The Market in Review

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This week's articles and insights

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"I think if you spent over 13 minutes a year on economics, you've wasted over 10 minutes.

I mean, it's not helpful. Everybody wants to predict the future, and I've tried to call the 1-800 psychic hotlines. It hasn't helped.

The only thing I would look at is what's happening right now."

— Peter Lynch

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	26,806	- 0.82%	+ 14.91%
S&P 500	3,010	+ 0.41%	+ 20.08% (+15.04% in $CDN)

TSX	16,369	- 0.35%	+ 14.29%

The More Things Change…

Canada just held an election, but did anything change? The Liberals were in power before the election, and they are in power after it. The west was mad because the east decided the election, but when has that ever been different?

After all, a vote in the Maritime Provinces is worth more than a vote in B.C. based on population per Member of Parliament. A vote in New Brunswick and Newfoundland is worth 1.5 votes in B.C. (they have 74,000 people per MP and we have 110,000) and a vote in Prince Edward Island is worth 3 votes out here (they have just 36,000 people per MP). Such is the nature of regional growth and political seat distribution – they don't always move in the same direction.

As investors, ours is not to favour one side over the other, but to invest according to the cards dealt to us. Not a great deal changes from an investment perspective with the election of 2019. At least, not yet. We saw a lot of promises for more programs (also known as "free stuff") but not a lot of new ways to pay for them. One necessarily follows the other, however. The bills always come due.

Over the decades, whenever wealth gets too concentrated in a small number of pockets, as it is today, the pendulum swings so that money is more spread out. Justin Trudeau's father Pierre was also chastened with a minority government in 1972, after his huge majority win in 1968. He held on to power for another decade by cutting the national poverty rate in half through a tripling of the country's debt. Some will argue that it took 30 years to clean up the burden of these deficits, but his policies certainly evened incomes out across the country. Higher taxes on wealthy Canadians became the new reality.

This may be the template going forward – spending more on Canada's poorest while raising taxes on Canada's wealthiest. It helped keep the ruling Liberals in power for another decade.

Have no doubt - Justin Trudeau will be studying his father's playbook. Higher taxes most certainly lie ahead for those of us with investments.

Over Here, Over There, Lower Rates Are Everywhere

September and October are typically weak months for the stock market. This year has proven to be different, so far. Most accounts were up in September after declining in August. What changed?

Marty Zweig, a well-known money manager from years ago, used to say “Don’t fight the Fed!”

What he meant was if the U.S. Federal Reserve is tightening – raising interest rates and restricting cash – stocks will suffer. The opposite was also true – if the Fed was cutting rates, it meant the tide was coming in and all the boats would float.

Over the last month, there was a lot of good news on the monetary front.

- The European Central Bank announced more Quantitative Easing (the buying of bonds to lower rates) and reduced capital constraints on foreign banks.
- The U.S. Federal Reserve also reduced capital requirements on banks and restarted its own QE program of $60 billion in monthly treasury bond purchases.
- The U.S. Federal Reserve cut interest rates a second time in September.

Companies eventually need rising earnings to justify higher stock prices, but lower interest rates and easier credit are also very stimulative.

Cuts Coming for Canada?

Canada has been a notable laggard on the interest rate front. Canada followed the U.S. in hiking rates in 2018, but our interest rates have remained unchanged since. In 2019, 13 countries have cut rates while only 2 have raised them. With most economies struggling, it suggests Canada’s next move will be toward lower rates.

This suggests locking in a little longer, if you can. Instead of buying a 1-year bond or term deposit yielding 2%, consider investing in the 2-year term for the same or slightly more.

The chances are, rates could be lower when you have to renew in a year.

The Importance of Diversification

The concept of not putting all your eggs in one basket is a very old one. In fact, the earliest mention of diversification came from the Talmud, thousands of years ago:

“Let every man divide his money into three parts, and invest a third in land, a third in business, and a third let him keep by him in reserve.”

The number of stock traders has declined dramatically over the last twenty years. Why? Picking individual winners was always hard, but it has become extremely difficult today with the advent of algorithmic trading programs and hedge funds. Also, most traders used to invest in small companies. Remember penny stocks? Today, the biggest winners are the biggest companies. Hundreds of small companies have vanished from the indexes for lack of interest.

As a result, we don’t have a lot of active traders anymore.

An interesting piece of research was done in 2017 by Hendrik Bessembinder, a finance professor at the W. P. Carey School of Business at Arizona State University. We all know (or should know) that the stock market has delivered gains far above those of T-Bills. It is something like 9% on average for stocks since 1926 versus 3% for T-Bills. A big difference.

Dr. Bessembinder’s work showed that just **4% of all the companies** over time were responsible for this extra 6% in returns. 96% of all stocks just returned 3% or less over the last 90 years. It was a stark reminder that everyone needs to spread their money around into various stocks and industries, for you don’t always know which will be your next big winner. Or your next big loser.

“The problem is, I have no idea which companies will generate the best returns over the next 10 or 20 or 30 years, “ Professor Bessembinder said. “Probably it will be some companies we’ve never heard of. Maybe it will be companies that don’t even exist now.”

“In a market where most of the gains are attributable to a few big winners that are hard to identify in advance,” Professor Bessembinder said, “it makes a lot of sense to diversify your position — to avoid the danger of omitting the big winners from your portfolio.”

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

http://www.dividendvaluepartners.com

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Prices shown as of October 24th, 2019

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