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## Should we hold more cash?

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While the world faces a highly polarizing U.S. presidential election in November, also looming in the not-too-distant future is a meeting between OPEC members to solidify a precarious agreement to limit oil supply, a constitutional referendum in Italy that could lead to its exit from the European Union and a potential interest rate hike by the U.S. Federal Reserve. There are plenty of reasons to expect heightened market volatility throughout the remainder of 2016. But before selling all of your investments and heading for the hills, here is something to consider: There can be a heavy price to pay for holding cash – and it's not just a loss of purchasing power due to inflation.

Cash is an important risk management tool that, when used prudently, can benefit investors. However, holding cash comes with an opportunity cost which, given today's low interest rates, is approximately equal to the total return of capital markets that an investor forgoes by not being invested. In most cases, the longer an investor stays out of the market, the higher the opportunity cost. To avoid this cost, investors would have to execute trades with extremely good timing. While it sounds simple, numerous studies show that market timing is a highly unreliable strategy.

Rather than relying on predictions, which paradoxically lead to unpredictable outcomes, we follow a process that combines the analysis of valuations, fundamentals, and cross-asset correlations. The valuation process goes beyond simply looking at bond yields and price-to-earnings ratios. It includes assessing the health of the global economy by continually analyzing data points and identifying underlying trends, which aid in determining forward-looking valuations. Today, we continue to see signs of low global demand driven by weak income growth, rising global debt and limited capital expenditures. Hence, there are some sovereign bonds in the world that appear more reasonably priced than what their historically low yields would suggest considering the current weaker fundamental backdrop.

Cross-asset correlations are gaining importance in our investment process. The margin of safety typically available to investors that seek undervalued assets has progressively narrowed as valuations have risen, making correlations an increasingly important risk management tool. A multi-asset class approach that combines investments moving independently from each other while each generating positive performance is the key to maximizing risk-adjusted returns.

Holding large cash positions tends to negatively impact long-term investors the most as the opportunity cost is greater. Therefore, we typically maintain modest cash levels in the equity-centric portfolios and do not

change them frequently. For shorter-term investors, we actively adjust cash positions in response to changing valuations. In today's environment, we continue to believe that combining longer-dated government bonds with the U.S. dollar is the best defense against a market correction.

*Combined top 15 equity holdings as of September 30, 2016 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:*

1. Microsoft	6. Chubb	11. Walgreens Boots Alliance
2. Apple	7. Tourmaline Oil	12. Thermo Fisher Scientific
3. Altagas	8. Simon Property Group	13. CIBC
4. Alphabet – Class C	9. Toronto-Dominion Bank	14. Synchrony Financial
5. Atco	10. UnitedHealth	15. PrairieSky Royalty

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