The Market in Review

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This week's articles and insights

"Capitalism doesn't do well in popularity polls, despite the fact that it has eliminated many of mankind's worst problems, such as pestilence and gross hunger and poverty."

– *Walter Williams, professor of economics at George Mason University*

Your Index Report

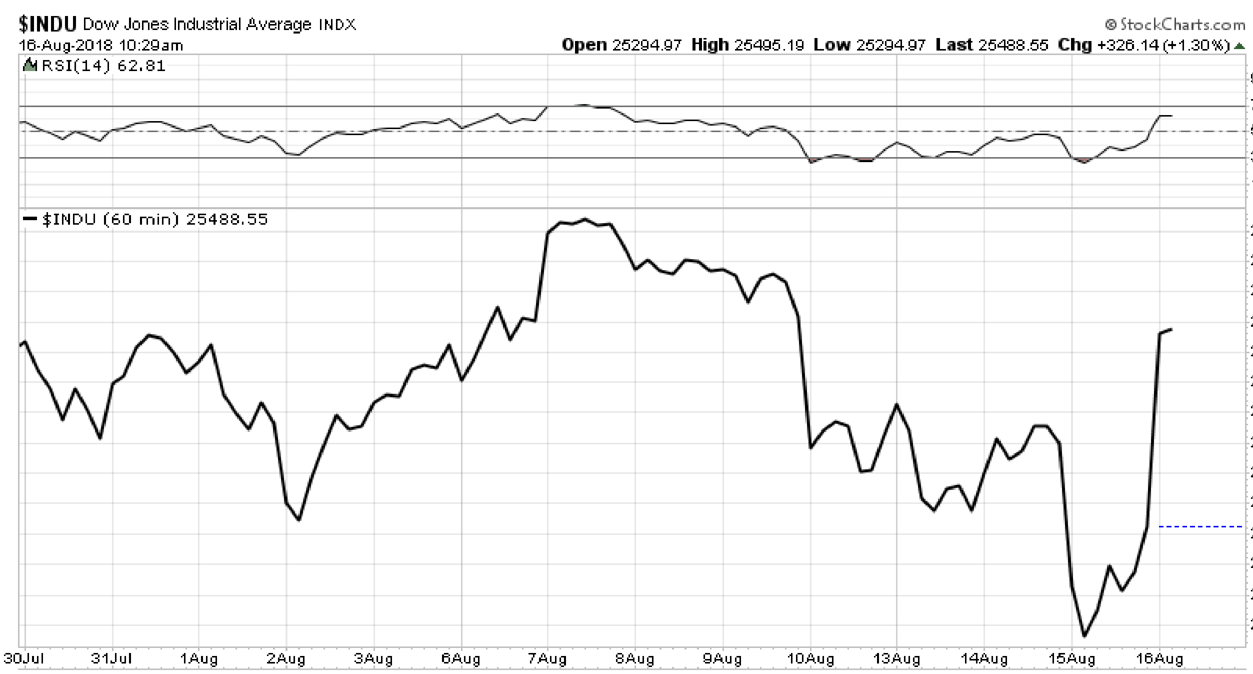
	Current	Last Week	Year-to-Date

Dow Jones Ind. Avg.	25,669	+ 1.41%	+ 3.84%	
S&P 500	2,850	+ 0.59%	+ 6.60%	(+10.61% in $CDN)
TSX	16,324	- 0.02%	+ 0.71%	

Tennis Match Markets

Summer is tennis season, and if you have ever been to a tennis match, you will know that the worst place to sit is at centre court, beside the net. Unless you have a standing date with a chiropractor, that is. Watching the ball bounce back and forth is brutal on the neck, so seasoned fans know the best seats are at the ends of the court.

Markets this month have been ‘tennis match markets’ in August so far, with no clear winner. The Dow Jones Industrial Average is in the same place as three weeks ago after travelling almost 2,000 points – nearly 8% of its value. That’s a hard market to ‘love’.



Earnings season (a quarterly occurrence) is now over. August and September are traditionally two of the weakest months of the year for returns, so even though the volatility surprises us, it shouldn’t.

As one market pundit put it, “if the market is going to rest, then this is a good time to do it.”

Returns So Far

It has been a challenging year so far for conservative investors.

The Universe Bond Index (which includes almost all bonds in Canada) is negative for the year to July 31st. Europe, Asia, the emerging markets, and most commodities are also underwater, which just leaves the US market.

And with three stocks – Amazon (**NASDAQ AMZN**), Netflix (**NASDAQ NFLX**), and Microsoft (**NASDAQ MSFT**) making up 71% of the gains in the S&P 500 as of July – it means there have been few areas to find outperformance so far in 2018.

This Just In

Markets jumped sharply on Thursday of this week. Why?

China confirmed that it will send a delegation to the U.S. later this month for trade talks. These are low-level talks to discuss "economic and trade issues between China and the U.S." according to a statement from the Chinese Commerce Ministry. They are unlikely to solve all the issues raging between China and the United States, but they are a hopeful start.

We have written previously that the market is expecting an all-out trade war. If this can somehow be averted, the market could take this very favourably. President Trump may feel that if enough progress is being made, he can declare victory and back off his sanctions, especially with mid-term elections on the horizon.

Imagine a positive tweet from the White House for a change.

Turkish Fright

Many tools are used in war. In WW2, those tools were bullets and bombs. In the Cold War, the tools were spies and disinformation. Today, we are engaged in an economic war where the tools of engagement are currencies and tariffs. Look at the current Turkish conflict as an example.

In truth, it seem like the US is at war with just about everyone. But the country directly in the gunsights at the moment is NATO ally Turkey. Under President Recip Erdoğan, Turkey has become more Islamist and pro-Russia than at any time in its recent past. This has been conveniently ignored for years until things came to a head recently. Tariffs and sanctions are now flying about, but these are not the real root of Turkey's problems. As with most economic calamities, debt lies at the bottom of Turkey's woes.

In 1997, Thailand and its banks had been lending US dollars to every Thai borrower with a pulse. Like many small countries eager to grow when interest rates are low, Thailand made the mistake of offering cheap loans in US dollars. This worked well from 1993 to 1996 until the US dollar strengthened. 1997 was the tipping point. When the US dollar soared against the Thai baht – and interest payments jumped - Thai homeowners and shopkeepers began to default. The currency crashed, setting off a contagion that rippled around the emerging markets of the world.

Turkey may be the Thailand of 2018.

"Turkish banks and businesses borrowed hundreds of billions of U.S. dollars and euros to fund a domestic construction boom in the years after the global financial crisis" said Matthew Klein in Barron's. Turkey had US $375 billion in foreign loans in January. With the 40% collapse of the Turkish lira this year, those debts are now closer to US $550 billion.

"Since the botched coup attempt in mid-2016, the country has been racked by purges, snap elections, and a constitutional change to enhance Erdogan's grip on power. The new finance minister is Erdogan's son-in-law," continues Klein.

Will this cause a global contagion?

Most emerging market nations have far more reserves than they did in the 1990s, so the chances of a domino contagion of falling currencies are lower. Where Turkey has debts equal to 70% of its GDP in foreign currencies, it is only 27% for Brazil, 33% percent for Russia, 35% for Indonesia, and 50% for South Africa (National Review). This gives us some comfort that Turkey is somewhat of an isolated case.

The risk for the US and NATO is that this crisis has a deeper political side to it. Russia is consolidating its influence in the region rapidly. Recently, Russia, Iran, Azerbaijan, Kazakhstan, and Turkmenistan agreed to a long-fought partition of the oil riches of the Caspian Sea. This is an irritant that has been around for decades. Russia and Qatar are offering aid to Turkey, which means America's enemies are suddenly making nice with its shaky allies.

The optimistic end to this mess is as follows:

- We here in North American are relatively untouched by the goings-on in the Middle East and Asia. This is what happened in 1997-1998. North American markets corrected, then rallied for another two years.

- Oil, copper, gold, and soybeans and lumber are down sharply in price, which are tempering the outlook for inflation. This could allow the pace of interest rate hikes to slow, which would be <u>grea</u>t news for our economy.

The pessimistic side?

- Turkey defaults and needs a bailout. This disturbs the markets into 2019.
- We could see a widening trade war. If we lose Turkey as a NATO partner, and continue to butt up against a stubborn China and a newly-confident Russia, the world could be pushed into a tense recession.

For now, we lean toward the 1997 case: a correction here that is likely to be brief. Overseas assets will get hit harder. European banks were big lenders to Turkey (will they never learn?), so they will pay the price of increased defaults.
Gold will sell off as weak nations (Venezuela, Turkey) sell their bullion to stabilize their currencies. Oil will moderate as China pauses. Both gold and oil will rebound once this passes.

"Erdoğan can lock up dissidents and shut down newspapers. But he can't lock up the markets. (He) wants his people to boycott iPhones. Given the state of the lira, few of them will be able to afford one."

- Kevin Williamson, National Review

No Room For You!

New Zealand recently banned foreigners from buying property. This is something we have considered here in British Columbia, as have many other areas with soaring property prices.

Whether or not this will work is one issue. The other is the whole concept of economic freedom.

While both China and Russia tout their communist and ‘free market socialism’ economies as superior to the West’s capitalist markets, we don’t see money rushing to get into Beijing and Moscow. Instead, Chinese and Russian money has been pouring into New Zealand, Australia, Canada, the US, and Great Britain.

Why? Because these countries have secure property rights, rule of law, an independent judiciary, enforceable contracts, and flexible labour markets. In other words, investors can buy and sell as they please.

If the Russian and Chinese economies are superior, why are their investors so eager to invest elsewhere?

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

Matchmaker, Matchmaker

Matchmaker, Matchmaker,
Make me a match,
Find me a find,
catch me a catch
Matchmaker, Matchmaker
Look through your book,
And make me a perfect match.

Matchmaker, from Fiddler on the Roof

We have written before about technology disrupting entrenched social patterns, and nowhere is this more evident than in modern dating.

Romance was once incubated in church, sorority parties, and other community gatherings. Young men had their “wingman” at outings, who would talk to the less attractive friend to create an opening with the more attractive girl.

Jewish singles might consult a matchmaker, also known as a Shadchan, while Japanese singles would visit a Nakodo. Today, we use *Tinder*.

In the modern era, where most people now have a smartphone, we are more trusting about entering personal data. The first paid computer dating site was created in 1965, but the industry did not catch on until the internet and e-mail arrived in a big way in the 1990s. Match.com (**NASDAQ MTCH**) was born in 1995 and became one of the early leaders where two people could meet online and compare their similarities before they met.

“Ten years ago only 3 percent of relationships began online. Today it's closer to 30 percent.”

Many Ginsberg – CEO Match.com

As one of the older married men in our office, I met my wife at one of the venues mentioned above: at a sorority party. Today, most of the young singles have either tried, or regularly use, on-line dating sites such as Plenty of Fish or Tinder. Both are brands of Match.com, the largest on-line dating company in the world. Today, Match.com operates in 25 countries and has 7.7 million subscribers. Some of its 45 global brands include:

okcupid
Plenty of Fish
BlackPeopleMeet
Our Time (50+)
Hinge
Tinder

By 2017, the age of the matchmaker was long over. The internet is where most singles meet their first dates.

“In this country, 35% of marriages are the result of dating apps and people don’t mind paying 20, 30, 40 bucks a month for the hope of finding someone that they can fall in love to marry.”

- Mandy Ginsberg

What's next?

Biological data is becoming more accessible and more and more commercialized. Many people now have their DNA sequenced to tell them where their ancestors came from, as well what diseases they are prone to.

Expect to see dating sites merge with these DNA sites in the future. Ideal "matches" will then include not only pictures and preferences of your date, but also how compatible your two DNA lines will be if you choose to have children.

The sky is truly the limit in this new era of data.

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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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Prices shown are as of close August 17th, 2018.