Huggan White Wealth Management

Protect Capital. Manage |Risk. Provide Income.

Portfolio Management Report

Second Quarter 2019

"Risk vs. Volatility" – Our Take…

We learned many years ago from a trusted colleague that the essence of portfolio management is the management of risk, not the management of returns. In other words, if you manage the downside the upside should take care of itself, allowing for positive performance within a portfolio. What we find interesting though is the miscommunication used by some to describe the terms risk and volatility. To us, risk is permanent loss of capital – investing in an asset that loses 50%, 75% or 90%+ of its value. Business models that are unpredictable, unstable, lack transparency or are unproven generally fit this description. Alternatively, volatility to us is the tendency for an asset class to deviate outside of its mean- the greater the divergence, the greater the volatility. When looking at the set of asset classes available to investors, all carry some degree of volatility. Stocks, bonds, commodities, real estate, precious metals, alternatives and currencies behave differently on any single trading day.

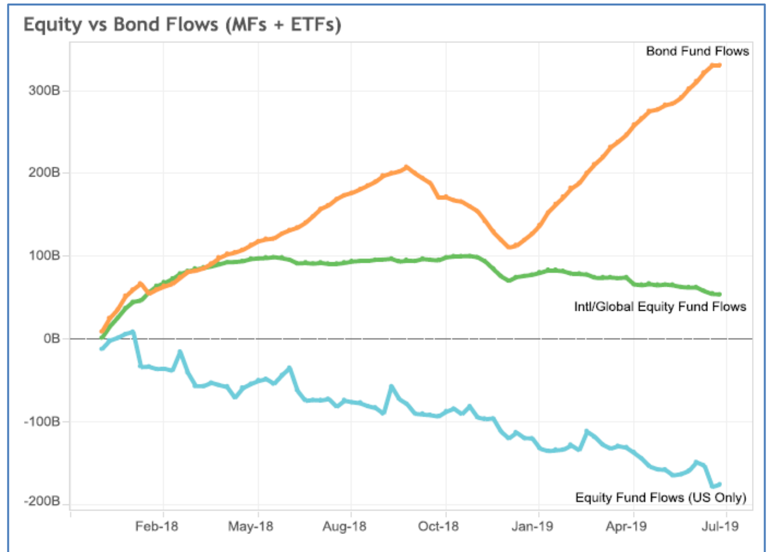
When constructing an investment strategy, we look for the optimal mix of each asset to ensure that volatility remains subdued. By strategically shifting between these asset classes based on the current and forward looking landscape, we believe volatility can be managed more effectively than a strategy exposed to just one. Simply put, we do not expose our clients' capital to the former "risky" assets and strive to mitigate volatility by implementing a diligent, thoughtful process that is focused specifically on the latter. In the end, we believe clients are rewarded with above average returns.

The stock and bond markets provided an abundance of volatility and misdirection over the second quarter of 2019. Between May 1st and the 3rd of June, the benchmark US index S&P 500 fell 7% as the trade war between the USA and China started to accelerate. When the tariffs began, their effect on corporate earnings was unknown. Since indeterminate effects are negative influences on stock prices, the sellers dominated trade for a month. Just as suddenly and for no other reason than the market seemed to be “oversold” (prices driven to lower than reasonable levels by emotion, mainly panic) stocks started a rally on June 4th that erased the entire May sell-off in less than three weeks. The net result for the quarter was a modest advance of around 3% for stocks in the index but a dramatic 15% (7% down then 8% up) swing in valuations. The market’s fear gauge, a mathematical representation of bias achieved by measuring the price movement of certain derivative securities, climbed back into the 20% range in May, an unsustainably high level of price volatility that ended the way all such periods have concluded over the past several years - with stock prices almost unchanged.

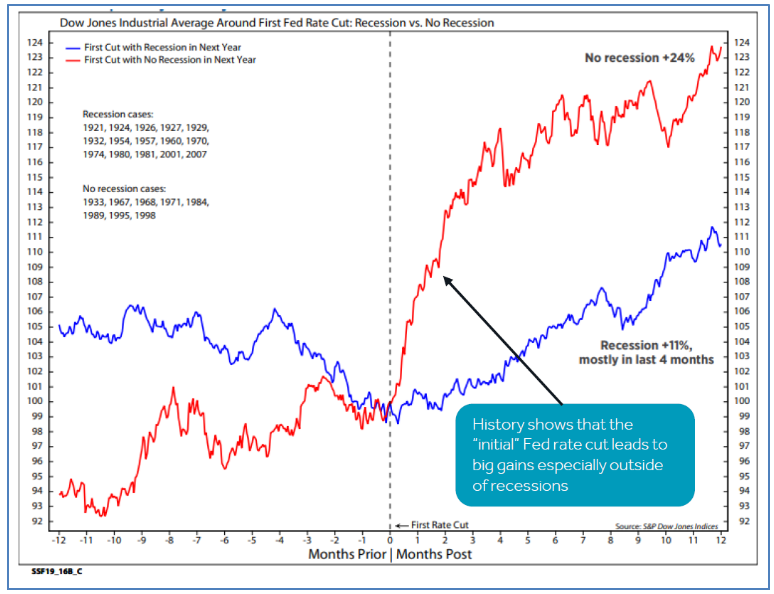
Our mandates performed very well and avoided much of the volatility over the quarter. The takeover of WestJet Airlines by Onex Corporation helped the Canadian portfolio maintain its pleasantly-chronic, over-achiever status. CCL Industries, Premium Brands and Intact Financial were also key contributors to this mandates’ positive performance. Energy-related names in Canada and elsewhere continued to drag on returns as oil prices gyrated amid growing concerns about a potential global economic slowdown. Gladly, our exposure to that sector has been well below-normal for some time. Turning to the U.S. markets, our global mandate also generated a positive quarterly return as core names like Visa, Microsoft, Walmart and Coca-Cola led to the upside and contributed to total return. Moving forward, we are mining for new opportunities in sectors such as technology, healthcare and consumer cyclicals where valuations are compelling and we have seen an improvement on the technical front.

Markets continue to focus on trade issues, their effect on global economies and the direction of interest rates as investors try to anticipate the mood of equity markets in the last half of 2019. Lower rates, the overwhelming bias of the U.S. Federal Reserve governors at the moment, normally translates to higher stock prices. The old mantra of Wall Street, “*never fight the Fed*”, still has merit because as bond yields decline, dividends from equities become more attractive. We have witnessed this over the past several weeks as several higher yielding equities have once again caught a strong tailwind. At the same time, the growth rate of corporate earnings is in question due to the decline of global political relations in the past year, especially those between the USA and China. The chronic economic threats from Brexit, weakened European banks, Russian economic problems and a potentially significant slowdown in Chinese GDP growth, all of these concerns and worries remain present. With second quarter earnings season about to kick off, we are closely monitoring positions to determine the impact, if any, on their financial metrics. This is when an active approach becomes paramount, as *“the wheat truly becomes separated from the shaft”.*

Finally, stock prices cannot rise in a totally optimistic environment. If everyone believes the economic environment to be risk-free and stock prices to be without risk, then markets will fall. In simple terms, we would run out of buyers. If the optimism is amplified, what is typically called a bubble, then the decline can be significant and even trigger a recession. At this time, the wall of worry appears to be alive and well which has more less been the case since the 2008 financial crisis. As witnessed in the second quarter, stock prices keep recovering from periodic sell-offs because the underlying fundamentals are strong. Sentiment continues to be cautious and unaccepting; with fund flows representative of this preference for bonds over equities (contrarians take note). In summary, we remain focused on individual situations, how each company is managing the environment at hand and the longer-term outlook for the health of their businesses. We believe this approach and discipline to managing wealth continues to serve our clients well.



Source: Credit Suisse Trading Strategy, ICI, Factset



Thank you for your trust and confidence in allowing us to manage your financial affairs.

With regards,

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