The Market in Review

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This week's articles and insights

1. *Summing Up the World*
2. *Growth in Canada*
3. *Investments This Quarter*
4. *Renewal*

"I am proud to be paying taxes. The only thing is, I could be just as proud for half of the money."

-Arthur Godfrey

April marks the 100th anniversary of Canada's income tax, introduced during the First World War.

In the words of the government of the day, "If young men are to be conscripted, wealth should be too."

It was intended to be a temporary wartime measure.

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	20,453	-0.98%	+ 3.49%
S&P 500	2,329	-1.13%	+ 4.03% (+3.14% in $CDN)
TSX	15,535	-0.84%	+ 1.62%

Summing Up the World

We are at an interesting point in the world of financial affairs. We are reminded daily of how precarious things are, and yet somehow, the world hasn't ended. In many cases, conditions have actually gotten better.

Let's review:

Political uncertainty remains high. Europe has a number of elections in 2017 and the fear is that a Brexit-style rebellion will occur somewhere else on the continent. The Netherlands dodged the bullet in March when the existing leaders returned to power and the far-right challengers were sent packing. France is next. The centre-right party appears to be holding the far-right Marine Le Pen at bay.

In America, the current Republican president is following in the footsteps of every past Republican president since 1980 by bombing a country (Grenada under Reagan, Iraq under Bush Senior, then Afghanistan and Iraq under Bush Junior). The recent US missile attack in Syria has upset the delicate balance of power between Russia and US forged since the November election. Trump, to no one's surprise, is proving to be as unpredictable as a ruler as he was as a candidate. In this case, it may actually be an advantage because no one knows what to expect. It is hard to see this bringing the war to an early conclusion, however.

The biggest flash point right now is North Korea. Recent evidence points to Kim Jung-Un being closer to possessing a hydrogen bomb than first thought. And because he knows what happens to rogue states without nuclear weapons (Iraq, Libya), an escalation could get out of control quickly if he is pushed. We have to remember, though, that North Korea's bluff and bluster have led to nothing for over 70 years.

We'll count Political Uncertainty as a negative right now.

On the ***Economic Conditions*** front, growth is strengthening in Europe, the US, and Canada. The risk, therefore, of all of us tipping over into recession is remote. Very few signs are present that would indicate a global slowdown. Some indicators point to a pause of sorts in the United States, which would not be a surprise after the torrid pace of the last six months. This could slow the rate of interest rate increases, which is positive for stocks.

We'll count Economic Conditions as positive.

Finally, ***Valuations***. US stocks are among the most expensive in the world, but have the growth to back up most of their elevated ratios. The banks will benefit from the surge in new companies listing their shares, as well as the jump in mergers and takeovers. Employment numbers have been strong, particularly up here in Canada. While stocks in North America are likely fairly valued, those in Europe and the Emerging Markets are well below those over here. We are starting to see money flows shift from here to there as investors move to greener pastures.

There are early signs of speculation, such as the nosebleed valuation of Tesla (**NASDAQ TSLA**), which is now worth more than both Ford (**NYSE F**) and GM (**NYSE GM**), even though Tesla produces barely 100,000 cars per year compared to Ford's 7 million vehicles. Chalk this up as something to watch. It is not so much that stocks are at the high end of their valuation range, but that stocks fall harder if they are expensive when a recession hits.

Valuations, then, are fair-to-high in North America, and fair-to-low in Europe and the Emerging Markets.

Overall?

The period from November through April is generally friendly to stocks. We have enjoyed a sharp rally in the last six months, which validates this seasonal lift. The period from May through October is typically less friendly to stocks, and we are approaching that period now. We are due for a mild decline in stock prices. Canadian and US stock indexes have been churning in place for the past two months, with prices today at the same levels as mid-February.

Since we remain far from recessionary conditions, however, stocks should still have further to run. We expect earnings in Q2 (just ahead) to be strong.

We expect to be buyers if such a decline ever arrives.

Growth in Canada

Canada has enjoyed several quarters of economic growth that has been above expectations. In March, even Nova Scotia added 4,600 jobs. Compared to the dismal state of affairs in March of 2016, when oil was just recovering from its US $27 low, things are looking up.

So why hasn't Canada begun raising interest rates? Our benchmark interest rate has been stuck at 0.5% since 2010 even as the US has raised their rate three times.

"It's largely demographics," says Brian DePratto of the TD Bank (source: Advisor.ca). The Bank of Canada has noticed we are getting older as a population, which will mean fewer and fewer young workers, lower employment and hours worked, and slipping productivity. While the Bank of Canada expects a strong 2.6% growth rate this year, it sees 1.9% in 2018 and 1.8% in 2019.

We suspect a lower Canadian dollar is the unspoken goal of Canadian monetary policy. We are an exporting nation and a weak loonie helps our prices. The Bank hinted at its first rate increase by 2018, which says they are in no hurry.

Investments This Quarter

While we have generally invested RRSP and TFSA contributions, at the portfolio level we are largely waiting for lower prices to get more excited about new equity positions. Our portfolios, and those of many of our outside managers, may hold higher amounts of cash to reflect this.

At the individual stock level, we have been busy scouring the new ideas. In particular:

Oil

- The energy sector was probably the weakest sector in the first quarter of 2017. The "global glut" of oil is gradually being worked off, though, so we are actively looking for producers or pipelines that fit our dividend + value preference. Stay tuned. We are getting closer. Some utilities also fit this list.

Drugs

- As mentioned above, even Canada's Central Bank has noticed we are all getting older. The traditional "big pharma" stocks are not the only ones bringing new cures and treatments to market. Some of the younger biotech companies are now as big as their older peers. We are doing a deeper dive into one biotech company that has fallen on hard times, but presents good value. It even pays a 3% dividend.

Emerging Markets

- Imagine investing in something that has lost you money over the past ten years. That's the emerging markets, as a whole. The price of the leading exchange-traded unit for emerging markets sits at the same price it did in July 2007.
- What's different? Many of the leaders then, like Brazil and Russia, are now very cheap due to the collapse in commodity prices and poor governance. Others, like South Korea, have seen political leaders go to jail, not to mention North Korea at its border. There are also new growers that are ascending the ranks of world growth, such as India and Indonesia. India will be the world's most populous country within a decade, and Indonesia is projected to become the 4th largest economy by 2050, just behind the USA (source: PWC Global).
- In particular, Lincoln is evaluating an investment fund in India.

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Renewal

This Sunday marks Easter, the most joyful day of the Christian calendar. We approach Easter after the long forty days of Lent with its prayer and fasting. We then warm up with Maundy Thursday – the commemoration of the Last Supper. Good Friday commemorates the event of Christ's crucifixion, and finally Easter Sunday celebrates the resurrection and the forgiveness of His transgressors.

Like Christmas, Easter has pagan roots. Christianity, like all faiths, was built upon the foundation of beliefs that came before it. The name itself came from a number of possible sources. The Sumerian goddess Ishtar was similarly hung upon a stake and resurrected. The pagans of northern Europe had a spring festival called Eostre whose symbol was a rabbit. The word 'Easter' could have derived from either Ishtar or Eostre.

Other Easter traditions predate Christianity. The exchange of eggs, for example, was an ancient custom taken up by early Orthodox Christians as a symbol of the resurrection. Jewish bakers were making sweet buns since Old Testament days. A 'hot cross' was added when Christian church clergy were unable to put a stop to the practice. They relented by blessing it instead.

Easter is normally celebrated about two weeks apart by the Orthodox Church and western Christianity. The former refused to adopt the Gregorian calendar in the 1500s, which dropped about fourteen days from the Julian calendar to correct for the changing length of a year. All countries of the world use the Gregorian calendar now, but the Orthodox church has stuck with the historic Julian version. As it happens, both faiths will celebrate Easter together this year on April 16th. This will not happen again until 2034.

The concept of rebirth is common in the human narrative, both in our faiths and in the business world. Most companies meticulously write out business plans only to see them barely survive their first year.

> *"No battle plan survives contact with the enemy."*

- Helmuth von Moltke, German military strategist

Even successful companies have to reinvent themselves to survive. Studebaker began as a horse buggy company in 1852, for example. Seeing the changes coming to its industry, the company introduced a gasoline-powered automobile in 1902 and remained in production until its demise in 1966. American Express began its corporate life as a pony express company delivering mail in the American west. When it started offering money orders to its customers, it quickly realized they were more profitable than mail and ditched the horses.

Today, we are witnessing the resurrection of Blackberry (**NASDAQ BBRY**), the Canadian company that invented the smartphone, as it re-emerges as a security software company. The changes have been wrenching to both employees and shareholders, but the company just might pull it off.

In the spirit of renewal, rebirth, and resurrection, we wish you all a happy Easter.

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