THE LATEST

INSIDE

INVESTMENT TEAM

Robert McKim
CFA
CEO & Chief Investment Officer

27 Years at SEAMARK
39 Years in Industry

Donald Wishart
CPA, CMA, CFA
President

13 Years at SEAMARK
22 Years in Industry

George Loughery
CPA, CGA, CFA
Chief Portfolio Manager

17 Years at SEAMARK
26 Years in Industry

Beste Alpargun
MBA, CFA
VP Fixed Income, CCO & Portfolio Manager

9 Years at SEAMARK
28 Years in Industry

CIO Commentary / Q4 2018

It was a December that investors will soon want to forget. A trifecta of concerns conspired to deliver a lump of coal for Christmas, rather than the traditional year-end rally. Trade tensions with China, rising interest rates and some slowing of global growth were issues that dominated trading. Not to mention that U.S. Government dysfunction reached new heights: reckless foreign policy by tweet, protest resignations from Secretary of Defence Mattis and Special Envoy McGurk, malfeasance forcing the shuttering of the President's family charity, and oh yes, a government shutdown - all within just one week. Throw in a heavy dose of year-end tax selling, and we have witnessed the worst December in generations.

It has been a tough couple of years for investors. After one market pundit referred to 2017 as a "freak" year, 2018 has just ended with a giant thud. The freak reference was in recognition of a mere handful of big technology stocks driving the U.S. market higher without pause, until February 2018. Shortly after that, the market advance did broaden to include many more industry groups than in the lop-sided 2017. But the market that registered healthy gains in the third quarter, turned decidedly negative in the fourth quarter.

Truth be told, many investors have been suffering the ravages of a down market. Before accounting for dividends, stocks as measured by the Morningstar Developed Markets Large-Mid Cap PR Index declined by 10.6% (USD), the S&P 500 Index fell 6.2% (USD), and the S&P TSX Composite Index retreated by 11.6%. Since reaching a high at the end of September, the tech heavy NASDAQ Composite has plunged by 17.4% (USD). The price of gold shed 1.8% in 2018, West Texas Intermediate Oil 24.3%, and Western Canada Select Crude 8.3%, after being down as much as 64.5% in November. Even high-flying bitcoin crashed more than 80%, trading at $3,723 after peaking in Dec. 2017 at $19,666. Against all odds, in an environment when administered interest rates were rising, the flight to safety in the last weeks of the year allowed bond prices to recover lost ground, and essentially deliver their coupon rate of return to fixed income investors.

All this price deterioration is a resounding disconnect from the real economy, which will register GDP growth of about 3.1% in the US, and 2.1% here in Canada. It is true that markets look ahead and discount the future. But the U.S. Federal Reserve is still expecting 2.3% growth in 2019, and 'full' employment with only 3.7% unemployed (Obama should have been so fortunate). The Bank of Canada has reduced its forecast to 1.7% in Canada, cognizant of Alberta's imposition of an 8.7% cut in oil production for 2019.

So, although still trending in the right direction, all the economic language is softer. We may have slowing growth, but corporate earnings should continue to grow, albeit at a much-reduced level from the torrid tax-driven pace in the U.S.

And today, more than ever words matter. In the very short term they have more impact than the big picture. Investors now live in a world where first generation Artificial Intelligence (AI) is a new factor in the marketplace. AI algorithms search news for certain words and phrases (slowdown, higher interest rates, inverted yield curve, impeach, indict - for example), and then press buy/sell buttons accordingly.

…CIO Commentary continued

These algorithmic trades, or algo trades, are only for short term gain, indifferent to longer term context, and oblivious to valuation levels. When overlaid with bullish or bearish stock price chart patterns, AI has the effect of driving market averages quite sharply in the short term, compressing what would normally have taken weeks or months to unfold. Volatility is increasing. The VIX, which languished between 9 and 15 in (the freak year) 2017, has been solidly in the 15-25 range in the last two months, and eclipsed 30 in late December.

Much has been made of Fed Reserve Chairman Powell's Dec 18th decision to raise US rates by 25 basis points. He made a cogent argument for a continuing growing economy, and a more dovish view of rates for 2019. Many seasoned investors respected Powell's resolve, especially considering President Trump's bullying tactics, publicly calling for no rate increase ahead of the Fed's meeting. But others have accused the Fed Chairman of being tone deaf to the early signs of slowdown. Apparently, Powell's phrases "two rate increases instead of four" and "we have achieved the low end of normalized interest rates" weren't on the radar of AI algorithms, because markets moved lower even as Powell took questions after the meeting.

The year-end swoon of the market seems to suggest that Powell's GDP forecast of 2.3% is optimistic. Perhaps so, but from 10,000 feet it would appear that the slowdown is largely a self-inflicted phenomenon, rather than a fissure in the financial system. Brexit, trade negotiations, and turbulence in the White House are man-made issues to be resolved. Certainly, a better trade understanding with China would be seen as a boon for the economy, and just the right medicine for a market that has a case of the jitters. For now, we would look to any softening only as a refreshing pause. This suggests that today's market consternation will pass, and that investors should stay the course as we position portfolios for the long term. *It is always a market of stocks – some remain overvalued, while others offer compelling value.*

SEAMARK has long used the sailing term "lean into the wind" to provide colour on our active investment management style. We are often sellers into price strength, and buyers when prices retreat. By taking advantage of ebbs and flows, we can add value to client portfolios. In 2018, those portfolios recorded many large gains as we reduced or sold overvalued companies. Proceeds were often reinvested in companies that offered a better value proposition as we look out a couple of years. The AI phenomenon, bringing with it higher volatility, enhances the opportunities for longer term thinking and our style of investment management.

Sincerely,

Robert G. McKim, CFA
Chief Investment Officer

A TIMELY REVIEW OF THE LOW VOLATILITY EQUITY MARKET

As alluded to, in the CIO commentary, 2018 will be the year that will be remembered for its brutal ending, causing most world bourses to record double digit declines, even in the face of a growing world economy.

In 2011 we introduced a new mandate for investors, named Low Volatility Equities. The concept was born out of the ravages of the 2008/9 bear market. The mandate was designed to achieve certain markers, or key performance indicators for its investors. The objectives of the mandate were defined such that the underlying stocks in the portfolio would deliver sound economic returns with a reduced level of volatility. There was an inherent expectation that some of the upside of investing would be sacrificed for better downside protection, in effect allowing investors to sleep better at night.

The mandate purposely ignores the typical industry benchmarks in favour of absolute measures of success. If the manager achieves the key performance indicators set out for the portfolio, results should be rewarding for investors.

It is undeniable that investors have high expectations for their money, or for their money manager. It is also understandable that investors' expectations may change with the context of markets. It is truly a challenge for all investors to keep from chasing the latest hot performance. That usually doesn't end well, often leaving investors asking, "What happened?". The obvious antidote to chasing is showing patience…but that's easier said than done. Investors should always resist the temptation of the chase, by asking if the original mandate is doing its job, as advertised. Well intentioned investors can fall prey to impatience by trying to draw conclusions from the most recent year's performance. But the investor's time horizon is more than one year, as is the money manager's investment time frame. And a complete investment cycle is made up of many subcomponents, each of which can easily last for a year or two. An annual return is destined to always be an incomplete part of the story.

How has the SEAMARK Low Volatility Equity mandate lived up to its key performance indicators?

The essence of any Low Volatility Equity product should be to demonstrate a lower downside capture than a common index would deliver. The product did just that in 2018, the first negative return year for equity investors since 2011. In a year when most stock indexes declined by more than 10%, the SEAMARK Low Volatility Equity Composite recorded a negative return of just -2.4%, a better return than even the SEAMARK Pooled Balanced Fund. That experience mirrored the Fund's lower downside capture in 2011. These become proof statements that the Low Volatility mandate better protects investors' capital in declining markets.

What of the other markers for the mandate? The Low Volatility Equity Composite offered a yield of 4.3% at year-end, with 8.4% of the Composite's holdings having increased their dividend rate during the year. The average rate of dividend increase was 81.3%. These results exceeded the Fund's objectives, as has been the case, year after year. And for those investors that have been patient over the years, they have been rewarded by an ever-increasing yield on cost for their savings. The value of this latter marker should not be understated, for the cash flow from dividend increases that is building from year to year is going to provide a lifetime of retirement income, irrespective of how the market may perform from year to year. The Low Volatility Equity approach conveniently helps investors keep their eyes on the prize.

WELCOME BACK!

SEAMARK is pleased to announce that David Driscoll, CFA will be joining the investment team by way of an arrangement with Coeus Research Associates, an investment research firm owned by Mr. Driscoll. Dave is a natural to rejoin SEAMARK in a research capacity. Having previously worked for the firm for 12 years, Dave is already familiar with SEAMARK's investment process.

All members of the investment team have worked with Dave in the past and look forward to once again collaborating with him through the SEAMARK Master List process.

GOOD HOUSEKEEPING ADVICE

Many Canadians may be obligated to file a U.S. tax return and not even realize it. The obligation arises if you meet the Substantial Presence Test (SPT), which is based on physical time spent there. Under the SPT, you're considered a resident of the United States if you're physically present there for 183 days or more in any particular year. But you'll also meet the test if, during the three-year period that includes the current year, you're there for a total of 183 days or more based on the following formula: Add the number of days present in the current year (2018), plus one-third of your days present in the U.S. last year (2017), plus one-sixth of the days in the United States the year before that (2016). Does the total come to 183 or more? If so, you're caught under the SPT. If you are nearing retirement, and planning to travel extensively, you should keep this calculation in mind.

On another front, the annual contribution limit for tax-free savings account (TFSAs) will rise to $6,000 for 2019, up from $5,500 this year. A TFSA's annual contribution limit amount is indexed to inflation, and rounded to the nearest $500, using Statistics Canada's consumer price index. With the TFSA contribution limit rising, the cumulative TFSA contribution limit in 2019 will be $63,500 for a Canadian who has never contributed to a TFSA and who was 18 years old or older in 2009, the year in which the program was launched. The TFSA limit for the years 2013 to 2014 and for 2016 to 2018 was $5,500. The limit for 2015 was $10,000. The limit for 2009 to 2012 was $5,000. SEAMARK can accommodate your TFSA investments through the use our pooled funds. Don't hesitate to contact us!

SEAMARK

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2017 Pooled Fund Capital Gains Tax Deferrals

	Tax Loss Carry Forwards*
SEAMARK Pooled U.S. Equity Fund	$ 21,834,243
SEAMARK Pooled Total Equity Fund	$ 17,788,240
SEAMARK Pooled Low Volatility Equity Fund	$ 4,946,610
SEAMARK Pooled Canadian Equity Fund	$ 4,962,722

*Audited Financial Statements, as at December 31, 2017

Some of these tax loss deferrals are significant compared to the assets in the respective Pools.

Please contact Ann-Marie Slawter for more information:
902-423-9367 aslawter@seamark.ca

Composite Performance Update

Annual Periods as at December 31, 2018

	Q4 018	2018	2017	2016	2015	2014	2013	Since Inception	Inception Date
SEAMARK Balanced Composite (%)	**-4.6**	**-5.2**	**4.9**	**8.8**	**6.0**	**12.8**	**16.4**	**6.6**	12/31/2009
Balanced Benchmark* (%)	-4.5	-1.4	7.4	7.8	3.9	10.7	11.7	6.4	
SEAMARK Low Volatility Equity Composite (%)	**-3.1**	**-2.4**	**6.7**	**12.4**	**7.0**	**15.1**	**23.5**	**9.4**	12/31/2010
S&P/TSX Composite Index (%)	-10.1	-8.9	9.1	21.1	-8.3	10.6	13.0	3.8	
SEAMARK Canadian Equity Composite (%)	**-8.2**	**-12.7**	**5.2**	**19.8**	**-6.3**	**13.8**	**17.4**	**5.1**	01/31/2011
S&P/TSX Composite Index (%)	-10.1	-8.9	9.1	21.1	-8.3	10.6	13.0	3.8	
SEAMARK Total Equity Composite (%)	**-7.4**	**-6.0**	**5.9**	**12.2**	**6.7**	**16.0**	**26.6**	**10.5**	09/30/2011
Total Equity Benchmark** (%)	-9.3	-4.0	12.1	13.2	5.3	14.2	25.3	11.0	
SEAMARK Fixed Income Composite (%)	**1.2**	**1.6**	**2.6**	**1.8**	**3.8**	**8.4**	**-2.1**	**2.9**	04/30/2012
FTSE Canada Universe Bond Index (%)	1.8	1.4	2.5	1.7	3.5	8.8	-1.2	3.0	
SEAMARK U.S. Equity Composite (%)	**-7.2**	**2.4**	**3.4**	**13.9**	**14.1**	**18.5**	**35.5**	**13.7**	04/30/2012
S&P 500 Index (CAD) (%)	-8.9	4.0	13.8	8.6	21.0	24.0	41.5	18.3	

*Effective 30 Sep 2018, the SEAMARK Balanced Composite Benchmark is 5% FTSE Canada 91 Day TBill Index, 40% FTSE Canada Universe Bond Index, 27% S&P/TSX Composite Index, 20% S&P 500 Index, 8% Morningstar Developed Markets ex North America NR Index
**50% S&P/TSX Composite Index, 35% S&P 500 Index, 15% Morningstar Developed Markets ex North America NR Index

Links to Q4 2018 Pooled Fund Profiles

Balanced   Canadian Equity   Low Volatility Equity   Canadian Bond   U.S. Equity   Total Equity

Stay in Touch!

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