VIS-A-VIS
INVESTMENT COUNSEL INC.

DATE: April 2, 2014.

FROM: John Evdokias

RE: VIEWPOINT- Client Communiqué 4/2/2014

Point:

Food prices are a fair proxy of inflation? Maybe.

Interest rates are low? Surely.

Expectations are high? Probably.

1255 UNIVERSITY STREET, SUITE 1016, MONTRÉAL, QUÉBEC CANADA H3B 3W9
Telephone (514) 399-9936 Facsimile (514) 399-9861 email: Priority@Visavis.ca

Background:

“Retail Prices of Selected Foods in U.S. Cities, 1890–2011”
http://www.infoplease.com/ipa/A0873707.html

The table below shows historical US$ prices for some food items [also serves as a 3rd party indicator of ***food inflation*** in the USA].

Retail Prices of Selected Foods in U.S. Cities, 1890–2011

Prices below are in dollars or cents.

Year	Flour (5 lbs)	Bread (lb)	Round steak (lb)	Bacon (lb)	Butter (lb)	Eggs (doz.)	Milk ($^1/2$ gal.)	Oranges (doz.)	Potatoes (10 lbs)	Coffee (lb)	Sugar (5 lbs)
2011	$2.75	$1.48	$4.69	$4.82	$3.67	$1.95	$1.86	$6.00	$7.35	$5.65	$3.51
2010	$2.36	$1.41	$4.41	$4.77	$3.63	$1.47	$1.66	$6.00	$5.79	$4.16	$3.11
1970	58.9¢	24.3¢	$1.30	94.9¢	86.6¢	61.4¢	65.9¢	86.4¢	89.7¢	91.1¢	64.8¢
1965	58.1	20.9	$1.08	81.3	75.4	52.7	52.6	77.8	93.7	83.3	59.0
1960	55.4	20.3	$1.05	65.5	74.9	57.3	52.0	74.8	71.8	75.3	58.2
1955	53.8	17.7	90.3	65.9	70.9	60.6	46.2	52.8	56.4	93.0	52.1
1950	49.1	14.3	93.6	63.7	72.9	60.4	41.2	49.3	46.1	79.4	48.7
1945	32.1	8.8	40.6	41.1	50.7	58.1	31.2	48.5	49.3	30.5	33.4
1940	21.5	8.0	36.4	27.3	36.0	33.1	25.6	29.1	23.9	21.2	26.0
1935	25.3	8.3	36.0	41.3	36.0	37.6	23.4	22.0	19.1	25.7	28.2
1930	23.0	8.6	42.6	42.5	46.4	44.5	28.2	57.1	36.0	39.5	30.5
1925	30.5	9.3	36.2	47.1	55.2	55.4	27.8	57.1	36.0	50.4	35.0
1920	40.5	11.5	39.5	52.3	70.1	68.1	33.4	63.2	63.0	47.0	97.0
1915	21.0	7.0	23.0	26.9	35.8	34.1	17.6	n.a.	15.0	30.0	33.0

NOTE: n.a. = not available .*Source:* U.S. Bureau of the Census, *Historical Statistics of the United States, Colonial Times to1970, Bicentennial Edition, Part 2.*, Bureau of Labor Statistics, 2011

1255 UNIVERSITY STREET, SUITE 1016, MONTRÉAL, QUÉBEC CANADA H3B 3W9
Telephone (514) 399-9936 Facsimile (514) 399-9861 email: Priority@Visavis.ca

<u>Observations</u>:

The magnitude of the change in food prices over the 96-year period (1915-2011) seems remarkable. (In other currencies, the comparison is surely more pronounced.) As examples, flour prices went up 13x, bread 21x, potatoes 49x, milk 10x… Average increase per year of this basket is approx. +17%)

Another way to gauge the pertinence of these price increases is to impute a compound rate of growth in these prices. My approximate calculation shows that over the 96 years considered in this example, these food prices have increased at compound rates of between 2.7% and 4.1%.

We know history repeats itself and **inflation**, however you define or observe it, ends up '*robbing* our savings' and our purchasing power.

My conclusion? If the inflation assumption above is valid, I think that buying bonds that yield **less** than 6% per year (taxable account) *assures* losses; at 6% you can expect to maintain the purchasing power of your savings. Why so many investors are deliberately accepting disproportionately higher risks with their investment portfolios, is probably a result of 'chasing yield'. Currently, less than investment-grade corporates and troubled Sovereigns offer such 'above-market' yields. What about short-term paper that offers little or no yield? Because the opportunity-cost of maintaining high liquidities is currently low (i.e. you are not losing much in the fixed-income market), having such sums available for opportunistic, future investments is warranted. Such an opportunity materialized recently: By December of 2012, the improvements (optimism) in expectations and in the world economy were becoming discernable. Our observation at the time:

> "Our expectations are that this discernable improvement and future improvements, will affect the capital markets in a much more desirable fashion. Basically, we think that "global equities will likely be the best performing asset class"; interest rates and inflation will increase; bond markets will be a drag to investment portfolio valuations, pressures on underfunded pension plans to abate, somewhat." ***Visavis*** *12/12/12*

Uncharacteristically, every pension fund and retiree woke up at the beginning of 2013 and realized that the 2%-3% returns in fixed-income markets would not solve a serious problem; such low yields, were not enough to generate cash-flow needs.

1255 UNIVERSITY STREET, SUITE 1016, MONTRÉAL, QUÉBEC CANADA H3B 3W9
Telephone (514) 399-9936 Facsimile (514) 399-9861 email: Priority@Visavis.ca

Off, they went into the stock market, where dividend yields were higher than fixed-income rates and growth in capital was more conceivable. It worked--that year.

Lately, ETFs [exchange traded funds] have become mainstream investments for almost all capital pools, private and public. A recent report I read, illustrated how over 60% of American's IRAs are now invested in ETFs. Why? Simplicity, instant diversification and false sense of security. Why false? Because when the market drops, as it always does at some point, your investment will suffer in the exact proportion of the loss, as in the Index. When markets advance, thankfully the opposite is also true. **The Key, is to be aware that ETFs are as risky as their components.**

In the intermediate term, continued diligence and financial flexibility are still encouraged; basically, lower equity allocation in balanced portfolios and higher cash components in stock portfolios. Longer term, seeking reasonable growth through owning a well balanced portfolio, will help maintain the integrity of your savings and provide you with a more reliable retirement income.

For performance-oriented accounts, meaning those who seek higher returns and are willing to accept higher risks, the portfolio management approach is materially different. (e.g. Diversification, for deemed 'aggressive' investors, is less critical to portfolio structure and by design, is not sought by investors in these cases.) However, I have found that even deemed aggressive-investors, those who are more conscious of risk, are ill-prepared to lose money.

An investment 'matrix,' built dynamically on restructuring debt of various kinds, forms and magnitude, contributes to determining world interest rates. (cost-of-capital component?) If the sought economic recovery materializes, as we all hope it will, then world interest rates should increase smartly. It would be easier to then achieve a 7-10% longer-term total return on your investment portfolio, without accepting a disproportionate risk that comes with higher equity allocations.

Please let me know if you require or wish further clarification of the thoughts shared with you in this communiqué. As always, it will be my pleasure to discuss these matters further or any other financial considerations you may have.

Sincerely,

John Evdokias

These statements represent the author's opinions regarding future events that, by their nature, are uncertain and outside of the author's control. The author, Visavis and its clients may, from time to time, hold some of the securities which may be mentioned herein.

1255 UNIVERSITY STREET, SUITE 1016, MONTRÉAL, QUÉBEC CANADA H3B 3W9
Telephone (514) 399-9936 Facsimile (514) 399-9861 email: Priority@Visavis.ca