The Market in Review

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September 14th, 2018

This week's articles and insights

"Brazil's most popular presidential candidate has a small problem: he is in prison. Luiz Inácio Lula da Silva, president from 2003 to 2011, is serving a 12-year sentence for corruption and money laundering. Lula finally conceded that his name will not be allowed on the ballot and handed over to his running mate, Fernando Haddad. Haddad and opponent Geraldo Alckmin both face criminal charges over campaign violations, while another candidate - Jair Bolsonaro - is in intensive care after being stabbed at a rally."

- ***Pavel Molchanov, Raymond James energy analyst, commenting on how tame US elections look***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	26,155	+ 0.92%	+ 5.81%
S&P 500	2,905	+ 1.12%	+ 8.65% (+12.59% in $CDN)
TSX	16,013	- 0.48%	- 1.21%

Buzz In Our Bubbles

Here is an inconvenient truth: our bodies like things that are bad for them.

How else do you explain the lasting success, over many decades, of cigarettes, soft drinks, coffee, and alcohol? While our conscience might suggest a vitamin maker would be a fine investment, the reality is that Philip Morris, the maker of Marlboro cigarettes, has been a much better one.

Of course, tastes and fashions change. Even companies that cater to our sins have to adapt. In fact, a major change may be on the horizon for many of today's "sin" stocks.

One of the first socially acceptable mildly-addictive products was cola. Coca-Cola (**NYSE KO**) is said to have originally contained cocaine from the coca-leaf which was mixed with caffeine from the kola nut and sugar. This made it a very refreshing drink, in a variety of ways. By 1903, however, the public had begun to sour on cocaine as a harmless additive, and so it was removed from the formula (LiveScience).

Over the decades, tastes changed. Coca-Cola introduced fruit juices through Minute Maid in 1960 as part of the growing health trend. USDA studies had showed that the average American was consuming 160 pounds of sugar each year, up from just 5 pounds in the year 1900. A decent amount of this was coming from soft drinks. Diet Coke was introduced in 1982 and both Coke and Pepsi-Cola (**NYSE PEP**) offered caffeine-free colas around 1983 as studies showed the negative effects of caffeine.

But, our bodies want what our bodies want. Many fruit juices contain as much or more sugar than soft drinks, so we simply found a guilt-free way to satisfy our craving for sweets. And just as Coke and Pepsi were cutting caffeine out of their colas, a little company out of Seattle called Starbuck's (**NASDAQ SBUX**) began its rapid expansion in 1987. Specialty coffee stepped in to satisfy our need for the morning jolt caffeine provides. In some ways, coffee became the new “safe” stimulant of the 1990s, with the mocha replacing the martini.

Pepsi partnered with Starbucks in 1994 to bottle its coffee for supermarkets, and Coke just bought Costa, a UK-based rival to Starbucks for US $5.1 billion.

Water became the next safe and healthy category in the 1990s, with Pepsi unveiling Aquafina and Coke its Dasani line. Of course, even water needed to be enhanced, so “smart water” arrived with added calcium, magnesium and potassium.

Despite the water, teas, and juices offered to keep us healthily hydrated, our basic craving for sugar and caffeine surfaced in a new area: sports drinks. Pepsi acquired Gatorade through its purchase of Quaker Oats in 2000 and quickly dominated this category, even as Coke countered with Powerade. Energy drinks arrived soon after – carbonated colas with double the caffeine and sugar, and soon Pepsi introduced Amp and Mountain Dew Kickstart while Coke partnered with Monster Beverage.
These companies certainly know how to evolve with the times.

Soft drinks are not the only beverage category needing to evolve. Beer companies are dealing with the same reality that the soft drink makers faced years ago – the younger generation does not drink as much of the stuff anymore. Molson Coors (**NYSE TAP**) said beer sales dropped for four straight quarters, and Heineken's sales are down in the first half of this year. Blame aging, restrictive impaired driving laws, and research that alcohol is really not very good for us. It all points to lower alcohol sales, even as we still crave a buzz in our bubbles.

A new category has corporate hearts all a-flutter: marijuana-infused beverages. And it seems to be perfect for both its health and inebriation qualities. Marijuana contains two active ingredients. The first, THC, gives a euphoric high as well as prevents nausea. The second, CBD, is not psychoactive while purportedly offering relief from seizure disorders, pain, and anxiety.

The beer makers have taken notice. Constellation Brands – the bottlers of Corona beer – has invested $4 billion into Canopy Growth (**TSX WEED**), to develop marijuana-infused beverages and other products. Heineken has introduced a THC-infused sparkling water. Will it stop there? Some coffee stores are now offering lattes with CBD added. So, you get a jolt from the caffeine, and then are calmed by the CBD. Can CBD or THC colas be far behind? Will Hire’s Root Beer become “Higher’s” Root Beer in the near future?

From an investment perspective, we are still in the Wild West stage for marijuana. It is set to become legal in Canada on October 17th of this year, and hundreds of new companies have sprouted up. Projections abound that THC products will outsell alcohol ones by 2030, and that cannabis is the future.

Maybe. Just remember this: while we consume much more coffee than we did thirty years ago, there has really been just one big coffee success story (Starbucks). Most of the other sales go to brands that are parts of larger conglomerates. Juice, water, sports drinks, energy drinks, and carbonated wine were once hot new categories that were going to take over the world. Now, they are just part of some multinational's global portfolio.

CBD and THC beverages, after an initial grand entrance, are likely to be no different. It will certainly be interesting to see the effects of the first new stimulant to be introduced to the global food chain in a century.

Maniajuana

Finally, as an example of the lunacy of trading in marijuana stocks, consider this.

Tilray Inc. (**NASDAQ TLRY**), a medical marijuana company headquartered in Nanaimo, rose to a value of US $10BB market cap yesterday. This is $13BB in Canadian dollars..

The median dwelling in Nanaimo (house/condo/townhouse) is worth $243,000 (VIREB). The city has 45,000 households. If every household owned a dwelling (they don't), the net value of homes in the city is approximately CAD $11BB.

Therefore, Tilray is now worth more than every home in Nanaimo. Throw in commercial buildings, and Tilray might be worth the entire town.

Therefore, Tilray should sell itself and buy Nanaimo.

Returns This Week

It was a negative week for most major indexes around the world, with the exception of the S&P 500, which eked out a small gain.

Here are the best and worst of the year so far (source: Morningstar):

+10.13%   S&P 500
+ 0.77%   Canada in CAD (-2.97% in USD)
-19.9%   Turkey in local currency (-50.9% in $USD)

Canada is still locked in negotiations for a new NAFTA treaty with the US. This is occurring while residential real estate sales slump across the country, and as commodities remain weak. Our stock market is not overvalued, but it is hard to get excited about much in Canada while we have this cloud hanging over our heads.

The Canadian Dollar – Up or Down From Here?

Of Canada's exports, approximately 24% are energy related (National Energy Board, 2014). It is an inconvenient truth that we are such a clean country, yet are also so bound to the price of oil.

It also helps to explain a mystery among money managers today who manage global bonds for Canadian investors. Several of the largest, including Manulife and PIMCO – companies who run multi-billion dollar portfolios for pensions and foundations, have gotten the direction of the Canadian dollar this year. The chart below shows why:

Since Canada joined the club of oil exporting nations decades ago, our dollar has become tied to the price of West Texas Intermediate Crude oil (WTIC), which is the benchmark used for US and Canadian light oil. Energy makes up 10% of Canadian GDP, which means $0.10 of every $1.00 generated in Canada comes from somewhere along the energy chain. This includes natural gas, chemicals, and refined products, such as gasoline.

Despite a few months where oil and the Canadian dollar diverged, such as 2014 and early 2017, the two snap back to their parallel movement within a year every time. And therein lies the conundrum facing global currency and bond managers. Most know of the tight relationship. When oil rises, so does the Canadian dollar. And with oil prices rising since mid-2017, it made perfect sense to convert everything back into Canadian dollars to enjoy the same rise.

Except, it did not work out that way this time. Why?

Good question. The US tax cuts had a part to play, for they made US industry and energy more competitive than Canada's. Add to this the NAFTA talks, which put Canadian trade with the US at great risk, and the recent Supreme Court halt to the Trans Mountain pipeline. All of these made Canadian oil less attractive than oil from anywhere else. Canadian Western Canada Select oil (our home-grown blend of oil sands bitumen, conventional oil, and diluent) trades at a $28 discount to West Texas crude. This means the US gets US $68 per barrel while Canada gets just US $40.

Look at the chart again. Oil and the Canadian dollar have always worked their way back to synchronicity sooner or later, which suggests it will happen again. Either oil prices fall sharply (possible) or the Canadian dollar rises. It is hard to see why our dollar would rise with NAFTA negotiations dragging out for so long with no end in sight, but if an agreement is concluded, the Canadian dollar could shoot higher.

This is not a prediction. It is simply an observation that few people expect our dollar to rise, and there are billions of dollars of investor money that has bet on this. They may not be wrong about our dollar rising, just early.

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

Is Optimism Good or Bad?

Sentiment – the mood of the people – is often cited in the news:

"Consumer sentiment is at all-time highs."

"Small business survey shows gloomy mood."

The question is, is good sentiment good, or is it bad? That is to say, if things are great today, can they only get worse from here? And vice-versa?

It is a relevant question because recent surveys show that consumers, small business owners, and corporate CEOs are all quite optimistic right now – at least in the United States.

As it turns out, strong sentiment is a good leading indicator of near-term future economic growth. For example:

- High consumer sentiment today has led to a rising economy 8 months later 79% of the time since 1958 (NDR, Michigan Consumer Sentiment Survey). The economy also fell months after consumer sentiment plunged.
- Corporate profits rise most when their CEO chiefs are confident. Profits rise, on average, +14.3% for the year ahead when the CEO survey exceeds 62%. It is at 63% today.
- CEO confidence also leads to higher equipment spending months later.

We have said recently that our indicators show very little chance of a recession in the next year, and this appears to confirm it. Confident sentiment today suggests hiring, spending, and profits will all be higher 8-12 months out.

Beyond 12 months, the picture becomes more gray. Happy people with new jobs borrow more money today, which has to be paid back in the future. Debt tends to rise in good times, then falls as people stop spending or default in bad times.

Debt is quite high in the world right now, suggesting long-term growth (post 2019-2020) is likely to be lower than today.

http://www.dividendvaluepartners.com

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Prices shown are as of close September 14st, 2018.