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MONTHLY



Global Investment Letter



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“Something’s Happening Here...What It Is Ain’t Exactly Clear”

This line, borrowed from the great song by the Buffalo Springfield, seemed an apt title for this month’s introduction, given the significant moves by markets this past month that have suggested a host of new or potential trend changes set against a backdrop of unusual uncertainty.

The global geopolitical backdrop, which we continue to see as being an important influence on investment returns through the decade, remains troubled as 2021 nears. In the United States, Donald Trump has contested the election result as we anticipated. His allegations of voter fraud have not been supported by any evidence, which has prevented his many lawsuits from gaining any traction in the courts. While it appears that we may be spared the spectacle of Donald Trump having to be bodily removed from the White House, his potential for mischief remains considerable leading up to inauguration day on January 20. He is reported to be considering issuing blanket criminal pardons to many associates and family members, including himself, before he leaves office. He is also said to be considering staging his own “counter-inauguration” ceremony at the same time as President-elect Biden is being sworn in. Donald Trump possesses the full power of the presidency until January 20, so retains the ability to implement actions that could rattle markets. At the very least, Trump’s efforts to demean the American electoral process will serve to cast doubts in the minds of those prone to believing conspiracy theories and further polarize American society.

In London, the government of Boris Johnson is less than a month away from Brexit without any comprehensive agreement on future relations with the European Union. A no-deal “hard” Brexit has always been the worst-case scenario for Britain, and this appears to be what will occur. We have written of our belief that Brexit is fundamentally bad for Britain as it flies in the face of over 500 years of British foreign policy. The economic impact will certainly be negative, which will likely produce social and political consequences.

The European Union (EU) is currently enjoying a period of reduced concerns regarding its long-term viability, which has resulted in a stronger euro. This, in turn, has contributed to the weakness of the U.S. dollar that we have seen in 2020. A major reason for the new-found optimism about the EU was the historic unanimous agreement in August to coordinate financial aid to weaker members. The August accord was a notable political achievement, but it does not eliminate our longer-term concerns about the viability of the EU and the euro. The EU continues to face major economic and political challenges that lead us to believe both that the union will have a different configuration by decade’s end and that the euro may cease to exist.

The lack of political leadership and coordination among Western nations (e.g., the response to the pandemic) will serve to increase the potential for geopolitical volatility, as it will serve to embolden

adversaries such as China and Russia. One of the most important tasks of the incoming Biden administration is to restore a functioning Western coalition.

Beyond the tragic human toll inflicted by the pandemic in 2020 has been profound damage to the global economy. Despite unprecedented economic stimulus measures by central banks and governments, the recovery from the shock of the global lockdown has not returned the global economy to a semblance of its former level. The current presence of a resurgent second wave of the Coronavirus will exact further damage and suggests that serious recovery will not occur until a substantial portion of the population has received a vaccination. Even then, we anticipate the economic rebound will be slower than consensus opinion.

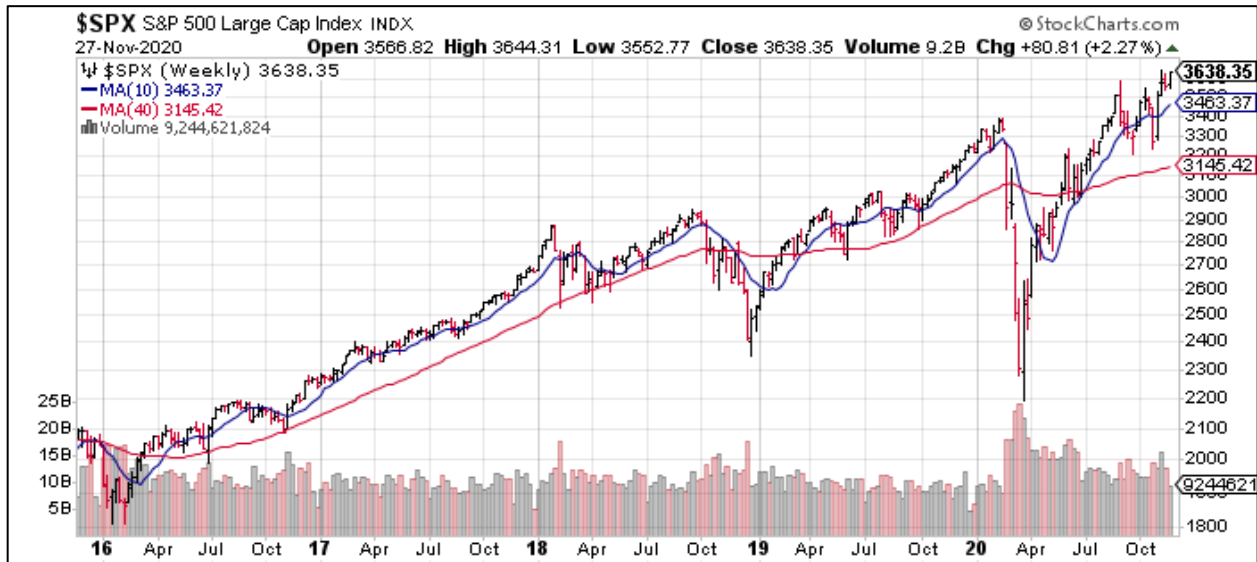
Against this sobering background, stock markets are breaking out to new highs and investor sentiment could hardly be more bullish. This positive view of the future has produced strength in the commodity markets, with copper moving very sharply higher on expectations of strong demand produced by economic growth.

It is this unprecedented disconnect between the current economic backdrop and consensus expectations priced into markets that we find difficult to understand and is producing our unease. Investor euphoria can be found everywhere. For example, in the copper futures market, non-commercial traders (speculators) are strongly bullish while commercial traders are net short.

Our task this month is to weigh the competing evidence provided by strong market price action (which suggests higher prices ahead) with soaring investor sentiment (which suggests caution). Rarely have markets been more challenging or have they had the potential to produce such significant risks and/or opportunities.

EQUITIES COMMENT

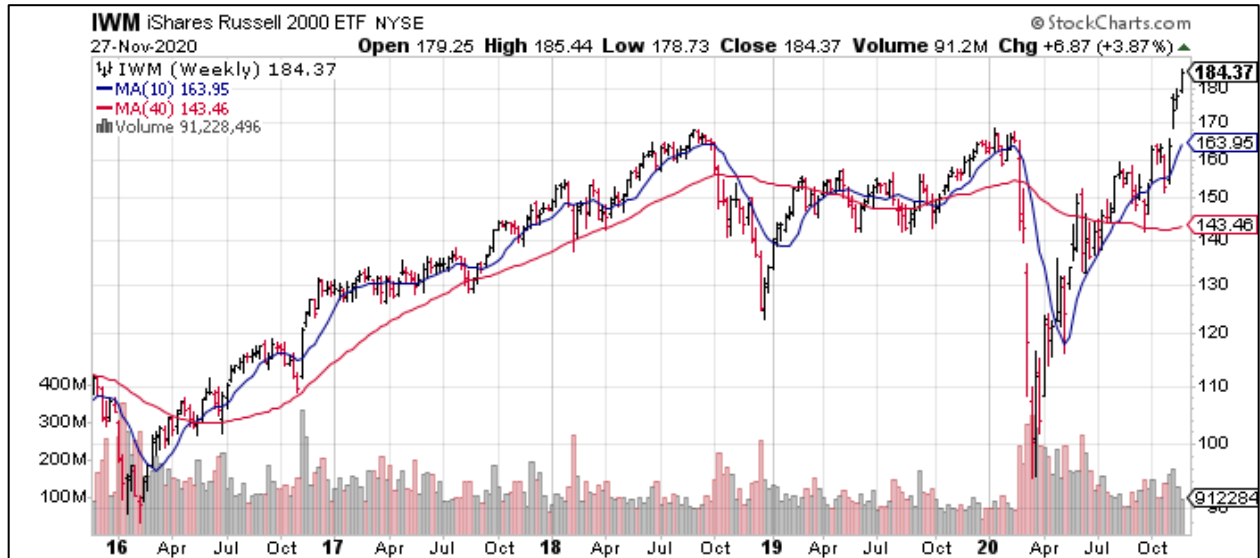
S&P 500 (WEEKLY)



As discussed in the November issue, we were prepared to change our view to bullish on U.S. equities on a breakout to new highs by the S&P 500. The move to new highs did occur in November and we adjusted our position accordingly.

Several factors continue to favour equities, notably the global economic support being provided by central banks and governments. November to April has historically been the strongest period to hold equities. The breakout is a bullish indication from a technical perspective.

RUSSELL 2000 ETF (IWM) (WEEKLY)



An even stronger buy signal was generated by the small-cap Russell 2000 index in November. It moved strongly to new highs in a manner that suggests the possibility of significant appreciation. Here again, we adopted a bullish position on the breakout.

The strength in the Russell 2000 may have larger implications for U.S. stocks, potentially signalling a change of market leadership. The Russell 2000 has been underperforming the large-cap S&P 500 for most of the past two years, though the gap has closed substantially of late. The underperformance of the small-cap index is very unusual during a bull market, which typically favours smaller companies.

We have attributed the better relative performance of the S&P 500 and, in particular, the very narrow leadership confined to the FAANG stocks plus Microsoft and a handful of others, to the enormous capital flows directed into the largest index weightings by passive investment strategies (which account for about 50% of invested capital). The addition of a new generation of retail “investor” in the wake of the distribution of stimulus cheques earlier this year appeared to accelerate the process. These new “investors” strongly favoured the FAANG stocks, Tesla, and a small number of other companies that exhibited strong price momentum.

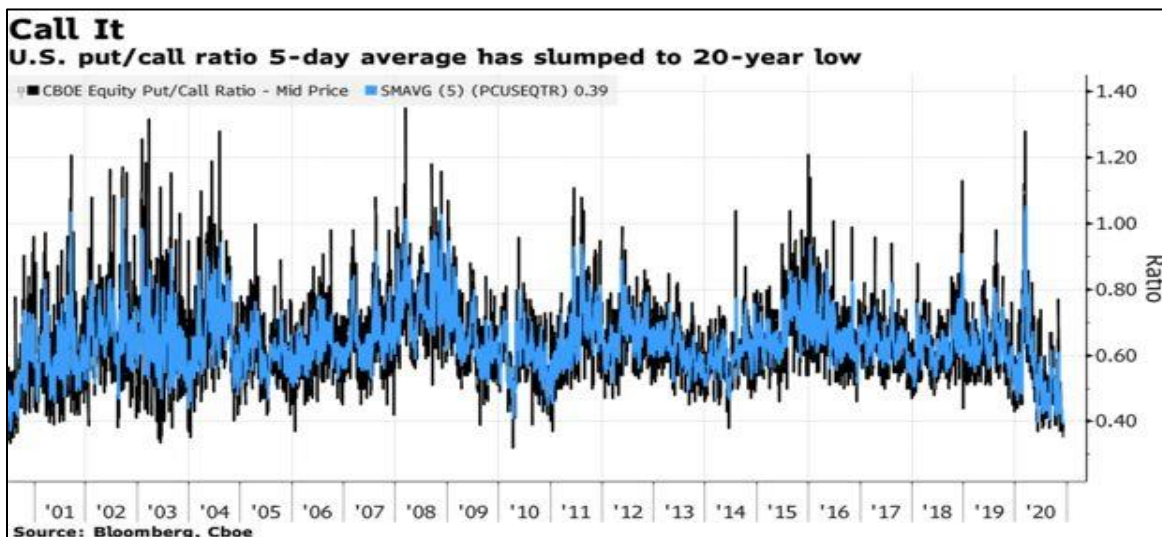
Whether the breakout by the Russell 2000 signals a change of market leadership remains to be seen. If the Russell continues to demonstrate strength, that would be in keeping with the continuation of the bullish market behaviour we have seen since the March low. The Russell 2000 does offer better valuation metrics and may be said to be under-owned given its lengthy period of underwhelming relative performance.

A change in market leadership to smaller companies will depend on a continued shift of capital flows into this sector. Therefore, passive investment managers and retail investors must allocate more capital to the Russell 2000 and its constituent companies.

The price action of the S&P 500, and even more the Russell 2000, has been very bullish, but there are real reasons for caution despite the positive seasonality et al.

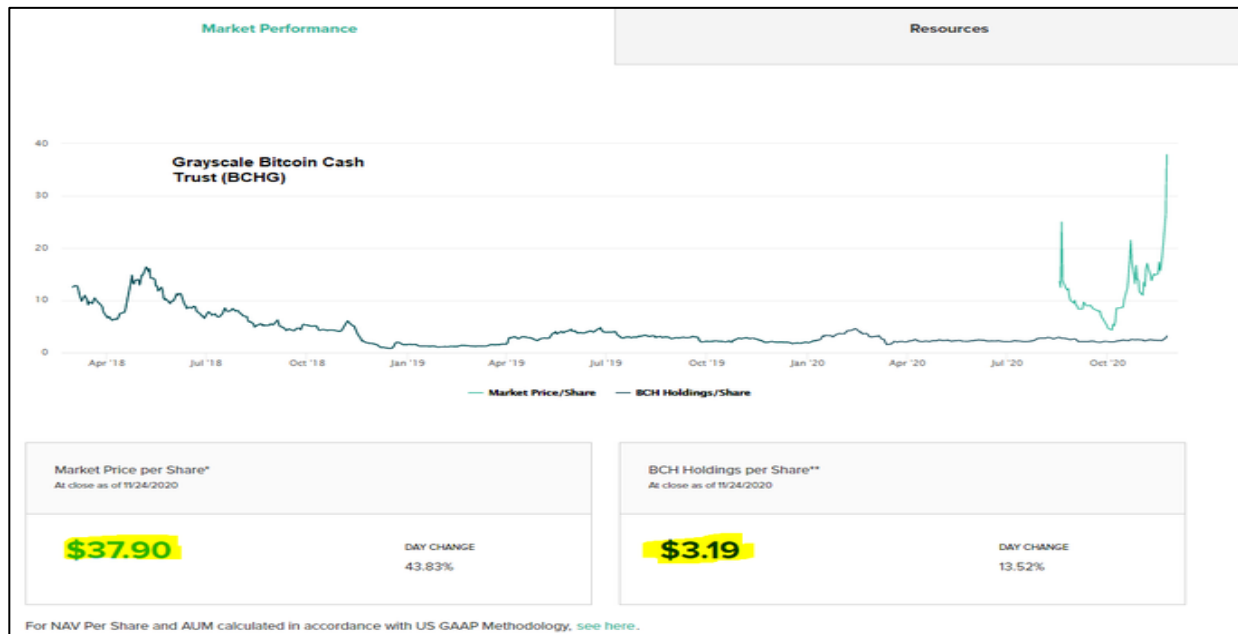
The historic disconnect between the capital markets and the underlying economy must be of concern. The global economy has yet to recover to levels approaching pre-pandemic levels. As well, the pace of recovery has appeared to weaken in late 2020 and there is a real risk of a double-dip recession in the first half of 2021 as a consequence of the resurgent second-wave of the pandemic. The distribution of vaccines is not likely to occur swiftly enough to counter the worst human and economic effects of the second-wave.

Why this historic disconnect exists is a product of extremely bullish levels of investor optimism. The source of this investor enthusiasm seems to stem from a confidence that the stimulus actions of the Fed and governments will avert a lengthy recession. Many investors are looking past the current recession to a post-vaccine economy that will boom through continued fiscal and monetary stimulus. We have written, and continue to believe, that a recovery will be more muted and take longer than many expect. Consensus opinion disagrees with our thinking, which is reflected in the chart below.



The 5-day moving average of the put/call ratio has fallen to 20-year lows, to levels last seen in the last days of the internet bubble at the turn of the century. Such sentiment extremes are worthy of respect and warrant caution.

The most extreme examples of unrestrained investor ebullience can be found in recently launched public vehicles designed to hold cryptocurrencies.



The Grayscale Bitcoin Cash Trust (BCHG) traded at \$37.90 at the close of November 25. Its net asset value was \$3.19!! Investors were prepared to pay an over 1000% premium to its NAV!

As of market close on December 3, the price had fallen to \$36.65 while the NAV declined to \$2.71, further expanding the premium to NAV.

A similar vehicle, Grayscale Litecoin Trust (LTCN) traded at \$223 at the close of December 3, which was over 25 times its NAV of \$8.25.

BCHG and LTCN offer interesting hedge opportunities presuming that sufficient stock can be found to short against the underlying cryptocurrency.

In conclusion, we remain bullish on U.S. equities in consideration of the bullish price action and the maxim of “don’t fight the Fed.” However, we are mindful of the risks posed by the current environment of elevated investor optimism. We will be very quick to withdraw our bullish positions should the S&P 500 and Russell 2000 trade below their recent breakout points. Such a decline would be very bearish and open the prospect for much lower prices.

VOLATILITY TRADE

S&P 500 VOLATILITY INDEX (VIX) (DAILY)



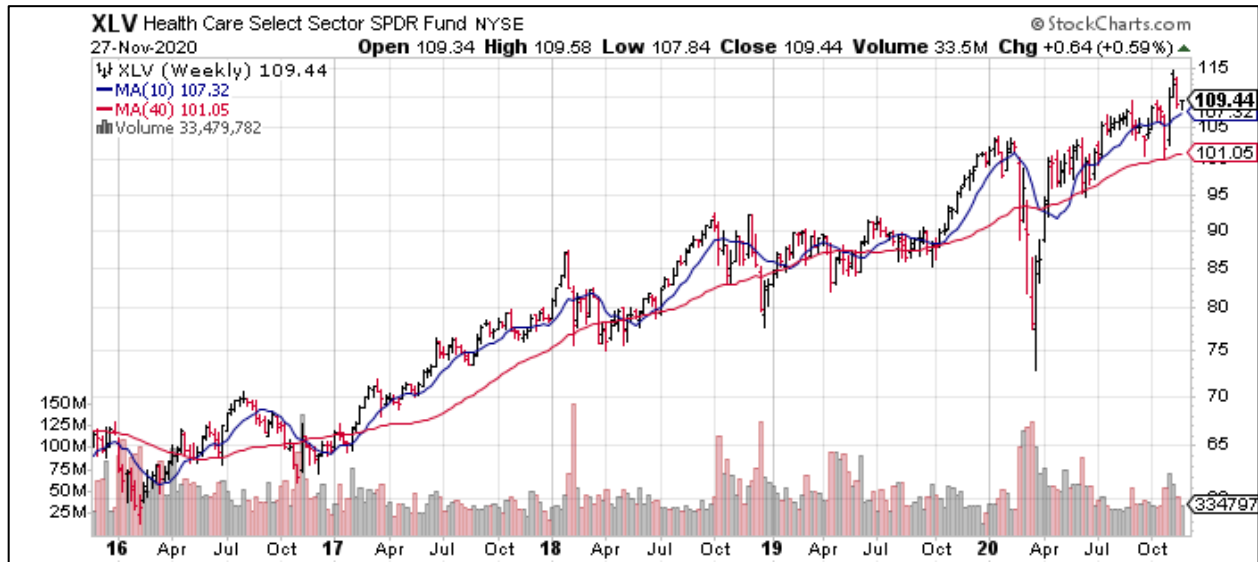
As discussed in the previous issue, we sold our long VIX position in October at 34 because we anticipated a drop in volatility as the markets moved into November, which has been seasonally very positive. That was certainly the case this year with the VIX ending the month at 20.84.

The VIX has fallen to levels last seen in August but is not yet at a level that would warrant its re-purchase. We remain flat on volatility but expect that another risk/reward buying opportunity will present itself this winter if bullish investor sentiment continues to build.

A return to the circa 15 level for the VIX would cause us to consider adopting a long volatility position once again.

HEALTH CARE TRADE

HEALTH CARE SPDR ETF (XLV) (WEEKLY)



The global health care industry remains a core long-term theme. The very favourable demographic trends in developed nations, combined with an ongoing stream of new technologies and treatments, make the prospects for this industry very positive.

We continue to favour diversified exposure to the health care sector, either through a basket of stocks or through holding the XLV ETF, which is our proxy for the industry.

FTSE 100 (DAILY)



The British FTSE 100 index moved sharply higher in November, essentially keeping pace with the U.S. equity indices. As a result, the FTSE finished the month trading above its long-term 200-day moving average for the first time since February.

We remain bearish about the prospects for British equities until the economic effects of the upcoming Brexit at year-end can be appreciated. The relative underperformance of the FTSE suggests that investors are anticipating a difficult time for the already fragile British economy.

We will continue to stand aside from this market until an attractive buying opportunity is presented. We will be watching for a sentiment-driven decline in 2021 that would produce an attractive risk/reward buying opportunity. Such an opportunity may or may not occur.

DAX INDEX (WEEKLY)

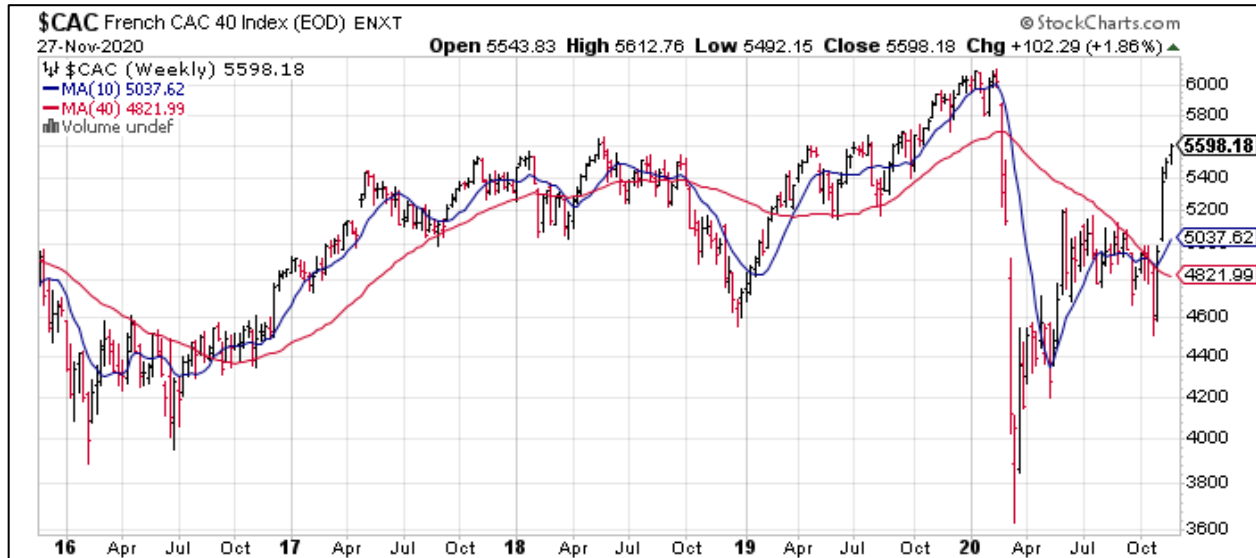


The German DAX index has been consolidating for several months very close to important technical resistance at the circa 13500 level. This level proved to be a reversal point for two previous rallies.

The export-dependent German economy, and hence the DAX, is perhaps being constrained by the strength of the euro this year. Further euro strength versus the U.S. dollar would provide additional downward pressure on the DAX.

A move above the circa 13500 level would be very bullish indeed. A sustained price move to new highs would cause us to reverse our current bearish view to bullish for this market

CAC 40 (WEEKLY)



The CAC 40 seemed to wake from its consolidation slumber to vault higher (over 10%) in November.

While the strength of the move is impressive, we remain on the sidelines with the CAC for two reasons. Firstly, the strength of the move suggests the market may be overbought and subject to retracement near term. Secondly, the market is nearing its high of early 2020, which may prove to be a reversal point for the rally.

A move to a new high or a successful retest of the lows is necessary for us to return to a bullish view of the CAC.

NIKKEI INDEX (WEEKLY)



We have long maintained, and repeated in the last issue, that we could not become bullish on the Nikkei until it broke above the 24000 level, which had constituted formidable resistance for three previous rallies.

A break above 24000 took place in November, and we duly became bullish of the Nikkei index at that point. A market move such as we have seen by the Nikkei in November has historically been very bullish and led to much higher prices.

A previous constraint on past Nikkei rallies, policy tightening by the Bank of Japan, appears much less likely in this era of pandemic and global Modern Monetary Theory. As well, Japanese companies have substantial earnings leverage to economic growth. Lastly, Japanese equities are overwhelmingly owned by domestic interests, not least the Bank of Japan. Continued strength by the Nikkei would presumably once again attract foreign capital flows, which would provide additional fuel for a rally.

Long-term existential challenges for Japan remain, most notably a dismal demographic situation that will produce a sharply declining population in the coming decades. The major effects of that issue will not occur until well past our investment horizon. The current demographic tightening could produce a labour shortage in Japan that would limit unemployment and spur the economy in the 2020s.

The rise in the Nikkei is noteworthy given the relative strength of the yen versus the weakening U.S. dollar. There is typically an inverse relationship between the Nikkei and the yen because of the Japanese economy's dependence on exports. The yen/dollar exchange rate is especially important because some 25% of Japanese exports go to the United States. A market that rises when it should decline is very bullish indeed.

We maintain our bullish view initiated in the move above 24000 last month. We would only reverse our bullish position should the Nikkei again trade below 24000.

SENSEX (WEEKLY)



The SENSEX index achieved a new high in November and triggered a technical buy indication on its move through the 42000 level.

The move to a new high is noteworthy and this bullish development should not be ignored. We must change to a bullish posture re the SENSEX on a technical basis but also practice caution. The rise from the March low has occurred without a significant period of consolidation, which increases the prospects of the market being overextended.

The bullish technical state of the SENSEX market suggests establishing a modest initial long position while being watchful for subsequent opportunities to add to it. A move back below the 42000 level would be very bearish and potentially suggest much lower prices.

India has been, and is, our favourite emerging market for long-term investors, and long-term readers will recall that we profited handsomely from our previous long position in the SENSEX. Our ongoing caution reflects our recognition of the dynamic state of global markets and the many catalysts available that could produce market volatility, not least the continued presence of the Coronavirus pandemic, which could exact a severe toll in India given the nation's limited medical resources.

EMERGING MARKETS ETF (EEM) (WEEKLY)



The close above the early 2018 high by our proxy for emerging markets, the EEM ETF, was a very bullish development from a technical standpoint. Emerging markets have benefited from the general strength of global equities since the March low and the weakness of the U.S. dollar.

The bullish implication of a move to a new high compels us to move from a cautious to bullish stance on EEM. However, our newfound bullishness comes with residual caution. A resumption of trading below the 2018 high would constitute a failed breakout and would be a notably bearish development.

In keeping with our positive view of EEM, we would establish a small initial position on the breakout and add on subsequent buying opportunities during pullbacks and consolidation periods. We would be quick to reverse our position on a move back below the 2018 high.

FIXED INCOME COMMENT

10-YEAR US TREASURY NOTE (WEEKLY)



The 10-year Treasury weakened somewhat in November as expectations for lower interest rates in 2021 declined. This change in expectations is reflected in the futures market, which had been forecasting negative interest rates in 2021 but is no longer doing so.

The growing belief that we may have seen the low in interest rates has presumably been driven by the prospect that distribution of an effective vaccine(s) in 2021 will allow the global economy to recover to previous levels, putting upward pressure on interest rates. As well, there is the expectation that further massive fiscal and monetary intervention will be implemented in 2021 to help the economy gain traction in its recovery. This is also expected to result in a rise in interest rates.

We remain more cautious than many in our belief in the ability of the global economy to rebound quickly from the damage inflicted by the pandemic. There appears little prospect of a level of economic growth sufficient to drive interest rates at the long end of the yield curve meaningfully higher in the nearer term.

That being said, an important aspect of inflationary expectations that can drive interest rates higher is psychological. The massive expansion of global money supply, and rising commodity prices in 2020, has fueled concerns of inflation with many investors.

Experience has taught that the bond market is often a better gauge of economic prospects than the stock market, which makes the behaviour of bonds especially noteworthy. A break below the 137 level would be a bearish development and cause us to shift our bullish view to bearish, as it may be indicative of an important change of trend.

A change in trend in the bond market, whenever it may occur, will have enormous consequences for capital markets because of the massive amount of global capital attached to the bond trade. Stock markets would likely be the beneficiary of capital flows out of bonds. The timing of major capital outflows from bonds remains uncertain, but we are of the view that it will be part of the scenario that will produce the great market volatility we expect later this decade.

For now, we will be watchful for a breakdown in the 10-year Treasuries.

CURRENCY COMMENT

US DOLLAR INDEX (DXY) (WEEKLY)



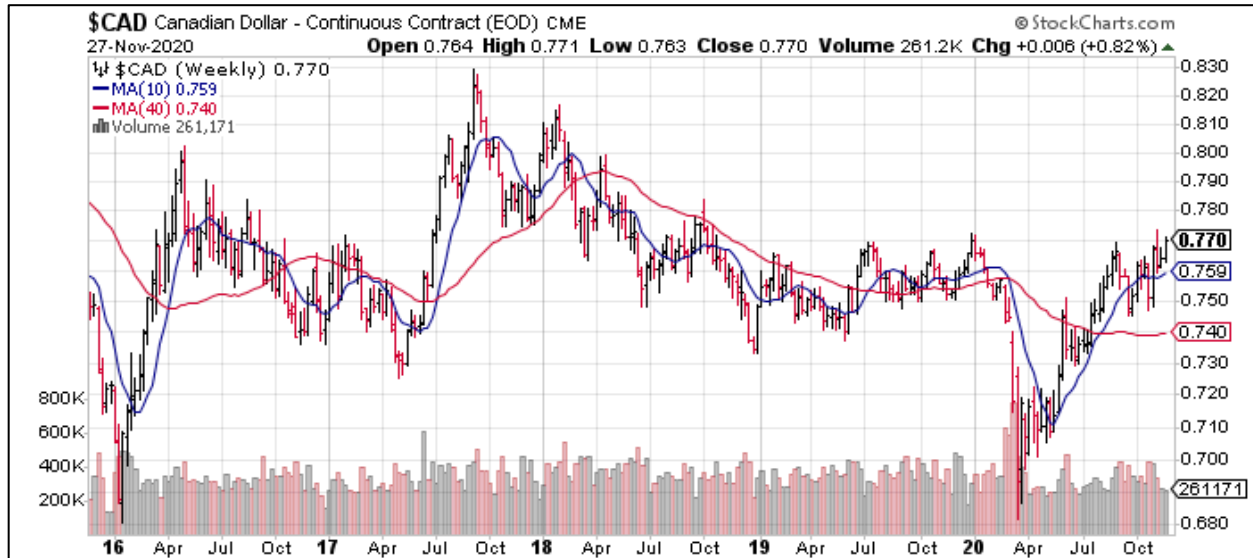
The U.S. Dollar Index exhibited renewed weakness against most currencies in November and closed the month at the bottom of its recent trading range. The price action of the dollar has been bearish for some time and, while we remain dollar bulls for the long-term, we must acknowledge that the prospects for dollar strength in the near-term are less than compelling.

We, therefore, return to a bearish stance on the Dollar Index, reversing our recent adoption of a bullish view based on our expectation that enthusiasm for the euro was waning. Enthusiasm for the euro remains, which suggests the Dollar Index will have difficulty rebounding in the immediate future.

A break below the circa 91.5 level (which seems likely) would be bearish and suggest that the Dollar Index will trade down to circa 89 to test the early 2018 price lows.

We remain surprised at the weakness of the U.S. dollar, given the positive interest rate differential it enjoys against most currencies and its ongoing role as the reserve currency. Still, we must respect what the market is telling us and await an attractive risk/reward buy point with which to restore our bullish view.

CAD/USD (WEEKLY)



The Canadian dollar performed strongly in November, benefiting from the weakness of its U.S. counterpart and, more importantly, from strength in the price of oil.

The Canadian dollar closed November near the important resistance level at circa 77 cents. Several previous attempts to move through this level have produced price reversals. A sustained move higher would be notably bullish.

We continue to be cautious of the Canadian dollar. The significant correlation of the dollar to the price of oil is problematic, given our ongoing reservations about the prospects for the oil price (see comment further on in this issue). As well, a lower dollar is in Canadian interests to facilitate trade with its giant neighbour to the south, which is by far its largest trading partner.

We would be surprised if the Bank of Canada does not work to temper the recent strength of the dollar, possibly through an interest rate cut.

EUR/USD (WEEKLY)



The euro strengthened against the dollar in November. A move through the 1.20 price point would be a bullish development and suggest a move higher to test resistance at the circa 1.26 level.

The level of confidence in the European Union, and hence the euro, has risen substantially in 2020. We illustrated this in the last issue with our discussion of the sharp rise in the use of the euro as a component of currency reserves.

The price action of the euro continues to be bullish as it trades above important moving averages and very near the 1.20 breakout level.

A move by the euro above 1.20 would compel us to reinstate a bullish view of the euro.

A potential reason for caution with the euro is found in the November 24 Commitment of Traders Report (COT). The COT revealed that non-commercial traders (i.e., speculators) were extremely bullish while commercial traders had a rather large net short position in the euro. These large divergences of sentiment tend to ultimately resolve in favour of commercial traders. The COT reports are but one component in assessing sentiment, but we have found large divergences useful to consider.

POUND/USD (WEEKLY)



The British pound rose against a weak U.S. dollar in November and is again approaching formidable resistance at the circa 1.35 level, which has been a reversal point for several previous rally attempts.

We remain bearish on the pound, believing it is highly likely that the Bank of England will seek a weaker pound to facilitate the transition to a post-Brexit economy.

YEN/USD (WEEKLY)



Unlike the recently initiated bullish trend by the Nikkei, the yen continues to trade in a very broad sideways channel. There is very significant resistance to further yen strength against the dollar at the circa 100 level, which presumably limits further yen appreciation to about 4%.

A move below 100 by the yen would suggest a bull market, which would have negative consequences for the export-dependent Japanese economy and stock market. We expect the Bank of Japan to work actively against further significant appreciation of the yen versus the dollar.

The absence of a clear trend prompts us to continue to stand aside in this market.

YUAN/USD (DAILY)



The yuan continued to strengthen versus the U.S. dollar in November, which most recently can be largely attributed to dollar weakness.

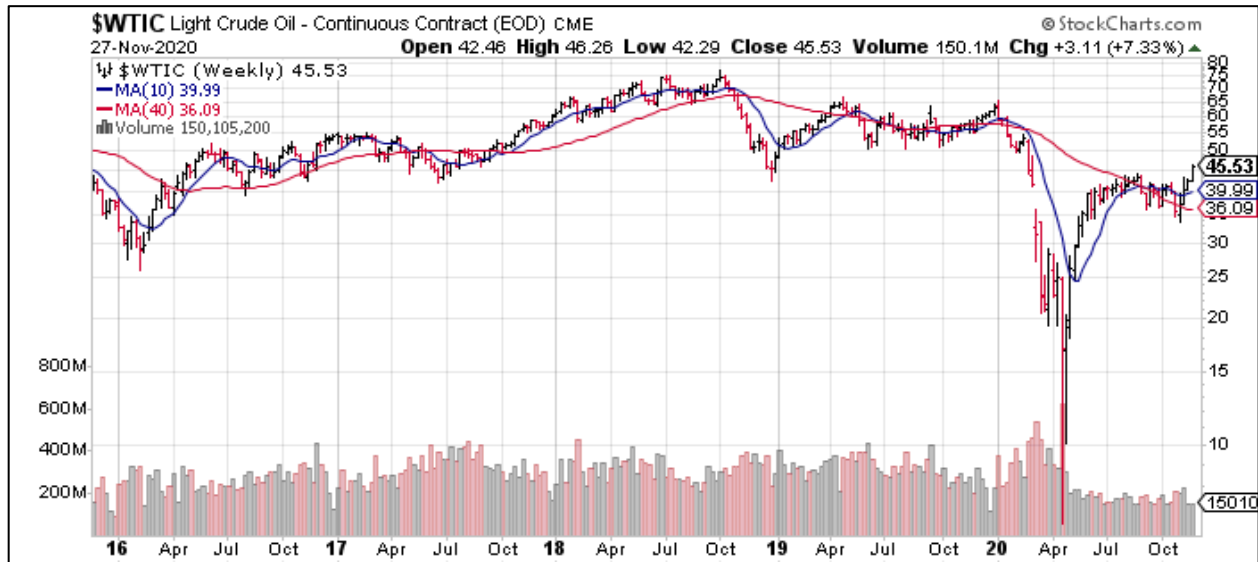
The bullish trend of the yuan since the summer cannot be denied, but we remain somewhat puzzled as to what is driving its strength.

The exchange rate has traditionally been a barometer of China/U.S. relations, which have worsened in 2020. Moreover, a stronger yuan does not appear to be in Chinese interests long term. Perhaps the exchange rate reflects concerns about the economic consequences of the poor handling of the pandemic by the United States. If so, the distribution of an effective vaccine may reverse the yuan's current trend.

We continue to recommend hedging exposure to the yuan, given our uncertainties and the potential of the Chinese government to implement a sudden devaluation.

OIL COMMENT

CRUDE OIL (WTI) (WEEKLY)



Crude oil performed strongly in November, breaking above the trading range it occupied through the summer and above its long-term 40-week moving average. This is ostensibly very bullish behaviour. However, the path to higher prices has its challenges.

The major premise driving prices higher is the belief that the recently announced vaccines will result in a sharp global economic rebound in 2021, a rebound that will result in significantly higher oil demand. While oil demand will ultimately recover, we believe the process will take longer and be more muted than many expect. The world economy is likely to be weaker in the first half of 2021 than consensus opinion forecasts. For example, in the United States, some 20 million workers are receiving some form of unemployment benefits. Half of these people lose much, if not all, of their benefits by year-end when federal programs expire. With the total U.S. workforce being about 164 million, the real unemployment rate is 12%, which is much higher than the “official” reported statistic of 6.9%. Similar impacts on employment are being seen in most nations. The pandemic has likely produced permanent changes to the way economies function, such as accelerating the adoption of online shopping and working from home, that will hamper future increases in oil demand.

The supply picture for oil remains less than bullish. While inventories in the United States have fallen significantly from the summer highs, they remain above their 5-year averages. As well, U.S. oil production began to increase again in September, rising 286,000 barrels per day from August levels. It should be noted that U.S. production was significantly lower (1.635 million barrels per day) than the year previous. Continued price strength can be expected to produce further increases in U.S. production.

The production discipline displayed by most OPEC members (and Russia) continues to be surprisingly good, and oil bulls must count on this cooperation to continue. However, there have been increasing reports of discord among members, some of whom (e.g., Russia) are suffering mightily from the combination of low prices and diminished production. OPEC and Russia cut production an unprecedented 9.8 million barrels per day in May and eased the cuts to 7.7 million barrels per day in August in response to the stimulus-driven economic rebound. The current agreement calls for the production curbs to ease modestly in January, adding some 500,000 barrels per day at the height of the second wave of the pandemic.

While the recent price action of oil has been very bullish, the fundamentals of supply and demand do not support significantly higher prices. We are reminded of the old maxim, “price leads fundamentals,” but my reservations persist.

The price of oil may continue higher, but we do not have the confidence in the prospects for higher prices necessary to adopt a long position at this time.

DEFENCE SECTOR COMMENT

US AEROSPACE & DEFENCE ETF (ITA)(WEEKLY)



The defence sector, as represented by our ITA ETF proxy, moved sharply higher in November. The defence sector benefited from the general strength in stock markets and the particular strength of Boeing, which has seen its MAX 737 aircraft reinstated.

The global defence industry remains a core long-term theme for us, given the deterioration of global geopolitics and the demands of rapidly evolving technology to update and/or replace military hardware.

While the recently positive price action is heartening, we must continue to refrain from initiating a position. The risk/reward for ITA remains less than attractive, having performed relatively poorly since the March low and being within sight of major resistance at the circa 230 level.

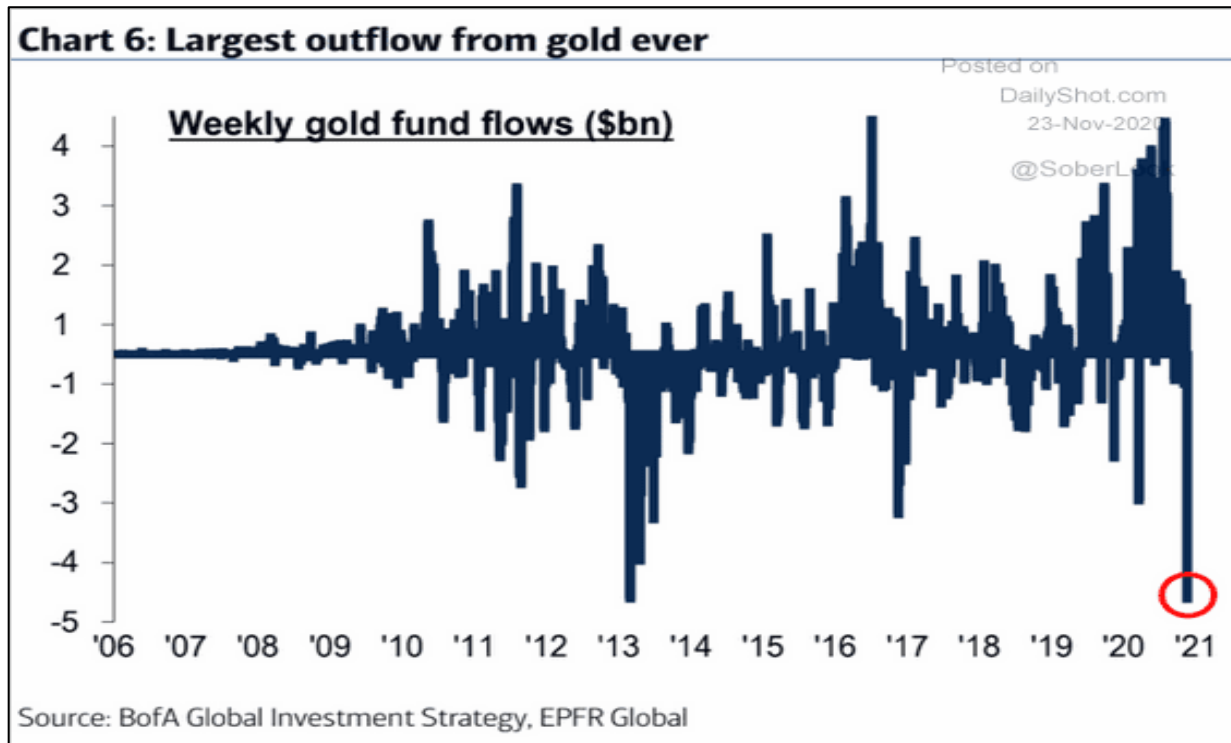
We expect the optimal buying opportunity has yet to emerge, and there are more attractive alternatives in the equity universe at this time.

GOLD COMMENTARY

GOLD (WEEKLY)



Gold broke down in November from what we construed as a likely bullish continuation to end the month trading just below its long-term 40-week moving average. Both developments must be considered bearish, at least for the short-term. The abrupt change of sentiment toward gold is illustrated by the chart on the following page, which suggests that November saw the largest outflow from gold funds ever.



The recent price weakness is disconcerting given the generally very positive environment for gold. Unprecedented fiscal stimulus and money supply growth, in addition to a weakening U.S. dollar, should be supportive of higher gold prices. We are reminded of an old investing maxim that if an investment is acting bearishly when it should be bullish, that is a very bearish sign indeed.

We are therefore both surprised and concerned about the recent behaviour of the gold price and have looked for a rationale. In our view, the most likely cause of the recent price weakness has been a general belief in a sharp reduction of systemic risk derived from the election of Joe Biden as president and the emergence of several potentially effective Coronavirus vaccines that are expected to be widely available in 2021. That “risk-off” view is reflected in the performance of equity markets.

Also, bullish investor sentiment reached an extreme in November. The November 24 Commitment of Traders report (COT) revealed a strongly bullish stance by non-commercial traders while commercial traders were strongly short. Such a divergence in sentiment usually warrants caution.

Gold is likely going to require some time to consolidate before it begins to move higher. Further price weakness from current levels, especially below circa \$1700, would be very bearish and call into question its longer-term prospects.

We remain long-term bullish on gold, especially given our expectation of considerable volatility by capital markets later this decade. However, recent price action suggests near-term prospects are muted with the caveat that a major negative geopolitical event, or sharp break in stock markets, could restore the “risk-on” trade that would benefit the gold price.

ABOUT THE EDITOR

The Editor and Publisher of the Global Investment Letter is Jonathan Baird CFA. Prior to founding the Global Investment Letter, Jonathan spent more than 25 years as an award winning money manager in Canada, most recently winning a Lipper Award in 2010 for managing the #1 Global Equity Fund in Canada. Jonathan managed several #1 ranked funds over the course of his career as a money manager, investing in all major industries, asset classes and markets. Along with his interest in the world of investment, Jonathan has been a lifelong student of history and uses the lessons of history to help interpret and provide context to current events. Jonathan no longer invests money for others, managing only his own account. The Global Investment Letter represents his personal thoughts and opinions.

Jonathan well understands the difficulty of the investment process, and the essential role that quality information and opinion play in successful investing. Each monthly issue will contain comments on major markets, economics, geopolitics as well as investment ideas. There may also be discussion of investment philosophy or practices and reviews of books deemed of potential interest to readers.

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