The Market in Review

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This week's articles and insights

1. *Bitcoin Mania*
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"There are just four kinds of bets. There are good bets, bad bets, bets that you win, and bets that you lose.

Winning a bad bet can be the most dangerous outcome of all, because a success of that kind can encourage you to take more bad bets in the future, when the odds will be running against you."

- **Larry Hite, interviewed in Market Wizards by Jack Schwager**

About 70 percent of people who win a lottery or get a big windfall actually end up broke in a few years.

- National Endowment for Financial Education

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	24,232	+2.86%	+22.61%
S&P 500	2,642	+1.53%	+18.02% (+10.88% in $CDN)
TSX	16,039	-0.43%	+ 4.91%

Bitcoin Mania

In 1991, the first diamond was discovered in Canada’s Northwest Territories. Diamonds are found in cone-shaped tubes of kimberlite – very old lava tubes that solidify, in simple terms. In southern Africa, which is the most diamond-prolific area of the world, the tops of these kimberlite pipes were eroded away a long time ago. This means less of the original diamond-bearing “cone” is left.

In Canada’s arctic, the entire pipes were preserved beneath the ice and snow, which meant any kimberlite pipes discovered could hold far more diamonds than their African counterparts. While this proved to be exactly the case, fewer pipes were discovered than were hoped for, and Canada never became the diamond giant some expected. We produce approximately 9% of world supply today, though they are among the highest quality in the world.

When the first discovery was made, the price of shares of any mining company with claims within a thousand miles of the Ekati discovery skyrocketed. Scores of miners changed their names to include diamond-this and kimberlite-that, and even more new companies were floated. The company - Diamet Minerals - that made the first discovery, rose from pennies to over $50 until it was acquired by de Beers. The diamond mania lasted several years before the reality of few discoveries set in.

We have seen many manias since then. Fibre optics and the dot.com bubble in 2000. Graphite five years ago and lithium last year. The biggest of them all, though, is Bitcoin.

Bitcoin is a digital currency. You exchange your dollars or yen or rubles for Bitcoin and then spend them like you would any other money. But, they do not exist in physical form.

Anyone with a shaky currency (Venezuela), with money they want to get out of the country (China, Russia), or involved in crime (everywhere) is keenly interested in Bitcoin. It is money that is unregulated, untaxed, and invisible.

Bitcoin surged from a few dollars years ago to US $1,000 on January 1st of 2017, only to touch over US $11,000 today. A Bitcoin exchange has signed up more new accounts than Charles Schwab, the brokerage company, so the public is definitely embracing this boom with both hands.

Manias rely on scarcity. More demand coupled with limited supply equals a higher price. Bitcoin is supposed to only ever have 21 million “coins” in total and we are at about 16 million now. But watch out. The financiers are coming.

The CME futures exchange is developing a futures contract on Bitcoin, which means they will be able to create more in an artificial way. A large competitor called Ethereum is almost the same size as Bitcoin, and there are reportedly 1,322 other cryptocurrencies listed on the Coinmarketcap.com website.

In other words, the scarcity of these new digital currencies will vanish in time. Whenever there are huge profits, financiers create supply to meet the demand.

In the long run, digital cash is here to stay and the world will never be quite the same. But in the short term, Bitcoin is due for a tumble at some point. It could go even higher first, but the eventual decline will then likely be even more steep.

Here’s what we are watching:

- How – not when – will governments seek to regulate and tax Bitcoin?
- How will this affect the price?
- When will governments implement their own all-digital currencies? In other words, make physical cash obsolete?
- If Bitcoin does tumble, what effect will this have on stock markets? Bitcoin is symptomatic of the rise of risk-taking behaviour. More and more people are taking on risk they do not understand.

Gold Coins vs. Bitcoins

What does this do to gold? Gold has been the hardest and most physical currency for the last 5,000 years. Bitcoin has temporarily taken that crown.

However, not everyone is buying into Bitcoin:

Germans are a major buyer of gold according to the recent report from the World Gold Council. From the WGC, "Germany has established itself as a 100 tonne-plus per year market for bars and coins.

German investors have an acute awareness of the wealth-eroding effects of financial instability. Hyper-inflation in the 1920s lingers on in the collective memory but, perhaps more importantly, German investors have seen fiat currencies come and go: in the past 100 years, Germany has had eight different currencies."

- *Peter Boockvar, The Lindsey Group*

Tax Reduction, Market Expansion

The S&P 500 in Canadian dollars, is up 10% so far this year. It is up over 5% in just the last month.

Part of this can be attributed to enthusiasm about a pending tax cut in the US. Those opposing the bill say it will add to the deficit. Those supporting it say it will promote growth.

Either way, stocks like the idea.

US tax reduction is not the only thing lifting stocks. Global growth is also helping.

US growth in the 3rd quarter, originally set at 3.0%, was raised to 3.3% as more data came in.

Current models have the 4th quarter tracking at +3.4%, which would make this the third consecutive quarter of above-3.0% growth, the longest such stretch since early 2005.

Our Ned Davis Research models predict the next recession as being at least a year away, or more. Things are still getting better, not worse.

What are we watching and doing?

1. Letting profits ride. We have taken enough gains already this year.
2. Technology stocks are correcting. This is a good thing for those wanting to get in, but we are also seeing more interest in "old economy" stocks such as banks and food companies. Some of our laggard value funds and managers, which are full of these, are about to see their performance improve.
3. There is fierce tax-loss selling happening right now. This is where people with capital gains sell their losers to crystallize an offsetting tax loss.

Energy and health care stocks top this list, so this is where we are looking for bargains.

Disruption, Continued

Our last letter on Disruption was one of our more popular ones in recent years.

A few further quotes and thoughts on this enormous theme.

"Not since the late nineteenth century have we seen more innovation platforms evolving at the same time. Roughly 150 years ago, the three innovation platforms changing the world were:

- *the internal combustion engine*
- *the telephone*
- *electricity*

Today, the five innovation platforms are:

- *genomic sequencing*
- *robotics*
- *energy storage*
- *connected mobile devices/artificial intelligence*
- *Blockchain technology.*

Thanks to the three innovation platforms in the late 1800s, unit growth and productivity exploded as costs dropped, creating a "deflationary boom" and an inverted yield curve".

- *Catherine Wood from ARK Invest*

Other more mundane trends are being driven by the Millennial generation, a group which now outnumbers the Baby Boomers.

Here are two broad trends influenced by the Millennials that were not previously mentioned.

First, Jim Cramer notes the preference among younger people for chicken over beef. We own Tyson (**NYSE TSN**), the country's largest chicken and pork producer. It is enjoying surging sales thanks to such companies as McDonald's, which have launched more and more chicken products. Chicken is perceived to be a healthier and lighter protein than beef and volumes bear this out.

Second, jewelry sales are dropping sharply. Once the epitome of fashion for women, diamonds are no longer a girl's best friend. What is? How about a new iPhone? Thanks to lower incomes, smaller living spaces, and an urge to "renew and replace" every couple of years, "techno-bling" has taken over from expensive rings and necklaces. Plus, fewer people are getting married, and those who do are waiting until their thirties.

We want to say thanks to our clients for introducing their friends and family members to us throughout the year. It's a tremendous compliment and a huge responsibility, and something we never take lightly.

Downsizing

Canadian Baby Boomers are aging. Each day, approximately 1,000 of us turn 65. In the US, this number is 10,000 per day. Many 65 year-olds are as fit as a 55 year-old a decade ago, so perhaps 65 really is the new 55. That is the sort of math we can all embrace.

As people age, their kids move out and they begin the gradual process of decluttering and downsizing. Out go the old toys and sports equipment. Bedrooms are turned into offices and sewing rooms.

Eventually, even the house itself gets downsized. Why live in 4,000 square feet when 1,800 will do just fine? This is where downsizing starts to get difficult. What do you keep and what do you pass along to kids? What has value and what doesn't?

An article in the New York Times talks about the rise in the businesses of storage and organizational consultants. It is a good read for anyone about to "shrink their footprint".

https://www.nytimes.com/2017/08/18/your-money/aging-parents-with-lots-of-stuff-and-children-who-dont-want-it.html

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