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A Gloomy Consensus can be Wonderful

A. The Year that was!

The year 2015 proved to be a largely unrewarding year for investors (see the 1 year returns in the chart below) and one that was filled with anxiety and uncertainty. Most asset classes struggled and a number of macro shocks dominated the financial headlines. From another Greece-induced sovereign debt crisis, a sharper-than-expected slowdown in China and the long-awaited Federal Reserve lift-off, to the late-year meltdown in commodity prices, continued terrorism threats and an inexplicable U.S. political and election backdrop, it is understandable that most investors are asking, "What just happened here?"

While all of the aforementioned items, and more, presented headwinds for stocks, the fundamental issues of weakening corporate earnings, lack of economic growth and debt challenges around the world are largely responsible for the lackluster results. The combination of a strong U.S. dollar and falling oil prices acted as a drag on revenues and earnings, especially within Canada where our largest export is energy. It was not a surprise that energy, materials and some industrial companies began to face serious problems as the year progressed. What was somewhat surprising to the economic pundits was that the benefits of lower oil prices, only marginally helped the earnings of consumer-oriented and other "energy-using" segments of the market.

For our investors this was not a surprise. As we have been telling you for several years, the high levels of personal, corporate and government debt are not sustainable and central banks will have difficulty keeping things moving forward without serious adjustments! We will summarize a number of these challenges in the next section.

	1 Year Return	10 Year Return
TSX (CDN)	(8.3%)	4.3% per annum
S&P 500 (USD)	1.3%	7.3% per annum
Bond Index	0.98%	3.7% per annum
Gold (USD)	(10.4%)	9.1% per annum
Silver (USD)	(10.9%)	4.6% per annum
CDN$ vs USD	(16.2%)	(17.9%) total period
Oil-WTI (USD)	(37%)	(32%) total period

As at December 31, 2015

It is very interesting to note that this latest "economic recovery" remains the least-believed economic recovery and bull market of the last 35 years. For American investors the Standard & Poor's 500 index has tripled in value since the end of the

"Great Recession" in March 2009 and yet emotions of fear and uncertainty continue to plague investors as they look at the real economy and the state of politics in Washington and around the world. In Canada, at the time of writing this report (January 20th) the S&P-TSX is back to levels not seen since 2006 effectively wiping out any investment returns and gains experienced over the last 9 years, excluding dividends. It is even worse when one factors in the current value of the Canadian dollar (69 cents), which is trading at levels that take us back to 2003.

We thought it would be interesting to compare last years' return with the returns over the past 10 years. A couple observations might be helpful. First, the average annual compound rate of return in the S&P-TSX (Canadian stock market) was very low at only 4.3% per annum. This return has held back by Canada's large commodity exposure, specifically, base metals and energy. The best performing asset over this period was actually gold despite the weakness in the shiny metal since reaching its high in the fall of 2011. The bond index hummed along with an average return of 3.7% per annum with interest rates dropping to the lowest level in history! Don't expect much from bonds over the next 10 years! Unless rates go negative across the board, and stay there, returns in this asset class will be awful. Lastly, when you consider our Canadian dollar and the price of a barrel of oil they were trading at very similar levels at the end of 2014 as they were at the end of 2005! As a result the drop in value in 2015 and during the last 10 years are very similar. At current prices, the Canadian dollar and the price of a barrel of oil are both back at 2003 levels. It's amazing how prices can come full circle!

Overall in all our accounts last year we averaged a positive rate of return of approximately 4% based upon equity weightings of 60% with the remaining 40% in short-term bonds and cash. Over the past five years we have averaged a rate of return of approximately 6% per year again with an average weighting of 60-65% in equities. Our larger than normal cash holdings position us well for the year ahead!

As we enter 2016 there is a great amount of uncertainty throughout the global economy. In the first two weeks of 2016, global stock markets have had their worst start on record, dropping on average by approximately 10%! Many of the factors that we have highlighted to our investors over the past 6 years seem to be coming to the forefront. Market sentiment, which can change in a heartbeat, has shifted from one of cautious optimism to deep concern. We continue to be cautious and yet prepared to take advantage of significant swings in value. Opportunities always emerge when the levels of fear escalate and market sentiment becomes negative! Warren Buffett has a great quote to remember, "You pay a very high price in the stock market for a cheery consensus." For both long-term investors and investors with extra cash a gloomy consensus can be wonderful because prices are low!

B. Challenges Facing the Global Economy

Although we are optimistic in finding solid long-term values there are significant challenges facing the global economy that we must invest through and incorporate

into our investment decisions. We have briefly outlined some of these challenges for you!

1. The level of global debt and derivatives continue to escalate. Governments are by far the largest contributors to the growing debt. Every major government continues to run significant fiscal deficits, which add to their accumulated debt. Since the financial crisis of 2008-2009, the actual level of global debt, to the end of 2014, has **increased by USD $57 trillion or 40%!** In essence citizens and their governments have dealt with the debt crisis by going further into debt!

   Considering that the US is supposed to be the strongest economy in the world we remind you in the chart below of the enormous build up of debt since 2004. This piling up of debt is expected to continue forever without any problem…. We think otherwise!

U.S. National Debt
December 31, 2004 through 2019 Projections

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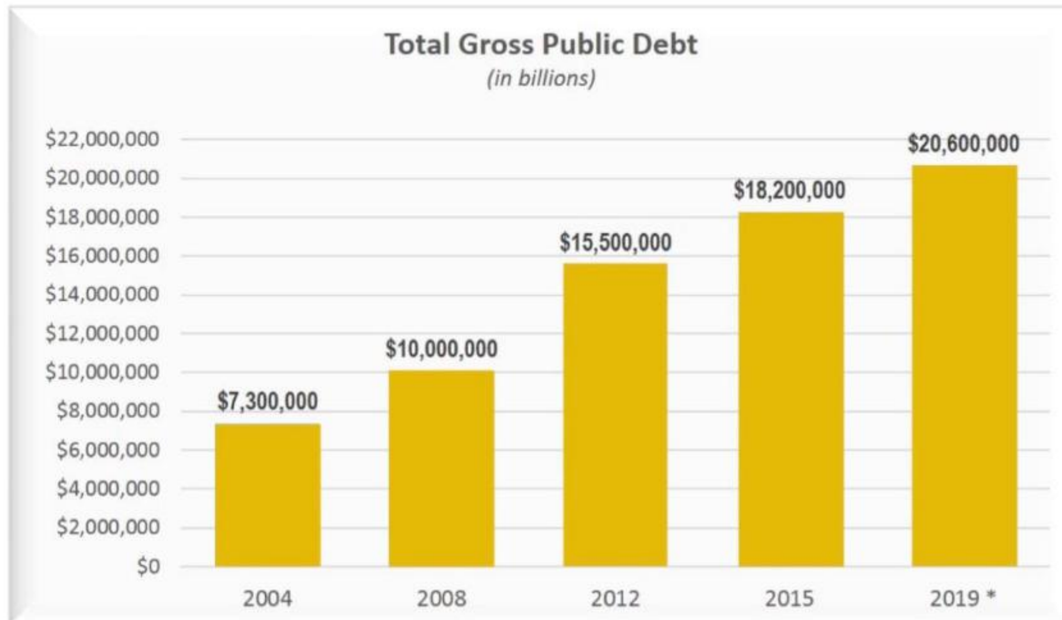

Source: Forbes "National Debt Tops $18 Trillion: Guess How Much You Owe?", April 24, 2015, DoubleLine

2. Unfunded entitlements, such as pensions and healthcare are estimated to exceed the total global credit market debt of $225 trillion. Governments have promised social benefits of over $225 trillion with very little money set aside to make good on these promises.

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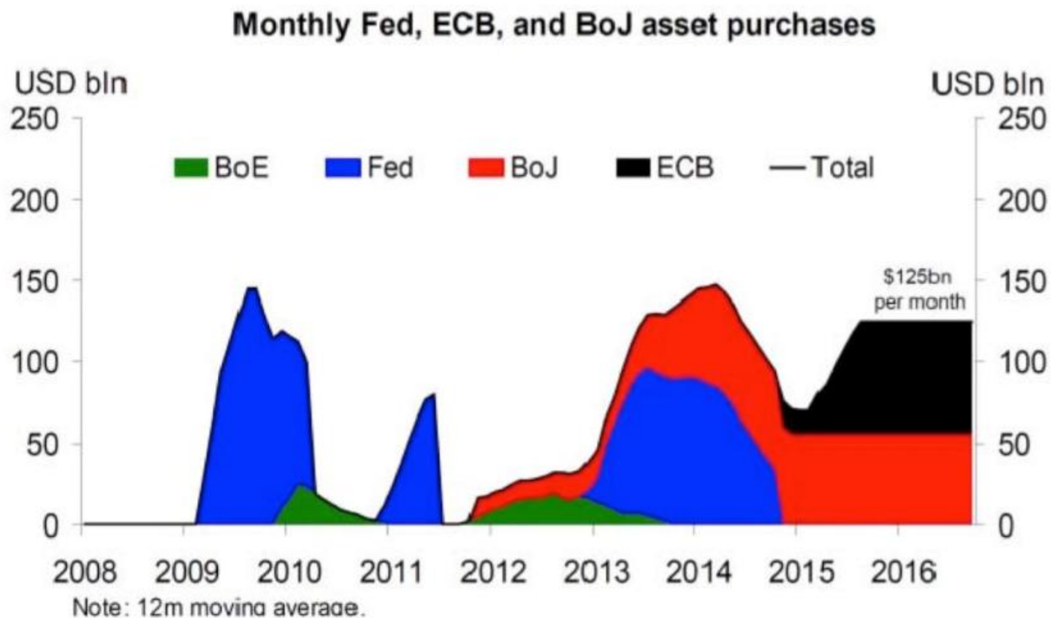
3. The majority of the world is experiencing a dramatic aging of their populations. Lower birth rates, high levels of abortion and the undermining of the traditional family are leading to conditions best described as catastrophic.

4. ZIRP (Zero Interest Rate Policy) continues to punish savers, erode long-term capital investments and make the population more dependent on the government. In addition to these problems it has contributed to an overpricing of bonds and an addiction to artificially low interest rates. In fact, in many countries (European) bonds are trading at negative yields.

5. Increasing money supply, also known as quantitative easing (QE), is taking place at an unprecedented pace. Central bankers can call this what they want, but the truth is, that this expansion of the money supply, is the debauchment/debasement of our money. In this environment it is critical that investors focus on maintaining their purchasing power. We have included a chart below that lays out the global QE that has and continues to take place as the global economy grapples with deflation and lack of growth. At the current time the global central banks are adding approximately $USD 125 billion per month in freshly minted digital currency just to keep the system going.

Global QE December 31, 2008 through Projected Year-End 2016 ROCKLINC



Source : BoE, DB Global Markets Research

Deutsche Bank Research Torsten Slok, torsten.slok@db.com +1 212 250-2155 November 2015

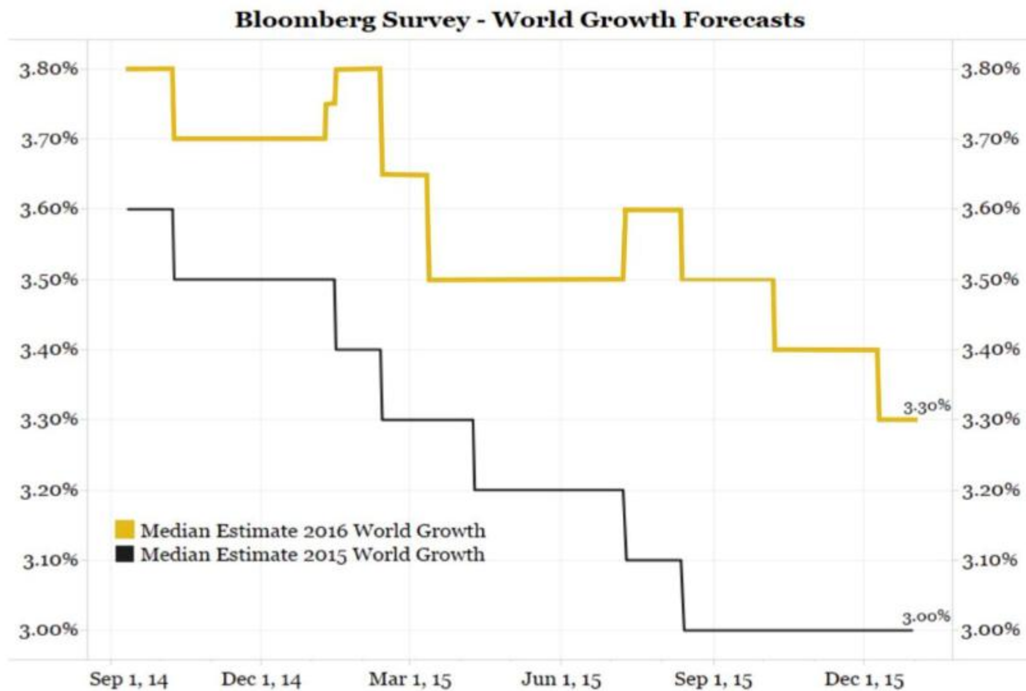
Source: Deutsche Bank Research November 2015 Report, DoubleLine
USD = U.S. Dollar, Fed = Federal Reserve, ECB = European Central Bank, BoJ = Bank of Japan, bln = billion, QE = Quantitative Easing.

6. Unemployment of young people is too high throughout all of the developed economies. The excessive level of debt coupled with zero interest rate policies is strangling economic growth. Businesses in general are hesitant to commit capital in this environment. This is resulting in slow job growth, and in many countries, increasing unemployment amongst the youth.

7. Taxes across the board are on the rise. This includes taxes on income, capital gains and dividends. Instead of penalizing debtors and allowing interest rates to move up, governments around the world are increasingly confiscating the wealth of savers and investors by lifting tax rates. This will certainly be the case with the election of the new liberal government in Canada.

8. Increasing regulation and growing state intervention is leading to less personal freedom. Everywhere we look the state is playing a larger and larger role. This increasing presence throughout our economy devours more and more of our scarce resources and crowds out the private sector. But, without a growing and vibrant private sector, we will note be able to grow the global economy and the extraordinary debt situation we face is intractable. In the chart below you can see the continued downgrading of the world growth forecasts.

World Growth Forecasts (GDP)
As of December 31, 2015 Projected 2016



Source: Bianco Research, DoubleLine
GDP = Gross Domestic Product is the monetary value for all the finished goods and services produced within a given country.

C. Royalty and Streaming Businesses

One of the sectors we continue to invest in is the precious metals sector. If there is one sector that is hated, perhaps even more than oil right now, it is the precious metals sector! As the expression goes, this sector has been taken out to the proverbial woodshed! If you go back to the first section of this newsletter you will see that over the past 10 years gold has actually outperformed the major North American Stock Indexes hands down! The primary way we invest in this sector is through the royalty and streaming businesses. As we have explained in previous newsletters, these are really bankers to the sector. In the right environment, when the blood is flowing on the "commodity streets" as it is today, you can refer to these businesses as "legalized loan sharks" because they can drive wonderful deals, for their shareholders!

Throughout our portfolios, we maintain a 5-6% total weight in the sector. This is spread amongst four leading firms. These firms are Franco-Nevada, Royal Gold, Silver Wheaton and Sandstorm Gold. Approximately half of our total exposure in the sector is in the largest and most profitable royalty and streaming company, Franco-Nevada.

With mining companies under extreme financial pressure as a result of record low commodity prices many miners have decided to sell a portion of their future sales for cash infusions now! Companies that bolster the balance sheets of major miners by buying future production in this weak environment can drive amazing agreements that we believe will massively reward long-term shareholders. In fact, 2015 was a record year for the royalty and streaming companies for acquiring future production. In the chart below we highlight some of the largest deals in 2015. It is expected that 2016 will provide even more opportunities to buy future production of gold, silver, copper and even oil at record low prices.

Largest Precious Metal Streaming Deals Of 2015

Buyer	Seller	Project (Targeted Metal)	Value ($M)
Silver Wheaton	Glencore	Antamina (Silver)	900
Franco-Nevada	Teck Resources	Antamina (Silver)	610
Royal Gold	Barrick Gold	Pueblo Viejo (Gold, Silver)	610
Royal Gold	Teck Resources	Carmen de Andacollo (Gold)	525
Royal Gold	New Gold	Rainy River (Gold, Silver)	175

While investors are running from the space we are slowly and carefully looking to add further to our positions in order to maintain a rational and meaningful exposure to this space. Disciplined investors could be rewarded with three to eight times their money on some of these companies over the next 4-5 years. Bottom line: We are astounded by some of the valuations. Remember, **a gloomy consensus is absolutely wonderful!**

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D. Conclusion

We have no allusions concerning the difficult markets we might see for the remainder of the year. The year has already begun with substantial losses in almost every industry sector. This does not deter us in the least because we believe we are prepared to weather and take advantage of the volatility. We also continue to talk to companies on a regular basis looking for new opportunities and trying to make sure our current investments are places we want to remain invested in for the foreseeable future. Overall we expect to add one or two new companies each year as opportunities emerge. This also means we look to exit one or two companies each year that no longer meet our criteria.

As we have stated many times, the best offence is a good defense, and we have some great companies to provide us cover in a world that is increasingly under the influence of “monetary delusion”. In our opinion, Central Banks are out of control and have distorted the markets with their zero interest rates and money printing. We must continue to be vigilant in protecting your capital from their dangerous and reckless policies. This is the reason we continue to carry significant cash positions that can be quickly put to work as stock prices drop. We appreciate your support and are committed to providing the highest levels of return consistent with a disciplined approach to risk management! **Please remember that a gloomy market can be wonderful!**

If you have a Facebook account you can like us at Rocklinc Investment Partners Inc. and follow our regular news updates.

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