The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

1. *Soup to Nuts*
2. *What Keeps You Up at Night?*
3. *The Second Year*
4. *No Colour – More Work!*

The new church of consumerism: More households subscribe to Amazon Prime (80 million) than attend church regularly (66 million).

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	24,263	-0.20%	- 1.85%
S&P 500	2,663	-0.24%	- 0.38% (+ 1.85% in $CDN)
TSX	15,729	+0.39%	- 2.96%

Soup to Nuts

Weeks ago, we wrote about disruptions happening everywhere in the corporate world. At first, this creates chaos. Opportunity eventually follows.

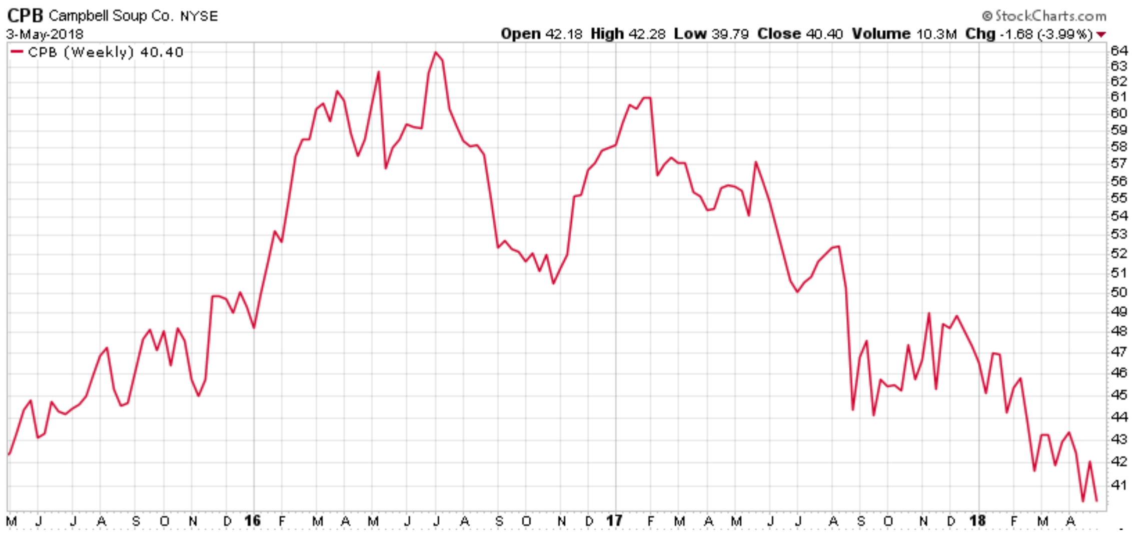
One of the biggest sources of modern disruption occurred when companies that once worked together in a partnership suddenly start competing. Take the movie and TV business, for example.

Not that long ago, you had TV and movie studios creating shows that distribution companies – TV stations and movie theatres – displayed to the world. It was a model that worked for close to a century with movies. Then, cable companies muscled in. They competed with both traditional TV stations and movie theatres, muddying the waters. The biggest changes came when the distributors – cable channels such as HBO and then an upstart called Netflix (**NASDAQ NFLX**) began creating their own unique series.

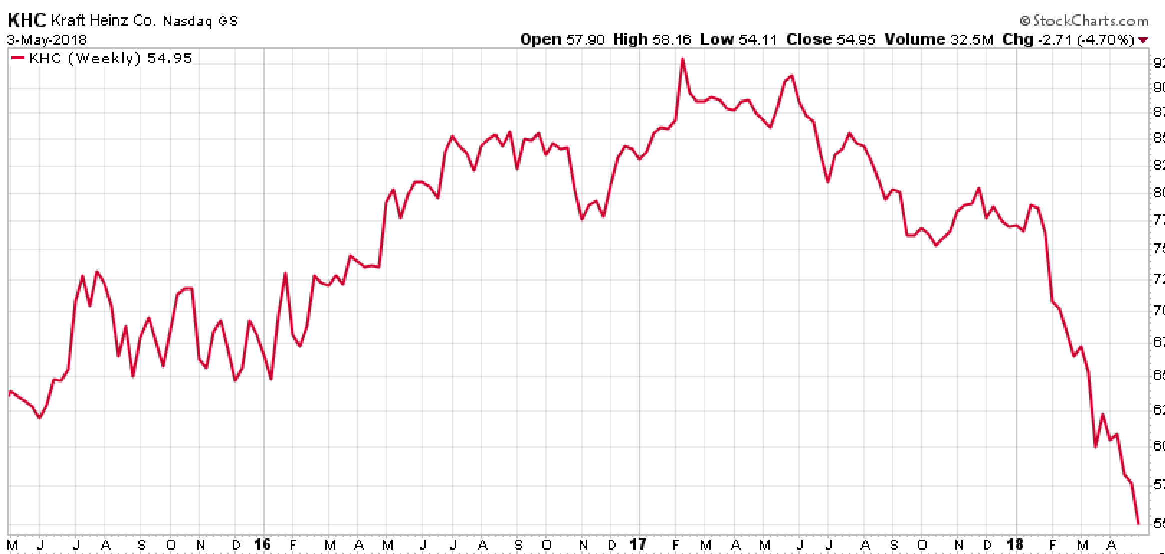
It was like a grocery store growing its own apples. Everyone in the entertainment supply chain had a reserved place at the table, and suddenly the chairs were mixed up and some removed. TV giants such as CBS and ABC are now dinosaurs whose cords are being cut by eager Netflix customers. Walt Disney (**NYSE DIS**) has so much original content, it is set to launch its own streaming service to rival Netflix sometime in the next year. Caught in the middle are the movie theatres. What happens when Disney launches a new Avengers movie on TV through their streaming service? Why even go to the theatre to see it?

A similar disruption is happening in the packaged food world. Brands that were once dominant and found in every cupboard are suddenly struggling to maintain flat sales.

Everything from soup (Campbell Soup Co.):

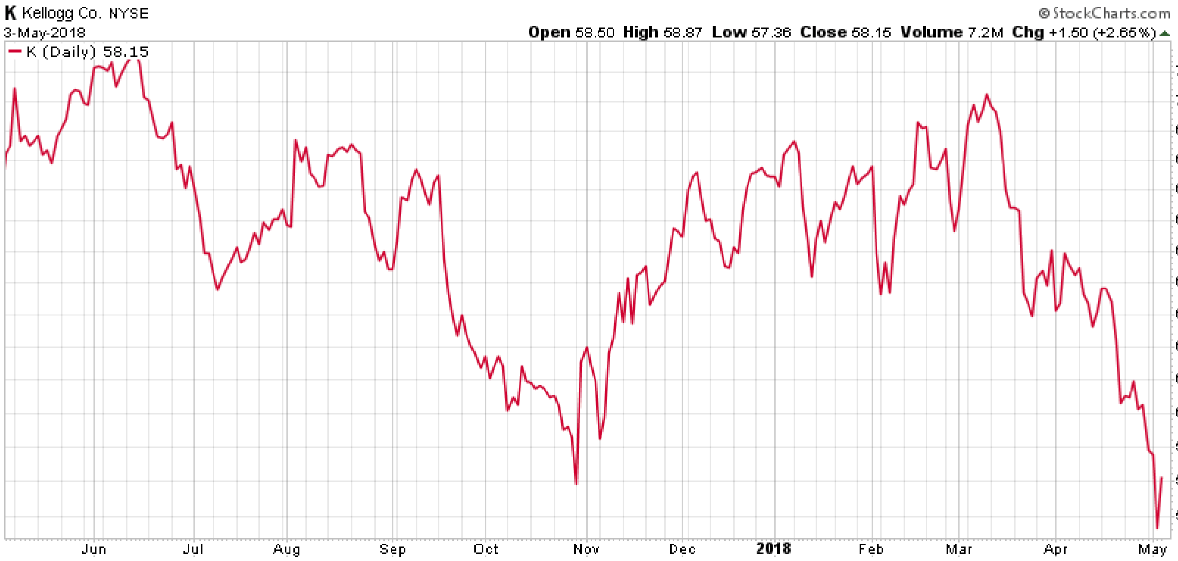


To nuts (Planters Peanuts and Kraft Peanut Butter):



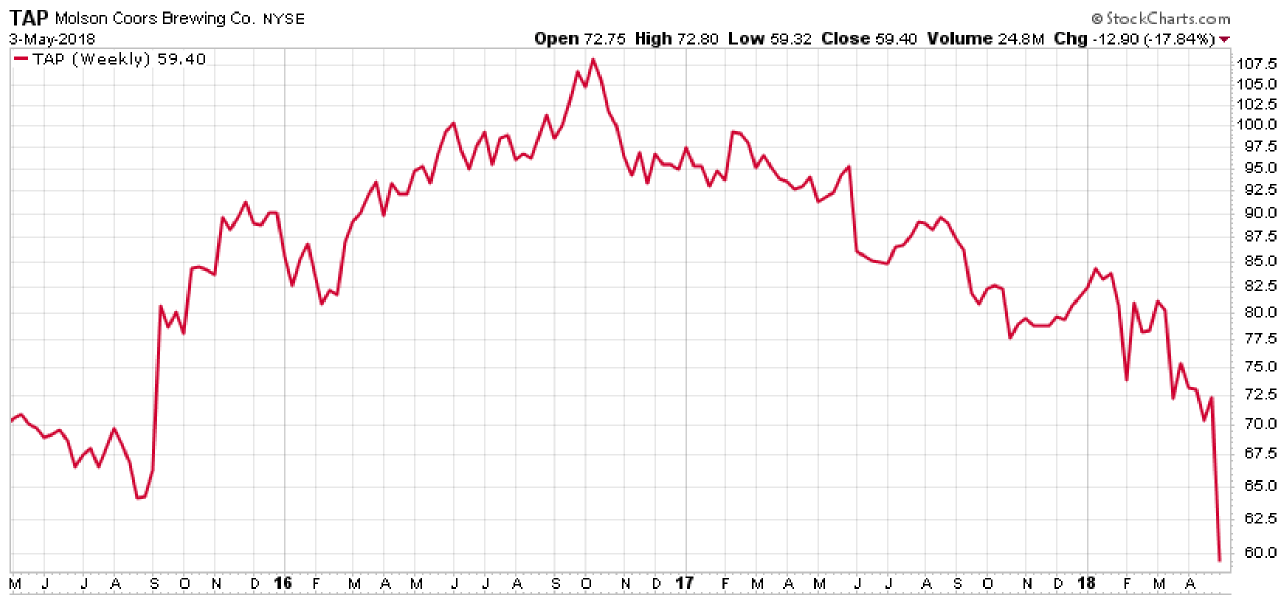
…have been crushed this year.

Breakfast cereal is another category that has struggled for several years. What used to be a quick breakfast isn't quick enough for modern eaters!



Even candy:

and beer are not immune:



There are several tidal forces at work.

The first is rising costs. Everything from cocoa to coffee to wages have risen, pushing up manufacturing costs. Gasoline and diesel prices have also surged, thanks to rising oil and tax hikes. Inflation has pushed an average meal at McDonald's (**NYSE MCD**) to nearly $10 today.

The second is rising generic competition. Go to any store today and you will find more and more in-store brands. Some of the fastest-growing chains, like Trader Joe's in the US, offer almost <u>only</u> generic brands, many of which are their own.

President's Choice from Loblaw's (**TSX L**) is now viewed as a high quality brand and so competes head-to-head with anything from the consumer giants. Kraft-Heinz (**NYSE KHC**) was the result of a merger between ketchup and cheese, but even with its 13 giant brands, it is seeing sales stagnate.

The third reason for the decline in these stocks is Amazon (**NASDAQ AMZN**). Known as the "Death Star" in retailing circles because nothing can stop it, Amazon demands huge discounts to sell your products. And then, they may launch their own generic brand to compete with yours. Amazon Essentials is just one of many clothing brands made for Amazon. Amazon Basics sells everything from luggage to batteries. And the on-line giant even announced its own pet food this week called Wag. This is targeting a slice of the US $72 billion Americans spend on their pets every year. Wag will compete with existing pet food brands like Kibbles (part of Smucker **NYSE SJM**) and Purina (part of Nestle).

At what point do all these negative threats (the yin) push values low enough to become opportunities (the yang)?

Warren Buffett's Berkshire Hathaway (**NYSE BRK**) invested a substantial amount into Kraft-Heinz because it believed brands like Heinz Ketchup would always be around. They very likely will remain in our households, but will we be as loyal as we have been in the past?

We are closely watching the consumer giants Kraft-Heinz and Molson-Coors (**NYSE TAP**). These were steady growth companies for years and now, much of that halo has vanished. As long as sales don't completely disappear (unlikely), they are starting to look inexpensive.

The second opportunity will likely be these larger food companies buying smaller ones. Blue Buffalo Pet Foods was just bought by General Mills (**NYSE GIS**) for $8 billion. Don't be surprised to see mid-sized corporations such as Campbell Soup (**NYSE CPB**) gobbled up in the next few years.

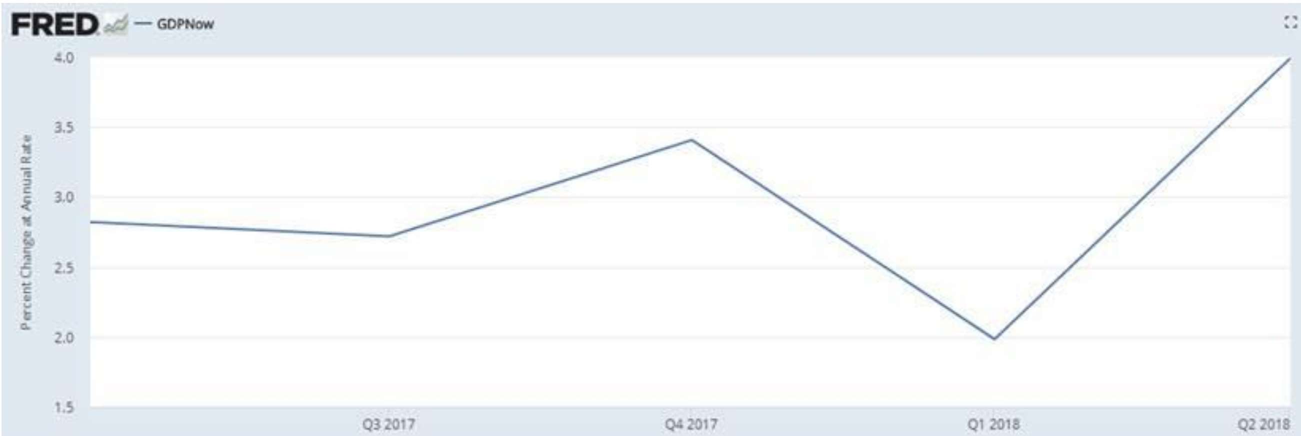
For many of these giants, however, the next twenty years will be much harder than the last twenty years.

What Keeps You Up at Night?

Clients often ask what keeps us up at night. These days, it seems like everything.

- The potential for an Iran-Israel conflict in the Middle East.
- US-China trade talks breaking down.
- Home sales in Vancouver hit a 17-year low for April. Governments want house prices lower and may be getting their wish.
- Interest rates continuing to climb. Next year, the US will run a deficit close to US $1 trillion that will have to be funded by new bonds. Those bonds will compete with money that could have gone into investments like the stock market.
- Earnings are great, but are we at a peak? 80% of S&P 500 companies have exceeded what was expected, the highest "beat" rate in 20 years.

- The US economy is also strong (see below). Is this as good as it gets?



Source: Federal Reserve Bank of Atlanta

For now, this sideways churning has made no one we know any money. It has, however, pushed stocks back to the levels they were at late last year. Earnings are sharply higher than they were in 2017, which means stocks are cheaper today than they were.

Meanwhile, the nerve-wracking moves have made investors very nervous. People are as negative on stocks today as they were in the decline of early 2016. Back then, oil was at $27, earnings were falling and the world had hit a pothole in terms of growth.

The Second Year

The second year of a US presidential cycle is the weakest of the four years. This one has started off right on cue.

But look at the volatility in the chart below. If it feels like we have been yanked around more than normal, it is because we have – a lot more.

Our conclusion is that almost all of our indicators (earnings, economic strength, employment, number of stocks hitting new highs versus new lows) continue to be bullish for stocks worldwide.

The clouds of trade, tariffs and Trump could linger on for a while, however, which means most of 2018’s gains could come in the last quarter.

That seems like a long time away.

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

No Colour – More Work!

My wife, Sue, has worked at an inner-city elementary school breakfast program for the past 25 years. She has seen waves of different immigrants come through over the decades, from Vietnamese to Russian and more recently, Syrian children fleeing the chaos in the Middle East. Canada has been more welcoming than most countries towards these desperate refugees. Our country plans to take in approximately 25,000 Syrians in 2018 of various faiths. This is in addition to the 275,000 other immigrants Canada will absorb.

Some say it is too much, and they have valid points. Others say Canada should take in twice the number, and they have valid points as well. Today's story is simply an interesting window into one family of two boys.

They come to school with their mother every day, and visit the breakfast window where fruit, smoothies, and toast are made available to every child who asks. Some kids are happy and noisy; others are quiet. These two boys smile when they receive their food, only to be reminded by their mother to say thank you. They do, and she does repeatedly, as well. Her English is limited, but her thanks for everything that goes into this free breakfast program – donated food, volunteers, teachers who arrive early outside of their working hours, a safe school, a safe country – is deeply heartfelt.

The teacher says the boys' English is improving every week. One day, she told them they could colour pictures once they finished their lesson. They looked at her with widened eyes.

"No colour. More work!" the older boy said. Their teacher gave them as much as they could take.

As Sue told me this, it reminded me of my own father, who arrived from Poland at the age of six. His English was also limited and heavy with a Slavic accent. His clothes were threadbare and his shoes already worn out by two children ahead of him. Like the Syrian kids, he outworked other students in elementary school, and all the way through university.

When I asked him why he studied so hard, he replied "I was sick and tired of being poor."

These two Syrian boys eagerly accept extra spelling and reading lessons. Why? Their ambition is likely no different than that of the Poles, the Italians, the Greeks, and the Vietnamese who came to Canada before them. To fit in. To get ahead. To buy stuff poverty denies you.

Immigrants take time to integrate, and it is not an easy path. Canada has long benefitted from the "No colour, more work!" attitude of its newest citizens. It is good to see they are still arriving.

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca

(250) 405-2417

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Prices shown are as of close May 4th, 2018.

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