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How did investors do in 2018?

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During any extended stock market rally, a curious thing tends to occur: several close acquaintances – who aren't professional investors – enjoy offering me their unsolicited advice on how to make money. But when markets fall, the same group often panics, demanding to know what they should do. This mixed bag of behaviour – a combination of overconfidence and anxiety – is common during every business cycle.

Following a relatively stress-free investment environment in 2017 with low volatility and high returns, most investors have not made money in 2018. Ned Davis Research divided markets into eight major asset classes – from bonds to U.S. and international stocks, to commodities – and concluded that not a single asset class has generated any meaningful returns in 2018.

Investors entered this past year with high expectations for economic and corporate earnings growth, not only for 2018, but also for 2019 and beyond. Growth in the U.S. met expectations in 2018 as tax cuts provided a boost. By mid-year, there were signs of weakness within emerging markets (EM). Globally, borrowing costs increased and currencies depreciated broadly. The U.S. was the bright spot but higher interest rates are working as intended – to slow growth. Interest rate-sensitive sectors such as autos and housing began to see slower sales growth. We had a similar situation in Canada. In addition, Alberta had to deal with lower oil prices.

Generally, when economies face challenges and stocks turn lower, bonds tend to perform well on expectations that interest rates will be lowered by the central bank. It was different this time: bonds fell as the U.S. Federal Reserve and the Bank of Canada remained committed to hiking rates. The good news is that sovereign bonds have little downside as the North American bond markets have already priced in a hawkish central bank bias. Any surprises are likely to have a positive impact if central banks change course.

There were also plenty of “landmines”, which we avoided in order to protect your capital. Many speculators (they often revert to calling themselves “investors” when things are working in their favour) cheered on cryptocurrencies in 2017. Bitcoin, the poster child for the group, was priced around U.S.\$19,000 per Bitcoin a year ago; it is now trading at just under U.S.\$4,000. That's a loss of 79%! Unfortunately, real money was invested in Bitcoins. All outstanding Bitcoins were once valued at US\$330 billion, but they are only worth US\$67 billion today. When Bitcoin was close to its peak, we appeared to have missed this seeming “opportunity”. A year later, I can proudly say we are better off having ignored it.

Investors, meanwhile, seemed to give up on Bitcoin, but they found another novel idea in 2018 thanks to Canada's federal government. The legalization of recreational marijuana prompted a frenzy in cannabis stocks. Among them is Canopy Growth, whose ticker symbol (WEED) is aptly named. WEED did well most of the year with expectations building up to the official launch date. The shares peaked at \$76.91 and are now trading at just over \$40 (at the time of writing).

Within a challenging environment in 2018, we preserved capital with little downside for our investors. We are in the process of finalizing our outlook and positioning for 2019 and will share this information with you in the January issue of Portfolio Construction.

We wish you and your family a happy and healthy holiday season.

Combined top 15 equity holdings as of November 30, 2018 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. Atco	6. E-L Financial	11. Canadian Utilities
2. Gilead Sciences	7. Microsoft	12. Emera
3. SNC-Lavalin	8. Bank of Nova Scotia	13. Franco-Nevada
4. Alphabet Class A	9. Industrial Alliance	14. AltaGas
5. Magna International	10. George Weston	15. CSX

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