ALLARD ALLARD & ASSOCIÉS

2013: An Amazing Year

2013 was a great year for equity investors.

Obviously some of the uncertainties of recent years were not resolved in 2013 - Europe is still struggling to recover from the 2008 crisis and geopolitical tensions in the Middle East remain. Also, in the Western world, the combination of stimuli and anemic tax revenues has increased government debt to unprecedented levels. In the United States for instance, the necessary increase in the debt ceiling twice led to clashes between Democrats and Republicans. In both instances, facing a fiscal cliff, compromise solutions were only reached at the eleventh hour.

However, as evidenced by increasingly good economic news, many of the efforts that were put forward by central banks and governments since the 2008 crisis are bearing fruit. It was, in part, the resulting growth in investor optimism that helped propel the market in 2013.

2013 Results

For the third consecutive year, the U.S. stock market in Canadian dollars (S&P 500 +41.7 %) outperformed the Canadian equity market (S&P TSX +13.0 %). The U.S. index in CAD, helped by the strengthening of the greenback (up 7.0 % vs. the loonie) had its best year since 1955. In Canada, equity returns in 2013 were above the historical average and although most sectors did well, the materials sector (-29.1 %) - and more specifically metals and mining (-37.8 %) - was a drag. As for fixed income, rising interest rates led to the first negative performance on the DEX (-1.2%) in 14 years.

Our security selection based on company fundamentals is ultimately the main driver of our long-term performance.

Several factors contributed to our strong relative performance in 2013.

In Canadian equities, our positions in consumer discretionary, financials and the absence of gold stocks (-44.0 %) in materials explain most of our outperformance for the year.

Throughout the year we increased our weighting in foreign stocks which was also beneficial.

On the fixed income side, in a rising interest rate environment, not holding long term bonds was the main factor of our outperformance against the benchmark. Being overweight in corporate bonds was also a positive.

2014 Outlook

The strong rebound in equity markets since the depths of March 2009 has led some analysts to predict a correction for 2014.

By the very nature of the stock markets, there will certainly be corrections in the future. However, at this stage, several fundamental factors lead us to believe that equity markets are not overly expensive and although the stock returns over the last five years have exceeded the expectations of many, the prospects for future returns remain very appealing.

We also believe it is futile to try to predict stock market declines. Rather we strive to find companies with strong balance sheets, growing earnings and whose shares trade at reasonable multiples. As long as securities in our portfolios meet these criteria, we will remain optimistic about our prospects for favourable long-term returns.

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Here are a few factors that bode well for stocks:

Corporate balance sheets

Companies have very strong balance sheets. They have ample liquidity that can be deployed to:

- Increase dividends;
- Buyback shares;
- Make acquisitions;
- Increase revenues and productivity through capital expenditures.

Economic Growth

With a weak economy, earnings growth since the great recession of 2008 has mainly been the result of productivity gains leading to an increase in profit margins.

At this point, it is the economic recovery - lower unemployment rates, resumption of construction activity, increased levels of confidence, strong sales of durable goods, etc. - that will have positive effects on corporate revenues and boost profits.

As the economy improves in the coming quarters and years, central banks and governments will undoubtedly become less accommodating. The market and the media will put significant emphasis on central banks' rate hikes and on fiscal strategies elaborated to reimburse government debt.

The "Great Rotation"

Following the 2008 crisis many investors adopted a more cautious strategy - favouring fixed income to the detriment of equities. A recent study by BMO Capital Markets demonstrates that the current asset allocation of investors is less heavily weighted to equities than its historical average.

However, by mid-2013, monthly purchases of equity mutual funds began to surpass purchases of fixed income funds. Vigorous stock market returns combined with sluggish fixed income returns should enhance this phenomenon and will be positive for stocks.

Our strategy

We do our best to manage portfolio risks - taking care to invest in well-managed companies which are profitable, financially sound and inexpensive. We firmly believe that well-diversified portfolios of securities selected through this disciplined approach will continue to provide superior long-term returns.

For investors looking for a competent advisor, no argument is more convincing than the recommendation of an existing client. Since our inception in 1995, the growth of our company has been greatly dependent on testimonials and references from many of you. For this, we are immensely grateful.

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