# The Market in Review

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## This week's articles and insights

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**"Whatever you do, always give 100%. Unless you are donating blood."**

### Your Index Report

| | Current | Last Week | Year-to-Date |
|---|---|---|---|
| Dow Jones Ind. Avg. | 27,675 | + 2.32% | + 18.64% |
| S&P 500 | 3,085 | + 1.57% | + 23.07% (+18.80% in $CDN) |
| TSX | 16,806 | + 1.96% | + 17.34% |

## The Rule of Three

Three is a very special number for the human race.

We find it in Buddhism, Islam, and certainly in Christianity (the Holy Trinity, the Three Wise Men, for example). It appears in fairy tales (The Three Bears), drama (beginning, middle, end), great speeches (persuade, assure, and rule) and even hockey (three periods).

It is very common in humour, as well. Most jokes start with a character or a situation, which forms the basis for a pattern. The second part repeats something about the character or situation, giving us the expectation of the pattern continuing. Our brains crave repetition, and we are engaged in this pattern happening again.

The punch line surprises us by what happens next. When it is not what we expected, we get a comic twist. And hopefully a laugh.

*"When my father dies, he'll see the light, make his way toward it, and then flip it off to save electricity."*

*—Harland Williams*

*A statistics student who hadn't studied takes a true/false final exam. He decides to flip a coin for the answers.*

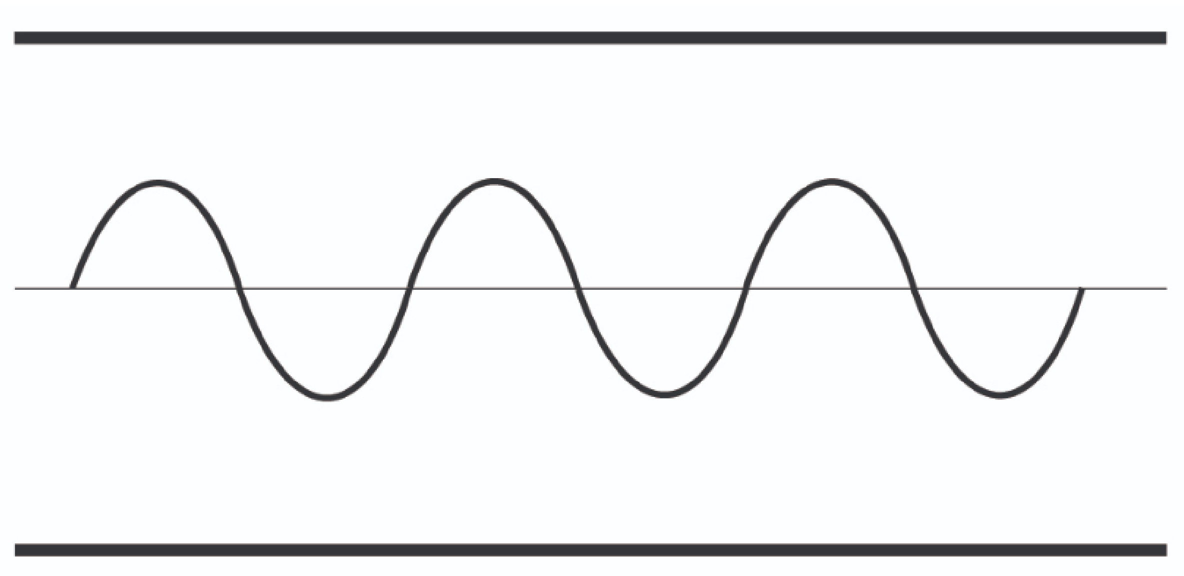
*At the end of the two hours, everyone else has left and the professor walks up and interrupts the student, who is still flipping his coin. "If you are just flipping a coin for your answer, what is taking you so long?" he demands.*

*The student replies, "Shhh! I'm checking my answers!"*

Similar patterns exist in the stock market and investing. Industries mature until three major players end up controlling 90% of the market. Think of Canada's three big phone companies and how hard it has been for new players to break in.

Stocks (and interest rates and economies) go up, sideways, and down. That's all they can do, when you simplify everything – make money, break even, or lose. The rule of three once again.

In its simplest form, the stock market looks roughly like this, over periods of years:



Not everything happens in threes. Economic cycles, for example, used to last about 5 years, on average. This meant we faced a recession or slowdown roughly twice in a decade. It is a pattern we became used to. And planned for.

The period since 2008-9 has been frustrating in this regard. Since 2009, we should have seen a recession or bear market by now. And yet we haven't. We've had a 10-year bull market thanks to the fuel of aggressively low interest rates. There have been two cooling phases in 2011 and 2015-16 but no recessions.

Valuations of stocks have moved above historic limits even as interest rates have gone lower than anyone ever expected. Global central banks have flooded the world with cheap money in the last ten years, an act which has distorted cycles and frustrated old-time investors. Many value investors have been sitting in cash on the sidelines for years, waiting for a decline to get invested. It worked for decades…until this last one.

We subscribe to the Ned Davis Research service, which is a firm that devotes all its energy to deciphering economic and market cycles around the world. We had a private call with them this week and we summarize their conclusions below.

They try to follow the data without prejudice and opinion, but they are also confused at times!

## Ned Davis Research – The Long View

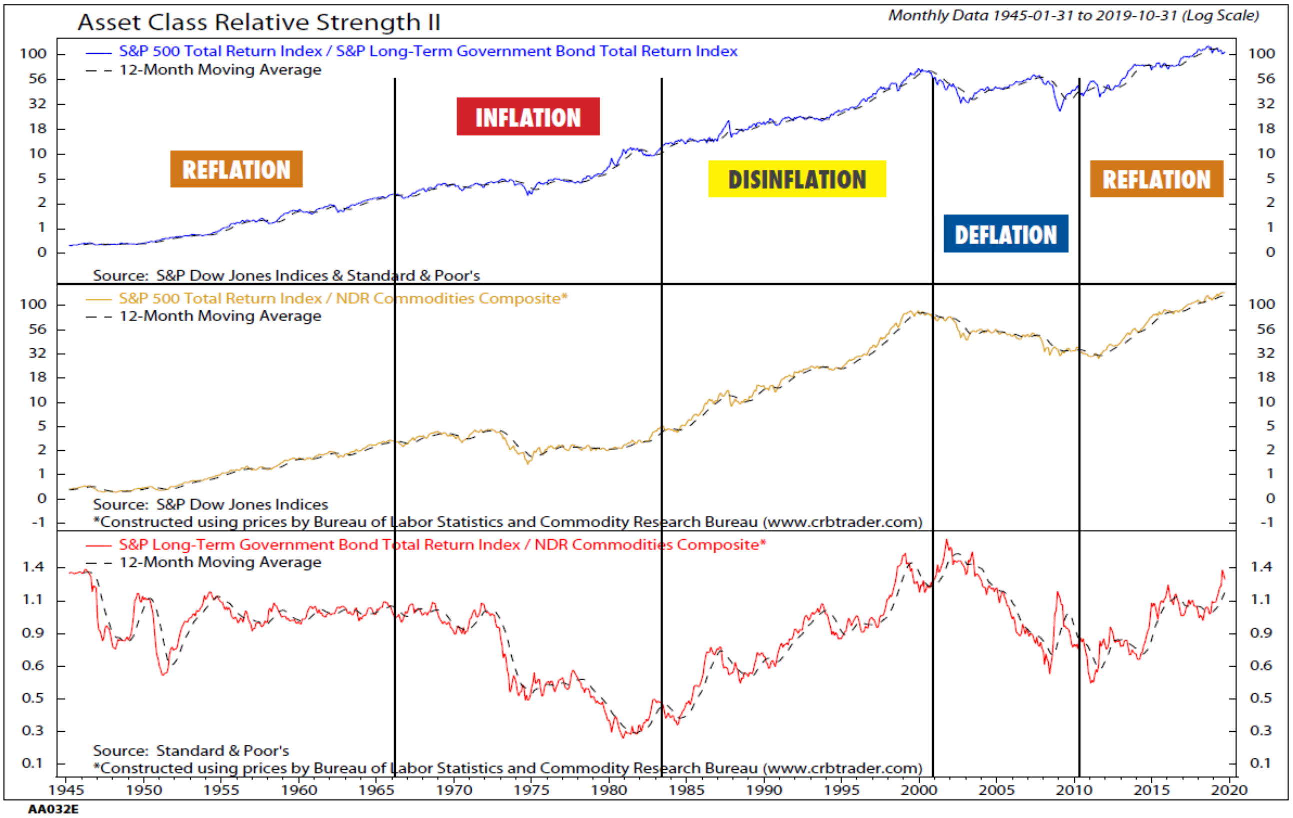
Much as we'd like this pattern to be in three parts, to go with the theme above, Ned Davis breaks economic cycles into four, as shown below.

The shortest period is the Deflation cycle, when money gets tight and business contracts. This last about a decade, and the last one before 2000-2010 was the 1929-1939 period. Note – this is the period when the worst market crashes occur (1929 and 2009).

Reflation follows, when interest rates are forced so low that borrowing can occur again. Deposits are built up and money begins to flow. The last Reflation cycle lasted about 20 years from 1945-1965, which suggests we are about halfway through this one.

The Inflation cycle follows next, and many of you will remember when gold, oil, minerals, and real estate boomed in the 1970s. This is when all that money starts to move and "too much money starts chasing too few goods". Stocks can do okay here, but bonds suffer badly as interest rates rise. Commodities have been in a bear market since 2011, which tells us the Inflation cycle is still a few years away.

Disinflation is the final cycle, when inflation moderates. It is the "not too hot and not too cold" Goldilocks period, and is often the best for stocks.

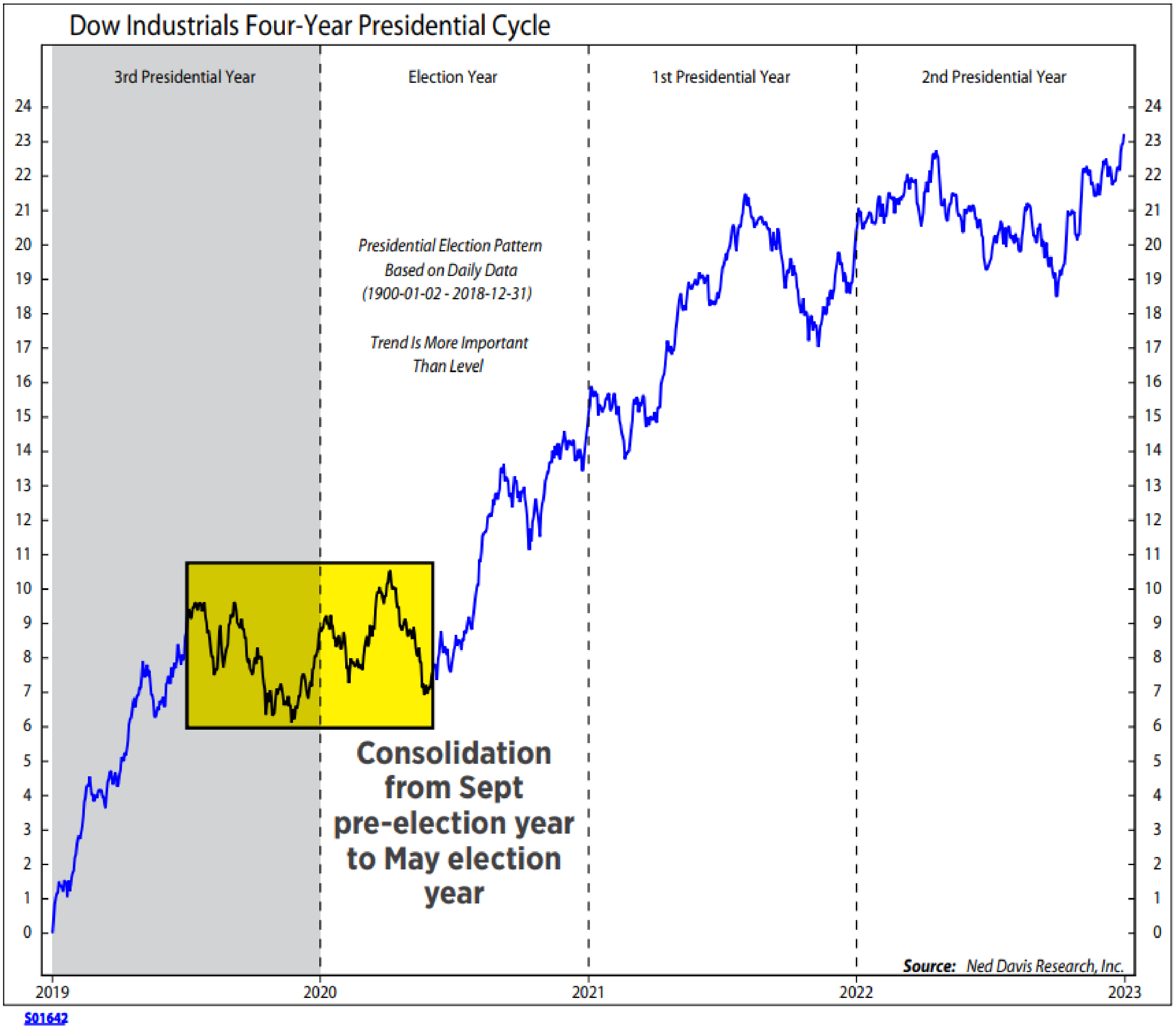



The above chart suggests that interest rates should remain benign for some time to come. In other words, don't hold your breath waiting to get 5% on term deposits and bonds.

## The Medium View

The US Presidential Cycle has been studied closely for many years, and the chart below is updated to show where we are now. The pre-election year has been good for stocks since the year 1900, and 2019 has followed the same pattern.

We are entering a choppy period, however, when the mudslinging starts between the parties and uncertainty reigns. Next year promises plenty of mudslinging, if what we are seeing now is any guide. The general pattern is that 2020 should be a positive year. A Presidential impeachment could certainly change everything.



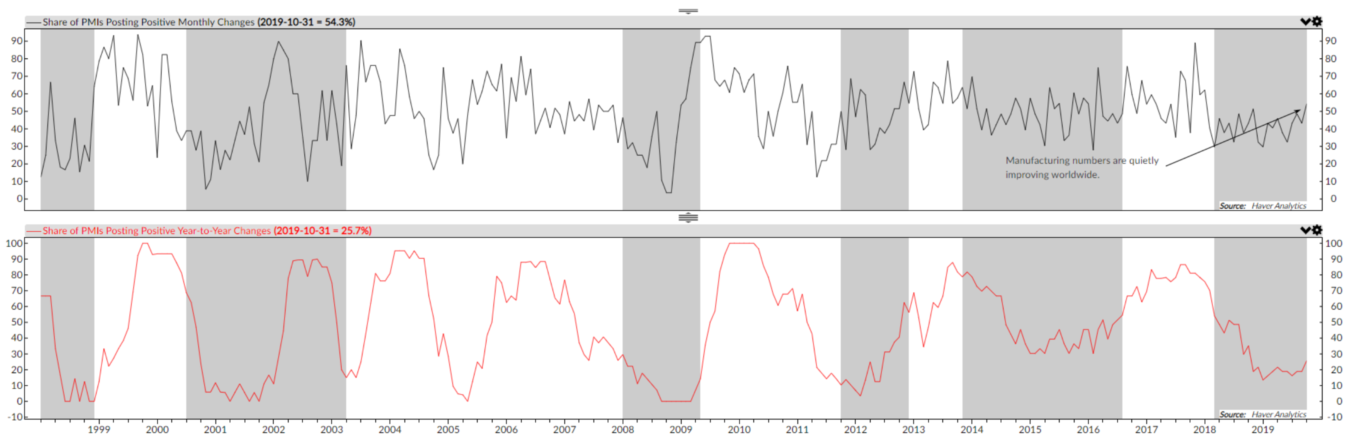

## The Near-Term View

Global economies used to be driven by manufacturing. Cars, ships, factories – big, heavy stuff. Services, such as shopping, websites, and tax preparation now dominate but manufacturing is still the tail that wags the global dog.

And since early 2018, it has been in decline everywhere but the US. Blame rising interest rates in 2018. The threat last year was four interest rate hikes in 2019 – we got three cuts instead! Or blame the US-China trade spat. Manufacturing in Asia and Europe ground to a halt, with the US starting its decline one year later.

We said above there were two cooling phases in 2011 and 2015. Add a third in 2018-9. It isn't a recession but it came close.

The first rays of light have begun to appear. There is now the possibility of a US-China trade deal by year-end, and global manufacturing as shown in the charts below has begun to inflect higher for the first time since 2017.

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So where are we now?

In absolute terms, stocks remain expensive. By some measures, stocks are in the top 90% of valuations seen in history. But compared to what? When measured against bonds yielding just 1% (or negative rates, as we see in Japan and Europe), stocks are actually quite cheap. Central banks are still easing and money is plentiful for those willing (and able) to borrow. Don't fight the Fed, in other words.

US stocks have had a marvelous run these last ten years. Much better than Canadian or global stocks. As a result, they are priced at higher valuations than those of any other country. However, the positive changes we see in manufacturing are happening outside of North America.

In point form, here is the Ned Davis view for the period ahead:

- US stock valuations are high. Deservedly so, as they were the market leaders.

- Recession risk is low. Jobs are still plentiful although the average worker doesn’t have much left over for additional spending.
- The paradox has been how nervous investors are about the markets, even as they continue to climb. This year alone, $216 billion has been pulled out of US stocks and mutual funds and $262 billion poured into bonds yielding very little.

As conditions globally deteriorated in 2018, the Ned Davis team cut global stocks from 65% to just 40% and moved that money into bonds. This was a good call - global stocks underperformed global bonds.

With manufacturing stabilizing, and valuations better outside the US than inside it, they just shifted 10% back into global stocks. While the US market is at all-time highs, only 20% of global markets are even close. Europe and Asia are showing signs that their decline is flattening (the prelude to a turn higher), suggesting it could be global stocks that lead the next leg higher.

The Emerging Markets are where the global decline hit hardest and where it started. Countries such as South Korea, Taiwan, and Brazil were flattened by the trade wars. This region may be where the decline ends first, as a result. Asia is the cheapest region in the world and a lower US dollar helps emerging markets most.

Current conditions suggest choppy times for the next few months, however. Investors have turned very bullish in the last month.

We should also mention that Ned Davis is bullish on gold. Ultra-low interest rates and rampant money printing devalue paper currencies, and they are seeing money flow into gold month after month.

## Key Tax Dates for 2019

Dec-13-2019 - Charitable Donation/Gifts of Equity and Mutual Fund securities In-Kind
Dec-16-2019 - Fourth quarter tax installment payment for 2019 due.
Dec-27-2019 - Last day to sell securities on Canadian markets to realize a gain or loss.
Dec-27-2019 - Last day to sell securities on U.S. markets to realize a gain or loss.
Dec-31-2019 - Last day to pay prescribed rate loan interest to deduct in 2019.

Dec-31-2019 - Last day to complete cash charitable contributions for 2019; be sure you allow enough time to complete donations that may require additional lead time.
Dec-31-2019 - Annual tax installment payment for 2019 due for farming and fishing income.

## The Best Months to Buy Stuff

As we approach the end of the year – the most expensive time of the year – many people start sweating about their budgets. We came across an article in USA News and World Report that breaks down the best time of year to buy certain items.

*The Best time to Buy a **Home**:*

- August and December offer the best bargains. If you want the largest number of choices, the best month is March, when inventory appears for the spring sales. The best month to sell a home is April.

*The Best Time to Buy a **Car**:*

- December. Sales deadlines come in December, and data shows this is when the highest discounts from list price appear.

*The Best Time to Buy **Clothing**:*

- End of season. August and September for swimsuits, shorts, and summer clothing. Conversely, spring is the best time to buy winter clothes.

*The Best Time to Buy **Appliances**:*

- September through October. New models come out in November, forcing retailers to clear older models out in the fall months.

*The Best Time to Buy **Furniture**:*

- February and August. New furniture is similar to clothing, with new lines arriving in the spring and fall. Just before these new seasons is when old inventory gets cleared out.

*The Best Time to Buy an Engagement **Ring**:*

- August. Spring and summer are the traditional wedding seasons, which means romance is at a lull at the end of August.

As with investing, timing is everything when shopping. Especially for seasonal items. There's a saying in the farm country around us about the importance of timing:

*The only thing worth less than a green pumpkin on October 31st is an orange pumpkin on November 1st.*

The best times to buy mattresses and TVs are also mentioned in the article below:

https://money.usnews.com/money/personal-finance/saving-and-budgeting/articles/the-best-time-of-year-to-buy-everything

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

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*Prices shown as of November 7th, 2019*

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