The Market in Review

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This week's articles and insights

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"The electric light did not come from the continuous improvement of candles."

- ***Oren Harari***

Jumping the Curve: Innovation and Strategic Choice in an Age of Transition

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	21,988	+0.80%	+11.26%

S&P 500	2,477	+1.37%	+10.62% (+1.94% in $CDN) The Canadian dollar has risen 8.5% this year alone!
TSX	15,191	+0.90%	- 0.63%

Harvey's Horror

The largest market-moving event of the past two weeks is Hurricane Harvey's decimation of Houston. While it was expected to be the worst storm of the year, it has now grown far beyond that because of the flooding. Rainfall that should have been spread over a multi-state path has instead stayed right over the city, filling the ancient flood plain Houston sits on.

In a normal year, the community gets about 40 inches of rain. Houston has had over 50 inches in just a few days. This is close to four times the amount that Hurricane Katrina dumped on New Orleans in 2005 and has now pushed Harvey to the worst storm in US history.

50 inches does not really tell the story of how big the volume is, for all of Houston and its surrounding counties are underwater. The New York Times explains it as follows:

Harvey might deliver 20 trillion gallons of rain by the time the storm is through. That may be even harder to comprehend, but it's as much as:

• *About 10 percent of Lake Erie.*

• *The biggest waterfall at Niagara Falls, Horseshoe Falls, pouring across Texas for about nine months.*

Houston and its surrounding areas are home to 6.8 million people and a huge economy. Many of the nation's largest oil refineries are in Houston and have been shut down due to the flooding. This has pushed their output product - gasoline – up in price while driving their input product – crude oil – down. Even Canada is feeling the pinch because so much of our oil is transported to Houston to be refined and shipped.

It is estimated that only 15% of Houston homeowners have flood insurance. This is, in large part, because flood insurance is typically excluded from home policies. As a result, insurance companies looked like they were going to get through Harvey without catastrophic losses, but as the damage worsened, their shares slumped. Most business policies, though, contain some flood coverage and the damage to offices is extensive. The cost to the insurance industry is now seen as at least $10-20 billion, with the government having to make up the rest.

Just three days ago, it was thought the overall damage would not exceed $30 billion. Today, AccuWeather predicts the costs will hit $160 billion. Rebuilding will take years.

Hurricane Irma, the next in this year’s storm season - “the most dangerous and costliest in 12 years for the United States” (David Dilley of proGlobal Weather Oscillations) - could hit the Caribbean in the next week and the US shortly after. Dilley predicts four major hurricanes this year.

Resilience

The stories coming out of the flooded areas speak to the great resilience and compassion of the people of Houston. Two teenage boys rescued fifty people with their boat. Furniture stores turned their bed departments into shelters. Texans have shown incredible heart, courage, and compassion towards one another.

It reminds us of the fires just a year ago in Ft. McMurray which destroyed over 2,400 homes and laid waste to much of the town. A year later, over 600 new homes are under construction or permitted to start. Humans have a way of bouncing back when faced with adversity.

And speaking of resilience, markets have withstood this disaster, as well as yet-another missile launch by North Korea. How can this be?

First, the economy has been strong. Hiring picked up in August with more new jobs and the US economy expanded at the fastest pace since early 2015. Canada was expected to grow at 3.7% in the second quarter. Instead, we blew past that number with an annualized gain of 4.5%.

We spent more on household goods, but the biggest change was in energy exports, which increased 9.2%. So much for new US supplies squeezing us out.

Second, some analysts see North Korea's missile launches as a sign it is preparing to negotiate. Reduced coal and oil shipments, as well as monetary sanctions, are biting deeply. Japan's stock market barely budged when the missile flew over, suggesting markets are looking past the Korean crisis.

And third, markets are also looking past Hurricane Harvey to the massive rebuilding that will be needed. President Trump does best when he has focus, and Texas gives him that. It also stalls an autumn rate hike and gives the Republicans cover to pass a new debt ceiling. After a brutal 2016 when Alberta's economy suffered from low oil prices and the fires, it has become one of the nation's leaders as it rebounded and rebuilt. Watch Texas for a similar bounce starting in 2018.

The world is not all roses, by any stretch, but there are fewer weeds than the news leads us to believe.

Markets survived August - the second-worst month of the year. Let's hope we can also escape the worst month, September, relatively unscathed.

Phone Overtones

A recent article by Vitaliy Katsenelson of Investment Management Associates raised questions about why malls are dying across America. The USA certainly has too many of them, for starters. America is the most "stored" nation in the world. Amazon (**NASDAQ AMZN**) is often pointed at as the culprit, with its billions in on-line sales stealing business from the malls.

But what if that is only part of the equation? In 2006, a minority of North Americans owned a mobile phone. Nokia was the market leader and it sold roughly $4 billion worth of the things in the US, with the total market being around $10 billion.

Today, 2/3 of the US population has a smartphone, including most kids over ten. He estimates we have spent close to $340 billion on devices and services since 2006, which is about $1,000 per person in Canada and the US. They have replaced calculators, cameras, watches, and traditional phones, but have they also replaced many items we would have bought at the mall?

Incomes have been roughly flat for ten years in Canada and America. This means the $1,000 we spent on phones had to come at the expense of something else. Clothing, running shoes, jewelry, and movie sales are all in decline. They say it is because kids today are less materialistic. Perhaps it is also because they only have money for one thing, and that thing is their phones.

On the topic of smartphones, Apple (**NASDAQ AAPL**) is due to unveil its iPhone 8 next month (September 12th). It is a major revamp of the popular phone with a new screen, new chips, and new software. Just about everything, in other words.

While Apple has done well, so have the companies that supply parts and chips to the iPhone. One company we have been evaluating for our portfolios is Intel (**NASDAQ INTC**). Long known for its dominance of the chips for desktop computers and servers, Intel will supply modems (essentially the part that connects your phone to the radio waves) to Apple's newest phone.

As consumers shifted to tablets and smartphones away from desktop computers, Intel has suffered through slowing sales. It is priced like IBM (**NYSE IBM**) – another former star that is now seen as a dinosaur. Intel is valued at its lowest forward P/E in 4 years (a little over 11x forward earnings) and has a 3.1% dividend that has grown every year. They have bought back over $25 billion of their own shares, so they think it is a bargain even if investors don't.

While sales of desktops have slowed, Intel has several other areas of growth that are not being priced accordingly. Intel makes new ultra-dense memory chips. It makes chips for Artificial Intelligence and machine learning. And its computer chips are increasingly being used as cheaper replacements for the routers Cisco (**NASDAQ CSCO**) makes. Finally, they just bought the leader in the autonomous driving sensor business – Mobileye. This is potentially a huge new area of growth for semiconductors.

Is Intel the next IBM, or can it become another Microsoft (**NASDAQ MSFT**), a company that reinvented itself and is a leader, once again?

We think it is somewhere in the middle. As new growth appears, Intel's shares should appreciate.

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.

Mid-Life Slump

A recent Bloomberg article reported that two economists had published a paper showing the existence of the mid-life crisis. They say their research proves that people's happiness slumps around the age of 40. Oswald and Blanchflower, the two economists, put the exact ages at age 37 for men and 41 for women.

This is a pertinent study because an entire nation – Bhutan – measures the happiness of its citizens. Even the UN is studying happiness.

The idea of the mid-life crisis started with a Canadian psychologist named Elliott Jaques.

"He was studying the creative habits of 310 famous artists such as Mozart, Raphael and Gaugin when he noticed a common trait: When the artists entered their mid-thirties, their creative output waned. Some became depressed. A few committed suicide."

His work gave men the excuse to go out and buy a sports car or get a hair transplant. (*FYI guys – you're still old and not fooling anybody*.)

The problem is, psychologists disagree with the economists. They say there is little evidence to support the idea of a mid-life U-shaped slump. They say the decline is gradual as we age. Our happiness simply declines as the burdens of job boredom, debt, and creaking joints set in. Even though a British study showed that people aged 35-55 were the most likely to hate their jobs, hating your job doesn't mean hating your life.

Another survey by the U.S. Centers for Disease Control and Prevention in 2010 showed that people aged 21 ranked their happiness as 3.75 out of 4 while those in their late forties were at 3.5 out of 4. That's still reasonably happy and doesn't agree with the idea of a mid-life slump.

Researchers at the University of Warwick in the United Kingdom studied over 10,000 older adults. They found getting older actually makes people happier. Perhaps it is the lower stress of retirement or the joy of grandchildren, but we do seem to mellow in our golden years.

The Bloomberg article concludes by saying that the economists may have simply proved what millennials are just discovering – becoming an adult is hard. Or, as many of our elderly clients have reminded us "old age ain't for sissies."

We are heartened that studies show happiness improving in old age. At least there's that to look forward to.

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Intel - Raymond James & Associates makes a market in shares of INTC.
Amazon.com - Raymond James & Associates makes a market in shares of AMZN.

Prices shown are as of close September 1st, 2017.
