

[How did the markets do in 2018?](#)

January 16, 2019

I would like to wish you and your family a Happy New Year. With this letter, I hope to provide you with a brief overview of how investment markets have performed over the past year, as well as some perspective for evaluating your portfolio's results in this context.

How did the markets do last year?

Well...not very well. It can easily be referred to as the year that no investment strategy worked. After an unusually calm year of solid performance for capital markets in 2017, investors experienced a much bumpier ride in 2018. Downward volatility resurfaced in the first quarter. Though markets moved generally higher through the summer months, a sharp sell-off in the fourth quarter meant that most asset classes registered negative returns for the year. For Canadian investors in foreign markets, losses were mitigated somewhat by the weakness of the Canadian dollar, which declined about 8% relative to the U.S. dollar for the year.

U.S. equities posted some of the best results among global assets in 2018, with the S&P 500 Index reaching an all-time high and setting a record for the longest bull market on record in the third quarter. After the fourth quarter sell-off, however, the index finished the year with a loss of 4.4% (a gain of nearly 4% in Canadian dollar terms). Canada's S&P/TSX Composite Index, meanwhile, was weighed down by themes that included plunging energy prices as well as weakness in materials and financial services. The Canadian benchmark finished the year with a loss of 8.9%. From January 1, 2018 to Jan 1, 2019 the TSX went from 16,310 to 14,347.20 (a loss of 12.03%) and the Dow Jones fell from 24,824.01 to 23,346.24 (a loss of 5.95%). The MSCI World Index, a broad measure of developed market equities, fell 8.2% in U.S. dollars (-0.2% in Canadian dollars).

Central banks in North America continued to gradually raise interest rates throughout 2018. Ten-year U.S. and Canada government bond yields rose and peaked early in the fourth quarter, but fell through November and December to end lower for the year. The FTSE TMX Canada Universe Bond Index, which broadly reflects results for the Canadian government and investment-grade corporate bond market, gained about 1.4% over the 12-month period.

Some perspective on volatility

Although it is always difficult to pinpoint a single reason, several economic and geopolitical developments have been linked to 2018's market gyrations. These include increasing trade friction between the U.S. and its trading partners, particularly China, and the fraught Brexit negotiations between the U.K and the European Union. Rising short-term interest rates in North America are leading to tighter financial conditions, while slower economic activity has weighed on commodity prices – particularly oil – and the materials and energy sectors.

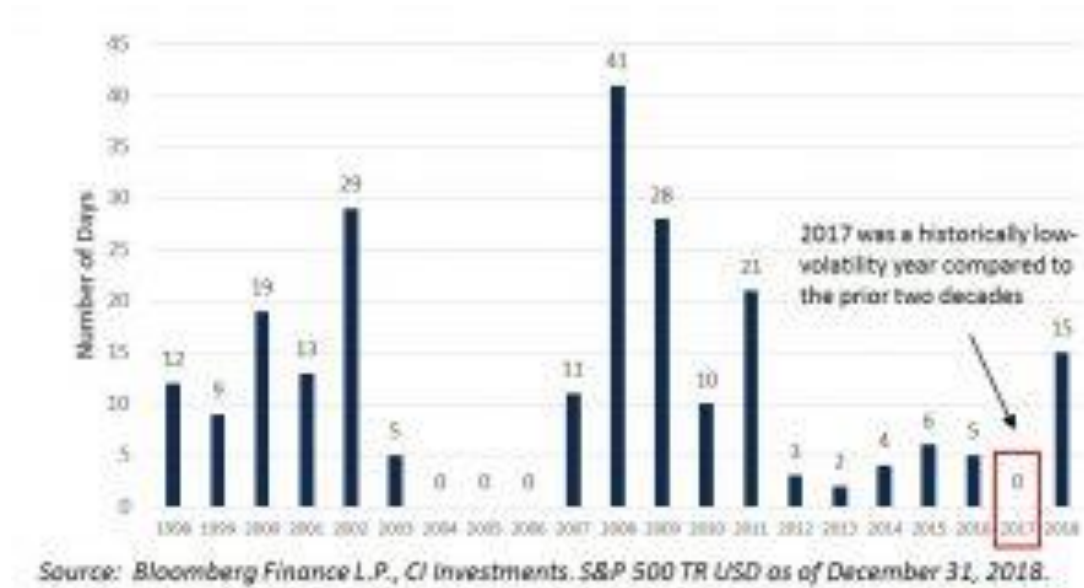
Regardless of the cause, there is no doubt that market turbulence can be unsettling for investors, and last year's volatile performance was particularly surprising following last year's steadiness. The reality, however, is that downside market volatility is normal.

The chart below shows that in most years, the S&P 500 will experience several days in which the value of the index drops by 2% or more. In this context, 2017 was an outlier with nearly non-existent volatility.

Last year, with 15 days registering losses of 2% or more, the level of volatility for the index returned to a more “normal” range.

Downside volatility is normal

The number of days the S&P 500 fell by -2% or more



The fact is, market volatility is not always a bad thing. Professional money managers often welcome market declines as a necessary ingredient for positive returns as it creates opportunities to add to existing positions or buy higher-quality businesses at reduced prices. In 2017, asset prices remained elevated, providing few opportunities to shop for “bargains.”

Furthermore, it is nearly impossible to predict when market swings will occur. Studies have shown that investors who attempt to time the market – that is, sell before a downturn and reinvest when markets are poised to rise – often end up missing the best upside days and underperform relative to those who stay invested. Markets do not advance in a straight line, but historically the long-term direction for equities has been up.

What’s in store for 2019?

In contrast to last year’s consensus outlook that pointed to a synchronized global economic expansion, many experts now believe we are in the late stages of the economic cycle, with global growth slowing and downside risks increasing. Nevertheless, developed economies are expected to grow throughout the coming year and inflation remains moderate. Global interest rates are low by historical standards, allowing corporations the flexibility to strengthen their balance sheets and invest in the future of their businesses. These conditions suggest a cautiously optimistic outlook for markets in 2019.

My advice: stay diversified, and invest for the long term

It can be difficult to set aside short-term distractions and maintain a long-term perspective when negative headlines dominate as they have in recent weeks. But looking back over the longer term, the most recent market decline can be seen as a setback in a strong run upward. From its lows reached

following the financial crisis in March 2009 to the end of last year, for example, the S&P 500 was still up more than 270%.

I believe the most important action to take as an investor is to create a sound, diversified investment plan that takes your time horizon and tolerance for risk into account, and then to stick to that plan through periods of short-term volatility. As asset classes do not typically perform in a correlated fashion, diversification can help to insulate your portfolio from the highs and lows, and provide a smoother experience over time.

In closing, I would like to thank you for the opportunity to work with you as your Investment Advisor. If you have any questions or concerns about your investments, or if your personal circumstances have changed, please do not hesitate to contact my office, toll free at 1-866-860-4190 or directly at 613-491-3344.

Sincerely,

John S. Bruce
Investment Advisor