# Quarterly Portfolio Review
## As at March 31, 2014

NELSON
PORTFOLIO MANAGEMENT CORP.

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*As at March 31, 2014*


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**Disclosures:** "Douglas Nelson is registered as Portfolio Manager for Nelson Portfolio Management Corp. and is responsible for making all final decisions regarding client accounts and the NFC Tactical Asset Allocation Pool. Doug was the author of this report, but any reference to "our" or "we" represents the collective efforts and contributions of various members of the Nelson team."


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# Announcements

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**Portfolio returns over the past three months were positive, ranging from 2% to 3%.** This is the equivalent 12 month return of 8% to 12%. At this time our bias is to err on the side of caution by reducing our exposure to higher risk areas while also adding stop loss orders, where applicable, to protect capital.

**If you are 100% invested into the NFC Tactical Asset Allocation Pool, the following comment does not apply to you.** If you have securities in your portfolio above and beyond the NFC Tactical Asset Allocation Pool, you will be paying a monthly administration & compliance fee ($67 per month + GST). On your Monthly Performance Report, you will see this figure being drawn as a management fee expense. However, you will also see that the figure for March is twice that of the figure for January and February. The reason for this is because the April fee was drawn on March 31st instead of April 1. If you have any questions about this, please let us know.

**On March 31st, the NFC Tactical Asset Allocation Pool paid out a quarterly distribution of interest and dividends of approximately 1%.** In most cases this represents the receipt of additional shares in the pool. For RRIF and LIF accounts, the distribution was paid into the client account in cash so as to help fund future income payments.

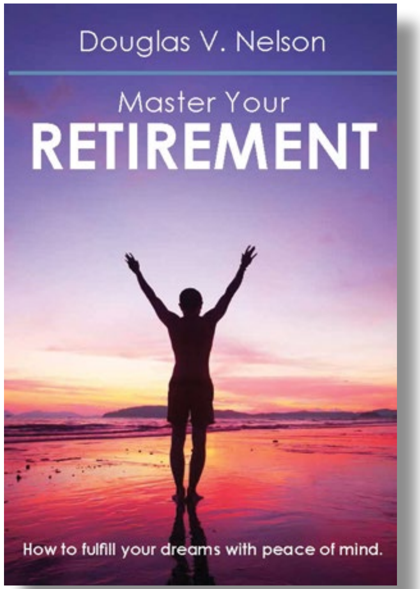
2014 TFSA Contribution Room is **$5,500 per spouse**.

**Income Tax filing deadline is April 30th.** If we can be of assistance in any way, please let us know. We work with the team of tax preparers and advisors at The Accounting Place www.theaccountingplace.net.

**Master Your Retirement 2014 Edition is now available.** If you would like us to send to you a copy, please let us know.

**Doug was interviewed on CJOB** on March 9th at 9 PM by Geoff Courier.
To hear this interview, go to http://www.cjob.com/audio-on-demand/

**Doug is now on Twitter.** Follow Doug's comments on retirement planning at https://twitter.com/RetireMastery




To see a sample of the book, click here www.nelsonfinancial.ca/book-promo.html

**Income Tax filing deadline is April 30th.**

# Commentary



The first three months of 2014 were good for investors (data drawn from www.globeinvestorgold.com and does not include distributions):

- The Toronto Stock Exchange (TSX) climbed in value by 5.7%. The TSX was flat from January 1 through to February 6th. Since then it has risen steadily.
- By comparison, last year's strongest market, the US, has traded sideways so far this year with a year to date gain of 0.90%. Between January 1 and February 2nd the S&P500 (ie: the index of the 500 largest companies in the US) had declined by almost 5%. Since early February the S&P500 has risen by 6%, in US dollars.
- From a Canadian investor perspective, we have also seen a rather significant decline in the value of the Canadian dollar relative to the US dollar. From January 1 through to March 14th the Canadian dollar declined by approximately 5.4%. This means that any US dollar investments, when converted back to Canadian dollars, realized an additional currency gain of 5.4%. This is very significant and is a good thing from the perspective of a Canadian investor owning US dollars. At that time the Canadian dollar traded as low as 89 cents to every US dollar. The last time we saw this level was in July of 2009. Since March 14th the Canadian dollar has risen back to over 90 cents, showing a year to date US currency gain of 3.3%. It is possible that we may see the Canadian dollar continue to decline relative to the US dollar.
- Japan: The Nikkei index of the 225 largest Japanese companies has declined by 7.5% since January.
- Europe / Asia / Far East (symbol: EFA): The index of non-North American stocks has a year to date gain of 0.4%.
- Brazil / Russia / India & China (symbol: CBQ): The index representing the primary emerging market nations had a year to date loss of 3%.

It is interesting to see that the Canadian market has done well relative to most other markets around the world.

From January 1st through to March 14th the Canadian dollar declined by approximately 5.4%.

***Commentary - continued:***

### When we break down the Canadian market, we see the following year to date returns:

- Financials (symbol: XFN): +1.8%. A respectable return but less than the TSX overall.
- Energy (symbol: XEG): +11%.
- Materials (symbol: XMA): This index includes the gold companies, the industrial miners and other companies in the fertilizer area. The year to date return was +9.4%. Within this group there was significant contrast between the gold companies like Barrick Gold (symbol ABX) (+8.5%), the miners like Teck Resources (symbol tck.b) (-11.6%) and Potash Corp (symbol POT) (+8%).
- Real Estate (symbol: XRE): +3.2%.

### Over the past three months we also saw some very good increases in the defensive holdings:

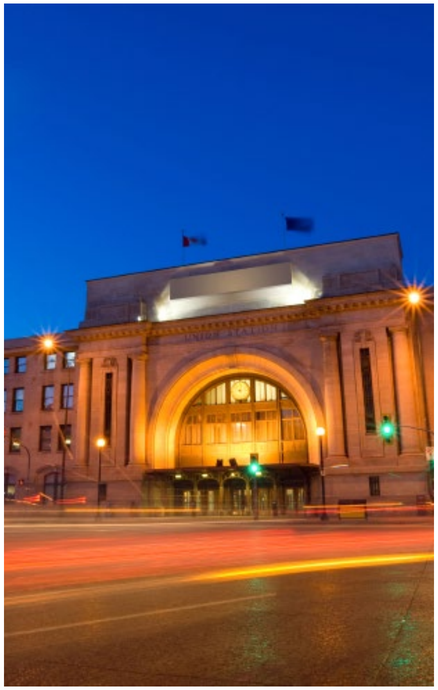
- Long Term Government Bonds (symbol: XLB): +3.6%.
- Preferred Shares (symbol: XPF): +4%. Our individual preferred shares performed well over the past three months: Manulife (symbol: MFC.PR.B) +5.7%, Sunlife (symbol: SLF.PR.B) +4.1% and Brookfield (symbol: BAM.PR.M) + 8.5%. These figures do not include the distributions paid during this time.
- US Investment Grade Corporate Bonds (symbol: XIG): +2.5%. This is the equivalent annual return of 10%. The current annual yield is 3.85%.
- US Non-Investment Grade High Yield Bonds (symbol: XHY): +2.2%. The current annual yield is +5.56%.

### This is interesting because:

- The US defensive holdings out-performed the US equities during this past quarter.
- In Canada, both the defensive holdings and the equities rose in value.

### Other items to note are:

- US Health Care stocks continue to be very strong. We have been invested in the BMO US Health Care Exchange Traded Fund (symbol: ZUH) for close to 18 months now seeing gains of over 50%. Since January 1 this index has grown by 8.5%. We continue to hold this exchange traded fund in the pool, as well as several individual US health care stocks.
- Gold has also had a strong three month return of +8.1%.



Our individual preferred shares performed well over the past three months.

***Commentary - continued:***

## What does all of this mean?

While markets have been mostly very positive these past three months, as we move into April and May, the downside risks typically rise. To measure downside risk we look at both the short term (ie: the trends over the past 12 months) as well as the longer term (ie: the trends over the past 5 years). The downside risk calculations show us the following:

| | Canada | US | Financials | Energy | Materials | Real Estate | Health Care |
|---|---|---|---|---|---|---|---|
| Short Term | 7.3% | 5.9% | 6.9% | 11.2% | 3.8% | 3.1% | 11.6% |
| Long Term | 12.5% | 24.9% | 19.0% | 9.7% | -24.9% | 2.5% | 31.9% |

The data in this table changes daily and is for illustration purposes only.

The figures above are meant to give us a general view as to how far markets could fall at this time. Looking at the Canadian market, we could see the market drop today anywhere from 7% to 12%, which would be a very normal spring and summertime correction. By comparison, we see the US, and in particularly the US Health Care sector, as having a much higher downside risk of as much as 25% to 30%. The lowest risk areas today appear to be the materials and real estate sectors. Our objective would be to purchase securities that have a short term downside risk of less than 10% and a long term downside risk of less than 15%. If the downside risk is negative, such as what we see above with the materials sector (-24%), this can represent a very good buying opportunity.

We will want to pay attention to protecting capital in the higher risk sectors by either a) adding stop loss orders to specific investments and / or b) selling these securities pro-actively. This also means that we will watch out for opportunities to add to our investments in the under-performing areas as they represent the lowest investment risk with potentially the best upside growth potential.

This also means that maintaining a reasonable exposure to our defensive holdings is also important. In the event we see a market correction, the defensive holdings typically help to protect the value of the portfolio.

Looking at the Canadian market, we could see the market drop today anywhere from 7% to 12%, which would be a very normal spring and summertime correction.

***Commentary - continued:***

## Today's Approach:

Your new portfolio design is made up of two components: i) the investments you hold directly and ii) the NFC Tactical Asset Allocation Pool. In general, the investments you hold directly are meant to be longer term investments that we hold over time. However, if we are concerned that a larger correction is likely, we will sell some of these investments to protect capital. The NFC Tactical Asset Allocation Pool is actively managed, which means that if we are concerned about markets we will likely be adjusting the asset mix of the pool to a more defensive stance by 10% to 20%.

For more information on what has happened in the pool over the past three months, read on!

# NFC Tactical Asset Allocation Pool

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## Current Values:

- Investment returns: Over the past 3 months the pool has gained in value by 3% and is up by 8.2% since August 30, 2013. This is a return exceeding 1% per month net of fees.
- Asset Mix: 8% cash, 39% bonds & preferred shares (=47% defensive) and 53% in equities. This is a balanced portfolio.
- Geographic Mix: 70% Canada, 26% US and 4% invested in Europe and Asia.
- Sector Mix: Financials (20%), Energy (10%), Real Estate (10%), Utilities (9%), Health Care (8%), Consumer (7%), Materials (6%), Telecommunications (6%), Technology (6%), Industrial & Transportation (7%), and Other (11%). The pool is well diversified across all primary sectors.
- Current Yield: 3.5% - 4%.

***NFC Tactical Asset Allocation Pool - continued:***

## Defensive Component:

- We have 40 holdings in the defensive part of the portfolio. This is a combination of individual bonds, individual preferred shares and a couple of sector specific exchange traded funds.
- Overall this component of the portfolio increased in value by approximately 2.4% (not including the interest income).
- The preferred share component grew by approximately 4.2%, with highlights being the Brookfield holdings (+8.5%), Citibank preferred (+6.25%), the JP Morgan preferred (+5.3%).

## Growth Component:

- The growth component currently has 64 Canadian stocks and 35 US stocks.
- Over the past 3 months the Tactical Pool held 70 of these holdings from January 1 through to March 31st. The total gain realized from these holdings is approximately 4.62%. By comparison, when we measure this against the Canadian market (the TSX: 5.7% return) and US market indexes (the S&P: 0.90% return) on a weighted basis (2/3 Canada, 1/3 US), the comparable return is 4.12%. This tells us that the stocks we held for the entire quarter outperformed the market indexes (4.62% vs. 4.12%).
- Some of the highlights include: Altagas (symbol: ALA) +13%, Aetna (symbol: AET) +9.4%, Agrium (symbol: AGU) +7.3%, Caterpillar (symbol: CAT) +13.8%, Emera (symbol: EMA) + 13.7%, Interpipeline (symbol: IPL) +13%, Precision Drilling (symbol: PD) +35%, Union Pacific (symbol: UNP) +12.7%, Veresen (symbol: VSN) +16.8%, Ishares Energy Index ETF (symbol: XEG) +12.4%.
- By comparison, some of the less successful holdings this past quarter were: Citigroup common shares (symbol: C) -11.7%, Glentel (Symbol: GLN) -8.84% and Susquhanna Bank (Symbol: SUSQ) -9.9%.
- Of the 70 stocks that we have held since January 1, 53 produced a positive return this quarter and 17 declined in value. 53 positive returning stocks means that 76% of these holdings have increased in value. Of the 53 that increased in value, the total unrealized gain is currently +6.91%. Of the 17 that declined in value over the past three months the current unrealized loss is -3.26%. In other words, of the stocks that have declined in value, they haven't declined that much.


Of the 70 stocks that we have held since January 1st, 53 produced a positive return this quarter and 17 declined in value.

***NFC Tactical Asset Allocation Pool - continued:***

## Securities sold over the past 3 months:

- 23 stocks were sold from the pool throughout the quarter. 18 of these stocks were sold at a profit.
- The highlights of this group include a 13% gain on Parkland Fuel (symbol: PKI), a 29% gain on Merck (symbol: MRK), a 17% gain on Barrick Gold (symbol: ABX), a 28% gain on Hewlett Packard (symbol: HPQ), a 16% gain on Canadian Natural Resources (symbol: CNQ); a 15% gain on West Fraser Timber (symbol: WFT), a 17% gain on Manulife (symbol: MFC) and a 19% gain on Chemtrade Logistics (symbol: CHE.UN).
- Of the stocks we sold at a loss: Rowan Companies (symbol: RDC) -5.5%; Cathedral Energy Services (symbol: CET) -17% (currently trading 10% lower than where it was sold); Canexus Corp (symbol: CUS) -20% (currently trading 10% lower than where it was sold); Teck Resources (symbol: TCK.B) – 17% (currently trading 6% higher than where it was sold).

## Securities bought over the past 3 months:

- Another group of 25 stocks were added over the past three months, in various sectors, in both Canada and the US. The highlights of this group include:
    - Canyon Services Group (symbol: FRC) + 17%. Purchased on February 5th and March 10th.
    - Encana (symbol: ECA) +15%. Purchased February 19th.
    - Rogers (symbol: RCI.b) +5%. Purchase March 5th.
    - Western One (symbol: WEQ) +6.7%. Purchased March 13th and March 26th.
    - AGF Management (symbol: AGF.B) +14.6%. Purchased February 18th.
    - Atlantic Power convertible bond (symbol: ATP.DB.A) +4.98%. Purchased March 10th and March 17th.

23 stocks were sold from the pool throughout the quarter. 18 of these stocks were sold at a profit.

***NFC Tactical Asset Allocation Pool - continued:***

## Our perspective:

- Sorry for the detail, we crunch these numbers just as much for ourselves as we do for you.
- With these figures in mind, we remain confident that both our buy and our sell strategies are serving us well.
- We continue to evaluate securities based on a 6 point scale. These securities have a lower downside risk, have a good yield and are considered to have good upside potential by other research analysts.
- At this time we also have 48 standing orders inside the Tactical Pool. These are orders to either sell a position (ie: a stop loss order) so as to protect capital or to purchase a new security at a lower price (ie: a limit order).

We wanted to provide this detail to you so that you can see that we are very comfortable i) taking profits when it looks appropriate to do so, ii) allowing other securities to continue to grow in value when the trends appear intact and iii) exiting positions when clearly they are moving against us.

If you have any questions, please let us know.

We remain confident that both our buy and our sell strategies continue to serve us well.

# Educational Note: Measuring Downside Risk

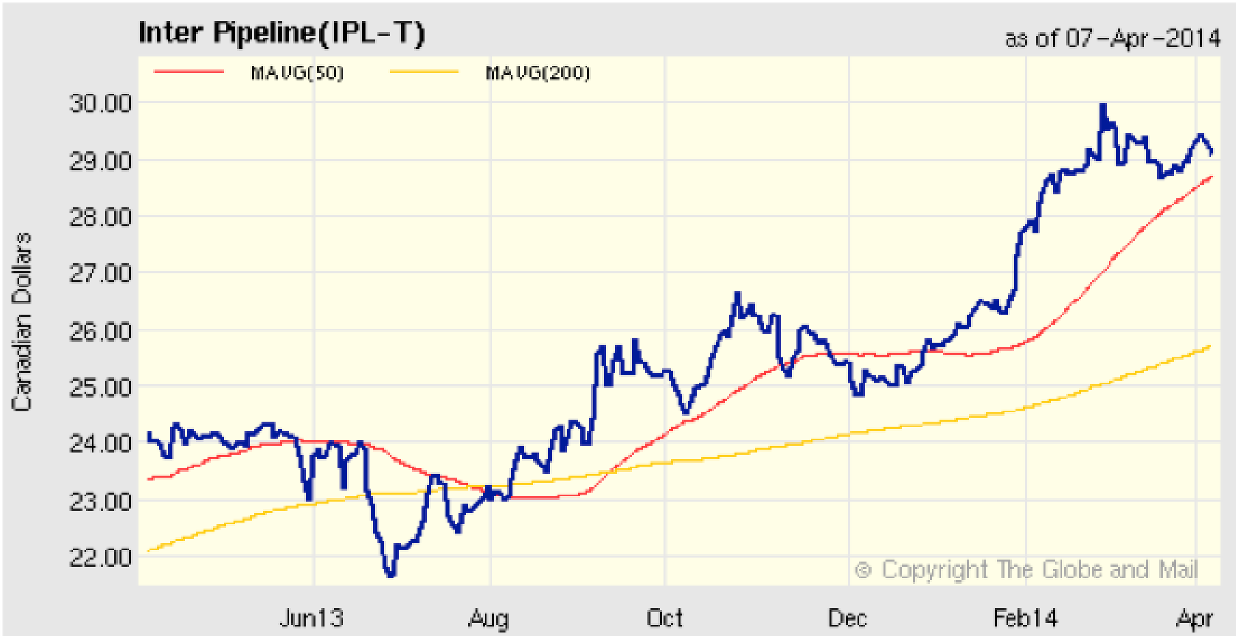
As mentioned previously in this report, one of the measurements we consider is "downside risk".

This is a calculation that shows the difference between where a stock is trading today and where it could trend down to in the future, based on longer term moving averages. A moving average is a mathematical process of smoothing out the day to day changes in the price of a stock. The moving average can be based on daily changes in the price of a stock or weekly changes. We like to look at both. We like to look at the relationship between the current stock price and the daily moving averages over the past 12 months and we like to look at the relationship between the current stock price and the weekly moving averages over the past 5 years.

# Education



***Education - continued:***




Consider the following examples. Company Name: Interpipeline Ltd. We hold this stock in the NFC Tactical Asset Allocation Pool. The first table shows the stock pattern over the last 12 months. From this chart we observe several things:

1. The stock (Interpipeline) has risen from $24 to $29 over the past year (the blue line).
2. The stock dipped below the moving average lines in June 2013, which presented a good buying opportunity.
3. Since that time the stock has continued to climb and move along its short term trend line (the red line). This is very good.
4. The short term downside risk is measured as the distance of where the stock price is today (approximately $29) and the yellow line (approximately $25.80). The difference between these two figures is $3.20, which is a short term potential decline of 11% (ie: = $3.20 / $29).
5. The greater the gap between where the stock is trading today and the yellow trend line, the greater the downside risk.

***Education - continued:***


Now let's look at the 5 year chart for the same company. In this chart we see the following:

1. This stock has been in a great long term uptrend over the past 5 years. It has risen from $7 up to almost $30.

2. But when we measure the downside risk, we see that there is a difference of $10 between where the stock is trading today and the lower yellow line. The current stock price is approximately $30, but the yellow line is only at $20. This is a difference of $10 or 30% (ie: $10 / $30). This means to us that the downside risk on the long term chart is 30%, which is very significant.

3. We also see on this longer term chart that a 10% correction has been common along the way. This means that at the current $30 level, this stock could trade down to $25 or $26, which would bring us back to the red trend line.

4. Depending on how much profit we have in the stock, we may choose to sell some or all of this holding if the price dropped below $29, with the plan to buy more at $25 or $26. By using stop loss orders and limit orders, we can exit a position at a specific price and buy back into the same position at a lower level.

*Education - continued:*


Let's look at one more chart. This is the 5 year chart of the price of gold. Notice how the price of gold spiked in the summer of 2011 so that the price of the investment was significantly higher than the yellow line. At that time the downside risk was measured at 38%, the difference between $180 and $115. When we see investments spike like this, we consider selling out of the position and taking our profit.

Also notice how the price has ultimately dropped back down to $120. When securities are trading below their longer term trend lines, we see this as a potential opportunity, but we may be early. Ideally we would like to see the red line begin to trend closer to the yellow line, just as we see on the left hand side of each of the two charts on the prior pages. As the trend lines crossed and the red line moves above the yellow line, new momentum is sometimes found for the stock and a new growth phase begins.

***Education - continued:***

These are three simple examples of how we measure downside risk. The purpose of this is to get a feeling for whether a security is closer to the beginning of its next growth cycle, or close to the end of its current growth cycle. If we feel that the security is close to the beginning, we may invest ½ of a normal investment amount now and then the rest in a few days or weeks if we see the security continue to climb. If we feel that the security may be closer to the end of its current cycle, we may take profit if it spikes, or set up a stop loss order to lock in our profit at a specific level. If the stock continues to climb then we will increase our stop loss level so as to lock in more profit.

We feel it is really important to manage the downside risk so as to help protect capital during fluctuating markets and to find new investment opportunities that have less downside risk and more upside potential.

We hope you found this helpful and interesting. If you have any comments, suggestions or questions, please send them to us.

# About Us



NELSON
FINANCIAL CONSULTANTS

We are an integrated financial services boutique that provides customized financial planning, portfolio management and insurance services. Even though we have three distinct entities, our services are designed to be seamless to you.

NELSON
FINANCIAL PLANNING CORP.

- Fee for Service, Custom Financial Planning & Retirement Planning Services
- The Financial Planning Monitoring Service
- 25 Point Portfolio Inspection Service

NELSON
PORTFOLIO MANAGEMENT CORP.

- Custom Portfolio Design
- Fixed and Variable Fee Schedule to Reduce Portfolio Management Fees
- The NFC Tactical Asset Allocation Pool is a core holding to increase efficiency in the portfolio management process

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- Licensed as independent insurance brokers so as to provide to you a wide selection of insurance options
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