The Market in Review – July 7th, 2017

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This week's articles and insights:

"A decent idea has value but a decent warning has ten times as much value."

- ***Mark Grant***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	21,414	+0.30%	+ 8.36%
S&P 500	2,425	+0.07%	+ 8.32% (+3.73% in $CDN)
TSX	15,027	-1.02%	- 1.70%

Looking Back, Looking Ahead

Canada turned 150 years old last weekend. It brought back memories of Canada's centennial celebration in Montreal - Expo '67 – that we could not afford to attend (or so our father informed us). Our holidays traditionally involved less expensive venues, such as tent-trailers and the bedrooms of relatives.

Instead, my mother took us to see the Confederation Train as it travelled through Edmonton. The line-up lasted four hours to see just six rail cars of memorabilia. After the displays of Canada's past were a few recent technological innovations. I remember the colour TV, which was introduced to Canada around 1966. What a marvel that was. It allowed professional hockey teams to actually wear coloured jerseys, instead of white and dark so they showed up on black-and-white screens.

Canada does a lot of things wrong, but we end up doing even more right. We seem to have a knack for wacky politics, particularly in British Columbia, and yet governments are toppled with little fuss and certainly no violence. In many countries, elections without riots are a rarity.

We took in over 300,000 immigrants last year which, for a population our size, is triple what the US admits. Our system is viewed as one of the best in the world for integrating new Canadians.

Thinking back to the Confederation Train of 1967, what innovations has Canada seen in the past 50 years? Well, arranged in order from oldest to newest, here are several:

- Coronary bypass surgery
- The calculator
- Smoke detectors
- Laser printers
- Fibre-optics
- Cushioned running shoes
- The personal computer
- Microprocessors
- Medical MRI's
- Cell-phones
- Digital cameras
- The popcorn bag
- Polar fleece
- Paintball
- The nicotine patch
- The self-wringing mop
- Viagra
- Hybrid electric cars

There are many more, of course, but if it feels like innovation is accelerating, it is because it is. Ray Kurzweil, a noted futurist, wrote in 2001 that our rate of progress was doubling every ten years:

"We won't experience 100 years of progress in the 21st century—it will be more like 20,000 years of progress."

And thank goodness for progress. Where would we be without the popcorn bag, the self-wringing mop, and Viagra?

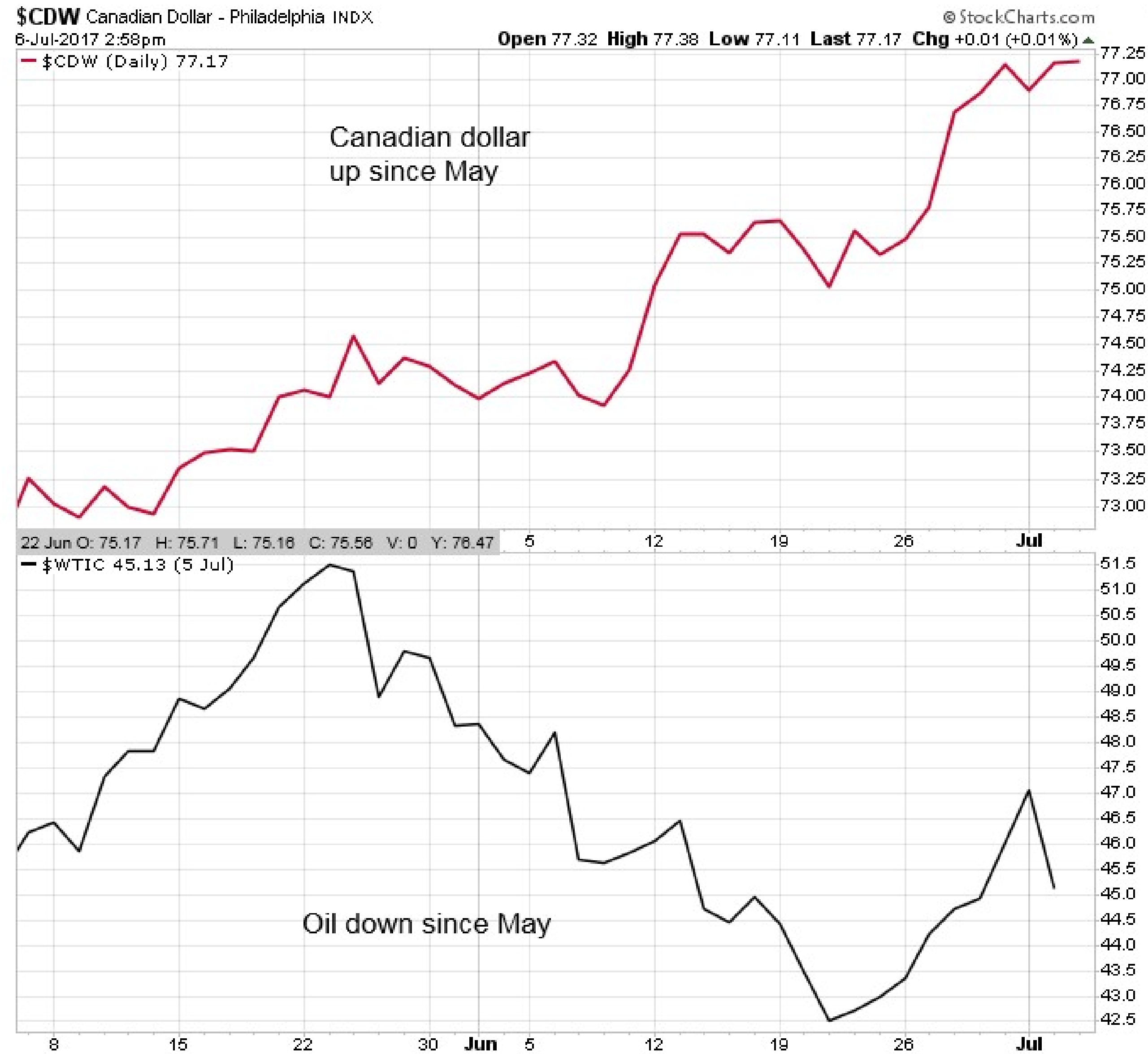
The Mighty Loonie

The story of the last month has been the sharp rise in the Canadian dollar versus the US dollar.

As Canada became a large oil exporter, our dollar has risen and fallen with our oil revenues. Here is a chart comparing oil (in black) and the Canadian dollar (in red) over the past 10 years.

We have become a petro-currency, with the loonie following oil very closely:

However, the two have diverged sharply since May:



In the first week of June, the head of the Bank of Canada began hinting that Canada's key interest rate could rise as early as the July meeting. It has been set at 0.5% for almost two years:

Many currency traders have bet against the Canadian dollar by selling it short. The sudden threat of a rate hike caused them to reverse their positions and buy it. This has caused many Canadian portfolios holding US stocks to suffer paper losses from the decline in the US dollar.

Where do we go from here?

It all depends on how many rate hikes lie ahead. If real estate prices in Vancouver and Toronto cool, we may see just one or two rate hikes. If not, then we could see as many as four, as we have seen in the US.

The 10-year relationship with oil is long and established, however. Close to 20% of Canada's export earnings come from energy, so if oil stays weak, the Canadian dollar should slide once again.

The Times, They Are a Changin'

We have mentioned before that this is the first time in a decade when the central banks of every developed country are tightening. This means the money spigots which were turned to "On" through Quantitative Easing and lower interest rates have now been turned to "Off" through the tapering of such programs. Even Canada has joined the anti-party, as discussed above.

Historically, stocks, bonds, and real estate do worse when interest rates are rising than when they are falling; the final impact remains to be seen. Why the uncertainty? Interest rates are still low historically. Paying 3% versus 3.5% on a mortgage is not likely to stop the sale of a house, for instance.

It does mean, however, that different groups of stocks could outperform. For example, technology companies – which tend to outgrow the economy when things are soft – and utilities – whose high dividends are very attractive when rates are low – could falter.

What companies benefit? Banks and other financials can do well in a rising rate environment, as can some industrial stocks, such as railroads.

Normally, energy companies would do well, and they may yet. There is just so much spare oil in the world today, however, that any rising demand could be met by the glut that is stored in floating tankers and stuffed into facilities in Oklahoma.

In our managed portfolios, we switched an oil producer for an oil pipeline in the last two weeks. Pipelines are inherently more resilient to moves in oil prices, and we prefer to be cautious rather than bold over the summer months.

Lots of Worries, But…

The biggest worry most investors have today is that we will see a repeat of 2008. News channels and websites are always looking for “eyeballs” and blare out the most terrifying headlines in order to attract them.

We are paid to worry, and there are things that concern us. Margin debt is too high, for example. And valuations of stocks are at the high end of historical values. But both have explanations that are credible.

Interest rates are very low, for example, so why wouldn’t people borrow at 2% to earn a 4% dividend, for example? Real estate investors do that all the time.

And company valuations are high because profitability is also high. The Tech Boom of the year 2000 was fueled by dot-com companies that made zero money. Technology companies today are the exact opposite – they are so profitable that they can afford to buy just about any competitor that stands in their way.

North Korea is a concern. The country is unpredictable, reckless, and desperate. But as Jim Cramer of RealMoney asks, why is the South Korean stock market booming and why is gold not jumping?

Finally, the technical services we subscribe to point to the underlying strength in the stock market – most notably the US stock market. The oldest and slowest of these is the Dow Theory buy-sell signal. This indicator just confirmed its bullish trend in the last two weeks, which suggests the underlying trend is still higher.

We remain both paranoid and cautiously optimistic.

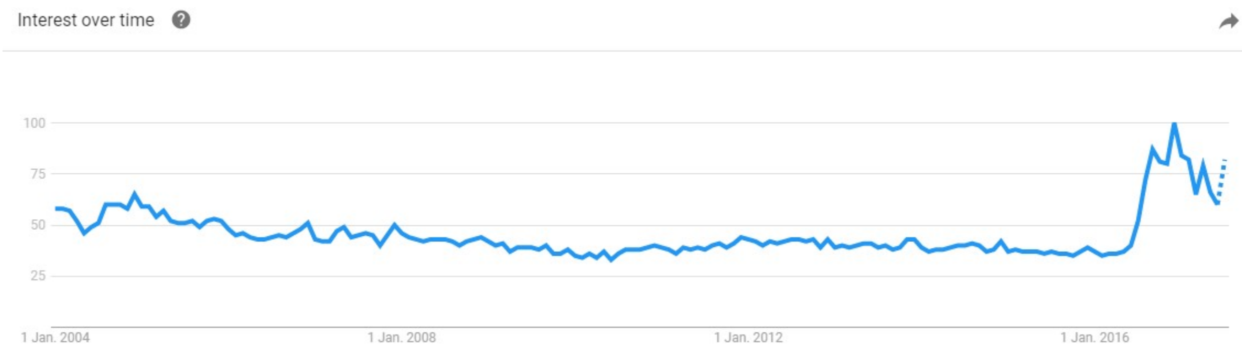
“Only the paranoid survive.”

- Andy Grove, founder of Intel

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.

Not Final on Vinyl

For you old music aficionados, there's something strange happening. The century-old vinyl LP is making a comeback. Sales of "records", as we called them, have almost quadrupled worldwide:



Source: Google Trends

Part of this is due to millennials wanting to portray a cool, "retro" image to their audiophile friends. The other part is that a number of recording artists have begun offering their music in vinyl format.

The problem is, there are just 16 operating presses capable of making vinyl records in the US and these are out-of-date and overloaded. Sony (**NYSE SNE**) just announced they would be opening a plant in Japan to start vinyl production, as the old format has begun outpacing digital music sales in some months.

Its like someone started offering horses and buggies again and we are lining up to buy them.

In fact, there are scientific reasons that vinyl records sound better than digital music. Analogue recordings store sound in the same smooth way our ears hear it. It is like strolling over a rounded hill versus marching up and down one that has had stairs cut into it. Digital recordings lose some of the texture of natural sound, especially those with softer volumes and acoustic passages.

Not all music sounds good in the old format. High volume music can shake the stylus, for example. And because there is less space to etch the sounds into the vinyl as you get closer to the end of a record, the quality degrades at the centre. Which is why most hits were placed near the outer edge of the old albums.

So if you still have vinyl LPs in your basement, you are free to drag them back upstairs. They are cool again!

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

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