The Market in Review

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This week's articles and insights

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**"When you believe in things that you don't understand,
Superstition ain't the way"**

- *Superstition, by Stevie Wonder*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	26,072	+1.04%	+ 5.47%
S&P 500	2,810	+0.86%	+ 5.11% (+ 4.46% in $CDN)
TSX	16,353	+0.28%	+ 0.89%

Patterns and Superstitions

A key function of the human brain is its ability to identify patterns. It is a primary survival technique.

For example, you and your Cro-Magnon pals are walking through the jungle every day and you notice whenever you smell a tiger, one of your chums disappears. This is a sequence of events your brain really should remember.

Similarly, a trail of fur on branches means a herd of gazelles may have passed by recently, meaning lunch is likely just ahead. This is an *A-leads-to-B* pattern where A (the gazelle) is directly connected to B (a good meal).

Our brains are wired to seek even more connections. Tigers like to hide in grass where their striping camouflages them, so clumps of grass are best to be avoided. They hunt in the day. Recognizing these dangerous patterns meant whoever observed them lived longer.

However, there is an old saying that “correlation is not causation”. If you ate a certain nut before the tiger last struck, you might be tempted to think the nut caused the attack. Of course, nuts and tigers have nothing to do with one another, but as long as the cost of such behaviour is minimal, what’s the harm? If it is a wrong pattern, nothing happens, but if it is correct, you avoid becoming tiger food.

And so superstitions are born. “Don’t walk under ladders because something might fall on your head” becomes a good luck/bad luck omen. An old superstition during the smoking years was that it was bad luck to light three cigarettes with the same match. This was born out of the trenches in WW1, when the first cigarette lit at night alerted an enemy sniper, the second allowed the sniper to aim, and the third became the target.

“An animal must balance the cost of being right with the cost of being wrong. The tendency to falsely link cause to effect – a superstition – is occasionally beneficial.”

- Kevin Foster, evolutionary biologist at Harvard University

As much as we like to think we have evolved away from such behaviour, modern humans are really no different. We still refuse to open umbrellas indoors, avoid stepping on cracks in the sidewalk, and refuse to book the 13th floor in a North American hotel or the 4th floor of one in Asia. Superstitious behaviour helps us believe we can control the uncontrollable.

January is a notable time in the stock market for superstitious beliefs. Commentators (like us) routinely quote the following:

- The Santa Claus rally: As long as stocks rise in the week after Christmas through to January 3rd, the year will be a good one.
- The 'first five days of January' indicator: If the market rises during the first 5 days of the year, the entire year will be positive.
- The January Barometer: As goes January, so goes the year.

Most have better than 50% odds of historical success, but they are all prime examples of correlation (i.e. they have successfully occurred in the past) but not necessarily causation.

Now, just for the record – take out the rabbit's foot here – the first two above were positive this year, which is a good omen.

As the market rises further and further and investors join in, more and more patterns are established. Investors can become very superstitious as profits mount.

"I saw a plane take off today and Boeing (**NYSE BA**) went up. I better buy Boeing the next time I see that again!"

On January 3rd, both TD (**TSX TD**) and RBC (**TSX RY**) reported that massive on-line trading volumes crashed their systems. So many people were following their bitcoin and marijuana stocks that the computers could not keep up with the volume. For several months, every time people checked their accounts, the prices of these stocks were higher. Being the pattern-seeking creatures we are, investors started checking even more because the action of checking seemed to help their stocks rise.

Such behaviours are more typical of the late stages of rallies than the beginnings, so this is one pattern we are wary of. Marijuana stocks look more like the "dot.com" stocks of the late 1990s than anything we have seen in the two decades since. Those were very profitable times to trade and timing the end is difficult. After tripling from 1994 to 1999, the peak in the Nasdaq was just a year away. What did it do in that last year? It went up another 100%!

But, when the party ended, it was not pretty. Many companies, like Buy.com, were essentially selling dollar bills for $0.90 and would never make money no matter how many eyeballs they reached.

As more and more marijuana stocks appear – medical, recreational, edibles, oils, fertilizers, hydroponics, lighting, greenhouses – it does make you wonder how much appetite there will be for ‘weed’ when all is said and done.

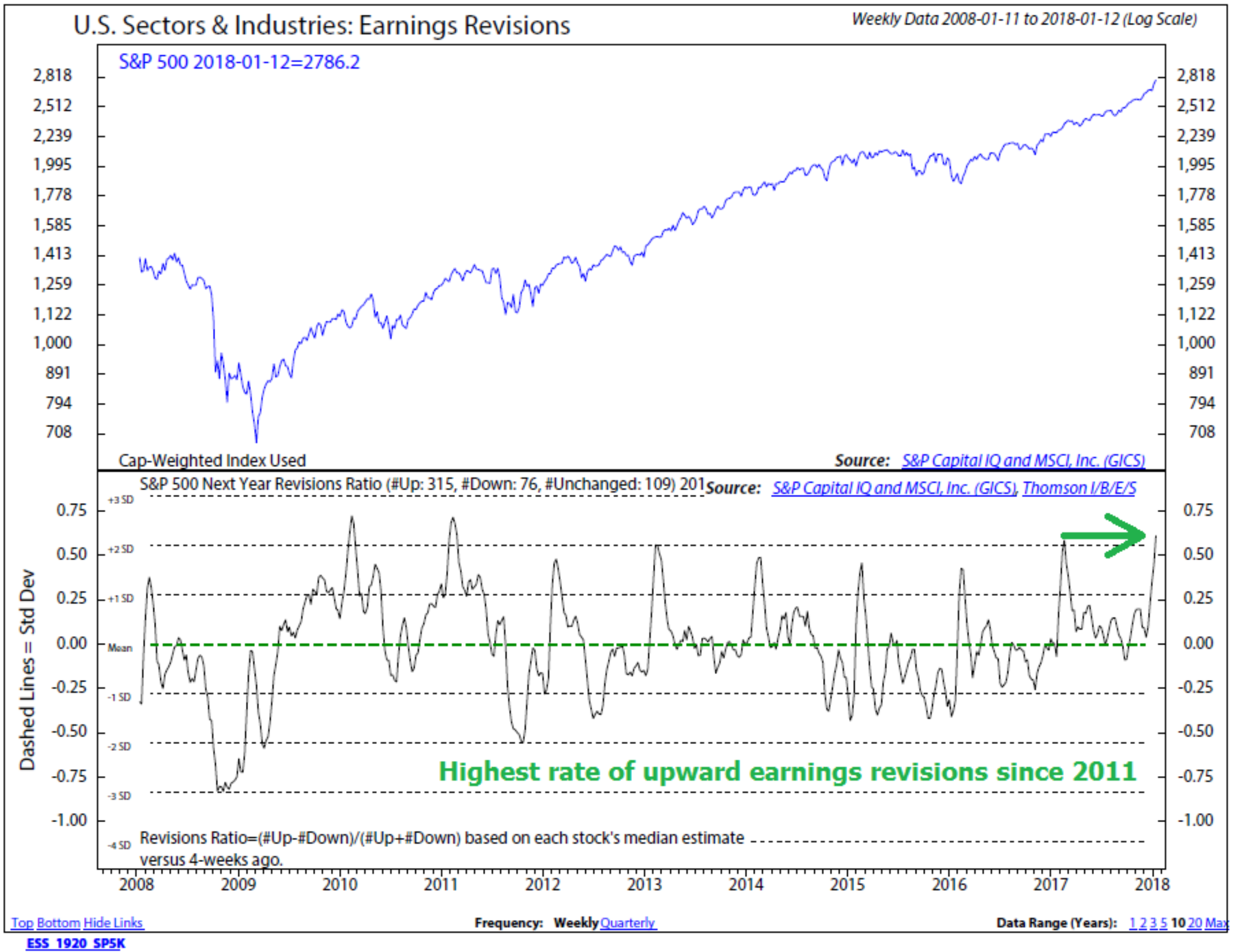
Enjoy the ride, but keep your rabbit’s foot close.

Up, Up, and Away

There is great deal of excitement happening in the US market at the moment.

The new US tax bill has lowered taxes for most corporations by a sizeable amount. This points toward much higher profits, as a result.

You can see this in the way analysts are revising estimates higher:



Some companies, such as Wal-Mart (**NYSE WMT**), have chosen to raise wages and pay bonuses. Many other companies are likely to buy stock back and raise dividends. Both are helping to power the US market higher.

As a result, the US market (the S&P 500) is up approximately +3.5% in just the first three weeks of 2018. In Canada, our tax rates have been going the other way (up), and so our market is limping along at about +0.5%.

Recommended Investment Actions

1. Eligible Canadian investors should contribute $5,500 to their Tax Free Savings Accounts.

2. Everyone should review their savings plans for the year ahead. Millennials, especially. This demographic is not saving enough.
3. Our preferences for investments are Europe (several years behind the US investment cycle), and emerging markets (much cheaper multiples with higher growth than developed markets).
4. We are closely watching several sectors that have started the year off poorly: the utilities and phone companies. Both pay rich dividends and have fallen up to 10% from December levels.

We would prefer a decline in markets before we jumped in. However, with over 80% of global economies expanding together, we are seeing more growth than we have in many years.

After years of "lower for longer" economic growth, it is truly eye-opening to watch.

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.

Notes from Down Under

Paul and Sue spent Christmas in Australia visiting their son, Ray. It was odd to have a picnic for Christmas dinner and to enjoy the longest day of the year on December 21st when Canada experienced the shortest. Temperatures also hit an 80-year high of 47C in Sydney just a few weeks after Winnipeg touched -46C.

Australia is similar to Canada in that it is having to cope with an influx of foreign money. Older buildings in Sydney are being replaced by new high-rises and the finger is pointed at China as the source, just as it is here. One report said 10% of Sydney's condominiums are empty, a vacancy rate similar to that in Vancouver.

The biggest observation was the minimum wage. It is a timely topic because of the recent hikes in Ontario and Alberta.

Australia has the highest minimum wage in the world. Workers over the age of 21 earn approximately $20 per hour and $45 per hour on holidays.

In Canada, the average minimum wage in 2017 was $11.43 per hour (source: Monster.com). Alberta's recently jumped to $13.60 and Ontario's rose even further to $14 per hour, an increase of 21%.

Many small businesses and fast food operators – companies that rely on minimum wage workers – have cut hours and benefits in response. Their issue, they say, is not so much the increase in the mandatory wage but the speed with which it is being done. Dollar store customers and doughnut buyers are likely to balk at a 21% hike in prices overnight.

Has such a high minimum wage sunk Australia?

Not really.

The Australian economy seems to work just fine at $20 per hour, although it has its own wrinkles. Australians don't tip like we do. Here, a dining-out customer is essentially billed for their meal and then they pay the server's wages through tips (now suggested at 18%). This is a source of debate "Down Under", as some decry tips while others readily solicit them.

The Australian minimum wage has been high for years and took years to rise to today's level. No one complains now because of the gradual adjustments. Businesses had time to adjust.

Self-scanning and self-checkout kiosks are more prolific than in Canada, which suggests jobs are being replaced by automation, as they are here.

Of course, there are trade-offs. The first is the cost of living. Food is much more expensive in Australia than here, especially when dining out. When wages of everyone from waiters to dishwashers is doubled, this filters through to $5 coffee and $10 beer. Bananas, a fruit 100% grown in Australia, are double the price we pay in Canada. Coffee at McDonald's (**NYSE MCD**) is also more than double.

Higher wages must be paid by someone, and that someone is ultimately the consumer. Expect to see higher food costs as Canada's minimum wages rise.

Overall, it is a societal balance. Income levels are flatter in Australia than in Canada and the US. A minimum wage worker can actually make a low-end living with one job at $20 per hour whereas this is impossible over here at $11 per hour.

Finally, Canada enjoys a very strong image worldwide, especially among immigrants. The world noticed how many Syrian refugees we took in and how well they have been treated. Some would even move from Australia to Canada if given the chance.

Just not to Winnipeg!

Top Forecaster

Lincoln Jiang, our research specialist, won the 2017 CFA Society of Victoria Best Forecast for most accurately predicting in January the interest rate on the 10-year Government bond at the end of the year. His prediction of 2.04% was not only the closest – it was exactly correct.

Well done Lincoln! Now, what is the market going to do this year?

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