The Market in Review

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March 5th, 2021

This week's articles and insights

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"So the last shall be first, and the first last."

- Matthew 20:16, King James Bible

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	30,924	- 1.52%	+ 1.04%
S&P 500	3,768	- 1.59%	+ 0.33%
TSX	18,274	- 0.54%	+ 3.97%

Spanking the SPACs

According to Charles Schwab, most U.S. and Canadian households saw an economic boost from the pandemic. In the U.S. more than one hundred million

Americans who never lost their job received cash support payments, pushing real incomes up over 10% in 2020.

And <u>another</u> $1.9 trillion stimulus bill is on the way, which will pay a further $1,400 per individual to most Americans.

Where has the money gone? A decent portion went into the stock market, and much of that went into risky new ventures, called SPACs – Special Purpose Acquisition Companies. A normal new stock listing is a specific *company* raising money. A SPAC turns that around – the money is raised and then a company found to invest in.

"For carrying-on an undertaking of great advantage but no-one to know what it is!!"

- *Famous new venture from the South Sea Bubble, 1720*

In 2019, there were 55 new SPAC listings. In 2020, $82 billion was invested in 248 new SPACs. We are already at 186 new SPACs raising $38 billion by February of 2021 (source: Statista). Most of the money has gone to companies in the technology, space, and "green" sectors as these are the hot sectors and what investors want most.

The worry of many insiders is that the supply of good private companies is running out, leaving only mediocre ventures for all the new money raised. Most may end up worthless.

What goes up often comes back down. SPAC companies often have great stories, but no earnings and little in the way of revenues. Their meteoric rise helped the NASDAQ to a 9% gain by mid-February, yet it has given all of that back and more in just two weeks. The NASDAQ is back negative for the year.

Flurry of New Worries

The US is vaccinating close to 2 million people per day now. Canada is lagging at about 70,000 per day, which is about 1/3 the rate down south. The market has already built much of the good news of the end of the pandemic in, so new worries are creeping in.

The two biggest worries plaguing the market are as follows:

1. **Oil prices**. They were below $40 a barrel not long ago, after going negative in the early part of the pandemic. Today, oil is close to $65. Saudi Arabia has turned down the taps so far there is actually a bit of a shortage happening worldwide. The Saudis love it, because it means higher revenues for the Kingdom. But stock markets (and drivers) definitely don’t. U.S. producers will eventually ramp production up, and watch the Russians. They will find ways to increase production because they need the money even more than the Saudis do. High prices help Canada, too.

2. **Interest rates**. The economy is gradually reopening and people are spending again. This means more competition for money, which is pushing rates up. Bad for bond prices, bad for borrowers, and bad for governments (the biggest borrowers of them all). Expect the U.S. Federal Reserve, the Bank of Canada, and all the other central banks to ramp up their mysterious bond-buying machines to bring rates lower. They have committed to keeping rates low for several more years, but the markets aren't co-operating.

Expected "Correxion"

We have said for too long now that markets need to correct, and here it is. If you are speculating in all the wild areas – SPACs, space exploration, cutting-edge green energy, unproven vaccine makers – expect to get the hair cut on your investments even shorter than it already is.

If you own quality growth companies, like Amazon (**NASDAQ AMZN**), Costco (**NASDAQ COST**) or NVIDIA (**NASDAQ NVDA**), we are likely closer to a bottom than a top. They could get cheaper here, but they aren't done growing by a longshot.

The old-economy value arena - banks, utilities, and energy - has suddenly become the world's fair. Energy – dirty old oil and natural gas – has been the best place to invest since November. Will it last? Hard to say, but oil and gas companies are cheap, suddenly very profitable, and have been out-of-favour for years. Their day in the sun has just started.

This is a classic rotation play, where "the last shall be first". It can be painful, but is also why we own diversified portfolios. You have to have a little of everything to ride out the cycles.

Meanwhile, our thinking hasn't changed. We see great value in those stocks yielding 3% to 5%, which include many of our old favourites:

PepsiCo (NYSE PEP)
TC Energy (TSX TRP)
Enbridge (TSX ENB)
Telus (TSX T)
US Bank (NYSE USB)

March is often a volatile month, so be patient.

> *"March is often prone to weakness in Post-Election years and comes in like a lion and out like a lamb."*
>
> - Stock Traders' Almanac

Buying into "The Next Big Thing"

We set off last weekend to buy a new TV. Like most people, my wife and I are watching more evening shows than we used to. Another thing to thank Covid-19 for.

The first television we ever purchased as a newly-married couple in 1983 was a small black and white 12" TV for $99. We had to sit quite close in order to see it. Those old CRT screens were notorious emitters of radiation (which may explain a number of things about our generation) but we are still alive, so no harm done.

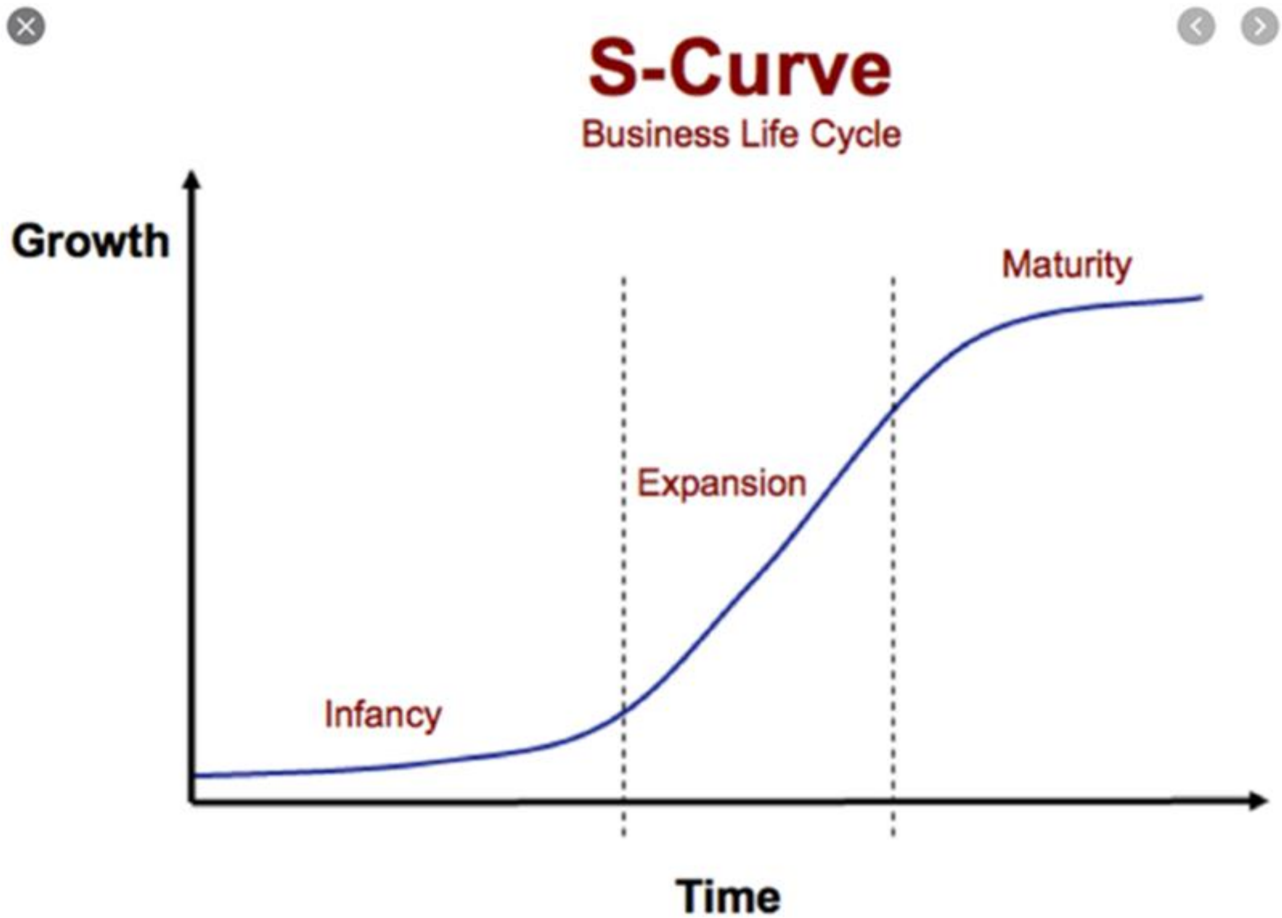
Our new TV is a 65" ultra-thin OLED high resolution marvel. What is even more amazing is that the price has dropped by 60% in just two years, thanks to demand and cost-cutting. The quality is so good, and the picture so large, you can probably watch this TV from across the street. Come to think of it, we'd better draw the curtains – our neighbour Victor is notoriously cheap and if he can see ours, he'll watch it. He probably still has a 12" black and white.

This exercise made me think about stock market cycles and the ideal time to buy a "next big thing" stock. Let's travel back to 1920 for a moment for an example.

In 1920, there were 5 radio stations in the entire USA. Thanks to the success of a new company called RCA – Radio Corporation of America – radio became the way America listened to news, music, and sports. By 1929, there were over a hundred times more radio stations (606 to be exact) in the country and people were spending 14 times as much money on radios than they had in 1922 (source: Motley Fool). This led to a second industry experiencing hyper-growth at the same time - the advertising industry – thanks to radio suddenly reaching almost everywhere.

RCA stock rose from approximately $1.63 in 1920 to $42 in 1925 and finally peaked at $490 in September of 1929. In the Great Depression, people still listened to radio, but the rapid rise in the sale of new radios stalled. Growth resumed, and there were over twice the number of radios sold in 1940 than there were in 1929, yet the huge rate of increase had slowed.

Why is this important? True growth stocks grow most in the first part of their lives. This is the Infancy phase of what is known as the "S-Curve":



In 1929, RCA shares reflected tremendous growth and traded at over 73x earnings. That actually seems tame today, when some companies trade at 100x revenues - they have sales but make no money on them.

The Great Depression fixed that. Radio sales were cut in half by 1932 and the shares fell from $490 to $10. RCA remained a pioneer, however, delivering the first TV in 1939, the first colour TV in 1954, and started its own studio, which it named NBC, shortly after. RCA shares did not regain their 1929 highs until sometime in the 1960s, although the 73x earnings valuation RCA fetched during its Infancy phase was never seen again. The company was eventually acquired by General Electric.

The closest parallel today is probably a company like Zoom Technologies (**NASDAQ ZM**). Zoom rose from $36 in 2019 when it became a public company to almost $600 in October of 2020, just before the vaccine made its debut. This marked the peak of the “work-from-home” era and the shares have fallen to $343 today, despite continued sales growth. Zoom is almost as ubiquitous as e-mail these days and is a household word now. It will continue to grow, but never again at the breakneck pace it saw during its Infancy phase. Already, larger competitors are gearing up to produce even better ways to "zoom", such as Microsoft's Virtual meetings using virtual reality and digital bodies.

So when is the best time to buy a "Next Big Thing" stock?

The very beginning is the most profitable time, since early Infancy is when the biggest gains in the stock are made. However, it is also the riskiest. Many "Next Big Thing" stocks become "Last Year's Bust" stocks when the story fizzles.

Also, the Expansion phase often experiences a very big correction in the middle of giant new themes. RCA – radio - is just one example. The shares fell from $490 in 1929 to $15 in 1932. It took years, but the shares did recover.

Amazon (**NASDAQ AMZN**) – internet commerce – is another example. The shares fell from $105 to $5 from 1999-2001 and are now about $3,000.

Ballard Power (**NASDAQ BLDP**) – hydrogen power - declined from $141 in 2000 to $0.60 in 2013. The shares touched $40 in 2021.

In all of these cases, the theme didn't stop growing. Investors simply pushed things too high and too early. The safest time was ***after*** the bubble burst, when prices were more reasonable and much of the growth still ahead. Perhaps we will see this with this new wave of vaccine biotech companies. There is going to be one heck of a hangover when the world is awash in Covid-19 vaccines. Already, there are 12 companies that expect to produce 10 billion doses this year. Behind that, there are over 270 vaccine candidates and dozens more companies ready to start trials (British Medical Journal). Expect to hear a big pop in the vaccine balloon sometime this year.

From those ashes, however, we are likely to see some amazing new discoveries arise in all areas of viruses and other diseases. That will be the time to really step into the "Next Big Thing" in the vaccine world.

The television industry experienced its fastest growth and highest valuations in the 1960s, when every household was acquiring one and then two. Today, they are commodities manufactured in distant countries in large factories with low-cost labour. TV is no longer a growth industry, despite our best efforts to prop up its profits.

Every leading-edge invention becomes tomorrow's commodity. When investing in hot markets, it is important to remember this.

Random Observations This Week

1. China is going to become greener much faster than most people think. Not because they claim they will (they keep opening coal plants, after all) but because they have to. Pollution is a real problem there.

   China is about to build the largest ultra-high voltage transmission lines in the world so they can move power from the remote interior to the cities on the coast. They are electrifying their automobile fleet faster than any country and are building more coal, wind and solar plants at a breakneck pace. The State Grid plans to invest $350 billion in new transmission lines by 2025. These are massive, state-of-the-art power lines that we in North America have very few of.

   Our first thought was "think of all the copper this will consume!" but copper is too heavy and expensive. They use aluminum wires and it is all produced in China.

   President Xi Jinping is targeting a peak in China's emissions by 2030 and to be net-zero by 2060. The first phase of electrification by 2030 will move the coal and natural gas plants into the interior and away from the cities - coal and gas aren't dead just yet. Nuclear may be China's next big step after that.

2. As we watch the price of oil spike up, we can see part of the reason in how much money has been raised to look for new oil and gas. Essentially zero.

   Green energy Special Purpose Acquisition Companies (SPACs) raised $40 billion in 2020 to buy emerging companies in the wind, battery, hydrogen, solar, and fusion arenas. Most are very early stage and won't produce much in the way of commercial power for years. Oil and gas exploration and production companies raised just $5.2 billion in 2020, even as oil demand is set to soar once car and airplane travel resume.

   We expect oil and gas companies to have a very good year this year.

3. All eyes have been on bitcoin as the digital currency moved from $5,000 to $55,000 in one year. No central bank wants to hand over their financial keys to an unregulated, untraceable currency, however, so expect to see state-sponsored currencies unveiled soon. The People's Bank of China is already testing its new digital renminbi by handing out small amounts to 50,000 applicants in two cities. China is the first big economy to unveil such a centralized digital currency, although the U.S. will not be far behind.

   Unlike using Visa (**NYSE V**) or PayPal (**NASDAQ PYPL**), transactions in the digital renminbi won't require the internet or a bank account. But unlike bitcoin, they will be tracked. Every transaction using the digital renminbi can be monitored by China's central bank in real time. Some experts say such currencies can even be made to expire in a certain amount of time, forcing the owners to spend them rather than save them.

China plans on showcasing their new digital currency at the 2022 Winter Olympics in Shanghai (WallStreetBreakfast).

Some forecasters say the next big fortunes will be made in the currency markets, rather than the stock and bond markets. Old conventional currencies are being printed without restraint and new digital currencies are arising to replace them.

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