F&A
FOSTER & ASSOCIATES
Quarterly Report
Fourth Quarter Report 2019

Alternative investments offer the promise of diversified returns, to balance your portfolio without stock market volatility.

Alternative investments, or ‘alternatives’ for short, are projected to grow 59% by 2023, reaching $14 trillion in assets globally.[1]

If you haven’t heard about alternative investments, you most likely will soon. Alternative investments, or ‘alternatives’ for short, are projected to grow 59% by 2023, reaching $14 trillion in assets globally.[1]

But what makes an investment an ‘alternative’ investment? In simple terms, alternatives are investments (usually funds) that are not publicly traded or publicly accessible, like stocks, bonds, and mutual funds. Examples of alternative investments include Private Equity, Private Debt, Long/Short hedge funds, Market Neutral and Merger Arbitrage strategies.

For many, the names of these strategies don’t have a lot of meaning, as they have historically been marketed to institutions and ultra high-net-worth individuals. They seem complicated and risky as a result. But there are good reasons that pension plans and other institutional investors have been flocking to alternatives.

The first (and probably the best) reason that money has been moving to alternatives is that they are great diversifiers. They offer the promise of returns similar to stock market returns, but without all the volatility. Institutions, like individual investors, have long recognized that the stock market offers the promise of solid long-term returns. The problem is, increasing their stock investments means making them more vulnerable to big selloffs, like in 1987 or 2008.

Possibly the second-best reason to think about alternatives, especially right now, is shockingly low interest rates. Interest rates in the very low single digits create a real problem for people who need predictable income, and they are also terrible for people who look to the bond market as a place to find protection against market downturns or recessions. Certain types of alternatives, such as Real Estate Investment Trusts (REITs), and Mortgage Investment Companies (MICs), offer the promise of predictable income well in excess of bond yields.

		2019 Q4	12 Month Returns
S&P/TSX*	17063	2.4%	19.1%
S&P 500	3231	8.5%	28.9%
Dow Jones	28538	6.0%	22.3%
Nasdaq	8973	12.2%	35.2%
$CAD	$0.7698	1.9%	5.0%
Crude Oil (WTI)	$61.06	12.5%	31.0%
Gold	$1,517.30	3.0%	18.3%

** The S&P/TSX, the S&P500, the Dow Jones and Nasdaq indices are not investable indices, and as such are not a direct comparison to any investment product available at Foster & Associates Financial Services Inc, and therefore should therefore be considered hypothetical in nature and for illustrative purposes only.*

You may wonder, what is the catch? Well, for starters, these investments are less liquid than stocks and bonds. While mutual funds, stocks and bonds can be sold quickly and easily, some of these funds may take months to sell and send money back. If your investment horizon is very short, most alternatives won’t be for you.

Another catch is that it’s just harder to select an alternative than it is, say, to pick which ETF to buy. When we at Foster & Associates put an alternative into a managed portfolio, we bear a responsibility to perform a higher level of due diligence before investing. This can take the form of site visits, interviews with the portfolio manager, analysis of their returns, a background check, and an assessment of the viability of their business.

The good news is that there have been some recent regulatory changes, and some financial

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innovation, that makes certain alternative strategies easier and safer to buy, and for much lower minimum investment levels. A decade ago buying an alternative investment with less than $100,000 was difficult. No longer.

Given the above, we believe the benefits of owning alternatives now outweigh the risks involved. This opportunity should not be ignored, and the further portfolio diversification and enhanced income they can potentially bring, must be embraced. Embracing alternatives for a portion of your portfolio may represent change, but most investors will remember a time when owning common stocks that didn't pay a dividend was considered highly speculative.

In the coming months Foster & Associates will be providing educational podcasts interviewing some of the top managers in this sector as part of introducing more investors to a greater spectrum of investment solutions to fit their needs and expectations.

Philip Marion, Portfolio Manager

The 12-Month Market Outlook

Stocks (U.S.)	▲
Stocks (Canadian)	▲
Bonds (US)	▼
Bonds (Canadian)	▼
Canadian dollar	--
Crude Oil	--

This table represents the way the firm is leaning in particular market sectors over the next 12 months. It does not represent a trade recommendation, nor does it play a major role in our portfolio construction, which involves much more than having a view on a particular market index, currency or commodity.

Investors catch a fee break

Late last year, the Department of Finance clarified that fees from registered plan accounts can now be paid from taxable accounts (registered plan accounts include RSPs, TFSAs and RRIFs). Previously, paying fees from outside a registered plan account was not allowed as it was considered an unauthorized contribution to the plan. This seemingly trivial judgement is actually a very big deal and can have significant positive implications for investors over the long term.

Let's take the example of an investor that has two accounts – one, a $100,000 taxable account and the other a $100,000 RSP account - and they each incur a 1.25% management fee. Under the new rules, the client can have each account pay an annual $1250 fee from each account, OR $2,500 from the taxable account and $0 from the RSP. This second arrangement would leave the full $100,000 in the RSP to continue to grow tax-free. Clearly the better option.

The other big benefit to charging one taxable account all the fees is that it reduces the overall number of required transactions for rebalancing. Often registered plans are fully invested, and have no cash to pay fees, so under the old regime investors would be forced to make small liquidations to pay fees. Even if you don't pay high trading commissions, having to do these transactions and incur redemption fees, or ticket charges, means extra costs to you. Far better to do only one trade outside a registered account if you need to generate cash to pay a fee.

Overall, this new guidance from the Department of Finance is a fantastic development for clients, and one that should not be ignored. Speak to your advisor about changing the way you pay fees - and start saving today!

David Winnell, CIM

Capitalize on uncertainty

Briar Foster
is a retired Portfolio Manager and remains an active investor.

The final quarter of 2019 resolved some important uncertainties. The Canadian Federal Liberals won the election but lost their majority. NAFTA II (USMCA) has been accepted, and Great Britain finally has a definite timeline to leave the EU. Still, there are some worries in the outlook.

Right now, the economy doesn't look to be one of them. Many pundits are predicting a North American recession, maybe late 2020 or early 2021. Some of them were also predicting a recession for 2019. Central to their fears seems to be that we haven't had a prolonged downturn in the economy for more than a dozen years, like a weatherman predicting rain because we haven't had any lately. They should realize that predicting an abrupt change in trends is brave but often hazardous.

Personally, my main worries about the Canadian economy are the shortage of skilled workers and insufficient infra-structure to export our energy assets to the world. Also worrisome is that Canada is weak at producing patentable technology that will produce revenue from abroad. Both the U.S. and Japan have positive trade balances in this area while Canada's balance is steeply negative. Canada's support program for technological research is largely based on support for university research. This does not seem to be working, possibly because universities do not engender the entrepreneurial instincts needed to take research programs to financial success.

But these are old concerns, ones fairly familiar to regular consumers of the financial press. Shorter term, what happens if the Democrats choose a leader too far left to assure a victory over Trump? If Trump wins a second term, it will surely mean a continuation of his primitive trade strategy of "tariffs, maybe more tariffs, unless…".

Geopolitical dislocations notwithstanding, there is a good case to be made for healthy financial markets for the period ahead. The economy is sloshing in money, credit is cheap, and the stock market has proven itself to be the best place to invest. However, markets are trading near all-time high levels, and apart from resource stocks there are not many bargains to be had. That puts a premium on anticipating dislocations and being confident enough to buy the dips in the market when and if they occur.

Technology looks to remain the best destination for new money in the market. Every industry is being affected by technology. Bricks and mortar banks are mortuaries, and data shows online shopping growing at a rate of 15% a year. Years ago, technology took over record-keeping and some diagnoses in healthcare. Now it also performs some of the most delicate surgeries. For investors, technology is the primary path for companies to grow or at least remain competitive. Companies producing or benefiting from technological advances remain uniquely promising places to invest.

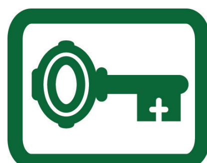
Strangely, technology, for all its wonders, doesn't yet look ready to be a great investment practitioner. Artificial intelligence applied to stock selection remains unimpressive. Even when these big techno-brains mull over all the information available from all the sources, its decisions often disappoint and disappoint even more often the longer the program is used. The only explanation is that the world of finance is constantly shifting, growing, pausing and shrinking in patterns that don't repeat themselves sufficiently often. Possibly similar to so many other complex human activities.

It doesn't look likely that investor grey matter will be put out of business anytime soon.

The views as articulated in this article are those of Briar Foster alone and do not necessarily reflect the opinion of Foster, and do not constitute a solicitation to engage in any specific investment or strategy.

Our core beliefs

What defines the culture of a firm is what stays consistent no matter what's going on in markets. Politics, market trends, and the business cycle will cause us to think different about the way we invest our clients' money. However, there are a few things you can count on from us, through good markets and bad, through recessions and buoyant recoveries:



Asset Allocation is Key.

While some individual securities will do well, and some less well, most of what will make or break your portfolio over time is asset allocation. Of course, we all remember our great buys, and mourn our missteps, but the key to how well you do in the markets will come from how much you owned of various asset classes, and when you owned them.

We Love Canada.

But it's not where we want to put all your money. The Canadian stock market is heavy on banks and resource companies, making true diversification hard to achieve. Venturing abroad can improve returns and lower volatility. You'll also find companies where Canada isn't as strong, such as in consumer staples and biotechnology.

Alternatives aren't that Scary.

Sure, some hedge funds can be dangerous, but there's more to the Alternatives space than hedge funds. There's private debt, real estate, infrastructure and market-neutral funds, all of which can provide a place of refuge during periods of excessive market volatility.

Costs matter a Great Deal.

Over time, even small increases in costs can significantly lower returns. If you pay us to manage your money, we will pinch your pennies for you.

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