The Market in Review

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This week's articles and insights

1. *The Never-Ending Rally*
2. *"To Know What You Don't Know"*
3. *Preparing for Retirement*

"One of the greatest pieces of economic wisdom is to know what you do not know."

- ***John Kenneth Galbraith***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	21,006	+0.88%	+ 6.29%
S&P 500	2,383	+0.67%	+ 6.44% (+5.86% in $CDN)
TSX	15,609	+0.48%	+ 2.10%

The Never-Ending Rally

The last two weeks have been rather remarkable. Not remarkable because of what changed but remarkable because of how stocks have continued to climb. The Trump administration's promises of tax cuts and huge infrastructure spending continue to entice investors to pile in, with the Dow Jones Industrial Average, the S&P 500, and the NASDAQ indexes all pushing to new highs this week. The new America-first, business-friendly policies have pushed the US dollar higher and drawn in money from everywhere.

The US is the new "it girl" of world markets. Everybody wants a dance.

While all eyes have been focused on Washington since the election, there has been good news in the rest of the world. Unemployment in Europe in January was 9.6%, the lowest in almost 8 years. Jobs even increased in beleaguered Spain. Most global markets rose over the past two weeks, as a result.

Canada's S&P/TSX has faltered, having set its highs two weeks ago. Our problem resides in our currency. The Bank of Canada's "steady-as-she-goes" interest rate policy has diverged from the US Federal Reserve's "four hikes this year" stated goal. There is also the threat of a border tax which would tax Canadian exports to the US. Such a tariff would not be good news for us at all. We expect the weakness in the Canadian dollar to persist.

As we have complained about for months, valuations in global markets have become quite stretched. Insider selling on the NYSE has reach an extreme level of 11:1 (eleven sellers for every one buyer), so company owners and insiders think it is wise to take some money off the table now (source: Vickers). Investor bullishness is, by one measure, at the highest level since 1987. Many value managers are complaining about not being able to find many stocks that are truly undervalued.

But, this is not a castle entirely built of sand. Improving global economic conditions support rising prices, and economic conditions are on the upswing in most countries. As a result, the chance of a recession this year is extremely low.

There have been many warnings that this is a bubble that is about to burst. Such warnings are likely premature, for it is very hard to accurately call the end of any trend.

For example, Robert Shiller, the noted bearish economist, first declared U.S. stocks to be in a bubble in December 1996. Prices went on to double by 1999 and when they bottomed in 2003, they never again hit the levels of 1996. And strong stock momentum often precedes an improving economy, just as we are seeing now. When January and February are both positive for US markets, the rest of the year is almost always positive. Since 1950, January and February have been positive 26 times. In 25 of those years, the year went on to be positive. Only 2011 broke the trend with a 0% return (source: LPL Research). Mid-year declines in these years tended to happen in the June through October period. Only 1987 and 2011 saw sizable declines during the year.

The market today does need to take a breath, though, at some point. With a US rate hike scheduled for March, we could see stocks retreat this month.

“To know what you do not know.”

This sounds like circular advice from a motivational poster, like this one from the movie “Mystery Men”:

He who questions training only trains himself at asking questions.

“To know what you do not know” was a phrase used by Robert McNamara, President of the Ford Motor Company (**NYSE F**) and then Secretary of Defense under Presidents Kennedy and Johnson. He explained to business students later in life that university case studies did not always prepare people for real life. They showed the problem in advance so students could deduce ways to solve it, but in real life, the problem is not always apparent. Business leaders do not realize a threat until it is too late (i.e. Blackberry **NASDAQ BBRY** and the Apple iPhone **NASDAQ AAPL**) and generals fight the last war and not the one they are in (i.e. the French Maginot Line).

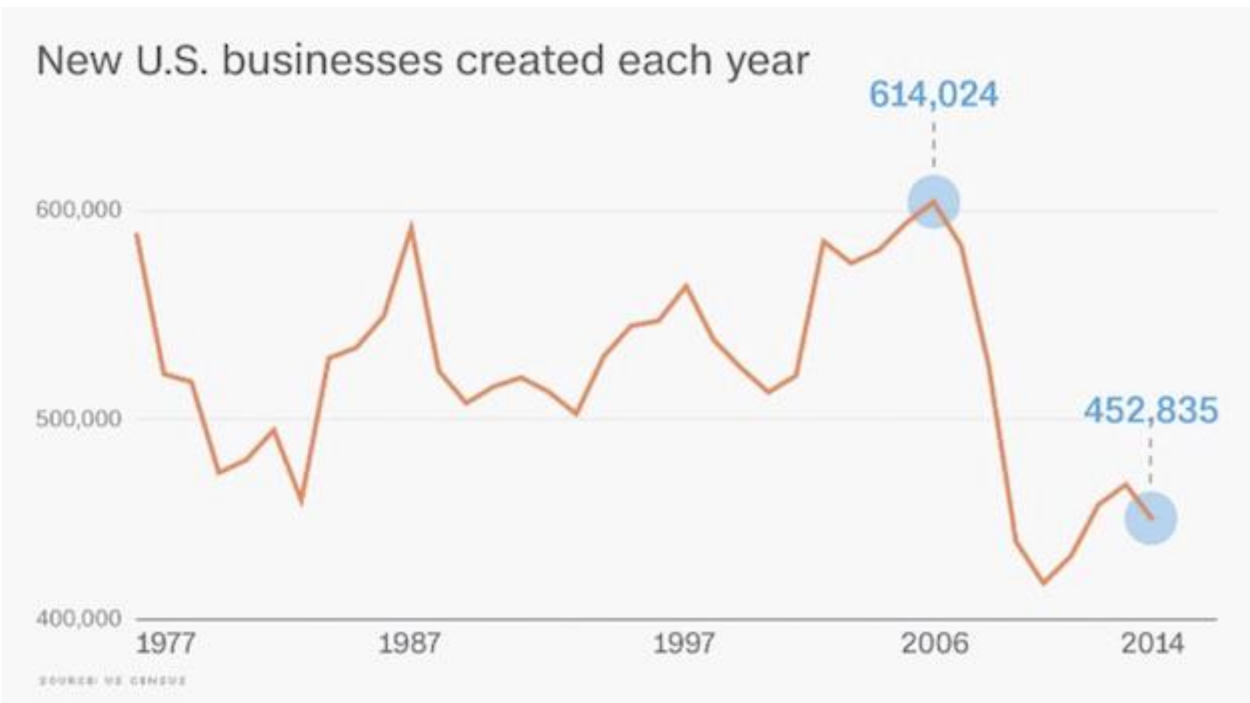
McNamara served during the Cuban Missile Crisis in 1962. The Soviet Union had begun to deploy nuclear missiles in Cuba at Castro’s request. These were a response to US missiles being stationed in Turkey and Cuba’s fears of another US-led invasion attempt. The problem was not as easy to define as it first appeared. President Kennedy wanted to avoid a war but the US generals wanted to start one. And no one really knew what the Russians wanted. McNamara had to play a delicate game of chess with both sides, and in the end, made the assumption that all the main players were rational people. He was able to work out a negotiated stand-down from nuclear war.

The phrase “to know what you don’t know” also applies to the stock market. The market “knows” what everyone already knows and prices itself accordingly. For example, if McDonald’s (**NYSE MCD**) sells more burgers, the stock price will rise in advance because the bun makers, butchers, and ketchup suppliers have seen it coming. Successful investors scour the world for things they do not know and try to find new insights to what is going on.

For example, the world knows the global population is aging and technology is accelerating. But what unknowns will these two tsunamis deliver that are not already apparent? Let’s talk about global aging first.

But not the aging of people – the aging of companies.

While investors love the safety and security of large stocks, as companies they are actually job destroyers. Large companies buy smaller companies to get their sales and inventions, then lay off most of the staff. Large companies reinvest profits into automation and find ways of doing more with less. As our society has slowed with age, so too has our desire to take risk by starting businesses.



Source: US Census

Since the beginning of the Great Recession, new business creation in the US has dropped by one-third, and in Canada it may be even worse. Small businesses are the real job creators, and we simply aren’t forming enough of them. This is why unemployment remains persistently high with many (mostly men) simply dropping out of the workforce altogether. Whatever policies our governments institute to “stimulate the economy” must result in more small businesses.

The “what don’t I know?” question applies even more to the rapid pace of new technologies. We discussed driverless cars a few letters ago and the changes here could be staggering. According to John Mauldin, here are some potential impacts to society just from this new technology alone:

- There are 250 million cars and trucks on US roads today. He believes up to half will no longer be needed by 2030 due to ride-sharing.
- 250,000 taxi drivers and 3.5 million truckers could be replaced over the next twenty years.
- Estimates predict that automated driving could reduce auto fatalities by 90%. This would affect the number of police, fire, and ambulance attendants needed if there are 90% fewer accidents. And what about the 500,000 auto repair shops?

Automotive company stocks are very cheap today - enough to make a value buyer salivate. The potential shrinkage in the entire industry certainly makes one pause, though. Maybe they are cheap because sales are going to be much lower in future years.

Another thing I notice about technology is that Millennials – those under 30 - hate answering their cell phones. Those of us whom they see as “old” grew up on the phone so we were conditioned to the ring. Not so the younger generation. Their phones buzz and chirp when a message arrives. Talking is slow and boring when you can thumb-tap a reply in a tenth of the time.

Taking this further, there are other behaviours we grew up with that are rapidly diminishing in the next generation. Congregating at the mall, for example, used to be a social thing. Department stores came to depend on crowds and mall owners built food courts to keep people around even longer. Today, those same thumb-taps that have replaced the telephone are now replacing the mall visit. Why drive to Sears (**TSX SCC**) when you can order whatever you want for less through Amazon (**NASDAQ AMZN**)? And have it delivered the next day?

In 1981, a trend forecaster named Faith Popcorn coined the term “cocooning” to describe our increasing tendency to stay home. It took longer than she expected and arrived a generation later, but here it is. Kids these days order pizza on their phones from the couch while they play games, then pre-pay digitally without even having to tip the delivery person. They buy and sell used clothes on sites I have never heard of and ride-share through Uber instead of taking a taxi or buying a car. Their movies are on Netflix, not Cineplex.

As a result, malls are struggling to stay relevant and while many are, some are half-empty. As a result, we prefer our real estate investments to focus on apartments and senior's homes rather than malls.

Change is happening fast. Staying ahead of it means a great deal of reading and thinking, and an open mind to "know what you don't know."

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Preparing for Retirement

From 2011 through 2030, approximately 10,000 Americans turn 65 every day (source: Infowars). In Canada, we have about 1,000 turning 65 daily. This means many of us have, or soon will be, retired.

In fact, it is the single biggest question I get at the ripe old age of 58. Fortunately, this industry allows a person to work as long as they want. We even have an 80 year-old advisor in our branch, so I have many years left to go, by his measure.

The transition to retirement is not always an easy one. We have watched many do it easily, but also many struggle. Especially those with successful careers. Men, especially, have a great deal of their self-worth invested in their work. Their status, social life, and daily routine are all bound together. Leaving this all at once can leave a very big hole.

A recent article by Amy Florian entitled "How to help your clients with the transition to retirement" offered some good insights. Here are a few of them.

1. Encourage people in their 40s and 50s to begin a wish list of things they want to accomplish, places they want to visit, and things they want to learn. Help them start on a few now, and keep adding to the list over time. This keeps people dreaming continuously, rather than waiting until retirement to achieve all their dreams.

2. Involve both members of a couple in discussions about retirement. Watch for differing expectations (i.e. he expects to retire to the cottage on the lake, while she expects they will finally sell the cottage and move to Arizona.) Work to help them get in sync.

3. Golf, sailing, or any other enjoyable activities can get old fast if they are the only focus of life. Prompt people to expand their thinking. If they want to volunteer, encourage spending an hour or two per week volunteering now until they find a good fit; this way they already have relationships and feel comfortable in that setting. Likewise, they can research community colleges and available options for classes they'd like to take when they retire. The transition is easier when clients retire "to" something interesting.

4. Retirement is a process, not an event. Recommend, for example, that they plan lunch or coffee a couple times a week for several months to personally thank colleagues. They may also take pictures of the office a month before retirement, then gradually take things down. As they do so, acknowledge the mixed emotions by asking what they look forward to, and what they will miss most.

5. As the day nears, suggest they plan at least one activity a month that they look forward to— like visiting adult children, a sports game, or a museum they haven't had time to explore.

The full article can be read at:

http://www.wealthmanagement.com/retirement-planning/twelve-steps-ease-clients-happier-retirement?NL=WM-05&Issue=WM-05_20170302_WM-05_851&sfvc4enews=42&cl=article_3&utm_rid=CPG09000005641371&utm_campaign=8644&utm_medium=email&elq2=15deda74f77143b7b55a5470f6dab8d7

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