The Market in Review

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This week's articles and insights

1. *The Fog of War*
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"No battle plan survives contact with the enemy."

- ***Helmuth von Moltke***

Your Index Report

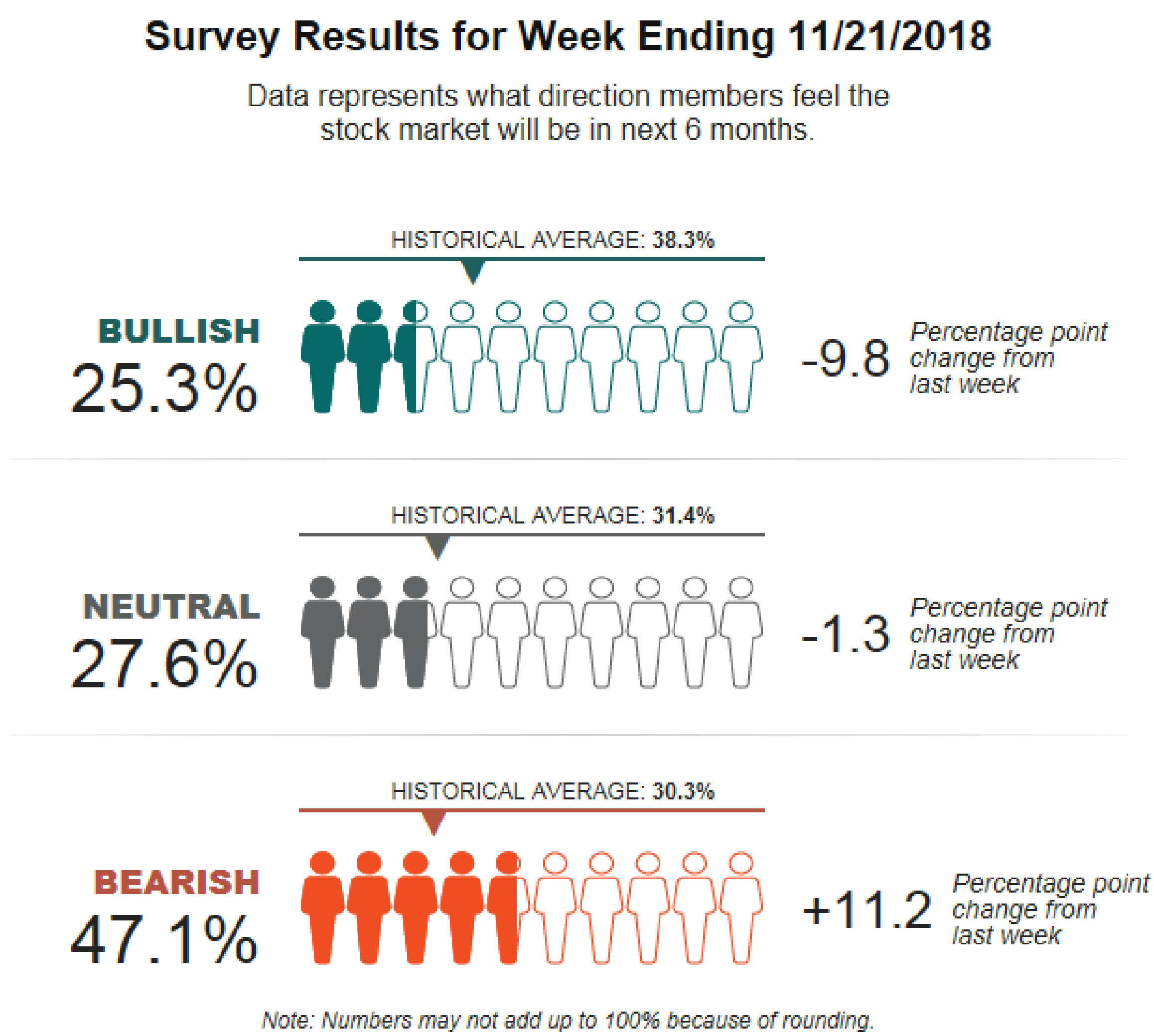
	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,339	+ 3.57%	+ 2.51%
S&P 500	2,738	+ 3.31%	+ 2.40% (+8.11% in $CDN)
TSX	15,194	+ 0.68%	- 6.26%

The Fog of War

Financial plans and carefully constructed portfolios rely on predictable, steady growth. Unfortunately, the stock market has moments when it is anything <u>but</u> predictable. We are coming through such a period.

In such times, markets ignore all good news, such as a great earnings report, or a dividend increase. Investors today are reminded daily of the Crash of 2008-2009 and no one wishes to go through that again.

We end up with investors becoming very bearish, very quickly:



Source: AAII Investor Sentiment Survey

Two weeks ago, we said we saw a bottom forming in the market. It took another week of selling, but stocks today are actually higher now than they were two weeks ago. That has been a very rare occurrence since September.

We have two Major Issues facing all markets today. The first is the U.S. Federal Reserve and its pace of raising interest rates, and the second is the U.S.–China trade dispute.

Rate Hikes:

When the economy is strong, interest rates rise. That always happens, because the demand for money goes up when borrowing surges. More demand for anything pushes prices higher; in this case, interest rates.

The U.S. Federal Reserve attempts to manage the pace of the U.S. economy through pre-emptive rate hikes (to slow things down) and rate cuts (to speed things up). Right now, they are in a very aggressive rate hiking cycle, with eight increases since 2015. In addition, they are withdrawing cash through this complicated process called Quantitative Tightening. This affects many assets throughout the world, including oil, because the U.S. dollar is the reserve currency of the world.

Their goal is something called the Neutral Rate, where interest rates exactly match what is needed in the economy. The neutral rate is a bit like a unicorn, though – often discussed but very hard to find.

It has also changed dramatically over the years.

Remember when T-Bill rates touched 20% in 1981? Or 13% in 1990, and 6% in 2000?

That was near the neutral rate at the peak of the economy in each of those cycles.

Today, both the Canadian and U.S. central banks can barely get T-Bills over 2% without the economy dislocating. The neutral rate today is much lower than in previous years because of the level of debt in society today. Many people carry $400,000+ mortgages and can't afford even the smallest rate hike.

The net result? Economies are slowing everywhere. Like tides, economies ebb and flow, but when rates rise too fast, economies become strangled. We have seen falling home sales (mortgages are getting expensive), falling auto sales (ditto for auto loans), and weak stock markets. When the U.S. Fed is blind to the pain it is causing, it can go too far, just as it did in 2007. The cuts in 2008 were too late.

This week, Fed Chairman Jay Powell indicated they are aware of the economic and market pain they are causing, and may slow their rate hikes in 2019. This was exactly what the markets wanted to hear, sending the Dow Jones Industrial Average up over 600 points.

Will it hold? That depends on the next Major Issue.

U.S.–China Trade

It the belief of the current U.S. administration that China is competing unfairly in world trade. They cite that western technology must be shared with Chinese competitors in order to sell into China, a practice banned under the World Trade Organization, as well as such things as discounted postal rates when shipping items to the U.S. This has created a playing field tilted toward China's benefit, in their opinion.

To force China to change, the U.S. announced a 10% tariff on $200 billion worth of Chinese goods on September 24. This will increase to 25% by the end of the year. A further $267 billion worth of imports from China will be subject to this 25% tariff in 2019. China has responded with a tariff on $60 billion of U.S. goods and threatens to increase this to $110 billion in 2019.

The U.S imports close to $500 billion worth of goods from China, while China imports about $110 billion from the U.S. Because of this imbalance, the U.S. feels it has greater leverage to force change.

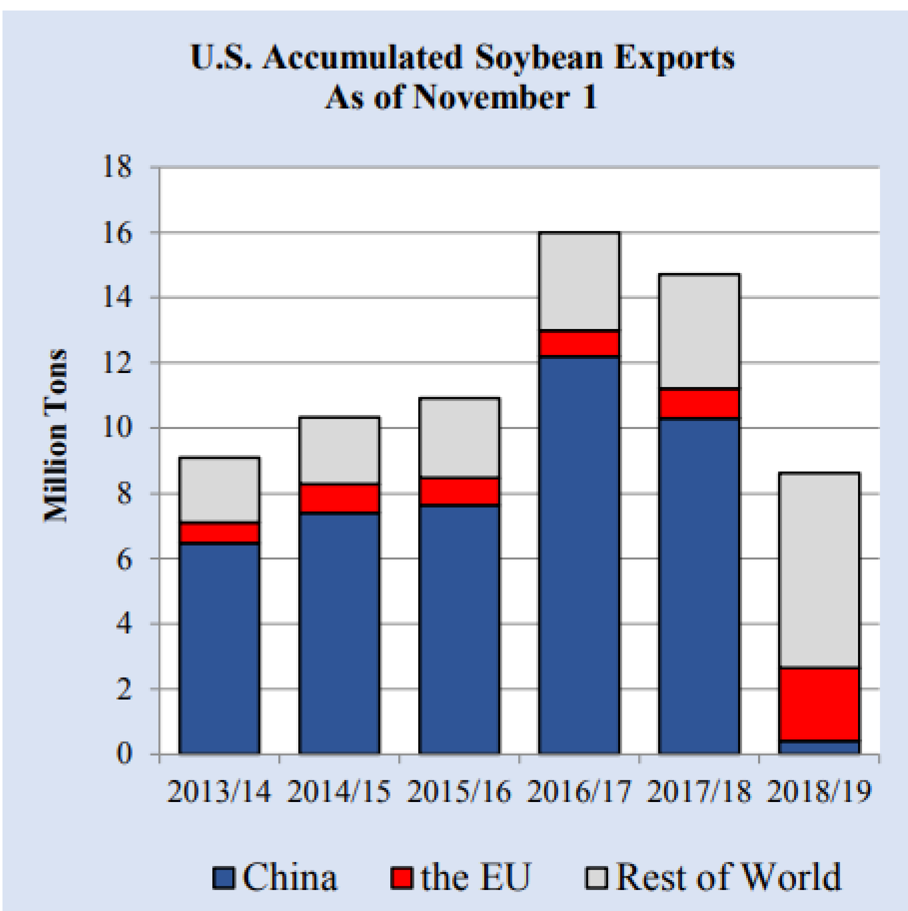
"It's impossible to know what happens in the fog of war."

- Hillary Clinton

Trade wars work well on paper. In the real world, they get real messy, real fast.

Chinese steel exports have plummeted:

And U.S. soy exports to China have dropped 94% from last year.



Source: Foreign Agricultural Service/USDA

President Trump and Chinese President Xi are slated to meet for dinner this weekend to discuss trade. Because of the looming election in 2020, President Trump might feel some pressure for a “win”. It may not happen this weekend, which would mean more market turbulence, but we expect some sort of concession before 2019 begins.

Market Swings

These huge point swings are difficult to trade unless you are nimble. As long as you own quality stocks, day trading is somewhat pointless.

We do note that some technology shares have become inordinately cheap, such as Alphabet (**NASDAQ GOOGL**), as has just about every oil company in Canada.

Canadian preferred shares have also become attractive, once again. For those looking for tax-advantaged yields approaching 5%, they are as cheap as they were at the lows in 2016.

Higher Tax Free Savings Account Limit

The TFSA contribution limit for 2019 is $6,000, up from $5,500 in 2018.

With the TFSA limit at $6,000 for next year, the total room available in 2019 for someone who has never contributed and has been eligible for the TFSA since its introduction in 2009 is $63,500.

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

Baby Bust

Canada and the U.S. now have one of the highest urbanization rates in the world. 82% of our people live in cities, rather than in rural areas (source: World Bank). This is up from 70% in 1960.

Coincidentally, the U.S. birth rate has now fallen to 1.76 (births per woman) – the lowest since 1976. Canada's is even lower at 1.60.

This explains why we take so many immigrants. Canada brings in about 350,000 per year and the U.S. about 1,000,000 legal immigrants. However, new data suggests even immigrants are having less children once they arrive.

Are the two related? Are we having fewer children because we can't afford a home large enough for more than one?

A recent article in The Economist suggests it is more than just a coincidental connection.

"Small-town-dwellers have more children than you would expect from looking at other aspects of their lives. It is almost as though extra bedrooms and child-friendly neighbourhoods make children," says demographer Hill Kulu.

Both housing and children have become increasingly expensive endeavours. Pew Research estimates that 47% of families today in the U.S. have just one child.

The article is an interesting read.

https://www.economist.com/united-states/2018/11/24/what-explains-americas-mysterious-baby-bust

http://www.dividendvaluepartners.com

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Alphabet - Raymond James & Associates makes a market in shares of GOOGL.

Prices shown are as of close November 30th, 2018.