

The Market in Review

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This week's articles and insights

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“There are unintended consequences to everything. The most corrosive piece of technology that I've ever seen is called television - but then, again, television, at its best, is magnificent.”

- **Steve Jobs**

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,289	- 2.69%	+ 2.31%
S&P 500	2,730	- 1.83%	+ 2.12% (+7.00% in \$CDN)
TSX	15,150	- 0.85%	- 6.57%

Unintended Consequences

There is a law we are all subject to that no one polices or enforces. Yet, it governs us relentlessly.

It is the Law of Unintended Consequences.

For example, Prohibition ended in Ontario in 1927. Until then, alcohol was officially illegal, even though it was ridiculously easy to obtain. Many farms had their own stills (full disclosure: my grandfather had one in Sexsmith, Alberta) and 'speakeasies' were clubs where beer and whiskey flowed freely. One federal US law enforcement officer once kept a tally of how quickly he could get liquor in each city he visited during Prohibition. The winner was New Orleans after he had been there just 35 seconds.

The minute Prohibition ended and illegal sales became truly illegal, the drinks dried up. Government stores didn't sell on Sundays and holidays, and it took years for legal distilleries to catch up to demand. In reality, the supply and distribution had simply moved from the efficiency of the bootleggers to the bureaucracy of the government.

Fast forward to today and the cannabis industry. We now have regulated dispensaries and approved farms – and they are woefully underprepared. Before October, you could buy pot on almost any street corner. Today? Wait in line at your community dispensary. Several marijuana companies have reported lower earnings because they cannot get enough legal product to sell. It will work itself out in time, for it always does, but we need to remember one thing. When something becomes "legal", it just means a new group is in charge.

Technology is another realm where unintended consequences are playing a major role. Computers, smartphones, and artificial intelligence were supposed to make our lives easier and faster. They do, for the most part, but there are side effects.

For example, data suggests far more oil contracts are traded than physical oil itself. What began as a convenient method for transferring oil without getting your hands dirty has become a high-speed speculator's game. The recent decline in oil occurred even as more oil was used than ever before. It was simply a new bearish perspective by speculative hedge funds that caused them to sell their contracts en masse.

It is not that different in the stock market, where over 60% of all stock trades are now done by computer algorithms. No wonder there is such volatility. Small squiggles in data can be magnified to enormous moves in stocks.

For example, Apple (**NASDAQ AAPL**) sells approximately \$1 billion worth of hardware and services per day, as of the current quarter. Since the end of the last quarter on September 30th, it will have sold about \$45B worth of goods. However, the overall stock value has declined by close to \$200 billion. Worries about slowing sales in China has been magnified far beyond their actual impact.

Transition

We often compare stock market corrections to the changing of the tides in the ocean. This is the period of time when the water can get very choppy due to all the cross currents. For example, here is what is now in transition:

Technology firms – once viewed as benign and good, they are now seen as all-powerful and uncontrolled.

The economy – we are shifting from high growth in America to slower growth. Asia has already slowed.

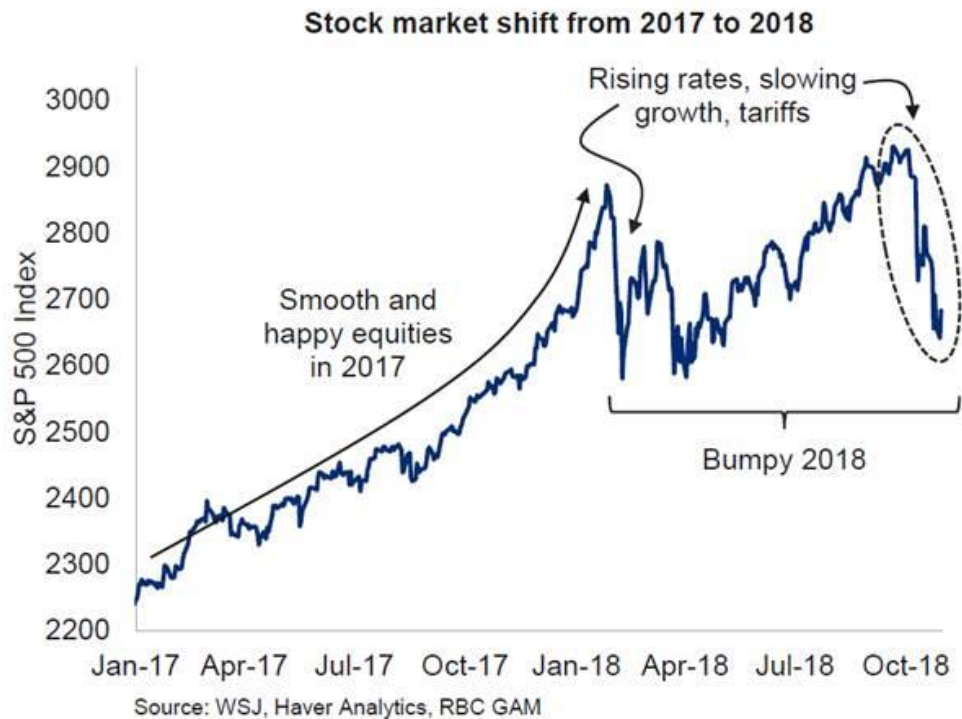
Oil – from undersupply to oversupply – in a month! New US shale production can be switched on and off much faster than anywhere else.

Interest rates – from “lower for longer” to “hikes as far as the eye can see”.

U.S. politics – from unlimited presidential power to gridlock.

With so many currents converging at once, it makes world conditions more uncertain than they have been in years. We had hoped that strong corporate earnings would shield stocks from sharp declines, but the waters have been more turbulent than we expected.

Challenging stock market



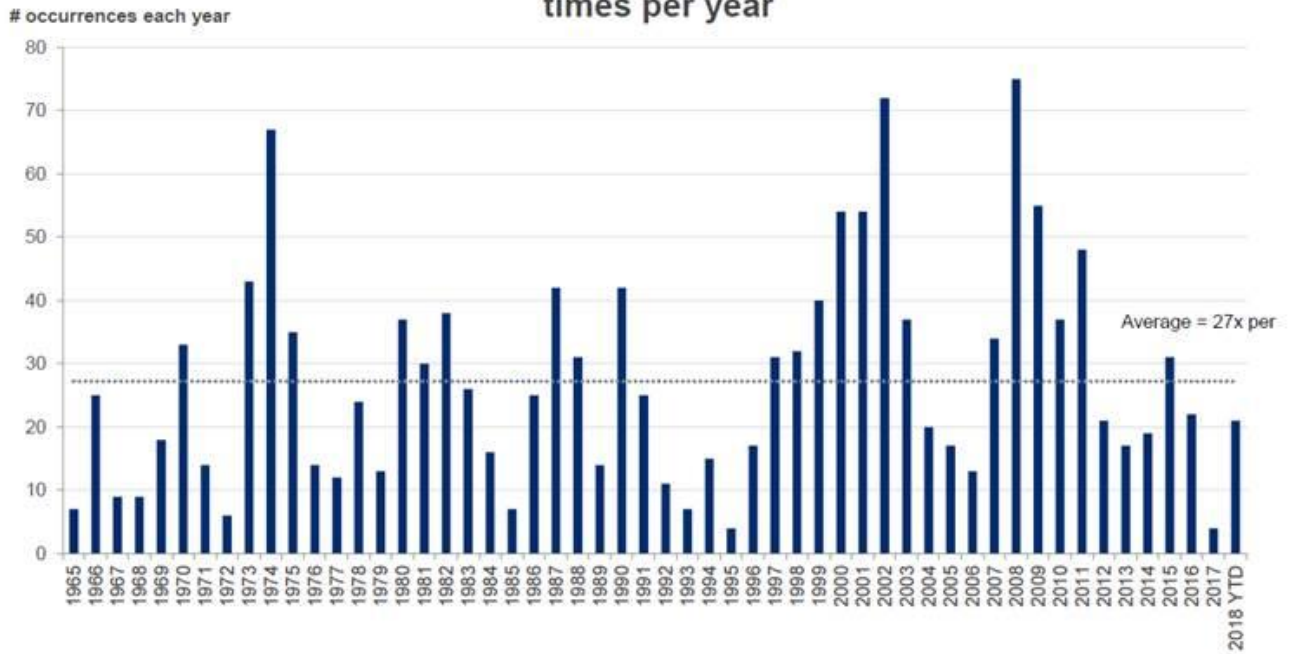
Glimpses of a Bottom

Since late 1985, when I entered the industry, I have lived through 24 declines of -5% or worse (as defined by the S&P 500). Only three went beyond -20%, though I remember them as if they were yesterday. Such is the human mind's propensity to recall great fear.

With the exception of the Big Three declines (1987, 2000-2002, 2008-2009), virtually every correction reversed its losses with 1-2 years. And, we regretted not buying the bargains that appeared at the time.

The number of 1% drops in the S&P 500 each year since 1965

On average, U.S. equities fall more than 1% in a day about 27 times per year



Canada's index, the S&P/TSX is down -6.66% so far this year, and -9% from its high in July. The S&P 500 is still +2% this year, though it is -9.9% from its high in September.

It feels worse. Why?

Stocks rarely hit their highs and their lows within a month. Normally, a new high means the economy is doing well and won't be derailed. Most corporate CEOs are also baffled by how quickly conditions have changed.

- This was the worst October for stocks since October 2009.
- This was the first consecutive 12-day decline in oil prices since the oil contract began trading in 1983.
- The Chinese stock market is -25% this year, and is back to where it traded in late 2006.

As always, it is impossible to tell right now. We are definitely mindful of the weakness in global economies from China to Germany. However, the US and Canada remain far from recession.

On the positive side, we are seeing encouraging signs. Here is how bottoms are formed:

- Selling dries up. Stocks making new lows on Wednesday on the New York Stock Exchange stood at only 175 compared to the peak in late October of 528.
- Different groups end their bear markets. Utilities and grocery stores, for example, began falling late last year. Now – quietly – they are rising.
- Capitulation in the worst-hit groups intensifies, then ends. Energy stocks as a group are nearing their lowest weighting in 14 years. This is the same for almost all commodities – copper, uranium, nickel, etc. Historically, a bull market occurs not long after.

Nearing a historic level of unimportance

Energy stocks have dropped to 5.5% of the S&P, near its lowest-ever weight



Source: SentimenTrader.com

We remain of the opinion that we are close to the end of this decline.

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

Protecting You and Your Data

China has a new system they call Social Credit. It is a points-based application you track on your smartphone that shows how well you are behaving. It can have serious consequences if you are not a good citizen.

For example, the central government wants to crack down on such small crimes as jaywalking and spitting in public. How can they do this without hiring millions of police officers?

The answer is technology. Overhead cameras now watch every intersection for jaywalkers (and spitters). They then identify them through facial recognition and even walking gait patterns. Once you are singled out, your Social Credit score loses points. At a certain level, you are no longer allowed to buy a bus ticket home at Chinese New Year. Even lower and your child is denied entry to the better public schools.

To no one's surprise, all forms of minor crimes have declined. Yet, one wonders what this form of state-mandated behaviour will do to the rebels and outcasts that often go on to great things.

Steve Jobs of Apple was once so poor, he lived in his car. Would a vagrant be allowed to attend university in China? Elon Musk held raucous house parties to make enough money to pay his rent. Would that sort of behaviour be tolerated?

Meanwhile, the unintended consequence of easy technology is that it is now easier to rob a bank from the comfort of your living room. In 1992, there were 847 bank robberies in the UK. By 2012, there were just 26 (source: The Guardian). Where did all the bank robbers go? On-line. Cybercrime is now a \$1 trillion per year business.

Raymond James now has close to 17,000 employees worldwide. We use 12,000 servers to provide over 25,000 e-mail mailboxes, among other things. There is an

enormous amount of data to protect. As the saying goes in network security, “the bad guys get to fail a million times, but we only get to fail once.”

The company – including Canada - benefits from being wrapped inside a world-class cyber-defense perimeter, which works in layers:

Firewalls - 530 firewalls are the outer walls of our castle.

Intrusion Protection – these are our “moats and spikes” to make it very hard to even try getting inside our systems.

Detection Sensors – to spot attack points.

Real-Time Monitoring – to stop the serious attacks.

How big a job is it?

We receive 1.2 billion e-mails per year. 67% of these are malicious or unwanted, and are blocked. Some are very serious. On average, we get six malicious e-mail campaigns per day aimed at multiple groups of our people.

And that is just e-mail. Our real-time Cyber Threat Centre (it looks like a NASA command room) detects 38 million network threats per day (14.1 billion ‘network detected threats’ per year). About 1,000 per day require our automated defenses to fire up, while about 54 per day require our human experts to thwart. We have a real-time schematic of the globe and can see where we are under attack and in which countries these originate.

Very few companies in Canada can afford to build, staff, and maintain such powerful defenses. Unfortunately, this is what is required in the connected financial world of 2018.

<http://www.dividendvaluepartners.com>

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Apple Inc. - Raymond James & Associates makes a market in shares of AAPL.

Prices shown are as of close November 15th, 2018.

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