The Market in Review

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This week's articles and insights

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"Gambling is entertainment. Financial markets, what one often refers to as speculation, is really the force by which we move capital to the best and highest use."

- ***Kenneth C. Griffin***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,710	+ 0.03%	+ 10.21%
S&P 500	2,808	- 0.09%	+ 12.03% (+9.37% in $CDN)
TSX	16,088	- 0.39%	+ 12.32%

Gambling vs. Investing

We had the occasion to stay at the River Rock Hotel and Casino last weekend to see a show in Vancouver. It is on the subway line and much cheaper than staying downtown. River Rock is somewhat infamous today because it was the prime casino where hundreds of millions of dollars in illegal cash was delivered in sports bags to be laundered. Most was dropped off at night, after the compliance officers went home, and no charges have ever been laid against the casino.

We won’t discuss that this week. It is a politically painful topic.

The word “gamble” comes from the Middle English word ***gamen***, which means “to play games.” People enter casinos to wager on uncertain outcomes in order to win money. In a perfect world, your odds are determined solely by chance, but in the world of gaming, the odds are tilted slightly in the house’s favour. Over time, they will always win 51 out of 100 bets (for example), so while you are gambling, they most certainly are not. Of course, the hotel operators tempt you with a free $5 gambling chip to get you into the gaming area.

Gambling used to be a male-dominated vice. Men (in general) prefer games of complexity such as blackjack, thinking they have an intellectual edge. Women are rapidly catching up, though, as measured by bankruptcies and calls to gambling help lines. Women prefer smaller-risk games of chance (in general), such as slot machines. The rapid rise in new machines in recent decades have helped draw more women into gambling.

It is both interesting and sad to walk through the gaming area. One would think people would be as enthusiastic and happy as they are in the commercials. In fact, they are more mesmerized and sullen than anything else. Most gamblers are very superstitious and believe that they can devise a system to win at what is actually a random event. They select “hot” slot machines and avoid “cold” ones, tap machines with a lucky charm, or see numeric patterns where none exist.

People are wired this way. Gambling plays to our addictive urges and gambling executives add inducements – lights, bells, and small wins – to reinforce these urges in us. New research shows gambling works the same on the brain as drug addiction.

“One must differentiate between boldness and gamble. A bold operation is one in which success is not a certainty but which in case of failure leaves one with sufficient forces in hand to cope with whatever situation may arise. A gamble, on the other hand, is an operation which can lead either to victory or to the complete destruction of one's force.”

— Erwin Rommel

Unfortunately, gambling is often used synonymously with investing when it comes to the stock market. Yes, short-term traders exhibit many of the same behaviours as gamblers, and often have the same results. But investing is more like what the casino does than its patrons do. With investing – as with the casino – the odds are in your favour over time. Returns systematically compound through favourable odds.

Because of a fear of risk, many investors don't actually take <u>enough</u> risk. Provincial government bonds today yield just 2.89% for 30 years. That is barely above today's inflation rate, meaning you are virtually certain to lose money in real terms over the next three decades. A new issue of almost $1 billion of Ontario bonds sold out in less than two minutes this week. We discussed inflation in our last letter:

Over 20 years, $100,000 only "buys" you $67,000 worth of goods after 20 years at 2% inflation.
Over 20 years, $100,000 only "buys" you $55,000 worth of goods after 20 years at 3% inflation.

The website Shadowstats says inflation is actually closer to 4%, which cuts your purchasing power even more.

Regulators insist that we, as advisors, should lower risk as clients age. Yet, buying more bonds may actually increase your risk of running out of money!

We had an elderly widow as a client for almost 30 years. Our projections showed she would run out of money at age 89, so rather than invest the majority of her money in low-yielding bonds, we kept her at 60% in dividend-bearing stocks. She was still going at 91, and so was her portfolio. When she finally passed away at age 94, her portfolio had six months left of payments. Taking a little extra risk (not gambling) gave her five more years of income.

"Always worry, but keep the worrying in context. Sometimes you can be too skeptical."

- Doug Kass, commentator and hedge fund manager

The Tide is Coming in

A repeated question has been where the market goes from here. After all, this is the strongest start for US and Canadian markets in many years.

Our first answer is that the market will correct. It almost always has after such a run, and it surely will, at some point. The question is: how much?

There is an old saying that goes “Don’t fight the Fed.” It means it is the US Federal Reserve that sets the direction of the stock market, more than anything else. It does this through its interest rate policy.

One way to look at it is by seeing stocks as boats. Bonds and currencies are the ocean. The bond and currency markets ($305 trillion – source: Visual Capitalist) are at least four times the size of global stock markets ($73 trillion) so how they move directly impacts how stocks move.

If the “tide is going out”, with interest rates rising and money being withdrawn, the ocean level is falling. Boats (stocks) sink lower. This is exactly what we saw in the second half of 2018 when the US Federal Reserve was aggressively hiking interest rates and removing cash from the system through Quantitative Tightening.

If the “tide is coming in”, with interest rates falling and money being printed, the ocean level is rising. Boats (stocks) can rise higher. Since late December, the US Federal Reserve has indicated its rate hiking days are over for now. Canada’s next move is likely to be a cut in rates, and Europe announced it is restarting new bond programs to aid banks. China is also stimulating.

Economic conditions are not great right now, which should be pushing stocks lower. This may yet happen. However, the tide is most definitely *coming in*, which is lifting all stocks. Until this changes – and there are no indications that central banks are about to start raising rates again – stocks should enjoy favourable conditions.

Notable Movers

We have seen notable moves in several sectors and companies this past week.

The biggest is Boeing (**NYSE BA**) and the second crash of a 737 Max aircraft. Setting aside the sad tragedy of the loss of life, this is a big reputational injury to

Boeing. The 737 represents 40% of Boeing's profits and the entire fleet of Max versions is grounded for now. In truth, even with these crashes, air travel has never been safer. Boeing will devote everything it has to fixing this problem, so unless they are covering up something, most of the damage has been done to the share price.

This also affected Air Canada (**TSX AC**), Westjet (**TSX WJA**) and Southwest (**NYSE LUV**), airlines which use the 737 extensively. It also touched GE (**NYSE GE**), which makes the engines for the aircraft.

On the plus side, Alphabet (**NASDAQ GOOG**), the parent of Google, announced it would be selling off a portion of its Waymo driverless-car division. This is likely to allow outside partners like Volvo to invest in Waymo, as well as to establish a value to a division that is buried inside Google at little value. Some see the value of Waymo already exceeding $100 billion.

Not to be outdone by fast-growing technology companies, utility stocks have been on a tear this year. Canada's largest utilities - Fortis (**TSX FTS**), Algonquin Power (**TSX AQN**) and Emera (**TSX EMA**) – are all pushing toward all-time highs. Utilities are often seen as bond substitutes. With bonds yielding just 2%, utility stocks with 3-4% yields are viewed as very decent alternatives.

Space, the Final Frontier

One of the key maxims of capitalism is that when costs drop, demand often soars. This has applied to everything from chocolate to long distance calling rates. The same dynamics are about to be applied to the "space race" – costs to launch are tumbling lower.

"Between 1970 and 2000, the cost to launch a kilogram to space remained fairly steady, with an average of US$18,500 per kilogram. When the space shuttle was in operation, it could launch a payload of 27,500 kilograms for $1.5 billion, or $54,500 per kilogram. For a SpaceX Falcon 9, the rocket used to access the ISS, the cost is just $2,720 per kilogram."

– Foundation for Economic Education

This means launch costs have dropped 95% due to the breakthroughs introduced by Elon Musk's SpaceX company. Close behind is Boeing, which will also launch a rocket capable of carrying humans to the international space station this summer.

Boeing may have problems with one of its airplanes, but it is also the world's largest satellite manufacturer.

The decline in launch costs will open up entirely new industries in the next decade, from zero-gravity manufacturing, new fuels to get into space, to "moon buggies" for driving around on the moon.

Toyota just unveiled its design this week:

https://www.forbes.com/sites/jamiecartereurope/2019/03/12/toyota-reveals-self-driving-moon-car-as-japan-prepares-to-land-astronauts-on-the-moon/#781b83c6dc87

There are few ways to invest in this new area today, but space is poised to be a significant new area of growth in the years ahead.

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

http://www.dividendvaluepartners.com

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Disclaimers

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