The Market in Review

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This week's articles and insights

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"A child cannot be president. I love my children; they cannot have the nuclear codes."

- ***Ross Douthat, New York Times***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	20,804	-0.44%	+ 5.27%
S&P 500	2,382	-0.38%	+ 6.38% (+6.96% in $CDN)
TSX	15,458	-0.51%	+ 1.12%

Trump's Troubles

Some of you may remember the Trump Shuttle, the current US president's airline that started in 1989 only to be shuttered by 1992. The airline got off to a very rocky start just three months after its inauguration when the nose gear crumpled on one of the jets, forcing a crash landing.

Trump the President did a similar nose-dive this week as the mercurial president became caught in a widening scandal between the Russians, the FBI, and himself. It seems he never misses an opportunity to point the gun at his own foot.

We bring this up simply because the markets are no longer brushing off the antics happening in Washington. Much hope has been built on the prospects for tax and health care reform, as well as the repeal of many regulations hampering business. All of these initiatives are now in doubt. Impeachment talk is now swirling, something that is still a longshot, but less of a longshot than just a week ago.

Markets hate uncertainty. There is suddenly too much, all at once.

But, here's how markets work:

- In the short-term, they are influenced by events, such as politics and wars.
- In the long term, they are influenced by earnings.

Earnings today are excellent. US earnings were +8.9% higher in the 1st quarter over last year, and 74% of companies beat their earnings estimates, compared to the five-year average of 68%. Dividend payments by US corporations are at all-time highs. A weaker US dollar and inexpensive oil are like stimulus programs to the world's emerging markets. Japan just recorded its longest string of economic growth in years and there are almost no signs of recession on the horizon..

Outside of Washington, the economy is fine. Better than fine, actually.

It will take a few days, or weeks, for the markets to digest all the turmoil and get a sense of what happens next. If impeachment becomes a real possibility, we could see markets flounder through the summer, but it does give us a chance to buy at better prices.

Fixing Debt With More Debt

Wouldn't it be nice to borrow as much as you want and never repay it? A credit card with no limit?

It seems like that is what governments have taught the world since the year 2000. Lower the interest rates and borrow more. Consume! Spend! Grow the economy!

There was a time in the 1990s when elections were won and lost simply on the deficit theme. Canada's Reform Party pounded the drum on Canada's growing debt, which then forced the governing Liberals to slash spending to get the balance sheet back onside. Ross Perot, with his clever infomercials about the growing US deficit, drew enough votes away from the Republican George Bush Sr. in 1992 to allow Bill Clinton to take the White House.

Today? Ontario now has more debt than Canada had in 1990. At over $300 billion, the province has twice the debt of California, a state with three times as many people and a state often singled out for its high debt. Granted, it is debt financed at much lower rates, so is more easily carried. But still…more than Canada had just as we approached our own debt crisis in 1995.

We are solving a debt problem by adding more debt, something that seems absurd on the surface. It works only if the debt never has to be repaid.

In its simplest form, a debt is simply borrowing money to consume today something you would normally consume tomorrow, when you had the money. By bringing demand into today, we remove it from the future. Think of borrowing to buy a car today instead of saving to buy one in two years.

The issue of global debt repayment is a simple question with a complicated answer.

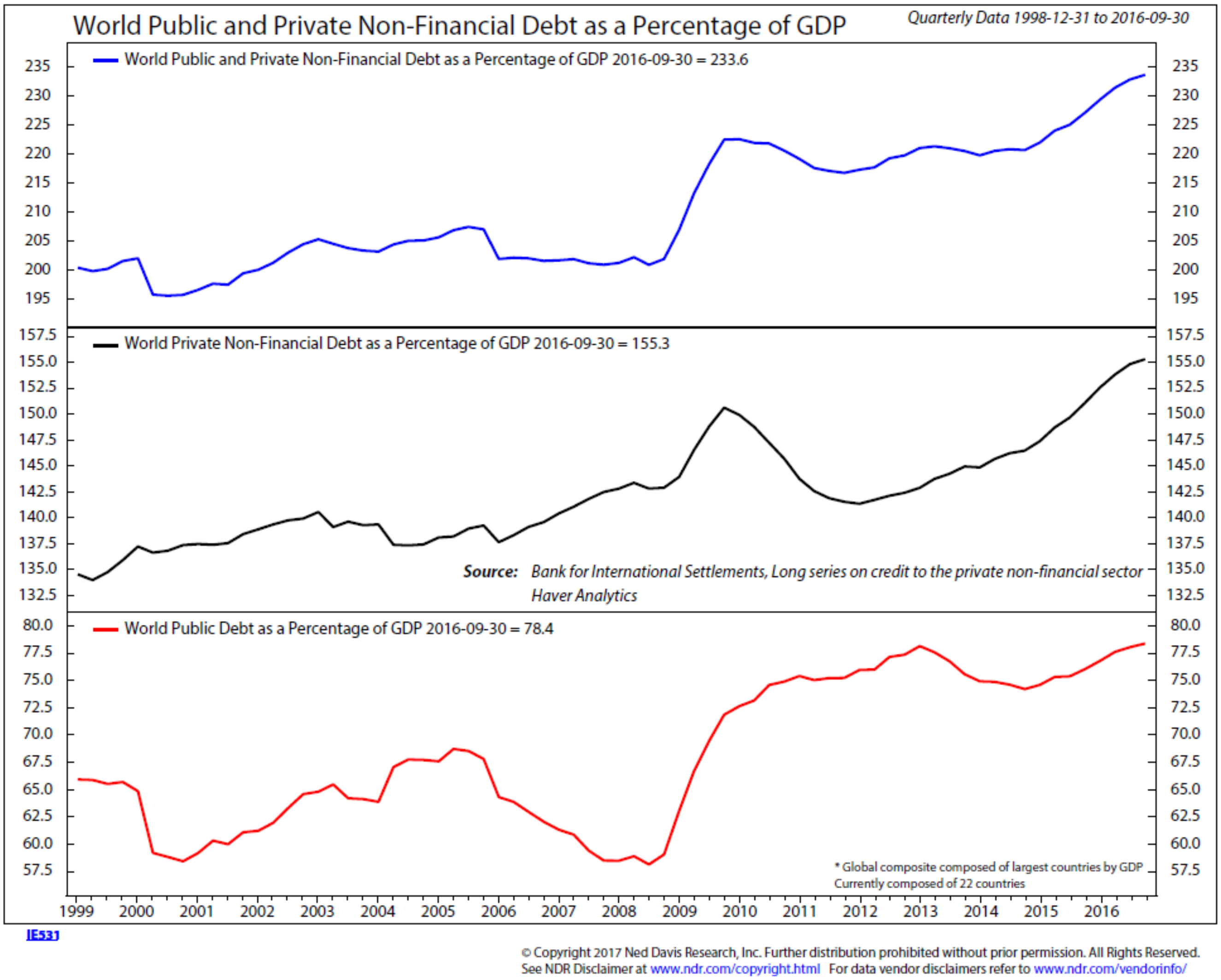
A debt is settled in one of three ways:

1. It is repaid in full.
2. It is defaulted on and the lender loses some or all of the investment.
3. It is repaid with a devalued currency, either through inflation or a devaluation of the currency.

Most of us like to think the worst of the debt crisis is behind us. The Financial Meltdown years of 2008-2009 were marked by poor credits, sub-prime loans, and mortgage defaults. Thankfully, this period is well in the rear-view mirror. Bank balance sheets and real estate prices in the USA have recovered nicely.

But at what cost?

A recent chart from Ned Davis Research shows total world debt (government and private) climbing to new highs. What? Weren't we out of the woods?



There was a pause in the level of global debt from 2010 to 2015. This was a period when hundreds of thousands of homeowners in the US defaulted, Cyprus banks were wiped out, and Greece negotiated a debt restructuring that removed US $130 billion from its balance sheet (most private investors were forced to accept $0.50 on the dollar).

Suddenly, though, we are back on the treadmill. The average Canadian now "owes" $94,000 per person in accumulated government, provincial, and personal debt (source: Government of Canada), a number that is climbing at a faster clip now that Alberta is adding close to $11 billion per year in new debt.

Should we worry? Interest rates are so low, we can carry ten times the amount of debt with interest rates at 1% as we used to when they were 10%.

But as Herbert Stein, the economist, once said "*If something cannot go on forever, it will stop*." At some point, the world will either start paying back all those bonds it has issued, or it will be forced to restructure them.

For now, governments have begun tapering back their extreme debt increases. Quantitative easing is finished in the US and slowing down in Europe. Of course, we are all still deficit spending every year, so debt continues to pile up. Just at a slower pace.

Reading various journals and speaking with a strategist from a leading fund company, it appears likely that rates will stay low for years. There is too much debt out there to raise rates very far without sinking us all, but growth will be low, as well.

Ultimately, just about every currency in world history has been devalued and restructured at some point. Ten or twenty years in the future, don't be surprised if this happens again to all currencies at once.

The ramifications of this are likely that bonds carry less risk for the next few years than we fear. If rates stay low and government tax revenues pick up due to a stronger economy, bonds should be fine. They would suffer most in an eventual devaluation, though that is likely many years away.

Stocks would do best in such a low interest rate, low-growth environment.

Gold is also likely to do well, but not until we enter another round of quantitative easing, zero percent interest rates, and a possible global currency realignment. Again, years away, but almost inevitable.

Merck's Keytruda

In 2006, three scientists began work on cancer drugs that worked differently than existing ones. Rather than attack the cancer directly, which was often almost as harmful to the patient as the cancer itself, they sought to harness the body's own immune system. Cancer cells have ways of hiding from our immune systems, which are normally very good at detecting and destroying errant cells. If the cancer cells could be unmasked, then the body's own defenses could destroy them far more efficiently than traditional chemotherapies and radiation treatments.

Today, these drugs are a reality. Other versions were unveiled by Bristol Myers (**NYSE BMY**) but the one that has emerged as the most effective is called Keytruda and it is made by Merck (**NYSE MRK**). Sales are running at almost $2 billion per year and are rising at an 80% clip. It is a new "blockbuster" drug for them, one which could become one of their biggest ever.

Pharmaceutical stocks have been tough to own since their heydays in the 1990s. Driven by breakthroughs such as Viagra in a time when medical costs were much less of an issue, the 1990s were the best days for the drug stocks. Many of these have declined in the last few years, with Merck one of the few near its all-time highs.

The drug is now being used for melanoma, lung, bladder, and head and neck cancer treatments. Interestingly, Merck is finding the drug works even better when paired with existing treatments, which could extend its reach even further.

Merck is held in our Dividend Value portfolios.

We want to say thanks to our clients for introducing their friends and family members to us throughout the year. It's a tremendous compliment and a huge responsibility, and something we never take lightly.

Don't Panic!

A recent study by the investor firm Dalbar looked at why the average investor underperforms. Not just underperforms the index, but often worse than the mutual fund the investor holds.

How can this be?

On average, over the last 20 years, investors underperformed the S&P 500 index by an average of 3.52% per year. This was composed of the following:

0.54% Lack of availability of cash to invest – return that is lost by delaying the investment
0.68% Need for cash (planned and unplanned) – return that is lost because of withdrawals before the end of the period being measured
0.79% Fund expenses
1.50% Voluntary investor behavior underperformance – panic selling, exuberant buying and attempts at market timing

The average investor received 5.48% per year versus the index return of 9.0% per year. The largest contributor (40%) was human emotion. In fact, this component was double the amount lost to fees, which is the current target of regulators and the press.

It has been increasingly shown that investors who use advisors are less prone to panic. It may simply be a second opinion, or just someone to "talk them down" when panic strikes.

And it will strike, for all of us. When it does, take a deep breath. It will save you money!

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Prices shown are as of close May 19th, 2017.