# Luft Financial Model Portfolios

**2019 Review**
**2020 Outlook**

January 20, 2020

HollisWealth®

Your Vision

Our Goal

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# 2019 Review

## A record year for global equities

2019 was a record year for stocks, with most major indices posting double-digit increases over the year as they rebounded from the 2018 fourth-quarter sell-off. It was an outstanding year for other assets as well, as returns in 2019 exceeded those from the preceding 10 years for almost every asset class (Figure 1). North American and European indices followed up on their best first-half performance in two decades with additional gains in the second half of 2019, aided by lowered trade tensions between the U.S. and China, accommodative monetary policy by key central banks, and dissipation of Brexit anxiety.

The TSX Composite gained 19.1% in 2019 to a new record, its best performance in a decade but one that was surpassed by several indices which advanced 20% or more (Figure 2). The S&P 500 surged 28.9% for the year, while the Nasdaq Composite soared 35.2%, the biggest gain for both benchmarks since 2013. The Dow Jones Industrial Average posted a comparatively smaller increase of 22.3% due to the underperformance of some of its constituents such as 3M and Boeing. While markets were roiled by occasional bouts of volatility, such as in May, when a couple of unexpected trade-related tweets by President Trump led to a 6.6% decline in the S&P 500, these pullbacks turned out to be buying opportunities as U.S. indices steadily powered their way to new highs. Investor sentiment especially towards the U.S. was close to euphoric by year-end, with the S&P 500 advancing in 11 of the final 12 weeks of 2019 and posting 20 new record highs in the final two months of the year. The giant emerging market BRIC economies (Brazil, Russia, India, China) also had a solid year, with an average gain of 28.3% in 2019.

**Figure 1: A stellar year for almost all asset classes**

**Source: Bloomberg**

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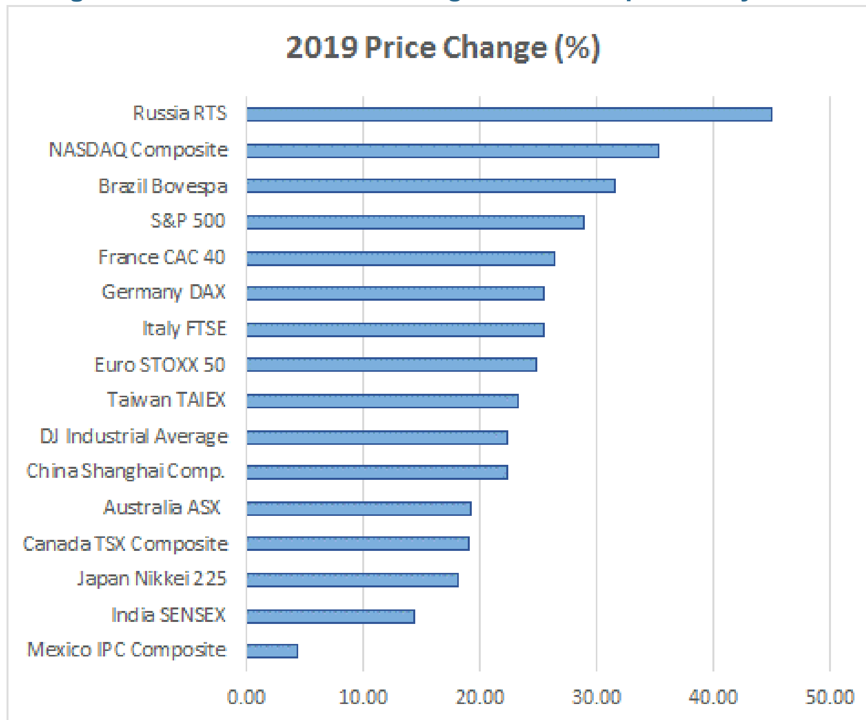
# 2019 Review

**Figure 2: TSX decade-best 19% gain in '19 surpassed by other indices**



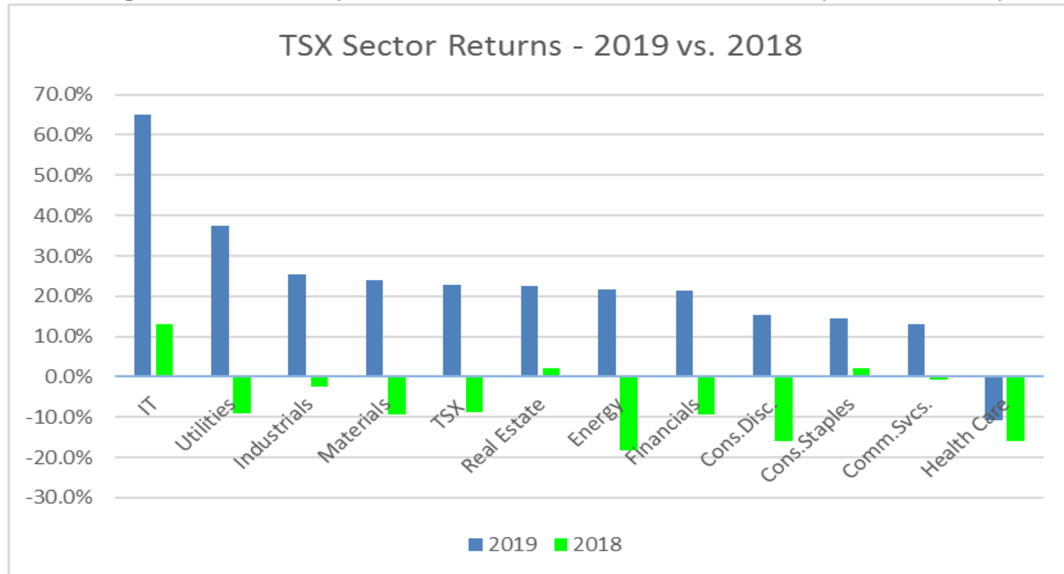

**Source: FactSet**

## Ten of TSX Composite's 11 groups had double-digit returns in 2019

The TSX Composite generated total returns (i.e. price change + dividends) of 22.9% in 2019, compared with -8.9% in 2018. As many as 10 of the 11 groups in the index posted double-digit returns in 2019 (Figure 3), in sharp contrast to the preceding year, when only three groups managed positive returns. The Information Technology sector was the best performer for the second year running; it returned 64.9% in 2019, led by Shopify Inc., whose 173% surge last year vaulted it into the ten biggest stocks on the TSX, with a current market capitalization of $68 billion. The Utilities sector, somewhat surprisingly, ranked second with a total return of 37.5%, as investors were attracted to the group's healthy dividend yields in a continuing low interest-rate environment. Industrials came in third with a 25.5% return, led by stocks such as Ballard Power (the second-best performing stock on the TSX last year with an 183% increase), Air Canada and Boyd Group. The Materials sector was not far behind with a 23.8% return as precious metals prices rose. The Real Estate sector also had a solid year, with a return of 22.6%, as REITs' above-average distribution yields and low volatility appealed to investors. The Energy group returned 21.7% as crude oil prices rebounded 35% after plunging 25% in 2018, while the Financials sector – which makes up close to one-third of the TSX – also had a return of over 21%. The consumer groups underperformed the TSX, although the Consumer Discretionary sector did have the best TSX performer of 2019 in Real Matters Inc (+273% in 2019), a provider of management services to mortgage lenders and insurance providers. Communication Services also lagged the index with a 13% return, while the Health Care group had negative returns for the second straight year as cannabis-related stocks plunged.

## 2019 Review

**Figure 3: TSX Composite Sector Returns – 2019 vs. 2018 (Total Returns)**




**Source: FactSet**

## Portfolio Constituents – Major Movers

- Almost one-half of the portfolio constituents that were held for the full year in our large model portfolios posted double-digit total returns (in Canadian dollar terms) in 2019, with 10 securities generating total returns above 20% (Figure 4).

- Our best performers in 2019 were a diverse bunch, reflecting the broad-based market rally. Four of the top five – **Qualcomm, Manulife, General Electric and Visa** – were among the best performers in the first half of 2019 and continued their outperformance in the second half of the year. Three securities – **Hydro One**, **Pembina Pipeline** and **CI First Asset Canadian REIT ETF** – belonging to interest-rate sensitive sectors also featured among the best performers, with a couple of factor-based ETFs – **CI First Asset Canada Momentum ETF** and **Invesco S&P 500 Top 50 ETF** – rounding off the Top Ten. This list excludes **CVS Health**, up 33% since we first purchased it in mid-March 2019.

- Only four securities in our large model portfolios posted negative returns in 2019. With most preferred share funds in the red for the year, two of our bottom performers – **Fiera Canadian Preferred Share Fund** (formerly Natixis Cdn. Pref. Share Fund) and **Purpose Canadian Preferred Share ETF** – were from this sector, finishing the year marginally lower as their healthy dividend yields offset most of the price declines. The **Dynamic Alpha** hedge fund and **Westshore Terminals** were our two worst performers, excluding **SNC-Lavalin** (-34.2% in 2019), which was sold from portfolios in November.

- In terms of contribution to portfolio return – which is based on portfolio weight and total returns – the five biggest contributors to our large model portfolios were: **Invesco S&P 500 Top 50 ETF**, **CI FA Canada Momentum ETF**, **Qualcomm**, **CI FA Canadian REIT ETF**, and **General Electric**.

# 2019 Review

### Figure 4: Portfolio Constituents' Top & Bottom Performers in 2019 (Total Returns in CAD)

| Security | Symbol | Type | Sector | YTD Gains |
|---|---|---|---|---|
| Qualcomm | QCOM | Stock | Technology | 52.9% |
| Manulife Financial | MFC | Stock | Financials (Insurance) | 42.0% |
| General Electric | GE | Stock | Industrial | 40.8% |
| Visa Inc. | V | Stock | Financials (Services) | 36.4% |
| Barrick Gold | ABX | Stock | Precious Metals | 31.9% |
| CI FA Canada Momentum | WXM | ETF | Canadian Momentum Stocks | 31.5% |
| Hydro One | H | Stock | Utilities | 29.1% |
| Invesco S&P 500 Top 50 | XLG | ETF | S&P 500 Top 50 Stocks | 25.6% |
| Pembina Pipeline | PPL | Stock | Pipelines | 24.8% |
| CI FA Canadian REIT ETF | RIT | ETF | Canadian REITs | 22.9% |
| Fiera Cdn.Pref. Share Fund | NXG5338 | Fund | Preferred Share Fund | -0.8% |
| Purpose Cdn.Pref. Share ETF | RPS | ETF | Preferred Share ETF | -1.0% |
| Dynamic Alpha | DYN394 | Fund | Alternatives (Hedge Fund) | -1.2% |
| Westshore Terminals | WTE | Stock | Industrials (Transp. Infrastructure) | -5.0% |

**Source: SIACharts.com**

## 2019 Summary of Portfolio Changes

- While we rebalanced client portfolios periodically throughout 2019 to take advantage of investment opportunities, we made major changes in mid-year and November to better position portfolios in response to changing market conditions.

- We undertook a major overhaul of our smaller model portfolios in June 2019, streamlining them by consolidating positions with low weights, selling under-performers and taking profits in some positions. In July, we extended this overhaul to our large models. With the TSX Composite up 15% for the year and U.S. indices at all-time highs at that time, we dialed down the risk profiles of our portfolios by taking profits in some long-standing positions and using the proceeds of these sales to initiate positions primarily in lower-beta (less volatile) securities.

- A number of these changes involved the Fixed Income sleeve of our portfolios, where we significantly extended duration, based on our view that interest rates could trend lower over time. This was achieved by replacing two short-term ETFs and an emerging-market sovereign bond ETF with the **TD Fixed Income Pool** and the **Pender Corporate Bond Fund**.

- Simultaneously, in the Global Equity sleeve, we replaced the BMO EAFE (Europe, Australasia and Far East) CAD-hedged ETF with the **BMO International Dividend ETF**, which consists of dividend-paying blue-chips based in international developed markets ex-North America. We also added the top-performing **AGF Global Select Fund** – which invests in innovative companies around the world – to complement the **Mackenzie Ivy Foreign Equity Fund**, one of our portfolios' long-term holdings that has a defensive tilt. In the Infrastructure sleeve, we replaced the **Sentry Global Infrastructure Fund** with the **Russell Investments Global Infrastructure Pool**.

# 2020 Outlook

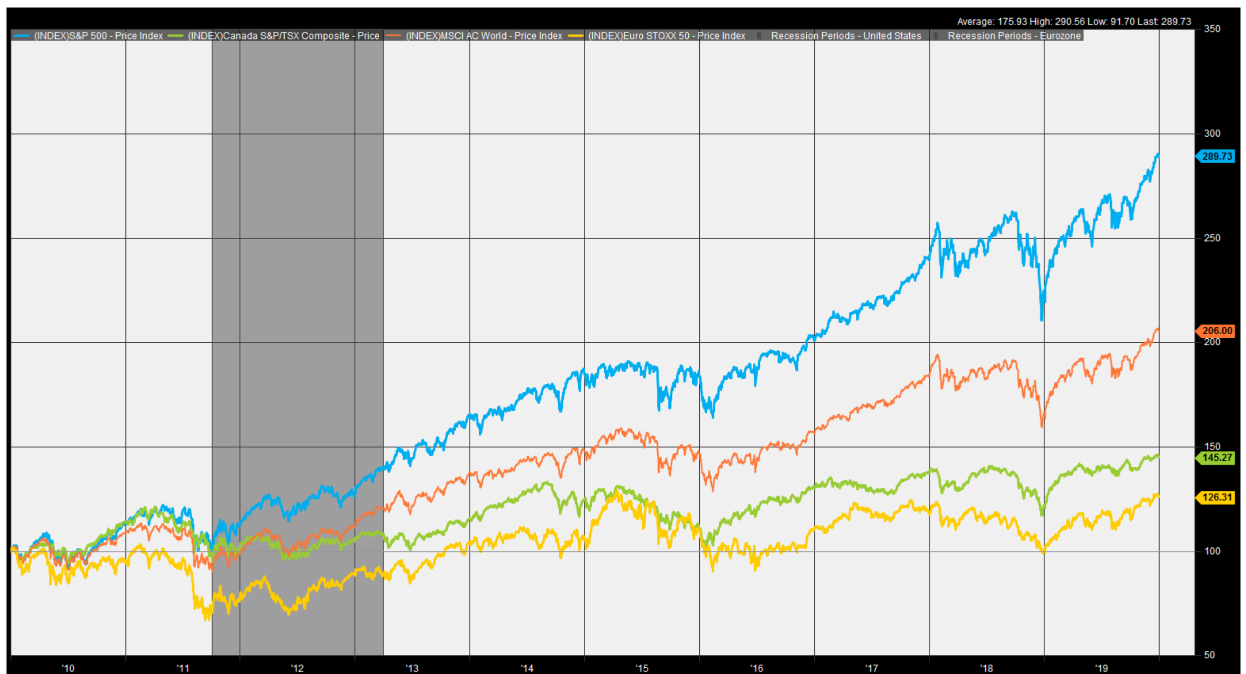
- In November, we took advantage of the market rally to sell a few securities that had underperformed significantly over the past couple of years, in order to harvest tax losses and improve overall portfolio quality. Our sell decision was based on a long-term risk/reward profile for these securities that we assessed was below average due to headline risk and/or deteriorating fundamentals; as a result, we felt that the capital locked up in them could be better deployed elsewhere. These securities included **SNC-Lavalin** (which had gained approximately 60% from its September 2019 multi-year low at the time of our sale), **Altria Group**, **High Liner Foods** and **BMO Equal Weight Oil & Gas ETF**. We also took part profits in **CVS Health,** one of our top portfolio performers in 2019.

- We used the proceeds of these sales to increase our positions in broad market factor-based ETFs such as the **S&P 500 Top 50 ETF** and **CI FA Canada Momentum ETF**, based on our view that markets would continue to rally into the year-end. We also added to positions in **General Electric** and initiated a new position in **Nutrien**, one of the world's premier manufacturers of crop nutrients, based on its attractive dividend yield, reasonable valuation, and upside potential.

## Looking Ahead – Can U.S. outperformance continue?

The past decade (2010 to 2019) has been an outstanding one for U.S. stocks, thanks partly to the tremendous performance of its technology giants. Figure 5 shows the change in four major indices over the past decade, starting from a base of 100. The S&P 500 surged 190% over this period, compared with a gain of 106% for the MSCI All-Country World Index (which had a 55.6% U.S. weight as of year-end 2019), 45% for the TSX and 26% for the Euro Stoxx 50 index. The trillion-dollar question is – can this U.S. outperformance continue in the years ahead?

**Fig. 5: S&P 500, MSCI World, TSX , Euro Stoxx 50 – Index change from 2010 to 2019 (Base=100)**



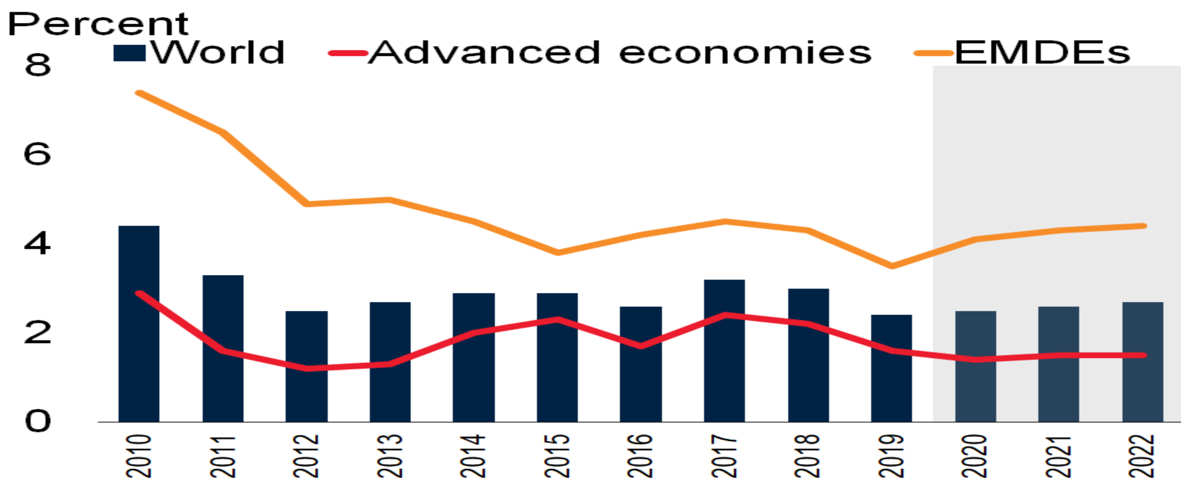

**Source: FactSet**

## 2020 Outlook

While 2020 commenced on an ominous note, with geopolitical risk escalating after a top Iranian general was killed by a targeted U.S. airstrike, North American markets have taken that development in stride as equity indices reached new highs in the first two weeks of January. Whether this is the latest manifestation of market resilience that has shaken off trade wars, political risks and soft economic data over the past year, or another sign of growing investor complacency, remains to be seen.

The global economy seems to be on the mend in recent months, but as the World Bank noted in its recent Global Economic Prospects report, downward risks – including re-escalation of trade tensions, a downturn in major economies and financial turmoil in emerging markets – remain dominant and could slow growth substantially if they materialize. As it stands, the World Bank forecasts that global growth will recover marginally to 2.5% this year – from 2.4% in 2019, the lowest since the financial crisis (Figure 6) – and edge up by 0.1 percentage points over each of the next two years. Growth in the advanced economies is forecast to slow to a 1.4% pace in 2020 (from 1.6% in 2019), while growth in emerging markets and developing economies (EMDE) accelerates to 4.1% (from 3.5% in 2019). U.S. growth is forecast to slow to 1.8% in 2020 (from an estimated 2.3% in 2019), reflecting the adverse impact of earlier tariff increases and elevated uncertainty. Against this backdrop, earnings for the S&P 500 are forecast to grow at a 10% clip annually over the next two years, and at 8% annually for the TSX over this period (FactSet estimates). Based on closing prices as of January 16, 2020, the S&P 500 trades at a forward multiple of 18.7x forecast 2020 EPS of $177.39, while the TSX trades at 15.2x forecast 2020 EPS of $1153. Those valuations are not lofty, but leave little room for error if forecasted earnings estimates turn out to be unduly optimistic. One potential wildcard that could affect U.S. earnings growth is if President Trump fails to get re-elected, since the current Democratic frontrunners favor (among other measures that are not market-friendly) at least a partial repeal of the 2017 corporate tax cuts that provided such a boost to earnings. We cite this as an example of the uncertainty that may creep into markets well ahead of the Presidential election in November. As a result, we continue to have a significant allocation to international equities (ex-North America), including a small weighting in emerging markets (Fig. 7).

**Fig. 6: World Bank Real GDP Forecast for Global Economy**




**Source: World Bank – Global Economic Prospects January 2020**

## 2019 Review & 2020 Outlook

Overall, we are becoming increasingly cautious on the U.S. markets given the increasing concentration in its biggest stocks – the top five companies now make up a record 18% of the S&P 500 – and the near-zero probability being assigned to an unexpected election result in November. We are neutral on the Canadian equity market, since it is heavily exposed to cyclical sectors that could underperform as the global economy slows, while the domestic economy has its own challenges such as highly leveraged consumers and an overvalued housing sector. Our model portfolios continue to be well diversified (Figure 7), with their blue-chip constituents offering a combination of reliable income and steady growth. We believe our portfolios are well positioned to participate in continued market upside, while offering protection against the growing risk of significant market declines.

**Figure 7: Model Portfolios – Asset Allocation as of December 31, 2019**

| Asset Class | Asset Category | Pursuit | Pension | Protection | Preservation |
|---|---|---|---|---|---|
| Equity | CAD Top Stocks | 21.00 | 15.00 | 9.00 | 0.00 |
| | CAD Broad Mkt. ETFs | 3.75 | 3.00 | 0.00 | 0.00 |
| | US Top Stocks | 14.00 | 10.00 | 6.00 | 0.00 |
| | US Sector ETFs | 0.00 | 0.00 | 0.00 | 0.00 |
| | US Broad Mkt. ETFs | 8.00 | 7.00 | 3.00 | 0.00 |
| | US Sm-Mid Cap | 0.00 | 0.00 | 0.00 | 0.00 |
| | North American Fund | 0.00 | 0.00 | 4.50 | 0.00 |
| | International Equity | 17.00 | 14.00 | 10.00 | 0.00 |
| | Emerging Markets | 4.00 | 3.00 | 0.00 | 0.00 |
| | Global Infrastructure | 4.00 | 3.00 | 3.00 | 0.00 |
| | Real Estate | 0.00 | 3.00 | 3.00 | 0.00 |
| Fixed Income | Fixed | 16.00 | 26.50 | 41.00 | 78.00 |
| | Mortgage | 4.00 | 3.00 | 3.00 | 10.00 |
| | Preferred | 3.00 | 5.00 | 6.00 | 0.00 |
| Alternative | Alternative | 3.00 | 4.00 | 7.00 | 0.00 |
| Other | Miscellaneous | 0.00 | 0.00 | 0.00 | 10.00 |
| Cash | Cash | 2.25 | 3.50 | 4.50 | 2.00 |
| Total | | 100.00 | 100.00 | 100.00 | 100.00 |

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