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**Dealing with negative yields**

It took 14 months, but the S&P 500 finally made all-time highs last week, surpassing its previous high-water mark of 2,132. While new highs are a welcome sign, investors remain largely skeptical about the sustainability of this rally. The fact that this is the second longest bull market on record, (a total of 2,688 days, outdone only by the 1987-2000 bull market) may be reason enough to unnerve investors. Contributing to the uncertainty are elevated price-to-earnings (PE) multiples (on the S&P 500) which trade at approximately 18 times forward earnings, more expensive than 5, 10 and 15 year averages. And it's not only US equities that are pricey. The TSX is arguably priced to perfection at 19 times forward earnings, notably more expensive than the US. The only market where PE ratios are more in line with historical averages is Europe. Considering the myriad of risks that plague the European Union, however, overseas equities may in fact be more expensive than they appear.

While valuations remain frothy, PE ratios alone are not concerning. What's more worrisome is the fact they exist alongside weak corporate fundamentals. The S&P 500 for example just entered its sixth straight quarter of negative revenue and earnings growth, an environment not synonymous with premium valuations. In light of this contradiction, the question remains: why are markets so expensive? You need look no further than global central banks for the answer. Increasingly, accommodative monetary policies have spawned ultra-low interest rates worldwide, which have driven bond yields to historical lows. And this is why valuations in the equity market have shot up, leaving many to conclude that even at elevated prices equities are attractive compared to low bond yields.

German 10-year Bunds (bonds) give a good indication of challenges facing fixed income investors with Berlin recently issuing the Eurozone's first negative yielding bond. It's estimated there's a total of \$12 trillion USD bonds with negative yielding debt. This fact alone highlights a shift in bond investor mentality; that is return of capital, not return on capital has become a new accepted norm. These negative yielding bonds represent approximately 30% of the global bond market and carry associated losses of approximately \$24 billion per annum. Low bond yields are here in North America as well, with Canadian 10-year government bonds trading with yields just above 1%, and the US 10-year treasury market (which looks extremely attractive) with a 1.6% yield. Notably, both countries offer yields that are below inflation which erodes purchasing power. In contrast, dividend yields offered by equities are higher, averaging 2.1% in the US and 2.9% in Canada, with the potential for capital appreciation. In light of this, it's no surprise why equities have enticed many to step outside of their risk comfort zones.

Despite higher equity markets, investors continue to question the sustainability of the current bull rally. Encouraging are the words of respected value investor Sir John Templeton who famously stated "bull markets are born on pessimism, grow on skepticism and die on Euphoria". Applying this view to today's markets, there's no ruling out that stock markets could march higher. Regardless, we believe diversification continues to be the best solution in any environment to help maintain exposure across asset classes. In terms of our strategic targets in the Active Balanced Portfolios, we remain neutral on equities with relative overweight positions in the US and Canada and an underweight position in international markets. And despite the low yields, we maintain a neutral position in bonds as they continue to perform their primary function which is to protect capital and manage volatility.

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