

# The Market in Review

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## This week's articles and insights

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**“God gave us memory so that we might have roses in December.”**

— *J.M. Barrie*

## Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	24,925	+ 1.92%	+ 0.83%
S&P 500	2,798	+ 1.39%	+ 4.66% (+ 9.50% in \$CDN)
TSX	16,567	+ 1.19%	+ 2.21%

## Earnings – Supertanker Momentum

There has been great concern that the good times are about to end because of the recent US tariffs. Well, they may, but history suggests otherwise.

In short, US earnings have been great. Last year's tax cuts invigorated spending, investment, and hiring such that corporate earnings have never been higher. And since rising earnings are the underlying foundation for rising stocks, we are seeing a rising stock market as well.

Like a supertanker that takes many miles to stop, the stock market also has its own momentum. The chart below shows rising earnings typically last at least 5 years:

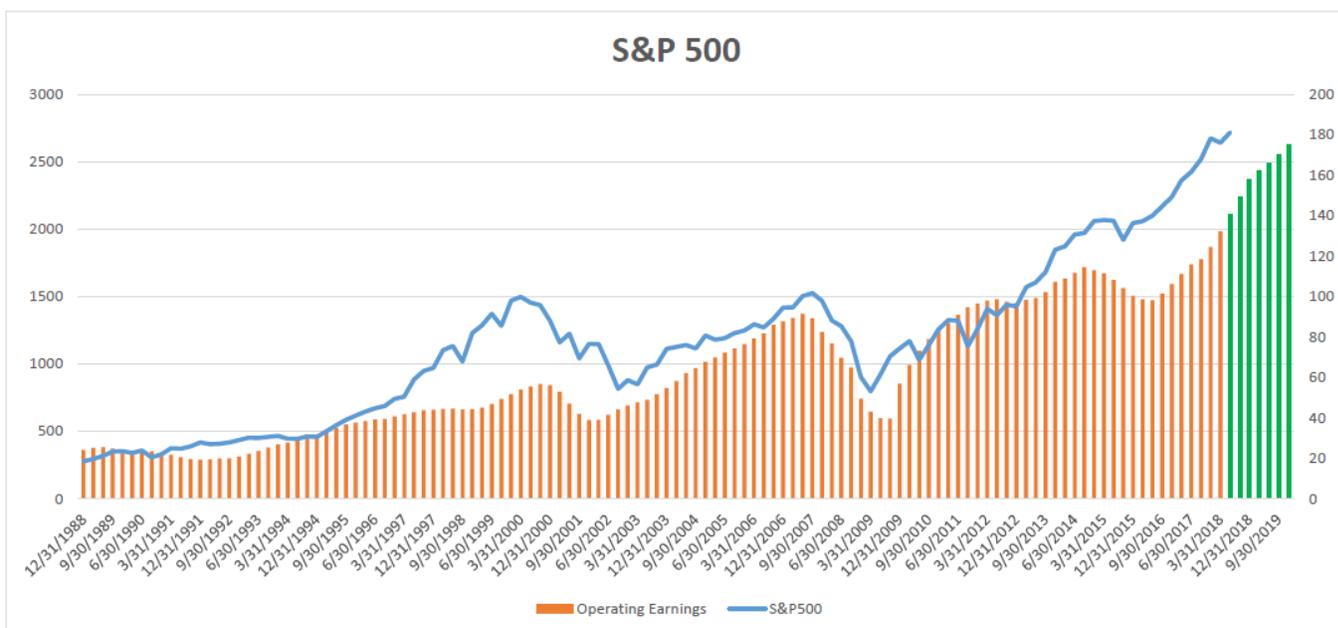
Trough to Peak:

1992-2000: 8 years

2002-2007: 5 years

2009-2014: 5 years

2016-today: 2 years and counting



Source: Raymond James research; S&P; estimates are consensus bottom-up operating earnings

## Markets This Week

It has been a busy week.

First, earnings season has begun, where companies report how they did from April through June. This always has the potential to send stocks flying or crashing. So far, we have seen just one company report – Alimentation Couche-Tard (see below) and it was a winner.

Second, employment and economic numbers have been strong, especially employment in the US. This has helped markets in July get off to a very strong start.

Third, because of the strong numbers, Canada's central bank raised its key interest rate to 1.5% from 1.25%. This is good if you are a saver, but not if you are a borrower.

Finally, the threat of US tariffs became a reality as its first \$50 billion of tariffs came into effect, followed by the announcement of another \$200 billion in two months. Of course, Canada, the European Union, and China all announced counter-tariffs, which seriously clouds the global trade picture.

Suffice it to say, any action which impedes global trade is a bad thing. European automobile makers, which enjoy a 10% tariff on US cars entering Europe compared to 2.5% on European cars entering America, have recently proposed dropping tariffs both ways to zero. This is exactly what the current administration in the US seeks.

Two final points on tariffs to ponder:

1. The US economy is \$20 trillion in size. \$400 billion in tariffs (about double the current amount) is only 2% of the US economy. Even if they are enacted as proposed, the impact is less than most people fear.
2. The media has focused on the tariffs failing, but what if they succeed? What if China does something like the European auto makers and agrees to lower restrictions on US imports? The market would view this very, very favourably.

Just food for thought.

## Responding to Change

These days, no company is immune to a changing market. GE (**NYSE GE**) was the longest-serving member of the Dow Jones Industrial Average at 114 years. The company began as a power and light bulb company founded by Thomas Edison. As those markets matured, it expanded into locomotives, jet engines, medical imaging systems, finance, and oil and gas. Some poorly-timed investments (buying oil and gas and power at the top of these markets) and sales (selling finance at the bottom) have forced the company to cut its hallowed dividend. It was booted from the Dow just a month ago and replaced by Walgreen's (**NYSE WBA**), the drug store chain.

Even companies like Alphabet (**NASDAQ GOOG**), formerly known as Google, are not immune. The latest battleground in technology is the home assistant – a "smart" speaker you talk to for access to the internet and to do things like listen to music and order things. It is a huge new frontier in technology.

Amazon (**NASDAQ AMZN**) is way ahead of the pack with its Alexa smart speaker, even though Alphabet was the first to introduce its device. The analysts at Morgan Stanley say Alphabet needs to give every U.S. home a free speaker to keep from losing the market to Amazon – that's how dominant Amazon already is, even though it has yet to deliver much profit or pay a dividend.

Even fighting the creator of Google is not enough for the "Death Star" Amazon. Amazon is now taking on the drug companies, the pharmacy chains, and the health benefit providers through the purchase of PillPack, a company that ships your exact prescription overnight at a lower cost than your pharmacy.

A company we own facing change is Alimentation Couche-Tard (**TSX ATD.B**), a Canadian company held in many of our portfolios. Not many Canadian companies are successful globally, but this is one of them. Couche-Tard is Canada's largest company by revenue with almost \$60 billion in sales – larger than all of the banks. It operates gas bars and convenience stores under the Couche-Tard ("Night Owl"), Mac's, and Circle-K brands in North America, with twice as many stores as Tim Horton's. Worldwide, the company includes the Ingo brand and has over 15,000 outlets.

For the record, Couche-Tard makes about CAD \$0.09 per litre of fuel – about 6% of what we pay per litre. Government taxes are 3-4 times that amount per litre. They don't make a lot selling a gallon of gasoline, but they sell a lot of gas.

We believe it is undervalued because of its consistent growth, repeat business (everyone who drives needs fuel), and eventual U.S.-listing under the newly-unified Circle-K brand name. The company knows this business better than almost anyone else, with even giant Imperial Oil (**TSX IMO**) selling 279 of its Esso retail gas stations to Couche-Tard for \$1.69 billion in 2016. They are pushing their own in-house coffee brand hard, as well as other services such as seasonally-adjusted car washes.

It also faces an enormous change in the years ahead with electric vehicles. Who will stop for gas and a coffee when cars no longer need petroleum products for fuel?

In the near and intermediate term, there is still lots of "runway" for Couche-Tard. It is still buying up smaller competitors, expanding into Asia, and delivering more and more fast food options outside of coffee and hot dogs. And billions of people in India and China still don't own a car or a motorcycle, but will in the next decade.

In the long-term, however, their world could be turned upside down. Most electric vehicles are charged at home overnight, and when driverless ride-sharing arrives and fewer people own cars, the once-a-week stop at the gas station becomes a thing of the past. What will the company do then? It is a question the company is exploring at the highest levels.

But like GE a century ago, when it switched from light bulbs to jet engines and locomotives, companies can evolve. Couche-Tard is already becoming a food company, as well as a fuel provider. They have a huge experimental facility in Norway because 50% of all new cars sold there are now electric vehicles. Couche-Tard now has over 100 charging stations in Norway and is experimenting with top-up charging at their stations. They also sell fresh food as well as fast food. And since charging takes longer, they even are looking at beauty bars while you wait. In the future, they may deliver food right to your door because your own car is busy charging.



*Multiple electric charging station.*

Will they be able to make such a radical change? Some companies do, but the truth is, many – like Xerox and Kodak - don't. Couche-Tard is way ahead of most of its competitors in the way it is using an entire country to experiment in, so it may survive the coming electrification of transportation.

At \$60 today, 11 of 12 analysts rank it as a Buy. Earnings this week were above expectations and the dividend was increased by 11%.

A good week for Canada's "Night Owl".

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## **Thanks for the Memories**

Dementia is a growing problem as worldwide populations age, with global costs estimated to be as high as \$600 billion annually when unpaid care is included (US National Library of Medicine - National Institutes of Health). Alzheimer's disease is the most common form of dementia and it has shown itself to be one of the most difficult diseases to treat in humans. A gummy substance called

amyloid plaque degrades memory and brain activity until the mind is completely lost.

How difficult is it to treat? One study showed that approximately 20% of new cancer drugs show some form of effectiveness. New Alzheimer's treatments have failed 99.6% of the time, in comparison. As Lincoln, our research analyst says, any new drug that works would be the "Holy Grail" of medicine.

An important milestone in the field of memory and aging occurred this week when a drug in trials to slow Alzheimer's actually worked. 856 patients in mild and early stages of Alzheimer's disease showed little change at 12 months, and the drug was thought to be yet another failure. To the scientist's surprise, the same group at 18 months showed a statistically significant slowing of plaque formation and memory loss.

The company that controls the drug is Biogen (**NASDAQ BIIB**), but we are simply watching it at this point. Many new pharmaceuticals have side effects or fail in later trials, which means this is still in the earliest of innings. Just look at how long we have been working to beat cancer.

This weekend, I was reminded of the importance of memory. I travelled to Calgary to visit four of my closest friends from high school, as we are all turning 60 this year. I have known some of them for 50 years, which means we have many stories, both heroic and downright embarrassing, about one another. Studies show that old friends give us perspective about ourselves, continuity from our past to our present, and a degree of acceptance that often exceeds that of even family. I don't think I have laughed harder in months.

It is impossible to make a new old friend. It takes work to hold on to the ones you have, but it is well worth the effort. I am grateful for the memories I have with these fellows, and hope new drugs arrive in time to ensure I keep them as long as possible!

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