



3 Key Risks Facing Investors in 2015

Description

An important aspect of successful investing is to avoid steep losses that often occur when unexpected events take place. Below I summarise three events that, while not expected at the moment, could impact the investment markets in 2015.

Continued decline in oil prices

Despite a small bounce in the price of oil in recent days, the price has declined by almost 50% from the June 2014 peak. Forecasts for crude oil prices in 2015 have been scaled back and West Texas Intermediate is now predicted, according to a recent Reuters poll, to average \$78 per barrel in 2015 and \$80 per barrel in 2015. That compares to an oil price of over \$90 per barrel in 2014.

I have previously written about the long cycles that characterise the movement in oil prices with only two major upcycles and one down cycle since 1970. A second down cycle seems underway, which, if history is anything to go by, could last for several years.

If this turns out to be the case, investors will not profit from chasing short-term rallies and should focus long-term holdings exclusively on top quality integrated oil producers with sound balance sheets, diversified income streams and low cost of production such as **Suncor Energy Inc.** and **Imperial Oil Limited** ([TSX: IMO](#))(NYSE: IMO). Alternatively, energy exposure could be gained through the pipeline companies such as **TransCanada**, which has limited direct exposure to commodity prices.

Canadian house prices (eventually) correct

According to data provided by *The Economist* magazine, house prices in Canada have increased by 77% over the past 10 years and adjusted for inflation, by 54% — a faster rate of increase than any of the major developed nations.

On a variety of measures, including price-to-income and price-to-rent, the Canadian housing market ranks among the most expensive in the world. At a major city level, the situation is worse with a good example being the almost doubling of house prices in Vancouver over the past 10 years.

Despite the warning signs, investors and speculators seem unperturbed as evidenced by an 80% growth in residential mortgage lending over the past 10 years by Canadian financial institutions.

Factors that may cause house prices to change direction in 2015 include declining commodity prices and increases in mortgage rates. My sense is that the risk of a correction in house prices in 2015 is material.

The obvious stocks to avoid during a house market correction are the pure mortgage lenders such as **Home Capital Group Inc**, mortgage insurers such as **Genworth MI Canada Inc**, and multi-family real estate investment trusts such as **Boardwalk REIT**.

Although the large Canadian banks are better diversified with a variety of income streams and fairly conservative home loan books, all will be impacted by a sharp correction in the housing market. Banks without a meaningful international profit centre and with large portions of their loan books extended into the domestic housing market such as **Canadian Imperial Bank of Commerce** or **National Bank of Canada** will probably be impacted most by such a correction.

Higher cocoa prices

Increased demand from Asian consumers and a healthy Western appetite for darker chocolate could result in a supply shortage of cocoa in 2015. In addition output may be constrained as the spread of the Ebola virus may impact major producers in the Ivory Coast and Ghana, which together supplies around 60% of the world's cocoa.

The cocoa price has averaged around \$3,000 per ton over the past 12 months and the IMF expects an average price of \$3,200 per ton in 2015. However, supply disruptions and possible tighter control of supply after the acquisition of the cocoa processing business of **Archer Daniels Midlands** by **Olam** may put upward pressure on prices.

The price of cocoa is unlikely to have a major impact on most investment portfolios but it may unfortunately make chocolates a little more expensive for those with a sweet appetite.

CATEGORY

1. Bank Stocks
2. Energy Stocks

TICKERS GLOBAL

1. NYSE:SU (Suncor Energy Inc.)
2. NYSEMKT:IMO (Imperial Oil Limited)
3. TSX:IMO (Imperial Oil Limited)
4. TSX:SU (Suncor Energy Inc.)
5. TSX:TRP (TC Energy Corporation)

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Author

deonvernooy

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