

# U.S. & Global Equity

COMMENTARY Q3 2016

FRANK MERSCH

FRONT STREET GLOBAL OPPORTUNITIES CLASS



## MARKET OVERVIEW

Equities climbed during the third quarter of 2016, despite the U.K.'s vote to exit the European Union, weak global economic data and uncertainty from the Federal Reserve.

We have maintained all along that the Fed has missed the opportunity to normalize the rate structure. And now, at the end of another quarter, the Fed has once again postponed an interest rate hike. While initial monetary policy was effective, we are of the opinion that these abnormally low rates are no longer benefiting the economy. Have negative interest rates helped Japan or Europe? It's unlikely, and rather than helping, these unorthodox monetary policies are becoming counterproductive and dangerous.

Nevertheless, we are no longer looking to central bank policy for investment direction. Rather, our focus has shifted towards stock picking, liquidity, trading and sector rotation. We no longer want to play with the central banks.

As we enter the fourth quarter of 2016, the biggest event ahead is the U.S. presidential election. Though we have just come through the least volatile quarter in quite some time, the question is, will this low-volatility persist? We have two U.S. presidential candidates that are widely disliked, and Americans will likely have a president that was not so much "voted in" as "won by default". At this point, we are contemplating the impact for each of the three most likely outcomes:

- I. A Clinton win with a Congressional house divided
- II. A Trump win
- III. A Democratic sweep

Of the outcomes, the first would be the most welcomed by the market. Both the second and third outcomes would likely cause an uptick in volatility and some downside in the market, initially. To us, the most devastating result would be a Trump win, as we have strong concerns around the impact of Trump's trade policy (interesting point: trade policy is one thing a president can direct without any congressional meddling). We believe that if he follows through on his seven-point trade policy, the result will be a global trade war. He would be undermining decades of growth and cooperation. This would not be good for global markets, and emerging markets in particular. Perhaps Trump will switch roles and be more pragmatic when elected? We do not believe he will, and thus, we will be vigilant in monitoring and protecting the portfolio going into this election.



## FRONT STREET GLOBAL OPPORTUNITIES CLASS

FUND MANAGER: FRANK MERSCH

Despite a pretty rough start to the year, the Front Street Global Opportunities Class registered a +5.27% return over the third quarter\*, versus the Dow Jones Industrial Average return of +2.75% and the S&P 500 return of +5.10% (both in Canadian dollar terms).

As you may recall, we made a tough call at the beginning of the year, thinking that we could take the Federal Reserve at its word when it called for four interest rate increases for 2016. We had anticipated that, with the Fed taking such steps, we would see a steepening of the yield curve and thus, financials would outperform. Unfortunately, the Fed failed

\*See chart below for specific performance information for the fund.

to follow through with rate increases as stated, despite an improving economy, falling employment and slightly higher inflation.

A top contributor to performance was the fund's holdings in Raytheon, a major U.S. defense contractor. Positions in health care sector holdings, ACADIA and Allergan, detracted from performance.

We expect the coming period to bring heightened volatility, and the Fund's outlook will depend much on the outcome of the U.S. presidential election and on the timing of expected interest rate increases from the Fed.

## FRONT STREET GLOBAL OPPORTUNITIES CLASS

Series A, as at September 30, 2016<sup>1</sup>

YEAR-TO-DATE	ONE YEAR	THREE YEAR	FIVE YEAR	SINCE INCEPTION
-9.0%	-7.2%	5.6%	11.8%	9.3%



33 Yonge Street, Suite 600  
Toronto ON M5E 1G4

TORONTO 416.364.1990

TOLL FREE 800.513.2832

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