The Market in Review

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This week's articles and insights

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"Snow and adolescence are the only problems that disappear if you ignore them long enough."

\- *Earl Wilson*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,310	+0.36%	+ 2.39%
S&P 500	2,747	+0.55%	+ 2.76% (+ 3.35% in $CDN)
TSX	15,638	+1.20%	- 3.52%

Say It Ain't Snow!

Forget the market drop two weeks ago, and the calamity of Canada's silver medal in women's hockey – Victoria has snow this week. Although we get some flakes every year, we are not prepared for more than an inch of the stuff. Victoria has an annual budget of just $36,000 for snow removal, which means we either get little snow, or we are just very bad planners. We think we had one city plow driver, though he may have retired – the $36,000 may be his pension.

By February, Victoria's first flowers are already up. The snowdrops, crocuses, and first daffodils have started colouring gardens by now and the first tree blossoms have started to unfurl. It seems odd that we should be subjected to snow in the middle of Victoria's spring. Shouldn't we be done by February?

February is the third coldest month of the year on the west coast, based on average daily temperatures. However, it almost ties with December for having days with the coldest temperatures. This makes some sense, in that the ground has had four months to chill and the arctic air, when it arrives, has had months of Russian freezing and North Pole darkness to become extra frigid. The biggest snow dumps happen in December, when the winter rains collide with the coldest temperatures, but we are never out of the woods here until March.

We average 1.2 days of 6 cm of snow in February (source: Currentresults.com). In other words, this happens every year, yet we are always surprised when it hits.

Climate change advocates say snow will soon be a thing of the past, so tell us to enjoy it while it lasts. There are still a few diehard cooling scientists out here who say the opposite – the Earth has entered a new mini-Ice Age - so more snow could be the norm.

For the sake of Victoria's snow removal budget, we are hoping for global warming. Or at least an early spring.

February's Decline: a Follow-up

In our letter of two weeks ago, we recommended not panicking. Both Canada's S&P/TSX index and the S&P 500 are up +3% since then. So far, so good.

Are we done with this decline? It is hard to say, but on average, after a decline of -11% (the maximum we reached), it can take 6 weeks to 6 months of churning before markets can resume their uptrend. What we like to see is a surge of eager buyers coming back in to the markets, when 9 of 10 stocks rise together over a couple of days. These are signals that the worst is over and the ultimate equation – more buyers than sellers – is working again.

Again, we have not yet seen that, so we are likely to experience more rallies, failures, swoons, and rebounds. Great for traders, but frustrating for investors. The machine algorithms also make these oscillations more pronounced.

Meanwhile, the economy continues to sizzle. Profits are climbing at the majority of US and Canadian corporations, which is the ultimate foundation for higher stock prices.

- The US Leading Economic Index (LEI) rose 1.0% in January, the second most since November 2013. The last six months were the best since April 2011 (source: Ned Davis Research).
- Canada finished off 2017 with a very strong quarter of growth as well.
- Unemployment in Canada is now 5.9% versus 4.1% in the US.

The biggest fears are stemming from interest rates. The US is poised to hike their T-Bill rate again in March. This has the effect of raising rates on everything from T-Bills to 10-year bonds.

The reality is that interest rates have been held too low for too long. They are now gradually normalizing. As long as the economy is growing at the same rate, or faster, than the rate hikes, things should be fine. As mentioned above, world economies are strong, and getting stronger.

The differences between the Canadian and US economies may become more apparent this year. The biggest drivers of Canada’s growth in 2017 were consumer spending and construction. Given that Canadians have nearly the highest debt load in the world, and governments in Ontario and BC are enacting policies to slow the runaway rise in home prices (which will likely slow the runaway rise in new construction), the good times may be near an end.

One of the biggest differences is in business spending – businesses spending to grow or become more productive. In Canada, worries over the cancellation of NAFTA, increasing US protectionism, rising taxes, and a firm dollar have led to a decline in business investment of -2.1% in the final quarter of 2017. This was the ninth quarterly contraction in a row (source: CBC News).

Canadian businesses are hesitant to invest in themselves, in other words.

Contrast that with the optimism in the US, where confidence has been spurred by the new tax cuts and “America First” cheerleading. Business investment in new equipment rose at its fastest pace in three years in the third quarter.

The Canadian dollar has declined $0.03 versus the US dollar since the beginning of February. This is one way Canada becomes more competitive with the US:

Source: StockCharts

Finding Value

We have had a few calls regarding bargains to be had as a result of the decline.

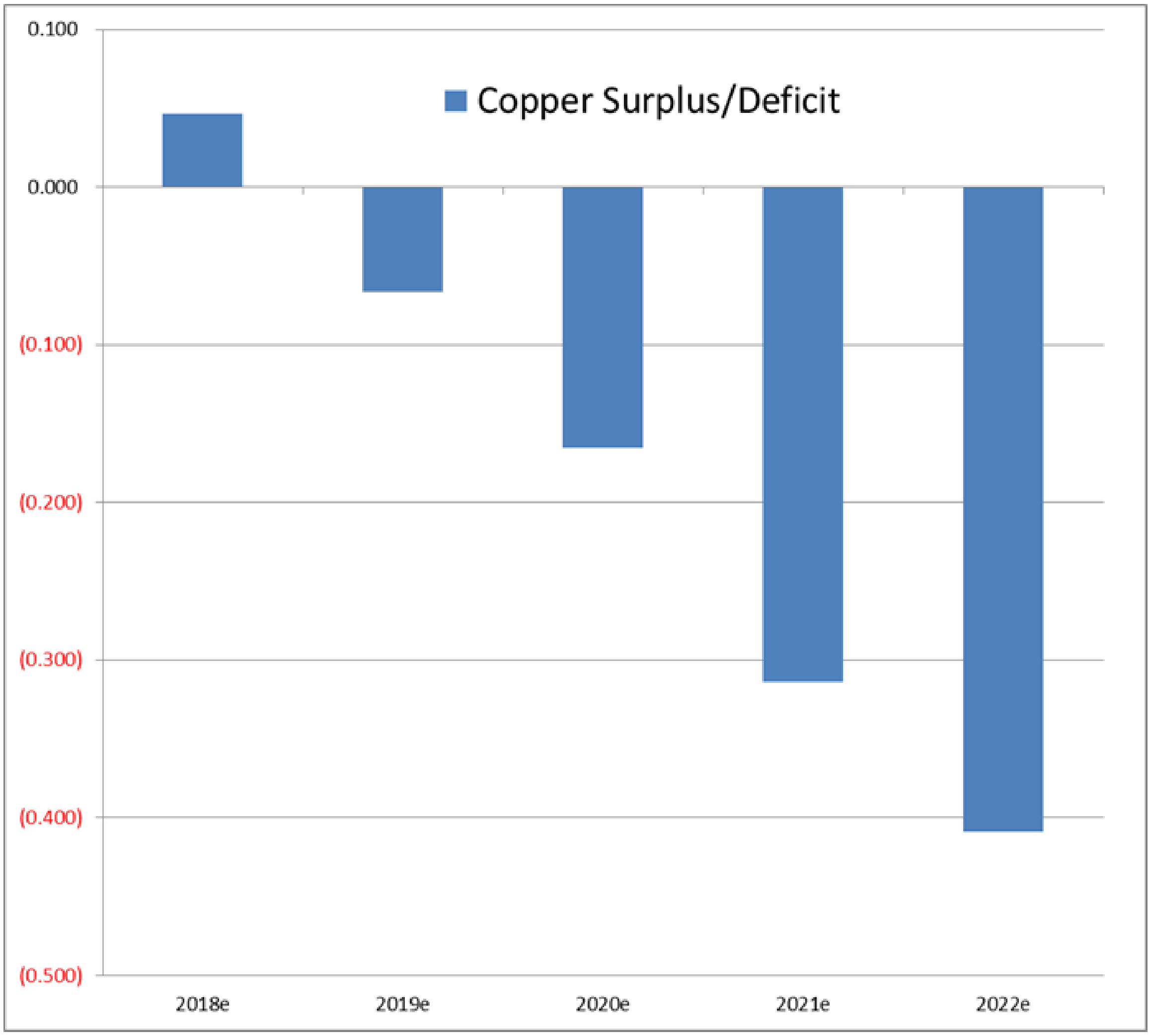
We offer these observations:

- The utility and pipeline stocks in Canada are very attractive at these levels. Once the darlings of the “low interest rates forever” crowd, they have been shunned for months. Fortis (**TSX FTS**), Algonquin (**TSX AQN** – the ‘greenest’ of the utilities), Enbridge (**TSX ENB**) and TransCanada (**TSX TRP**) are all offering dividends in the 4-6% range today.
- The growth stocks of the last decade, the so-called FANG stocks - Facebook (**NASDAQ FB**), Amazon (**NASDAQ AMZN**), Netflix (**NASDAQ NFLX**), Alphabet (**NASDAQ GOOGL**) – have slowed somewhat. A few are making new highs, but some, such as Facebook, are the same price they were six months ago. For now, they remain the leaders of the market. We favour cheaper technology titans, such as Apple (**NASDAQ AAPL**) and Intel (**NASDAQ INTC**), at the moment.
- As an economy matures into its so-called “late cycle”, different stocks rise. Mining, energy, and industrial stocks tend to begin outperforming. We have not yet seen the tide change, but theory suggests it eventually will.

In the mining/agriculture sector, we have been researching Nutrien (**TSX NTR**), the company formed through the merger of Potash and Agrium. It should fall into companies favoured in late-cycle investing, but check with us first. The new company just announced a 2% dividend and share buyback.

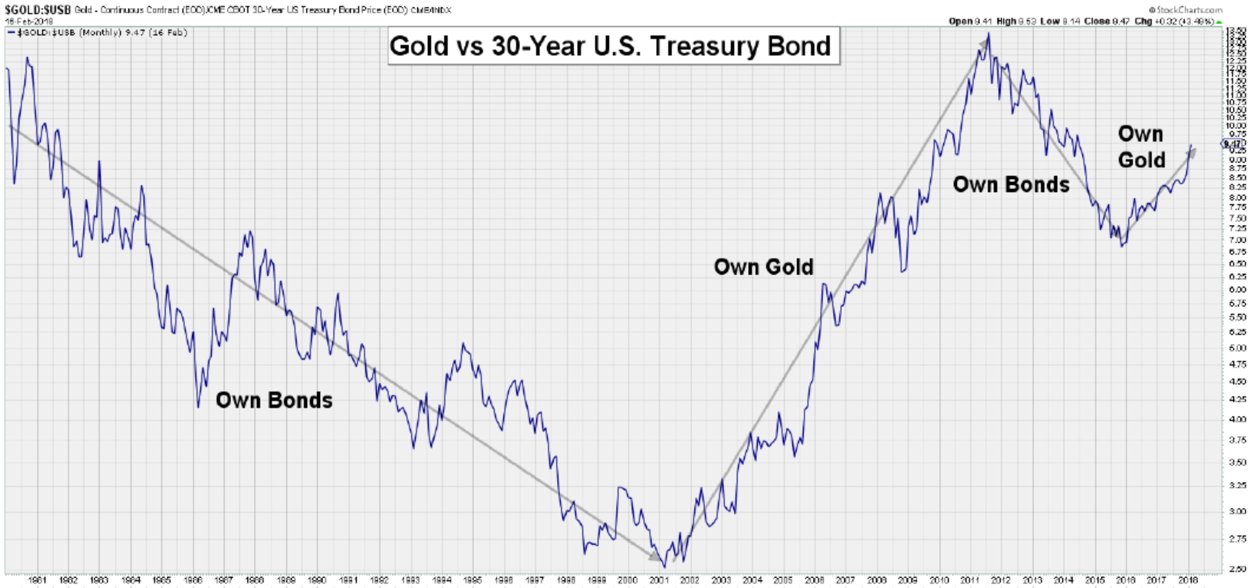
We spotted the two other interesting charts, which are shown below.

The first displays the coming shortage in copper. A new mine typically takes up to a decade to discover, finance, and prepare before first production. We can tell how much copper will be available in the years ahead by looking at new mines under construction. Since 2012, very few have been started, which means another spike in prices lies ahead starting in about 2020. Also, copper consumption is beginning to surge due to the electrification of automobiles.



Source: Bloomberg

Gold also falls into this "late cycle" class. Gold does poorly when inflation is quiet, as it has been since 2011. That changed about a year ago:



Source: Stockcharts.com

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Thoughts for the Curious Person

Working in the financial services industry is like living inside a candy store for a curious person. There is so much information about new companies growing, old firms struggling, new trends, and fantastic new technologies.

Here are four very interesting items that we noticed just this week:

1. Japan has been known as the fastest-aging country in the world. Well, not any more. After declining for over 20 years, Japan's fertility rate began rising after 2008. Japan's fertility rate of 1.42 babies per woman is now the highest since 1996. Go Japan! This puts them neck-and-neck with Italy and Greece, and now ahead of Poland and Singapore. Canada is at 1.60 babies per woman and the US at 1.84. The world leader is Nigeria at 5 babies per woman (source: Ned Davis Research).

2. A company in Canada just drilled the longest well in our history. Ensign Energy Services (**TSX ESI**) drilled a well almost 8km long (7,770m) for

Shell in the Duvernay shale beds. The hole went down 3.2km and then sideways for another 4.5km (about 2.8 miles). Not only was the length incredible, but it took just 14 days to complete.

3. We have packed on a lot of debt, but few notice because it has become so affordable. In 2007, the US national debt was $9 trillion. At an average interest rate of 4.75%, this cost the taxpayer $425 billion per year in interest. Today, the national debt is US $20.5 trillion, financed at an average rate of 2.25%. This costs the taxpayer about $460 billion per year. The US (and Canada is similar) has added an extra $11.5 trillion in debt "for free"! What happens when rates rise too far? (source: Larry McDonald).

4. Despite billions spent on public transportation, ridership has declined annually in cities from Houston to Portland. People want to go where they want, when they want, in privacy. Public ridership is changing faster due to the rise of ride-sharing services like Uber and Lyft, but will be completely upended by autonomous vehicles. Roy Amara, the late president of the Institute for the Future said, "We tend to overestimate the effect of a technology in the short run and underestimate the effect in the long run. ***Self-driving cars are as much of a paradigm shift as the invention of the telephone***, and we all need to get prepared for the ride of our lives." (source: Forbes). The ability for seniors to stay in their homes, and millennials to own their own homes because autonomous cars can drive them to work, could mean a huge shift of people back to the suburbs from the downtown cores. The most optimistic forecasts suggest most cars will be autonomous by 2030 – just 12 years away.

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