The Market in Review

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This week's articles and insights

1. *Big Money Speaks*
2. *Supply and Demand*

"Hang out with people smarter than you. You will see the difference."

- **Anonymous**

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	23,422	-0.50%	+18.52%
S&P 500	2,582	-0.21%	+15.34% (+8.74% in $CDN)
TSX	16,039	+0.12%	+ 4.92%

Big Money Speaks

I travelled to Los Angeles this past weekend to visit the Capital Group. This is a money management firm that manages approximately US $1.6 trillion. They have over 8,000 employees and are the largest global money manager in the world. Some call Capital the largest money manager in the world that no one has ever heard of.

While I took about six pages of notes, it was their broad discussion of technological and economic change I wanted to highlight in this week's letter. Capital has 384 portfolio managers and research analysts in every corner of the world, so their perspective is unmatched.

Disruption

While many people are worried about the relentless climb of stock markets this year, the Capital Group does not see any major stresses in the US economy. As a result, few recessionary signs are apparent. The global recovery is being enjoyed by almost every country in the world for the first time since the last 1990s, which bodes well for demand.

Do they have worries? They would not have beaten the global index for decades if they didn't.

Governments around the world have collectively printed money and bought $15 trillion of bonds since 2008, which has helped deliver the 2% growth we see today. These purchases peak next March as the European Union and the US shrink these programs. What happens then? Do markets reverse?

The exponential rise of some growth stocks have led Capital Group managers to take profits and switch leaders. While technology stocks are still 25% of their giant global equity funds, the top position is now a tobacco stock.

Wait, tobacco? The biggest revolution in smoking is the advent of the new heat-but-don't-burn tobacco products. These release the nicotine but not the tar and other cancerous substances, as well as providing a smoke-free environment for non-smokers. They may be the biggest technological change to hit tobacco since the lighter.

The 2nd Machine Age

The next decade is set to be profoundly interesting. Capital Group calls it the 2nd Machine Age, and it will usher in a period of global economic disruption. This does not necessarily have to be bad or good, but it will mean a period of great change for many companies which are leaders today, but may not be tomorrow.

There have been at least five periods of economic disruption in the past 250 years:

- 1770's Industrial Revolution
- 1820's Steam and Rail
- 1870's Electricity
- 1900's Automobiles and Oil
- 1970s Information Age and Telecom

All of these eras saw companies rise and fall, with even countries vanishing.

The decade from 2020 to 2030, or the 2nd Machine Age, as they call it, will see great advances in such areas as artificial intelligence and machine learning, and 3D printing. One of their key managers listed a few examples:

- The age of the Autonomous Cars is almost upon us and we may see parts of cities digitally "ring-fenced" by 2018 where driverless vehicles will be allowed to operate for the first time. A mass conversion of internal combustion engines to electric vehicles will take longer than many think, however, because costs are still too high for many electrical components. Eventually, electrical vehicles combined with autonomous driving will have a tremendously negative impact on auto manufacturing, municipal parking, and automobile insurance. The research specialist in this area sees the Audi as the most advanced self-driving car today and believes Tesla (**NASDAQ TSLA**) is a "fake business model" because every car made is heavily subsidized.
- Solar power has seen little new innovation or new investment in the last decade. By 2040 we could have solar collectors in the sky sending power down 24 hours a day, 7 days a week. This will make such things as water desalination in hot, remote areas much cheaper.
- 3D printing – 20% of everything manufactured will be 3D printed by 2030, including human organs.
- Bioengineering of food.
- Science leading to an elongation of life expectancies.

What are the ramifications?

There are likely to be fewer jobs, or at least fewer jobs in the industries we know today. In the past, new industries have spawned new employment. For example, think of how many people are employed in the cell phone industry compared to twenty years ago. Jobs may become obsolete much more quickly, however. It will be more important than ever before to save for retirement, especially if the next generation is going to live longer. My job will be to educate millennials about this.

Instead of many companies in each industry, we could see just 2-3 giant companies dominating each market. It will be vital to be on the right side of this as an investor.

The changes technology is bringing to the banking and financial services industry are just as profound. The new entrants are known as “FinTech” companies.

FinTech

Today, more and more people want better mobile services and access. Artificial intelligence is already helping people invest, and block-chain technologies and digital currencies could topple our need for banks almost completely.

Some companies will adopt the new changes and thrive. Many could miss the mark as new entrants arrive.

An example of new entrants are the social media companies. Not that long ago, our banks controlled us financially. They knew everything about our finances and dictated our spending and borrowing with this knowledge. Today, companies such as Facebook (**NASDAQ FB**) and Alphabet (**NASDAQ GOOGL**) know just as much about our finances as any bank. They also know our spending habits, our friends’ spending habits, and our locations at any moment.

Which company could become the largest financial firm in the world? The answer may surprise you.

Alibaba (**NASDAQ BABA**) in China had a very successful payment system called Alipay. It was so successful, they spun it off into a new company called Ant Financial. Ant is now the largest FinTech firm in the world with over 500 million customers in China alone. It operates the largest savings account in the world after just a year of being open.

Ant Financial is growing quickly because Asia is growing so much faster than everywhere else. Unlike in North America, most children in China did not grow up with televisions, Playstations, or Gameboys. For them, everything – gaming, commerce, communications, business – revolves around their phones. Companies such as Alibaba and Tencent (**NASDAQ TCEHY**) – the operator of the WeChat messaging network - have capitalized on this.

Remember those “ghost cities” that China built and were completely empty a few years ago? These were held out as evidence of China’s upcoming collapse. Instead, China spent even more on high-speed railways. Those ghost cities are full today because people can live there for half the price of Shanghai and Beijing, and are just a few hours away by high-speed train.

There were many other interesting thoughts I gained from the many global managers we heard from. For example:

Energy – They see oil reverting back to $60-75 next year, a rise that could happe even faster with the arrests that happened in Saudi Arabia over the weekend. Interestingly, they see the US shale beds as beginning to show signs of depletion (especially in the Bakken fields of North Dakota), which means there must be more oil investment around the world. It also puts the Canadian oil sands in a better light, since they have close to 200 years of known reserves. One manager’s favourite is Canadian Natural Resources (**TSX CNQ**), one of the largest oil sands companies, up here in Canada.

Artificial Intelligence in Canada - Canadian centres in Toronto and Montreal are now globally-renowned hubs for artificial intelligence research. All the big tech giants are setting up shop because of the recent successes and breakthroughs coming out of places such as Montreal and Edmonton.

Consumer Staples – “Millennials can’t cook”, stated one analyst rather bluntly. Many buy prepared meals at their grocery stores, which has led these stores to “shrink the middle (packaged foods) and expand the periphery (the deli)”. The packaged food industry has, as a result, seen a sharp contraction in sales due to this “Death of Brands” worry. The lead analyst for this group sees companies such as Kellogg‘s (**NYSE K**) and General Mills (**NYSE GIS**) as approaching attractive levels because of the negativity and selling of their shares. Millennials want fresh, new brands, and the packaged foods companies understand this. They are adding more fresh flavours than ever before to deliver the fresh and organic experience today's consumers desire. So much, in fact, that the world is experiencing shortages of such additives as vanilla and rose oil. Packaged foods also do better when the economy slows, so their time will come again.

Finally, Capital Group is one of the largest investors in emerging markets worldwide. They see most investors as vastly underexposed to this part of the world, where much of the growth and more of the young people reside. Values are still much better than in most developed markets.

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.

Supply and Demand

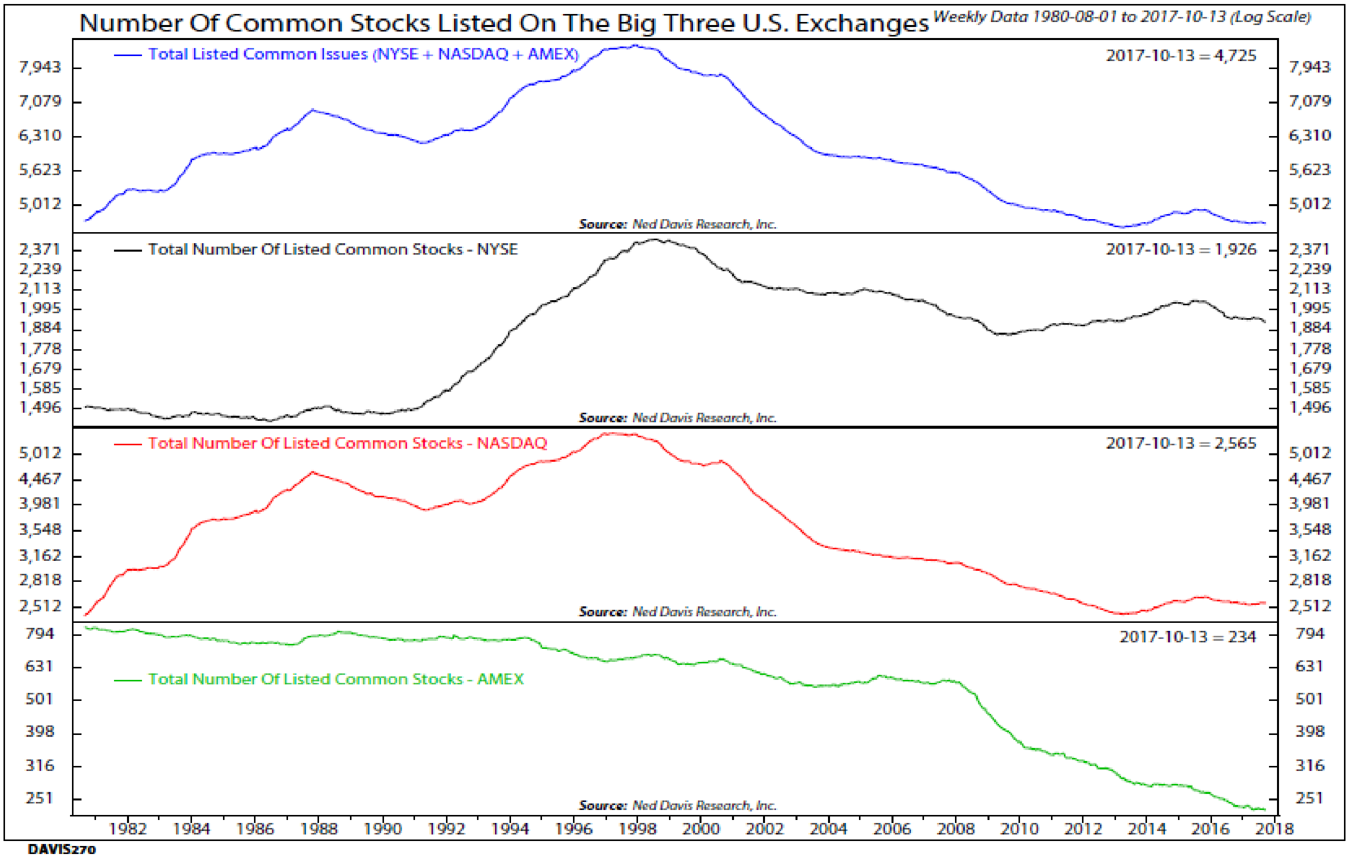
We all know stocks are at all-time highs and there are many reasons floated about to explain this.

One that is not commonly discussed is the supply and demand picture.

The Ned Davis Group published an interesting graph this month that shows the dramatic shrinkage in the number of publicly-listed companies in the US. The peak was around 1998, at the height of the dot-com era, when close to 8,000 companies were listed on the various exchanges.

Today, there are just 4,725. Not even enough to fill the Wilshire 5,000 Index, which holds just 3,618 stocks as of the end of 2016.

More demand and less supply may be another important reason for this bull market.



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