The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

June 8th, 2018

This week's articles and insights

1. *Always Listening*
2. *Markets in May*
3. *Acrimony in Italy*
4. *Stronger for Longer?*
5. *Want to Travel to Space?*
6. *A Mention About Pensions*

"Let's not kid ourselves here, robots already run most of our world. We'll be their butlers soon enough."

- ***Eric Stoltz***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,317	+ 2.77%	+ 2.42%
S&P 500	2,713	+ 1.62%	+ 3.94% (+ 6.82% in $CDN)
TSX	16,203	+ 0.99%	- 0.04%

Always Listening

Robotic devices will become more and more common in our homes in the years ahead. Not necessarily humanoid robots, but the trend that has been progressing for years is accelerating.

For example, we already have fire and smoke detectors that monitor our air, security systems that detect motion and unwanted intrusions, and ovens that clean themselves while we sleep. These seem commonplace today, but they were miracles when they first appeared. Robotic vacuum cleaners that scoot under chairs, retreat to their charging stations to sleep, and beep at us to empty them out can be bought at any hardware store. They are able to map and remember your entire floor and can avoid tumbling down stairs. They can even figure out a way to free themselves when they get stuck. This is not the future – these features were available in the 2015 models.

The newest class of devices is the home assistant, the most notable being Google Home (**NASDAQ GOOGL**) and Amazon Alexa (**NASDAQ AMZN**). These little electronic boxes answer all your questions, tune your TV to whatever you want to watch, and control your computer with voice commands. Some say they will be ideal companions for lonely seniors in the years ahead and could even replace pets.

It is early days for these, however, and several glitches have surfaced. Since they are always on, they are always listening and recording your conversations, even if you don't want them to. Amazon recently reported that Alexa misinterpreted a muffled background conversation, recorded it, and e-mailed it to someone in the home contact list. There are probably many things you would not want heard outside of your home, but these devices record and store all of them.

There are also hidden commands that can be embedded in songs or ultrasonic orders above the level of human hearing that the device can detect and act upon. Imagine hackers sending instructions in a song you are playing to open your door or send some files on your computer.

Safeguards will be built before these devices become truly mainstream, because privacy is a growing concern. Progress could bog down as robots are made safer, but they are coming - and coming faster than anyone expects - to every home.

Markets in May

May was a good month for equity markets in North America, with Canada's S&P TSX returning approximately +3% and the S&P 500 +2.4%. Global markets were lower by -2.8%.

North American markets seem to want to move higher, despite much world tension. More stocks are advancing than declining (a sign of "good breadth") and both the S&P Small Cap and the Russell 2000 indexes recently set new highs.

Our discretionary portfolios added more Alphabet (**NASDAQ GOOGL**) last week. Otherwise, we are having problems finding new ideas.

Bond returns were also positive, thanks to the Italian crisis described below.

Acrimony in Italy

British Columbia is set to hold a referendum on adopting a form of proportional representation to choose our legislative body. This would take us from the majority system we have now, where the party in power has almost <u>all</u> of the power, to a patchwork system with many diverse parties in a loose coalition. Italy had a pure proportional system between 1946 and 1993, but has been moving toward a majority system in small steps ever since.

In other words, the exact opposite direction we are about to undertake.

Why?

Canada has had 14 prime ministers since 1946, with three serving less than two years. Italy has had 29 prime ministers since 1946, with 19 serving less than two years. Seven didn't even make it to one year. The currency was as shaky as the party in power, with the lira losing 53% of its value versus the Deutschemark from 1979 to 1999.

Italy was in the news in the last few weeks, both because of its bond yields and its latest government collapse. Italy's 10-year bonds had been yielding around 1.75% until the government fell, leading to fears the country would seek to leave the European Union as Britain is attempting to do. Rates doubled to 3.44% before falling back to 2.5%. US bonds, as a comparison, yield about 3% for a 10-year term.

The first question we asked was “why are Italian bonds yielding less than US bonds in the first place?” Given country size and credit ratings, it makes no sense that Italian bonds trade at half the yield of a US treasury bond.

The larger issue is that the European Union has been buying up bonds from every country in order to keep yields low. German 10-year bonds fell to negative rates at the peak of this buying and still yield just 0.38% - a fraction of what you can get in Canada or the US. Perhaps investors are finally waking up and asking why anyone would accept such low rates for such long terms. Especially if the euro may not survive the next decade.

Rates have fallen back for now. The belief is that if Germany and France can keep Greece in the fold (which they did in 2015), they can work something out for Italy. Time will tell.

Meanwhile, on this side of the ocean, President Trump imposed sanctions on steel and aluminum on both Canada and Mexico. This rattled our markets and sent both the Canadian dollar and the Mexican peso lower. While these tariffs are tiny compared to the ones which brought world trade to a standstill in the 1930s, every avalanche begins with a single snowflake. Political commentary aside, markets prefer free trade and low tariffs. If these tariffs stick, Canada’s exports to America will only be competitive if our dollar falls further.

“If you cannot compete, your currency should be going down.”

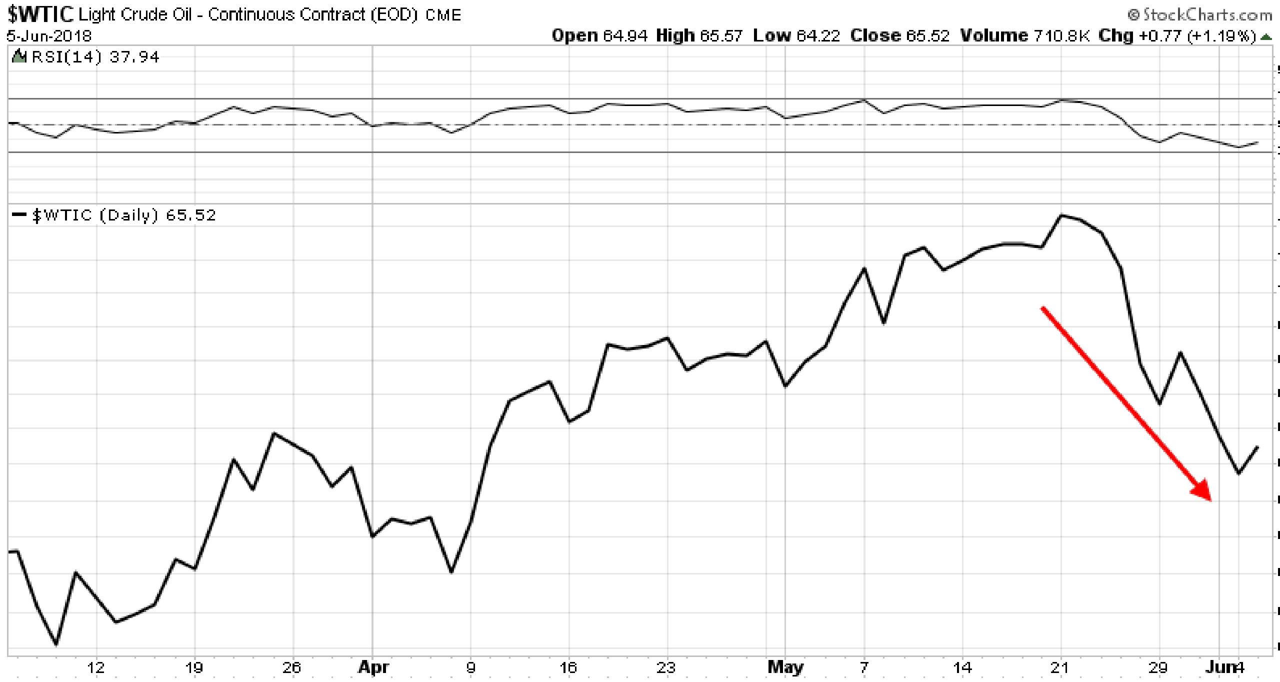
- David Rosenberg

Stronger for Longer?

The two biggest bull market killers are rising interest rates and a spike in the price of oil. Sometimes they occur together and sometimes they don’t. A higher cost for oil and a higher cost for money can cause recessions, so we have to be on the alert when these occur.

The Italian debt crisis and recent OPEC actions may have <u>*lowered the risk*</u> of both.

OPEC, led by Saudi Arabia and Russia, agreed to increase oil production this week. This sent oil prices down almost 10% from US $72 to $65. Lower oil prices are good for the world.



Meanwhile, Italy's problems mean the EU will likely continue buying bonds to keep rates low. This should help keep rates lower for longer, and economies stronger for longer.

The global bond pools we use have mostly avoided Italy and the peripheral European countries because of the artificially low yields. This may change if rates rise, but for now, the yields do not justify the risk.

Thank you for your referrals this month! They are always handled with great care and discretion.

Want to Travel to Space?

What is one of the hottest new areas of investment?

There are several investment pockets that are all the rage these days. Marijuana, of course, and bitcoin top the list. "Cloud" investments have also attracted billions in new investments.

One of the fastest growing, and less discussed, sectors is private investment in space exploration. Way back in 2004, President Bush announced a directive to promote commercial participation alongside NASA. It took a long time to get rolling, but in 2017, there were 120 venture capital firms that invested approximately $3.9 billion into commercial space companies last year (source: CNBC). There are now close to 303 commercial space companies in the market today, according to the investment firm Space Angels.

Like many areas, competition means the private sector can deliver a service or a product for less than the government can. Private space launches today cost about 1/3 what government launches cost, and with a slightly higher success rate.

Attached to this week's letter is an interesting piece entitled "Want to travel to space?" by Raymond James analyst Larbi Moumni.

A Mention About Pensions

Social Security released its actuarial report this week. It is worth examining for every US and Canadian senior.

Social Security is paid from a trust fund of accumulated savings, as well as revenues collected daily from payroll taxes. The trust fund is now being tapped because, for the first time since 1982, Social Security no longer makes enough from payroll taxes and the interest on its trust reserves to pay its benefits. The $2.9T trust fund will deplete by 2034, one year earlier than expected in the 2017 report.

There is some good news. Disability insurance surged after the 2009 recession because it became a replacement for unemployment benefits when those ran out. The recent decline in the unemployment rate, as well as a cap on disability payments, means this program has enough funds to last until 2032 instead of last year's 2028.

The bottom line is that the Social Security trust fund will run dry in 2034 and benefits will have to be cut by 21%. Unless payroll taxes are raised, benefits reduced, or a combination of both occurs.

Meanwhile, Medicare A - the trust fund which covers hospital and nursing home costs for seniors – is expected to run dry by 2026, three years earlier than last year's projection.

(source: Actuarial Status of the Social Security Trust Funds, June 2018)

These dates are not that far away.

Canada has two smaller pension systems. The two – CPP and OAS - combined cover less of a senior's living costs than Social Security does. The Canada Pension Plan was modified in the 1990s to increase contributions and the types of investments it could purchase. Part of Social Security's problem is that its trust funds can only be invested in U.S. Treasury securities, now yielding 1-3%. Canada's CPP can invest in real estate, equities, bonds, and infrastructure, whose returns have been much higher over time. As of 2015, CPP is expected to be able to meet its obligations over the projection period (the next 75 years). It is not completely funded, but pretty close.

CPP was recently expanded so that payments will be larger in the distant future. People today will pay more into the plan, but it is expected to be even more fully funded than the current program. In other words, to 2075 and beyond.

Canada's Old Age Security (OAS) pension is another matter. This is funded from general revenues and grows directly with our aging population. Although it is "clawed back" from higher income earners, it is still an increasing millstone around the government's neck as each year ticks by. The entire program cost Canada $49 billion per year in 2016 (2015 OAS actuarial report), or 2.4% of total GDP. This is projected to double to $104 billion in 2030 (3.2% of GDP) and more than double again to $247 billion by 2060.

The program was going to be extended from the current age of 65 to 67 until the government changed and the incoming leadership reversed this extension.

The bottom line?

All government pensions that are not fully funded by a flexible investment pool will have payments reduced, or the age eligibility will be extended, in the years ahead. Populations are living longer, which means we may also be expected to work longer while receiving less.

It is no longer about politics – it is about mathematics.

http://www.raymondjames.ca/siluchhill/

We thank you for your business and your referrals and we hope you find our site user friendly and informative. We would welcome your comments.

How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca

(250) 405-2417

Prices shown are as of close June 8th, 2018.