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Subject: VALUED CLIENT MAIL LIST - The Oil Story Continued

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THE OIL DRAMA PART 2 – INNOCENT BYSTANDERS

Source: Google Images

We are witnessing the global financial market drama continue into the start of 2016. The media anxiety being spun around daily events in the markets is a bit like watching a disaster movie with scene after scene of tornadoes relentlessly tearing through towns without relief. But, inevitably, the weather clears and the towns people come out to live another day, innocent bystanders at the hands of mother nature.

The current financial market chaos is tied to the price of oil which is still under pressure due to over-supply triggered by geo-political differences amongst oil-producing nations. The supply – consumption relationship has no influence at this time. Oil has historically been the "fuel" driving economic production but the energy sector does not represent the entire economic universe. According to the World Economic Forum, the energy sector is responsible for only **about 6%** of the total global economic output. This, of course, varies by country with some smaller producing nations having become dependent on the revenues from oil production regardless of the price.

However, we are witnessing the energy sector hold the financial markets hostage which is ***affecting the investor as an innocent bystander*** in the process. With a constant eye on the fundamentals, prevailing market conditions do not reflect true underlying global economic conditions. Therefore, we should really expect the current rhetoric to eventually dissipate and allow financial markets around the world to normalize again. Let's look at key factors again that support this view:

1. The two largest economies in the world, the U.S. and China, continue to experience positive GDP growth despite more modest predictions. Even Europe has re-emerged from negative GDP growth.

2. Regardless of central bank activity affecting short term interest rates, the bond market continues to reflect only modest concern about weakness and little expectation of inflation with long term interest rates remaining at historically low levels.

3. The higher profile equity "stock" market has been the segment most affected; other sectors such as bonds, gold and real estate have remained largely unaffected although they are near their highs at this time. The following chart illustrates the approximate relative magnitude of selected equity sector price movements over the past 12 months:

Equity Sector Change Year / Year (Market Value only not including dividends)	Approximate % Change
Oil price	**-50%**
TSX	**-13.5%**
Energy Sector	**-30%**
Financials	**-11%**

Source: Thomson Reuters data source as at January 21/16

4. Prior to this stock market correction, equity price-earnings ratios had reached new highs and have now returned to historical average levels, creating room for eventual upside.

5. Large amounts of investor cash still remains un-invested and much of the market volatility optic continues to be driven by program trading rather than mainstream investor activity.

6. Eventually the current level of oil prices will act to stimulate the global economy and the supply-demand balance will recover based on increased consumption.

7. The fear caused by the energy sector uncertainty is driving new and expanded non-energy related activities enhancing economic growth.

What do we do to protect ourselves as innocent bystanders?

1. **Continue to seek income flows to compensate for market value weakness.**

2. **Maintain a defensive profile including cash reserves and suitable market hedges which are immune to market weakness. A "pension fund" approach focused on nearer term liquid returns is far more suitable than seeking gains in this environment.**

3. **Restrict the equity component in our portfolios with a focus on high quality core companies, typically the first to recover while paying a reliable dividend in the meantime. These will also tend to outperform over the longer term.**

4. **As we manage our risk tolerance closely, we should also maintain an awareness that eventual opportunities will emerge as the current market climate stabilizes.**

5. **Remember that we are witnessing geo-politically driven events; knowing that our portfolios are structured to tolerate the passing volatility should allow us to look the other way and allow the market theatre play itself out. Having well-constructed portfolios in hand, excluding those sectors at the heart of the turmoil, should allow us the expectation that this too will clear up like the weather after the tornado.**

Regards
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