC is selling 10.01% of its stake – leaving it with 6.76% – to OMERS for $3 billion payable when the deal closes and $250 million in conditional payments over a 10-year period. National Bank analysts estimate that the stake sale valued the 407 asset at $31.11 per SNC share and $26.99 on an after-tax basis. SNC intends to use part of the sale proceeds to repay debt and will use the remainder for a capital allocation strategy – including share buy-backs – that would be the most accretive to shareholder value.
    - In our opinion, although political risk will continue to hinder SNC in the near term, substantially lower debt has de-risked the business while a potential share buy-back could support the stock, positioning it for significant upside once its legal issues are resolved.

- In the last week of February, we booked partial gains in some of the best performing securities and allocated it to those that had been lagging the rally, across all our models.

- On March 12, we made a change in the U.S. equity sleeve of our larger models. Specifically, we sold our full position in **AstraZeneca Plc (NYSE: AZN)** to book gains, and used the proceeds to buy U.S. health care company **CVS Health (NYSE: CVS)**. CVS has tremendous reach across the U.S. with a chain of 9,800 retail drugstores, over 1,000 walk-in clinics and a leading pharmacy benefits manager with 93 million members. Its recent acquisition of health insurer Aetna uniquely positions CVS to capitalize on opportunities in the inefficient U.S. health care space through an integrated approach that is expected to improve consumer engagement and health outcomes while lowering costs.

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## Looking Ahead – Growing Divergence Warrants Caution

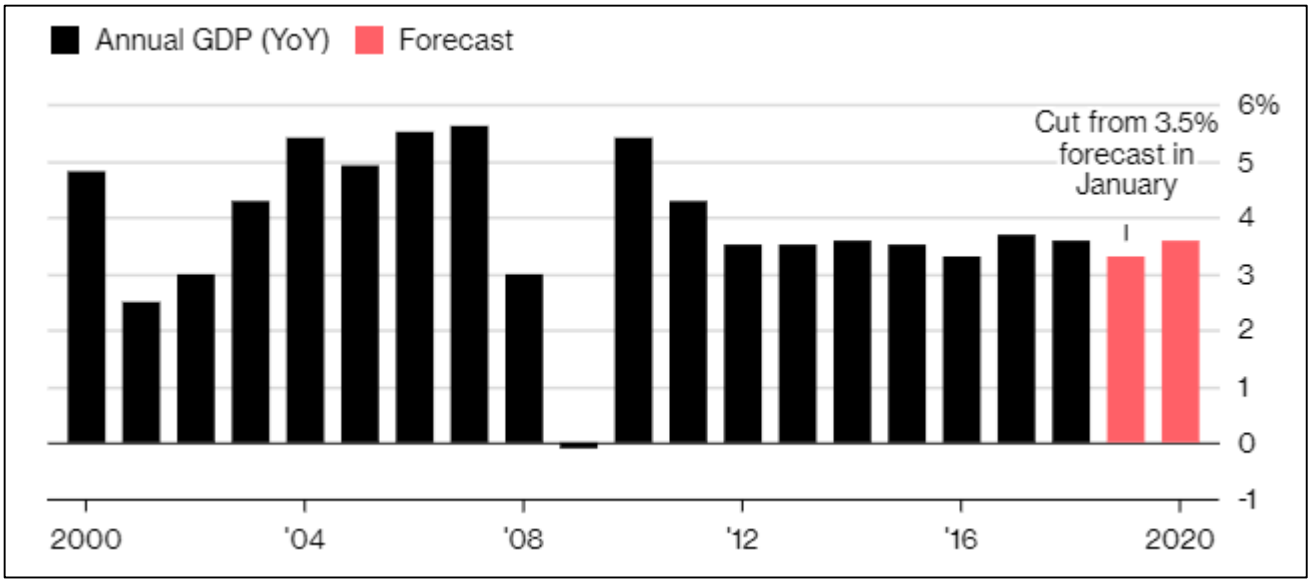
Equity markets have been surging, with the TSX and S&P 500 within striking distance of their record highs, despite mixed economic data that has been tepid rather than robust. The growing divergence between the markets and underlying data warrants caution, in our view, and supports a continued defensive stance with regard to portfolio positioning.

The biggest financial market development of Q1 was the about-turn in monetary by major central banks – including the Federal Reserve, Bank of Canada and the European Central Bank – as weak economic data forced them to pause in their efforts to normalize monetary policy or perhaps abandon it altogether. While this policy pivot provided a tailwind to global equities in Q1, its effect seems to be wearing off as we enter Q2.

Earlier this week, the International Monetary Fund (IMF) again reduced its 2019 global growth forecast by 0.2 percentage point to 3.3%, compared with its 3.5% estimate in January. This is appreciably lower than the 3.6% growth pace of 2018, and would in fact be the slowest growth since the 2008-09 financial crisis (Figure 2). Canada was among the nations with the biggest downward revisions to its growth estimates, with the IMF slashing its 1.9% January forecast by 0.4 percentage point to 1.5%.

While some of the risk factors that contributed to the markets plunge in Q4 – such as rising U.S. interest rates and fears of a full-blown trade war between the U.S. and China – have been significantly mitigated, other risks including a messy Brexit and a slowdown in Europe continue to persist. As a result, we intend to be judicious in deploying cash balances that have built up from recent client contributions to their registered accounts.

**Figure 2: IMF cuts 2019 global growth outlook to lowest since financial crisis (Source: IMF)**



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