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EXECUTIVE PERSPECTIVE

Mark Arthur, CEO
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As the new year, 2016, is now on the calendar, we are, of course, pondering what the new year will bring. Will it be as the year before ... or completely different? In recent years, in this publication, we have often repeated the view that developments in political economy and geopolitical matters have been sailing in uncharted waters. When formulating investment strategies and portfolio policies, simple extrapolation of past trends of the last 5 or 6 decades would not have yielded acceptable investment results.

That remains our outlook — an expectation of see-sawing trends, above average volatility and a continuation of challenging new developments. While that may sound daunting, such realism drives us to respond with corresponding approaches ... as well as to recognize new opportunities.

That's precisely the theme that Tyler Mordy (President) writes about in this issue's Global Insight article. He tackles the difficult topic (and opportunities) of an under-appreciated asset class — currencies. Did you know that the Canadian dollar now has fallen against the U.S. dollar by one-third since 2008? Indeed, the investment impact of currency trends must not be overlooked.

In the Client Perspective article found on page 3, we share an uplifting story of achievement. We interview Andrew Bloomfield who provides a very informative perspective on Aroha accounts. These structures can be employed to help disabled individuals to live a "good life."

Finally, on page 4, you will find the Portfolio Update which summarizes our current market views and global investment strategies.

We hope that you will enjoy and benefit from the Winter edition of Forstrong Global Thinking. Let us know what you think. Please feel free to provide us with any feedback that you may have.

Sincerely, Mark Arthur, CEO

What's New at Forstrong

Please visit our new "Global Thinking" section of our website (<https://www.forstrong.com/global-thinking/>) for all Forstrong interviews, videos and articles. You can also view regular video updates on topical investment issues from our Investment Team here.

Forstrong professionals frequently speak at investment conferences and are regularly quoted in the media. Notably, Tyler Mordy (President and CIO) and Randy Bullard (Head of Global Distribution) will be speaking at the world's largest ETF conference in Hollywood, Florida. Please see here for details: <http://www.etf.com/inside-etfs-conference/index.html>

Last Quarter's Highlights

- Global financial markets weathered a year of above-average volatility. Overall returns, viewed in local currency terms, were low to negative across almost all asset types. However, investors with a domicile in a weak-currency country performed very well with international investments.
- Investors in Canada, particularly, were buffeted by adverse trends in commodity markets. Notably, the Canadian oil economy has been under significant pressure due to the slump in energy prices.
- A slumping Canadian dollar (down 19.3% vs. the US dollar (USD) over 2015) offered a partial sinecure. This blunted the impact of slumping commodities priced in USD. Moreover, Canadian investors enjoyed excellent currency-adjusted returns on their international portfolio assets.
- To illustrate, the US equities declined 0.5% for the year in USD terms (S&P 500). Translated into CAD, for Canadian-based investors the S&P 500 gained 21%. Contrastingly, American investors in the Canadian equity market were stung with high losses of 27.6% in USD.
- The same currency impact of the CAD applies to international fixed-income returns. For example, Barclay's US Aggregate Index of US bonds experienced a flat year, returning only 0.7%. However, in CAD terms, returns were fattened to 20%.
- Ongoing developments suggest that financial markets will continue to see-saw for a time longer. Crucially, the monetary policies of the major central banks have diverged and geopolitical conditions are fragile.
- The world economies continue to be marked by tepid growth, disinflationary trends, active currency competition and the uneven impact of slumping commodity prices. While energy importers experience a windfall, exporting countries do not.



GLOBAL INSIGHT

Global Currency Exposure: An Unavoidable Decision

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An old Japanese proverb states that "many a false step was made by standing still." So it is with currency exposures in investor portfolios. Consider the recent experience of Brazilian, Russian and, even, Canadian investors — to name a few countries with steeply depreciating exchange rates. By electing to remain invested in their domestic currency, all have experienced a steep "loss" in their own global purchasing power (even if nominal values held up). An ostensibly conservative position of "standing still" has cost them dearly.

Welcome to the new, hyper-globalized world. Since the financial crisis, unorthodox policies — with central banks trying to outdo the effects of one another by plunging into a subterranean universe of quantitative easing and negative interest rates — have driven currency volatility much higher. Capital has a way of swiftly seeking out safe harbors and penalizing others who are not safeguarding their national currencies. Who would have thought that the once-august Swiss franc would lose its safe haven status?

Beyond The Academic View

Currency exposures are having an outsized impact on portfolio returns. But should investors respond or simply stand still? After all, the academic view has treated any active currency management with an almost mythical disdain. Traditional thinking teaches that, rather than dive into the ethereal world of currency analysis, one should recognize that currency changes “wash out” over time and therefore one should not try to actively manage them.

That’s true. Currencies tend to return to their fair values over very, very long periods — in many cases, on a 20-year or more time horizon. But almost all investors don’t have the luxury of these lengthy time horizons.

That said, can investors master the mysteries of currency markets and do better? To leapfrog over 750 words of well-chosen arguments, we suggest the answer is a strong “yes”.

The Case for Active Currency Management

We maintain that global currencies are overlooked and can produce significant amounts of that return-enhancing force called “alpha”.

Our first consideration is that currency is the largest and most liquid asset class in the world, dwarfing the daily turnover of bond and stock markets. The reason is the explosion in cross-border trading since the onset of a flexible exchange rate regime in the early 1970s.

Given the sheer size and depth of liquidity, many would be tempted to conclude that currencies are very efficient in terms of pricing. Actually they aren’t. An examination of the key participants in global currency markets shows why. The majority are multinational corporations simply hedging the foreign exchange exposure of their revenues and costs in their international business activities. In other words, they are passive investors with no profit motive.

Conversely, those participants trying to actively manage and benefit from exchange rate fluctuations are a clear minority. The net result is an inefficiently priced market with persistent opportunities.

Secondly, currencies bring that increasingly elusive property to portfolios called “low correlation” (i.e. they tend to “zig” when other investments “zag”). This is important in a progressively synchronized and interconnected financial system.

Factors Driving Currency Returns

The case for active currency management is strong based on market inefficiency and low correlation. But how best to make active decisions?

To be sure, currency analysis can be tricky business. Currency moves, once they begin, rarely proceed as policymakers intend. Often countries lose control of their currency. Other times, currency adjustments produce unintended effects in unexpected places.

However, investors should recognize that exchange rates tend to be long-trending markets, regularly entering different regimes but consistently varying more than their underlying fundamentals. This is often related to the particular macro policy regime a country pursues. In the case of Canada, the

“When everyone is thinking the same, no one is thinking at all.”

recent commodity boom created a steady wave of capital inflows, driving down yields and boosting the currency — a self-reinforcing cycle that drove the currency to lofty levels. Now all this is heading in reverse. However, the key point is that swings in the currencies are almost always far wider than is explained by differences in fundamental such as output and inflation.

A variety of underlying factors drive currency moves. In simple terms, currencies can be looked at as the “stock” of a particular country. A firm currency reflects a confident view in the quality of its fiscal situation. In practice, currency forecasting methodologies and models vary widely. Some approaches focus on the concept of purchasing power parity (the level at which two countries are broadly competitive with each other given prevailing inflation rates).

Others concentrate on measures of relative economic strength and resulting portfolio flows (i.e. a more attractive country growth profile will attract greater investment flows, creating demand for the currency and driving it upwards). Still others examine trade flows and attempt to determine the “equilibrium” exchange rate which brings a country’s current account into balance.

All of those are important factors to consider. Nevertheless currencies can and do become wildly overvalued and undervalued — just like stocks. Why shouldn’t investors view this characteristic opportunistically?

Examining investor sentiment is also critical. In financial markets, public opinion is usually unified and dead wrong at major inflection points, becoming too exuberant after prices have risen and too gloomy after they have fallen. Currencies are no different. Extremes in opinion often register shortly before major changes in trend.

Consider the recent experience of the Canadian dollar. From 2002 – 2012, the loonie soared by approximately 55% versus the US dollar. At the end of that run, Canadian dollar bears were nearing extinction. Even a 2012 cover of Maclean’s magazine confidently announced that Canada was unstoppable. In hindsight, that was a clear contrarian opportunity and the Canadian dollar promptly entered a steady downward path.

Currency Conclusions

While most investors understand the role that stocks, bonds and even commodities play in a portfolio, currencies remain opaque. So thick is the fog, that few investors are willing to confess any visibility at all looking to future currency trends. Yet that presents significant opportunities for intrepid investors.

And, with experimental monetary policy now widely accepted as standard operating procedure in today’s post-crisis era (even in Canada), the opportunities to add value through active currency management are even larger. Conversely, standing still carries significant risk.



What do you think?

Share your thoughts with us on Twitter!

@tylormordy or @ForstrongGlobal

CLIENT PERSPECTIVE

Andrew Bloomfield

Forty-seven year old Andrew Bloomfield lives with complex disabilities including autism and epilepsy. This interview was conducted in conjunction with his parents, Elizabeth and Gerald. They had felt impelled to think creatively about how to support Andrew because they had no extended family in Canada. Together, Elizabeth and Gerald have been actively supporting and advocating for people with disabilities for more than 40 years.

What is the most important advice you can give to those dealing with disabilities?

When you have someone with complex needs who will require support for many years, you need to start planning as early as possible. More importantly, you need to find a good advisor who has a lot of experience in this regard having handled a scenario like this before. After some false starts we found our current advisor who was quite helpful. He took the trouble to understand our situation and proposed strategies that would ensure Andrew was able to lead a good life long after his parents grow old and pass.

“I’m not an extravagant person but I do need money for my good life.”

What approach have you taken?

Before you can agree on strategies, you first have to know what your objectives are. The goal was to ensure that Andrew could be as independent as he wanted to be. The first objective was to make it possible for Andrew to live in his own home over his lifetime. A home was purchased for him. The property was bought in trust to be transferred to a registered charitable corporation that functions as a housing trust, making possible Andrew’s lifetime occupancy. Another objective was to ensure that Andrew was able to express himself as he cannot speak with his own voice. For many years now, he has typed on communication devices to say what he thinks, feels and needs. Thirdly, there had to be strong emotional and financial support to ensure that Andrew could continue to lead a good life. Because he is only one person, and cannot be a charity, an incorporated entity called an “Aroha” was created.

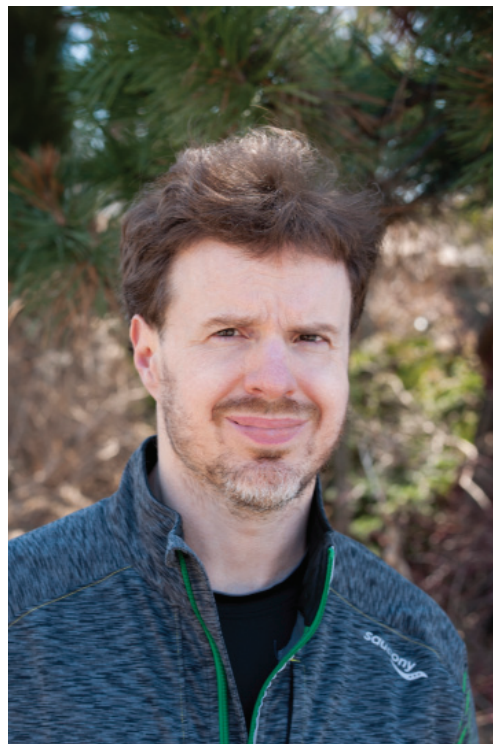
Tell us about the features of an Aroha?

An Aroha is a not-for-profit legal structure based on a model started in Western Canada. One was created with people who have known Andrew for a long time and will continue to know him after his parents pass on. There are six directors of the corporation who have the ability to make decisions and disburse funds. They are in Andrew’s age group so they are more likely to survive his parents. Unlike a standard corporation which will have independent directors, each have a broad knowledge of, and empathy for, Andrew’s situation. An Aroha is not just a financial arrangement; there is a very strong emotional component to it. Andrew has had a RDSP since they were established in Canada however, because of his age, contributions can be made for only three more years. The costs of buying and maintaining a home are small compared with

the costs of supporting someone with severe needs around the clock, day after day. Therefore, a supplementary means of financial support was required.

What are Andrew’s interests?

Running, gardening, reading and painting are some of Andrew’s interests. Last year he was honoured by the Mayor of the City of Guelph for his contribution and inspiration to others. This recognizes people who make a difference and who are a little out of the ordinary. There is the link to the YouTube video, My Good Life, which was Andrew’s reply to being given an award by Guelph’s Mayor Karen Farbridge for “making a difference”: <https://www.youtube.com/user/cityofguelph>. Andrew likes to say “I’m not an extravagant person but I do need money for my good life.” With the proper planning and support there is a lot of confidence about the future.



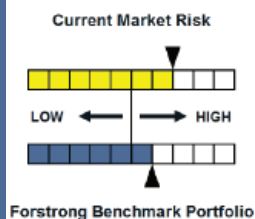
Notable Quotes

“THE ART OF INVESTING IS NOT ABOUT FIGURING OUT WHAT HAS ALREADY HAPPENED. IT’S ABOUT ANTICIPATING THE FUTURE AND CREATING THE FUTURE THAT OTHERS WILL READ ABOUT IN THE WALL STREET JOURNAL.”

-JOSHUA ROGERS

“IN INVESTING, WHAT IS COMFORTABLE IS RARELY PROFITABLE.”

- ROBERT ARNOTT



Current Portfolio Strategy

Major realignments have begun to occur internationally, both financially and geopolitically. And, to add to the conundrums, the windsock is blowing in different directions for various regions and asset classes.

The biggest change has been an emerging monetary policy divergence between the world’s major central banks. After more than 800 interest rate reductions by central banks around the world over the past 9 years (measured collectively), one of them has broken ranks and has begun to raise rates — the US Federal Reserve. While the recent rate increase was small (only a quarter of one percent), it nonetheless marks an important pivot point for investment strategy.

For one, we now are of the view that the US dollar (USD) is near its peak (versus the rest of the world’s major currencies). After a long period of maintaining a US dollar and international asset emphasis in our portfolios, a balance of factors now argues for a beginning retreat. Canadian-domiciled investors particularly have benefitted from this stance, experiencing much higher nominal returns on their globally-diversified portfolios.

The outlook for Canada is further complicated by a virtual crash in commodity prices, particularly for oil. Given that most commodities are priced in US dollars, the impact of the commodity bust has been at least partly ameliorated by a very weak Canadian dollar (year-to-date declining by some 19% against the US dollar!).

Since its intra-day peak versus the US dollar back in November 2008, the Canadian currency (CAD) has now fallen by more than a third ... remarkable, given the high level of trade between these two countries. The CAD could yet decline further, though it is now significantly undervalued. Given that short-term movements in currency markets are notoriously impossible to predict, we must orient ourselves to longer-term perspectives. As such, we have begun to phase in currency hedges to neutralize the currency translation risk on international portfolio assets.

Correspondingly, investment exposure to U.S.-based assets have also been reduced. The outlook for the U.S. equity and bond markets are the least attractive in years as earnings growth has turned down and interest rates and inflation pressures are heading up ... for at least a time. The optimistic consensus of international investors with respect to U.S. investment prospects appears vulnerable to disappointment.

All of the above factors suggest that a see-saw market environment will likely continue. Therefore, a discipline of broad diversification combined with an active, tactical approach is called for in this current environment. Some selected investment themes of our current strategies are highlighted next.

Minor Asset Mix Shifts. Cash levels in core portfolios and fixed-income allocations remain steady, raised slightly. Equity exposure remains overweight although reduced. Net cash levels remain modestly below benchmark.

Shifts in Regional Preferences. While the overall weight in equity markets remains modestly overweight, we have introduced significant intra-regional shifts. The allocation to the U.S. has been reduced to underweight, while allocations in Europe and Asia remain overweight. Allocations to Canadian equities remain steady this quarter at a neutral level.

Income, Income, Income: A major investment theme that we continue to emphasize is the investor response to an ongoing “global income crisis.” This remains an enduring theme though subject to short-term credit market cycles. An ageing populace will prefer to continue purchasing high yield and future income. New high-yield opportunities recently have served to enhance the overall cash yield. As such, all of our portfolios have yields well above their benchmarks.

Opportunity Investments. In all portfolios, we allocate opportunity investments — what are defined as asset-types that can provide diversification, superior growth opportunities, and are aligned with larger “Super Trends.” These selections are fixed at 25% of our balanced and aggressive portfolios.

Opportunity Strategies. Of the 23 holdings in this category, current strategies emphasize selected emerging markets’ equities, China and India, emerging market local-currency bonds, higher growth countries, and high-yield investments. Overall exposure to USD in this asset category has also been reduced.

Currency Protection Initiated. Should the US dollar begin to decline, (especially so against the CAD), preservation strategies are required for international asset positions. We have begun to phase in hedges to protect against a US dollar decline vs. the CAD. Approximately 25% of USD exposure is now hedged back to the Canadian dollar. Also, we expect the European economy to accelerate, this contributing to a rising euro.

The objective of our ETF Managed Portfolio strategies is to achieve stable, positive returns over the long-term without assuming excessive risk. We believe that the best approach in today’s atypical investment climate is to build portfolios that are globally diversified across many asset types, informed by a concerted focus upon a variety of common and unique risk factors.

Quarter 1, 2016	Investment Stance			Change from previous quarter
	Under	Neutral	Over	
Net Asset Mix				
Cash		■		↑ Increased
Total Equity			■	↓ Decreased
Total Fixed Income	■			↑ Increased
Opportunity		■		● Unchanged
CDN Investments				
Bonds		■		↑ Increased
Stocks		■		● Unchanged
US Investments				
Bonds		■		● Unchanged
Stocks	■			↓ Decreased
INTL Investments				
Bonds		■		↑ Increased
Stocks			■	● Unchanged

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