

The Market in Review

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This week's articles and insights

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“Every government intervention creates unintended consequences, which lead to calls for further government interventions.”

- *Ludwig von Mises*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	35,500	+ 1.24%	+ 15.99%
S&P 500	4,461	+ 0.72%	+ 18.76%
TSX	20,521	+ 0.71%	+ 17.71%

Unintended Consequences

1. Fire

Almost every person in power – a politician, business leader, office manager – starts with good intentions. But as the saying goes, *the road to Hell is paved with good intentions*.

This was certainly on my mind as my family ventured to the Okanagan last week. It seemed odd that all the traffic was going the other way – people leaving the Okanagan – until we drove into thicker and thicker smoke. The interior of B.C. has been hit hard by forest fires this year, though we hoped they would have burned themselves out by the time we arrived. They hadn't.

When we arrived in Osoyoos, one of Canada's most southern towns and one of its hottest, there were still spot fires up in the hills and the air quality was poor. Residents were suffering, especially the elderly, and even the grape harvest could face delays because the sunlight is filtered by all the smoke.

The Okanagan is a lovely part of the country, but not when visibility is only a few hundred feet.

In a natural forest, fires burn about every 2-4 years, with major fires every 10-20 years. Our forest services have done a masterful job of suppressing these fires – perhaps too masterful.

Most of B.C.'s forest and rangeland ecosystems have evolved with the influence of fire. Historically, an average of about 500,000 hectares would burn each year. Since the introduction of modern fire-suppression techniques, that area has declined to one-tenth the historical average.

- B.C. Wildland Fire Management Strategy

Suppressing fires means shrubs, trees, and deadfall grow thicker than they normally would over the years.

Then, add twenty years of mountain pine beetle devastation, and you have some areas of the forest where over half the foliage is dead. Fires in areas heavily loaded with combustible material can lead to temperatures so intense, they sterilize the soil of all beneficial bacteria. Replanting becomes much harder.

In today's warmer climate, the unintended consequence of stopping smaller fires has led to larger and hotter fires. Historically, Canada's indigenous population set fires to clear growth periodically. There are increasing calls to resume such proscribed burning.

Summertime often sees a slowdown in construction, which pushes lumber prices down. But fires can do great damage to the timber supply, so don't be surprised to see lumber prices bounce back after the summer ends. We had tight supplies before, and the loss of acreage may only make it worse.

2. Inflation

Inflation is another unintended consequence being experienced today.

Central banks printed trillions of dollars, euros, and yen to save jobs and preserve income during the pandemic. That worked initially, but then the extra cash started causing price hikes, to the point that higher wages are being erased.

Today, we are seeing price hikes in just about everything, but those in food are most visible. And painful.

Tyson Food (**NYSE TSN**), the world's largest meat and poultry producer, spoke about its own issues with price hikes and how they are passing them through to consumers:

"Costs are hitting us faster than we can get pricing at this point. We've seen unprecedented and accelerating inflation, and we're trying to catch up with that."

- Donnie King, CEO Tyson Foods



The maker of Jimmie Dean hotdogs is seeing all of its input costs rising, from animal feed to plastic packaging. As a result, Tyson hiked its pork product prices

by 39.3% in the last quarter, and beef and chicken prices by 11.6% and 15.6% respectively. It plans further increases in September with *more to follow*.

Food prices highlight the corrosive nature of inflation. From July of 2020 to July 2021, official inflation rose 5.4%. This means \$1.00 last year is worth just \$0.946 this year. If you didn't get a raise of this amount, or made this on your investments, your income and net worth declined in real terms.

Corporations like Tyson Foods have the ability to raise prices, and because of this, their shares have risen 21% since July 2020. Since 2018, the shares have not done much – they are flat over that period.

However, the dividend has been raised by 12% per year, on average.

Not all stocks behave the same way, but in general, stocks are a better way to beat inflation than bonds and cash.

3. Oil

The energy world is yet another example of unintended consequences.

A colleague sent me an article this week that said Russia is now the second largest exporter of oil to the U.S. The amount America brings in from Russia is almost exactly equal to what Canada's Keystone pipeline would have delivered had it not been cancelled for environmental and political reasons.

The U.S. government is now asking OPEC to increase the amount of oil it pumps to help lower gasoline prices. Since 2020, U.S. production has been cut, and Canadian supplies curtailed, for pandemic, environmental and political reasons.

Now, we are asking countries with lower regard for human rights or environmental concerns to produce oil for us – oil we have right here in abundance - even as we follow the highest standards of production in the world.

4. Government

One of the more far-reaching unintended consequences is increased government scrutiny of corporations. Companies like Facebook (**NASDAQ FB**), Amazon (**NASDAQ AMZN**) and Alphabet (**NASDAQ GOOG**) have grown so powerful, they are now in the gunsights of governments worldwide to curb their powers.

China has been the most aggressive so far, but the U.S., European, and Canadian administrations are also becoming more active. We have seen heavy fines and new rules to take back some of that power.

The Biden administration, for example, just appointed Lina Khan as Chair of the Federal Trade Commission (FTC). Khan wrote a paper while in university on breaking up Amazon, so we know she is going to be tougher than her predecessors.

Such actions are known as Anti-Trust laws, and they are rarely used. When they are, do they affect stocks prices?

Well, when the government is at war with business, they certainly can. The eventual outcome can be good for stocks, but generally not the process.

For example, antitrust legislation was used to break up AT&T in 1984 after a decade of legal battles. AT&T – known as “Ma Bell” to its shareholders, was the dominant monopoly for telephone calls in the U.S. at the time. During the decade of legal wrangling, the S&P 500 rose 50% while AT&T rose just 22%. Focusing all of its attention on lawyers and courtrooms certainly hurt.

Similarly, Microsoft (**NASDAQ MSFT**) was under the antitrust microscope from 1998 all the way through to 2012. The initial process concluded in 2002 with no breakup, but it hamstrung Microsoft’s monopoly such that it left openings for such companies as Google to emerge.

Microsoft shares were the same price in 2012 as they were in 2000.



The period after antitrust ends – either because a company is broken up or simply because legal costs decline – can be one of rebirth. AT&T became the seven “Baby Bells” and they became huge sources of capital gains for investors. Microsoft has risen to almost \$300 per share today from \$30 in 2012.

The period of antitrust action that lies ahead for the tech giants could be more of a struggle than people are expecting. Returns for these stocks could be slowed going forward.

Investment Conclusions

In reviewing the new U.S. appointments to rein in corporations through antitrust actions, it is important to see which industries are being targeted:

- Transportation
- Internet and communications
- Banking
- Agriculture

As we watch the Delta variant of Covid-19 spread, we note that one sector not being targeted is the health care industry. And, specifically, the pharmaceutical companies making the vaccines. Also, housing, manufacturing, heavy industry, and cyber-security have been left alone.

These may be the new “favoured industries” in the decade ahead, at least from a government perspective.

Markets This Week

Markets have been largely flat this month. Earnings have been excellent from most companies, but the big rise in the stock market over the last six months anticipated this, to a degree, meaning much of the good news is already baked in.

That said, some of our companies delivered much better than expected results, and the stocks jumped:

Nutrien (**TSX NTR**) saw fertilizer demand exceed expectations by a wide margin.

Finning (**TSX FTT**), a Caterpillar dealer, saw demand for heavy trucks and equipment soar.

Activision (**NASDAQ ATVI**), the video game producer of *Call of Duty*, saw continued demand for its games (helped, no doubt, by stay-at-home workers).

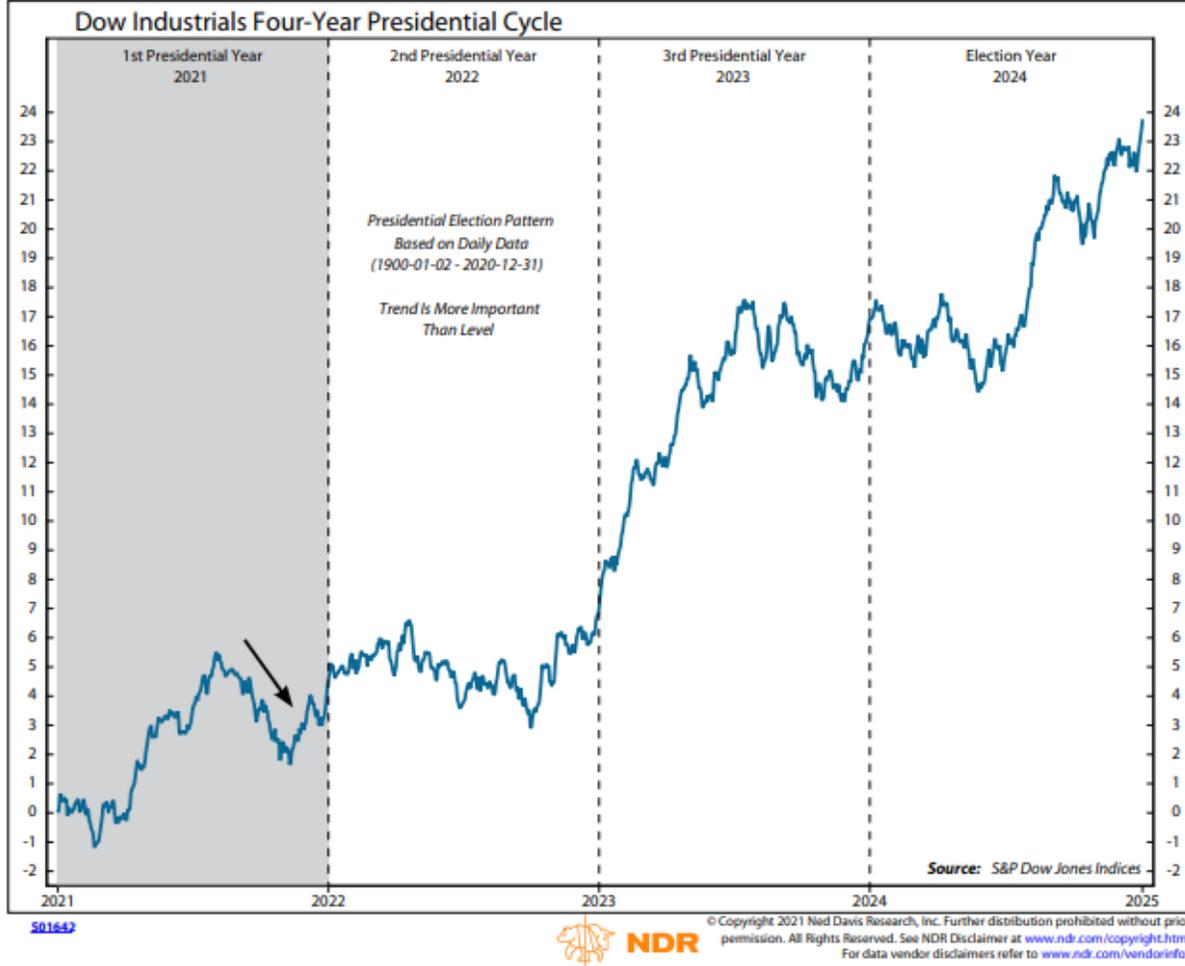
Election Reflections

It is likely Canada will see a national election called very soon – maybe by this week.

Markets follow an election cycle all over the world. The first year of any new government is the “honeymoon” period, when funds are ladled out to fulfill campaign promises. This is a good year for stocks, as seen below.

However, the “honeymoon” is followed by the “hangover” year when money gets tighter. The 2nd year is the weakest of the 4-year cycle.

Post-election years are 2nd weakest of 4-year cycle, on avg



While the U.S. is approaching its “hangover” year in 2022, Canada may just be starting our “honeymoon” period then, if an election is called now. This could be good for Canadian stocks.

Cling to that pleasant thought as we slide toward an election no one really seems to want.

Infrastructure Catch-Up

Covid-19 actually did the West some favours, in that it forced us to think about building things we should have built a long time ago.

The U.S. just approved a new \$1 trillion Infrastructure Plan which will address crumbling bridges, roads, rail, and digital networks. A renewed Canadian government may follow a similar path.

It is high time we got going, for it often seems like we can no longer get anything done anymore.

A case in point was in 2011 when I visited Dalian, China. This a city of 6 million people in eastern China, near North Korea. China has over 50 cities with more than 5 million people.

I flew through the Beijing International Airport, which had just expanded to a third terminal. This was built in one year from 2007 through 2008. When completed, Terminal 3 was the largest structure in the world, in terms of surface area covered.

Meanwhile, over in the U.K., a similar plan was debated and approved to add a third (smaller) runway to Heathrow Airport in London, plus a new passenger terminal. However, it was cancelled in 2010 by the new coalition government. It was re-approved in 2016, re-cancelled in early 2020, and re-reapproved recently. No dirt has yet been dug.

In other words, the entire construction of Beijing's Terminal 3 – the largest structure in the world by some measures - took less time to build than the first approval and cancellation of London's Heathrow expansion. Never mind that that expansion has yet to occur 14 years later.

Is it any wonder China is seen as the ascendant great power?

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