

The Market in Review

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This week's articles and insights

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**“There is something permanent, and something extremely profound,
in owning a home.”**

- *Kenny Guinn*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,466	- 0.32%	+ 12.61%
S&P 500	4,239	+ 1.10%	+ 12.86%
TSX	20,049	+ 0.54%	+ 15.01%

The Ketchup Squeeze



(image courtesy of Erik McLean on Unsplash)

It is no secret that consumers are seeing price increases in almost everything. Lumber that cost \$150 a year ago is now \$600. A \$3,600 state-of-the-art flat screen TV in 2020 now retails for \$5,000 in 2021. Thank chip shortages and a surge in home renovations.

One of the most unusual squeezes is in ketchup.

When the pandemic hit, sports stadiums, bars, and restaurants shut down. Ketchup sales plummeted. Covid-19 regulations hit the farms, as well. Most tomatoes for the domestic industry are grown in California.

Then a funny thing happened. Starting in May of last year, ketchup sales exploded. Sales in 2020 jumped 15% higher than in 2019. More people were eating at home, and used more ketchup. Restaurants pivoted to take-out orders to stay open.

But, it wasn't the traditional Heinz glass bottles or larger bulk containers they used for take-out deliveries. It was those small foil ketchup sachets - these became as precious as gold. The sudden shift to takeaway, as well as restaurants switching to single-use servings to satisfy sanitary restrictions, pushed sachet prices up 13% in just a few months.

Is the same thing happening for mustard? Sales of mustard are about half those of ketchup in the average year, but ketchup is *the condiment of choice* for French fries. While mustard sachets are also in demand, they pale in comparison to ketchup - the most used condiment in America and Canada. Heinz (**NYSE KHC**) controls 70% of the market in the US and 76% of ketchup sales in Canada. Yet even this tomato titan was unprepared for the surge in demand.

Is the shortage permanent? Are we doomed to in-store brands of inferior ketchup? And if Heinz is freely available once again, are higher prices going to stick? These are important questions because they point a spotlight on rising inflation in the world today.

And by the way, it's not just ketchup. Labor shortages and daily product price increases seem like a daily occurrence now. Sherwin-Williams (**NYSE SHW**) announced a +7% August 1 price hike on paint, and Chipotle Mexican Grill (**NYSE CMG**) raised its menu prices by almost 4%.

Heinz plans to open two new production lines in the U.S. and, after leaving Canada in 2014, is opening a new plant in Montreal. Much of the new production will focus on the foil sachets that are in such high demand, with a 25% increase in volume by this time next year.

Higher production should help lower prices, although single-use sachets are more expensive to produce.

However...some of the 'temporary' measures are becoming permanent. Wages, for example, have risen everywhere, thanks to generous government supports and higher minimum wages. These impact tomato pickers, canners, and restaurant workers. And, sanitary restrictions on multi-use bottles and bulk containers are likely to become permanent restrictions.

The end result is that inflation is likely to subside this year, but to a higher level than we are used to. The squeeze on ketchup is the new normal for prices everywhere.

(sources: Wall Street Journal, National Post)

Markets This Week

Canadian markets have been flat for the past two weeks, and U.S. stocks are at the same levels they were a month ago. Have the summer doldrums started early this year? Perhaps.

The U.S. and Canada are far ahead of most of the world in vaccination rates, which should be a catalyst for re-opening our respective economies. However, new outbreaks in Asia (remember when they were the example of how to do it right?) have put trips and trade back *on hold*.

Canadian interest rates were unchanged this week – another part of the equation that remains *on hold*.

And the flood of new government spending in the U.S. has hit pause, as political parties there debate over how much (or how little) to spend on infrastructure.

Bitcoin prices have been cut in half since April on fears that it will soon be regulated.

House on Fire

What is going on with house prices? It seems everyone decided to buy a home at once, and prices skyrocketed.

The real estate market has been hit by a perfect storm:

- The housing industry has still not recovered from the scars of the 2005-2010 boom.
- The millennial generation hit an average age of 30, which is prime “family formation” time.
- People were exposed to the new work-from-home (WFH) experiment, and they loved it.
- Many Baby Boomers decided to “age at home” instead of moving to retirement homes, which took their houses off the market.
- Low interest rates made houses more affordable.

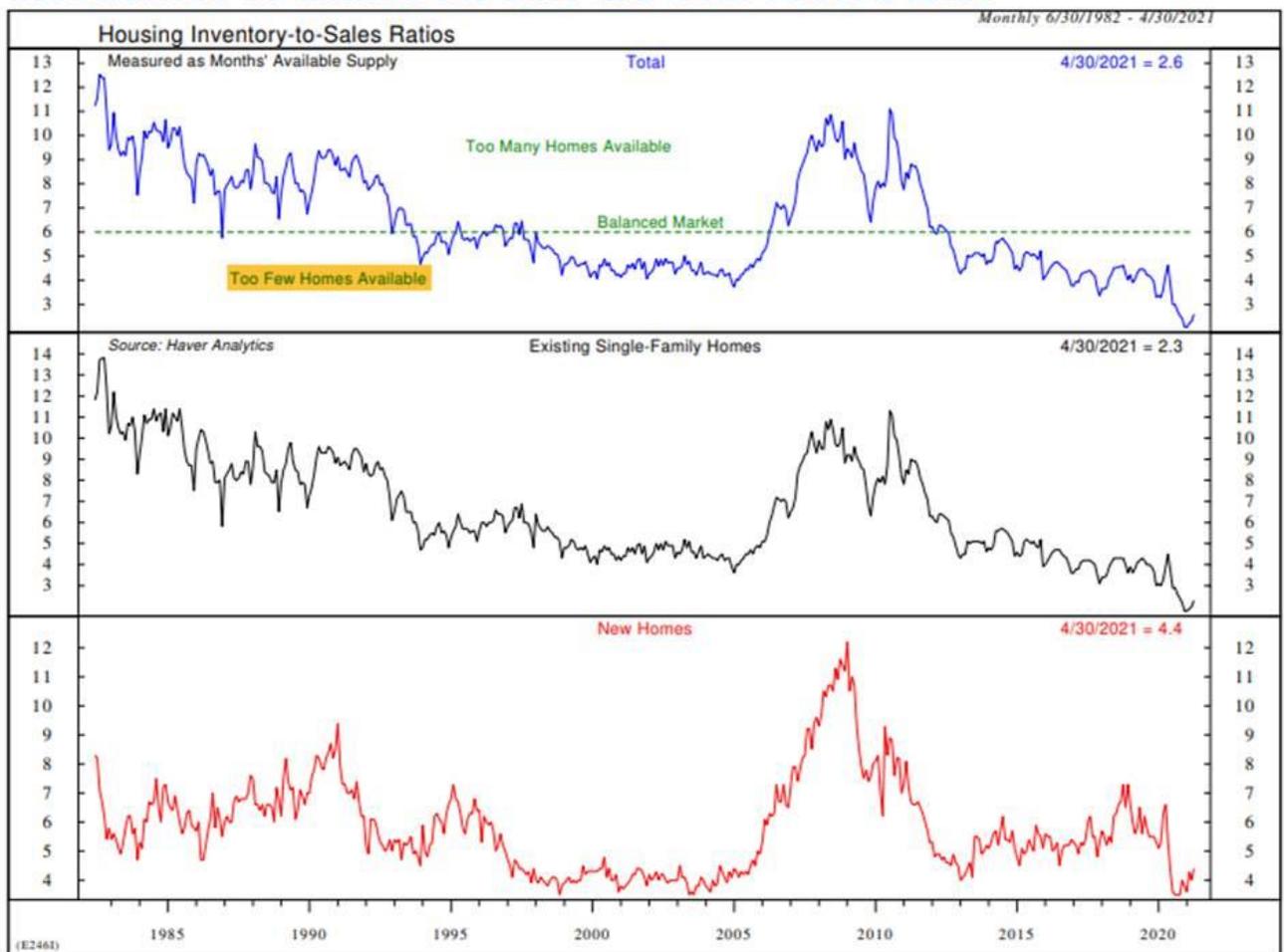
The Ned Davis Research group estimates the US is approximately 2.9 million home units short of what is needed to meet demand. This is a number determined by population, buying intentions, and wealth.

How about in Canada? Our numbers are approximately 1/10th of the U.S. numbers, and Statistics Canada estimates Canada needs about 100,000 homes

just to get to where the U.S. is now. In other words, if they have a shortage of new homes, we are starting from a position even further back. We need an additional 300,000 homes to get to where they feel a balance is - which, as it happens, is the level of homes available in the United Kingdom.

The graph below shows U.S. houses on the market since 1982. There was a boom from 2005 through 2010, followed by a long bust. Builders, buyers, and banks fell into foreclosure in those years, leading to a shortage of new homes.

Inventories of homes for sale are near record lows



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Each of the five factors mentioned are significant in their own right, but all five hitting at once has created quite a tidal wave of buying. A few comments on the larger themes:

Demographics

The Millennial Generation comprises those people born between 1981 and 1996. This age cohort is finally forming families, and they need homes to do that. The Millennial Generation is now larger than the Baby Boom generation – the largest in history, up until now – and yet twice as many of them still live with their parents. This is more than double the rate of the Baby Boomers at the same stage in their lives in 1981 (Statscan).

The good news is that thousands of millennials bought homes during the pandemic. The bad news is that not nearly enough new ones are being built.

Canada's high immigration also compounds the housing problem. We take in, on a comparable basis, almost 4 times the number of legal immigrants as the US (2 times when you include illegal immigration). Where are all these newcomers going to live? And how will they be able to afford home ownership?

Work-From-Home

The work-from-home trend made many realize they could live almost anywhere while staying employed. Towns surrounding metropolises such as Toronto and New York benefitted first, but even distant towns like Moncton, New Brunswick – a thousand miles from Toronto - have benefitted from the out-migration. We know of Seattle tech workers living in Victoria logging in to work every day.

Supply Shortages

Home prices have surged due to demand, but also due to shortages, as well.

- A shortage of labour to build apartments and homes.
- A shortage of available land, and a bewildering array of taxes, regulations, and by-laws that serve to keep land scarce.
- A shortage of building materials, from wood to steel.

Would You Buy Wood?

An investment perspective we will discuss today is the price of wood. The primary component of most single-family homes, wood prices jumped from \$300 per mbf (thousand board feet) 2019 to over \$1,700 this May. This was a classic “firehose spraying through the keyhole” problem that occurs when everyone decides they need to renovate their home or buy a new house all at once.

But there were other problems that were years in the making.

- Our forests in Canada are still recovering from the mountain pine beetle scourge from decades ago. New seedlings take years to grow and we are at least a decade away from the next large harvest.
- The average age of workers in the Canadian forestry sector is about 60. There is a serious labour shortage in this industry, which means it is very hard to ramp up when demand surges.
- While we are seeing some new sawmills announced, there have been even more closed in recent years. Forestry is a boom-bust business and most companies are still recovering from the last bust.

Lumber prices have since retreated to about \$1,200 from \$1,700 but remain far above historic norms.

The old range of \$300-400 mbf looked like this:



Lumber prices stayed close to these levels for a decade. In fact, this also happens to be the 25 year range, as well.

Once the pandemic-fuelled boom ends, prices could fall further. But the millennials aging won't stop and the trees aren't growing any faster.

“There has been a pent-up demand for housing since the 2009 financial crash, and with millennials now representing the largest percentage of first-time home buyers, that demand is even higher and houses are in short supply.”

- Andy Goodman, president of Sherwood Lumber

Other factors suggest things will not return to the way they were before the pandemic.

For example, trees can take up to 50 years to grow in British Columbia, although faster-growing varieties in the U.S. south can be harvested after just 25 years. This is still a long time to wait, however. Europe has few full forests left, which means wood prices are likely to stay higher for longer.

In addition to lumber prices, companies in the lumber products sector have done very well this year – most have jumped about 300% since the March 2020 lows.

But this masks the decline these companies have seen since 2018. In fact, the Big 3 Canadian companies – West Fraser Timber (**TSX WFG**), Canfor (**TSX CFP**) and Interfor (**TSX IFP**) – are all the same price they were back in 2018 when lumber prices were \$600. Lumber is close to \$1,200 today.

The Raymond James forest products team estimates lumber prices will average \$950/mmbf in 2021 and \$600 in 2022. A decline, but to a higher level than in the past.

In other words, the old range of lumber prices is likely to be adjusted upwards:



Another difference is how much money these companies are making. Profits are much, much higher than in 2018. And they are likely to remain higher for longer.

Dividends are also rising. For example,

- Interfor just paid a special \$2 per share dividend.
- West Fraser Timber hiked their dividend by 25%.

Companies only do this when they have confidence in future conditions.

Like energy, gold, and mining stocks, forestry stocks are cyclical. They go up for years, then go down for years. For those willing to take on this volatility, our analysts believe we are in a new upcycle for forest products companies.

Meanwhile, rising wood prices contribute to the discussion about inflation. Is inflation transitory and due to end soon, or permanent? Or somewhere in between?

Many of the factors pushing inflation higher – a spike in shipping costs, surging raw materials prices, labour problems because of Covid-19 - will subside once the pandemic fades. This means inflation's surge – like wood prices – will likely moderate as we move into 2022.

But as with wood above, the range for future inflation is likely to be higher than what we are used to. Fewer young people in the workforce, higher minimum wages, and a long-term shortage in many commodities means inflation is on the rise.

The degree of this rise will be the defining characteristic of the 2020s.

Raymond James Trust

An unfortunate aspect of getting old and wealthy is the getting old part. Contemplating what happens after you are gone is like eating beets – you know you should, but they are way down the list of fun things on the plate of life.

After many years of work, Raymond James has finally opened Raymond James Trust (Canada). This is a division devoted to providing executor and Power-of-Attorney services.

Most people have simple estates that family and friends can sort out. Some have blended families, or children and siblings that need assistance long after they are gone. This is where trust services can help.

If any of these pertain to you, we may be able to assist:

- Cross-border issues. If your executor children, or your beneficiaries, live in the U.S., you may need professionals on this side of the border to help.

- Blended families – second marriages – are often more complicated. Professional executors and trustees are impartial so they can look after all sides equally.
- If you have appointed someone from out-of-province as executor or Power-of-Attorney, they may need help. Raymond James Trust can be appointed as a back-up to assist them.
- We now offer bill-paying services for those experiencing cognitive decline.

In the meantime, we eagerly await our second vaccinations and the freedom this should bring.

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

<http://www.dividendvaluepartners.com>

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

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Prices shown as of June 10th, 2021

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