ECONOMIC TRENDS

INTERVIEW WITH AIME BWAKIRA

Aime Bwakira, CFA

Institutional Portfolio Manager

Aimé Bwakira is an Institutional Portfolio Manager in the Global Asset Allocation Group (GAA) of Fidelity Management & Research Company (FMRCo), the investment advisor for Fidelity's family of mutual funds. In his role, he helps provide and manage multi-asset class investment solutions to investors in the Canadian marketplace.

Aime holds an undergraduate degree in Business Administration from the École des Hautes Études Commerciales (HEC) in Montreal, and an M.Sc. in finance from the Université de Sherbrooke. He is a Chartered Financial Analyst (CFA), a Chartered Alternative Investment Analyst (CAIA) and a Financial Risk Manager (FRM).

We employ a disciplined investment process in analyzing economic and financial market conditions which we call the Four Pillars process. Leveraging the vast network of Fidelity professionals around the world as well as our Global Asset Allocation research capabilities, this four factor approach consists of:

1. Assessing the macroeconomic environment
2. Analyzing bottom-up company fundamentals
3. Measuring market valuations and
4. Gauging market sentiment.

We've included a summary matrix of our views for your reference.

What are your views on the current economic environment and financial market conditions?

Our overall views of the current environment are positive. We see moderate global economic growth, led by the U.S., as well as benign inflation. Economic growth is supported by accommodative policies by global central banks and generally less restrictive fiscal policy. Also, the collapse in oil prices in the latter half of 2014 is expected to have a positive impact on global economic growth, especially in large Developed Market economies which are oil importers.

In Canada, the overall effect of falling oil prices has been negative with the highest impact being felt in Western provinces. In addition, Canada's economy is facing high levels of consumer debt and a stretched housing market. The economy is expected to grow modestly in 2015 buoyed by the strengthening U.S. recovery. U.S. economic growth is forecast to lead developed markets as the economic recovery broadens out and labor market conditions continue to improve. Economies in Europe and Japan should provide tepid but positive growth as they deal with structural headwinds, offset by aggressive central bank policy. The picture is mixed in Emerging Markets which are experiencing weaker growth. In particular, commodity exporting countries are experiencing a much less favorable environment with the fall in commodity prices. In financial markets, equity valuations are reasonable to slightly expensive relative to history and company balance sheets are in good shape. We are cognizant of the fact that geopolitical and policy uncertainties remain challenges to market sentiment and present downside risks.

Reflecting these views, we are modestly overweight risk assets, equities and fixed income spread product, relative to our strategic asset mix. We maintain an allocation to fixed income given the defensive properties it provides to a diversified investment portfolio.

What is your view for the 2015 year:

We don't provide point estimates for the economy and markets. We have a generally constructive view on global economic growth and our base case is one of moderate global economic growth, led by the U.S. It should create a positive backdrop for employment and asset markets.

In looking ahead to 2015-2016, what is your outlook for:

Inflation?

We believe overall inflation will stay subdued in the months ahead as lower oil prices will put downward pressure on consumer prices. While headline inflation figures may temporarily dip below zero because of these effects, we believe we will be in a generally low inflation environment globally. Most developed market central banks have a price-stability mandate and a desired 2% inflation rate. We expect inflation to remain below the targets in 2015.

Interest rates and bond yields?

Short term interest rates, which are driven by central bank policy, are expected to remain low. In the absence of inflationary pressures, short-term interest rates should stay low. In Canada, we may see to see further BoC interest rate cuts following the January announcement given possible negative effects from the collapse in oil prices. In the U.S., the Fed is likely to raise rates at some point over the next year and any increase in the Fed Funds rate should be measured. Any central bank moves will be driven by the data and the evolution of economic conditions.

Bond yields should also stay contained and steady in the absence of inflationary pressures and moderate economic growth. Also, ultra accommodative monetary policy in Europe and Japan, as well as long term demographic trends from an aging population in search of income, will lend support to bond prices and suppress bond yields.

Mortgage rates?

Mortgage rates are closely linked to the level of interest rates and bond yields. Given the environment just described, we believe mortgage rates should remain steady.

Commodities in general and gold and oil in particular?

We think commodity prices will remain subdued and may experience further downside pressures. Global supply and demand dynamics are informing our view. On the supply side, more supply is becoming available in the marketplace at a time where demand is weak, mirroring the modest global economic growth. In addition, the Chinese economy's voracious appetite for commodities of the last decade has moderated. China's economy is maturing and is dealing with high debt levels and overcapacity in many sectors. Chinese policy makers are endeavoring to rebalance their economy to a consumer-led one, less dependent on fixed capital formation and exports.

We are not optimistic on gold. In this benign inflation rate environment, gold is less attractive. Also, with a resurgent US dollar, gold and other commodities which are quoted in USD become less attractive. We've also seen flows into gold exchange traded funds reverse in recent years and the selling has exerted downside pressure on bullion prices.

Following a supply shock and a weaker global economy towards the end of 2014, oil prices collapsed and crude prices were cut in half. We believe that oil prices will stay low over the short term given the abundance of crude supply and tepid demand growth. Recently, oil prices have been showing signs of bottoming but the market is still well supplied in oil. Over the mid-to-long term, it is reasonable to expect a gradual increase in oil prices to levels currently reflected on the futures curve in the $60 to $70 range.

The Loonie?

The Canadian dollar has depreciated markedly relative to the USD. By some measures, the Canadian dollar is near its purchasing power parity level after hovering above it for a number of years. While the loonie has stabilized in recent weeks, we believe that further downside risks to the loonie exist for a number of reasons:

- Imbalances in the Canadian economy which need to be corrected over time
- Differentials in economic growth and diverging central bank policies
- Overall strength of the USD globally

How do you earn yield in a low interest environment?

The low interest rate environment has presented challenges for investors seeking yield. As stated, we believe the interest rate will remain low. Investors require a holistic and balanced approach consisting in building a well-diversified portfolio allocated to both equity and fixed income. By diversifying portfolios with dividend paying stocks and fixed income plus sectors such as high yield, convertibles and emerging markets debt, investors will be able to generate additional yield in their portfolios. With proper asset allocation, investors can generate some yield without incurring significantly more risk.

What are your thoughts on the housing market in Canada at the present time?

For several years, we have voiced concerns about the stretched Canadian housing sector. Canadians have taken advantage of low borrowing rates to buy houses and bid up home prices. The stretched house prices represent a non-negligible risk to the overall economy. However, it is unclear if a catalyst exists that will cause a reversal in the fortunes of the Canadian housing market.

Could you share a little about the impact of Canadian currency within a global portfolio?

Simply speaking, all else being equal, a weaker Canadian dollar is positive for global portfolios since it increases the value of foreign holdings.

With respect to risk and risk management, please provide your opinions on:

How you would guide investors to manage their risk?

Risk management is essential for long-term investment success. It involves taking risk where it's best rewarded by the market. Investors can help mitigate investment risk, through research, proper diversification, and asset allocation. By holding diversified basket of asset classes which are imperfectly correlated, investors have the potential to achieve higher returns without incurring substantially more risk. In the current environment, investors could consider investing beyond our borders in both equities and fixed income. As discussed earlier, our portfolios hold bond positions for diversification purposes and we are also invested in non-traditional bonds such as high yield, convertibles and Emerging Market Debt. We also continuously monitor evolving market conditions to seek out opportunities while minimizing portfolio risk when warranted.

What would be your advice to consumers on risk, in particular regarding consumer debt?

This question is somewhat outside of the scope of our analysis of economic and market conditions. Statistics do show that the average Canadian consumer is holding the highest level of personal debt/disposable income ever recorded. We recommend consumers work with a financial adviser to manage personal debt and position their personal balance sheets for long term financial success.

What is your viewpoint on gold and what role does it play in a portfolio?

As indicated earlier, we are not constructive on gold. Over the long term, gold has been a store of value and hasn't been a wealth generator. It doesn't produce any income and isn't attractive for investors seeking a stable cash flow. In this benign inflation rate environment, gold is less attractive. Also, with a resurgent US dollar, gold and other commodities which are quoted in USD are less appealing. In addition, Canadian investors should keep in mind that the TSX is a market with a high representation of gold producers. Through a diversified Canadian equity portfolio, Canadian investors may already have enough exposure to gold through gold producers.

If you were to leave investors with one thing to keep in mind when it comes to investing, what would it be?

We encourage investors to stick to their long-term investment plans. With proper asset allocation, a well-diversified portfolio matching the investors' risk profile should help them weather market volatility and achieve their long term goals. For conservative investors, this will likely require adding a modest equity allocation to their portfolios.