The Market in Review

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This week's articles and insights

1. *Predictions About the Future*
2. *Who Are the Buyers?*
3. *Quarterly Performance*
4. *Where Did the Cash Go?*

"It's not the future you're afraid of. It's repeating the past that makes you anxious."

- ***unknown***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	25,718	+ 0.84%	+ 10.25%
S&P 500	2,815	+ 0.53%	+ 12.31% (+10.56% in $CDN)
TSX	16,155	+ 0.41%	+ 12.80%

Predictions About the Future

Some predictions are easier than others.

For example, the birth rate in China in 2016 was 13 children per 1,000 people. It fell to 11 per 1,000 in 2018, the lowest rate since 1961.

Predictably, kindergarten admissions in China fell by 740,000 in 2018, the first decline on record. An aging population is, perhaps, China's greatest long-term challenge.

Interestingly, Canada has roughly the same rate of births (10.4 births per 1,000 people), but we added 321,000 new immigrants last year, leading to a population increase of over 528,000 people. Youth is the lifeblood of any country, and our successful immigration system is being studied by just about every aging country.

Not all predictions are as linear as birth rates and school enrollments, however.

"The more unpredictable the world is, the more we rely on predictions."

- Steve Rivkin

Weather forecasting has improved dramatically over the years. Meteorologists now get tomorrow's temperature forecast right 80% of the time, versus just 66% 11 years ago (Forecastwatch). Hurricanes can be forecast as much as 72 hours in advance versus 36 hours in the past. The extra hours can save many lives.

The problem is, forecasting what stocks do is not like forecasting the weather. Financial markets are dynamic systems that our actions affect by the minute, making forecasts notoriously unreliable. It is as if walking in the rain changed the amount, or stepping into the wind altered the direction of the breeze. As investors, our actions affect the market itself, making its direction very hard to predict.

But still, our industry tries. Stock prices, interest rates, economic growth…we produce voluminous reports every day, even as things get more complex. I mean, why do we buy stocks in the first place? We buy stocks expecting them to rise in value, so anything that helps our accuracy improve is a big benefit.

The biggest and scariest prediction this week is that we are barreling towards a recession. This is because the yield curve inverted. As shown below, this means 3-month T-Bills in the US now yield more than 10-year bonds for the first time since 2006:

Why would we care about this?

When short rates yield more than long rates, it means there is less demand for long-term loans, which means a slowdown in business. It also means investors expect the central banks to cut rates soon as a stimulant.

Almost all recessions are preceded by an interest rate inversion. The business media has seized upon the “this happened before the Great Crash!” narrative, but while all recessions start with a yield curve inversion, not all inversions are followed by recession. Sometimes, it is just a slowdown in the economy.

Nothing is a sure thing in our business.

Booms and the eventual bust – recession - are normally categorized by more euphoria in the markets than we have seen in this cycle. The economy in 2006, for example, was much more buoyant than today, and credit conditions were in much worse shape. We were beginning to see sub-prime mortgages unravel in the US in 2006, and asset-backed commercial paper (a similar animal) in Canada was becoming harder and harder to sell.

Today, there are few stresses in the credit markets. This isn't to say there won't be - consumer debt, credit card debt, auto loans, and student debts are all too high - so delinquencies could increase. But, they aren't at worrisome levels now.

Are world economies slowing down? Yes. Europe and Asia have been decelerating all through 2018 and conditions in the US and Canada slowed sharply in the 4th quarter of last year. US growth had been first estimated at 2.6% in Q4, but was just restated to a much lower 2.2% this week when final numbers came in. Canada slowed to a crawl at 0.4% over the same period.

It's no wonder central banks changed course from declaring four more interest rates hikes in October to declaring "we're on hold" by December. They went too far and the economy stalled.

What conclusions can we predict from the picture above?

- The economy is clearly slowing down. For now, growth remains positive, so there is no recession in sight. Economies deaccelerate and reaccelerate all this time. Recessions are quite rare.
- Forget higher interest rates for now. The next move in rates from central bankers is likely a decrease, rather than an increase.
- This is good news to borrowers, like home buyers. Mortgage rates are falling.
- It is also good for bond holders and dividend stock buyers.
- We may also be entering a "goldilocks" period, when the economy is not too hot and not too cold.
- Alternatively, a recession could be looming.

Going forward, we may have several quarters of choppy, uncertain markets. Either a recession is coming (chances of a US recession are still very low) or growth resumes.

The amazing returns of the 1st quarter may be followed by a flat period for a few months. Stocks are a bit ahead of themselves in this uncertain time.

We also have to remember that growth is arriving in new and less predictable ways. Developments in such areas as the cloud, smartphones, tablets, apps, fracking, the genome, and 3D printing, to name just a few, don't require big factories or thousands of new employees (at least at the beginning).

Who Are the Buyers?

Canada's recent federal budget included an increase to the amount people can remove from their retirement plans to invest in a new home. This was introduced because home prices are so high, and young people need a leg up.

"That's nice," said a young staffer here. "Except I don't even own a retirement plan."

Millennials – those born between 1978 and 1994 (according to Newsweek) have gotten a raw deal. They came of investing age just as both stocks and house prices peaked, and they got overcharged for their university education compared to what the Baby Boomers paid. They really don't have much money to invest. On average, about 50% of older Canadians and Americans own stocks versus less than 25% of Millennials.

Not only are they off to slower starts than we were at their age, but there is a confidence issue. A Bankrate study from 2016 shows Millennials often perceive stocks as too risky and don't trust financial advisors. Again, when you consider that Millennials came of age during two of the worst bear markets – 2000-2002 and 2008-2009 – it is hardly surprising they don't trust stocks.

Quarterly Performance

The Chinese-US trade talks have been in the background this month, but like the villain in a mystery, their shadow looms everywhere. This week, we are seeing positive developments, with hints that China has made proposals on a range of issues that go further than it has before — including on forced technology transfer.

There may also be movement on the Brexit vote. Prime Minister May is proposing a watered-down version of her divorce deal to a vote yet again today, a vote that has been rejected twice by British lawmakers.

We have seen some weakness in Nasdaq technology stocks, but not all of it is due to poor corporate performance. There are several huge new companies coming public, with Lyft (ride-sharing) this week and Pinterest in April. The money has to come from somewhere, so is often taken from other high-fliers. Watch for Uber and Airbnb in the months to follow. These are the biggest new technology companies to debut in years.

This week marks the end of the 1st quarter of 2019. Hard to believe we are just nine months from the start of a new decade. How did the “20-teens” speed by so quickly?

It also marks one of the best returns for a new quarter in many years. The S&P 500 was +12.3% as of yesterday, and Canada’s S&P/TSX was +12.8%. Most balanced portfolios will return between 7% and 8%, which is an excellent return for a full year, not just three months.

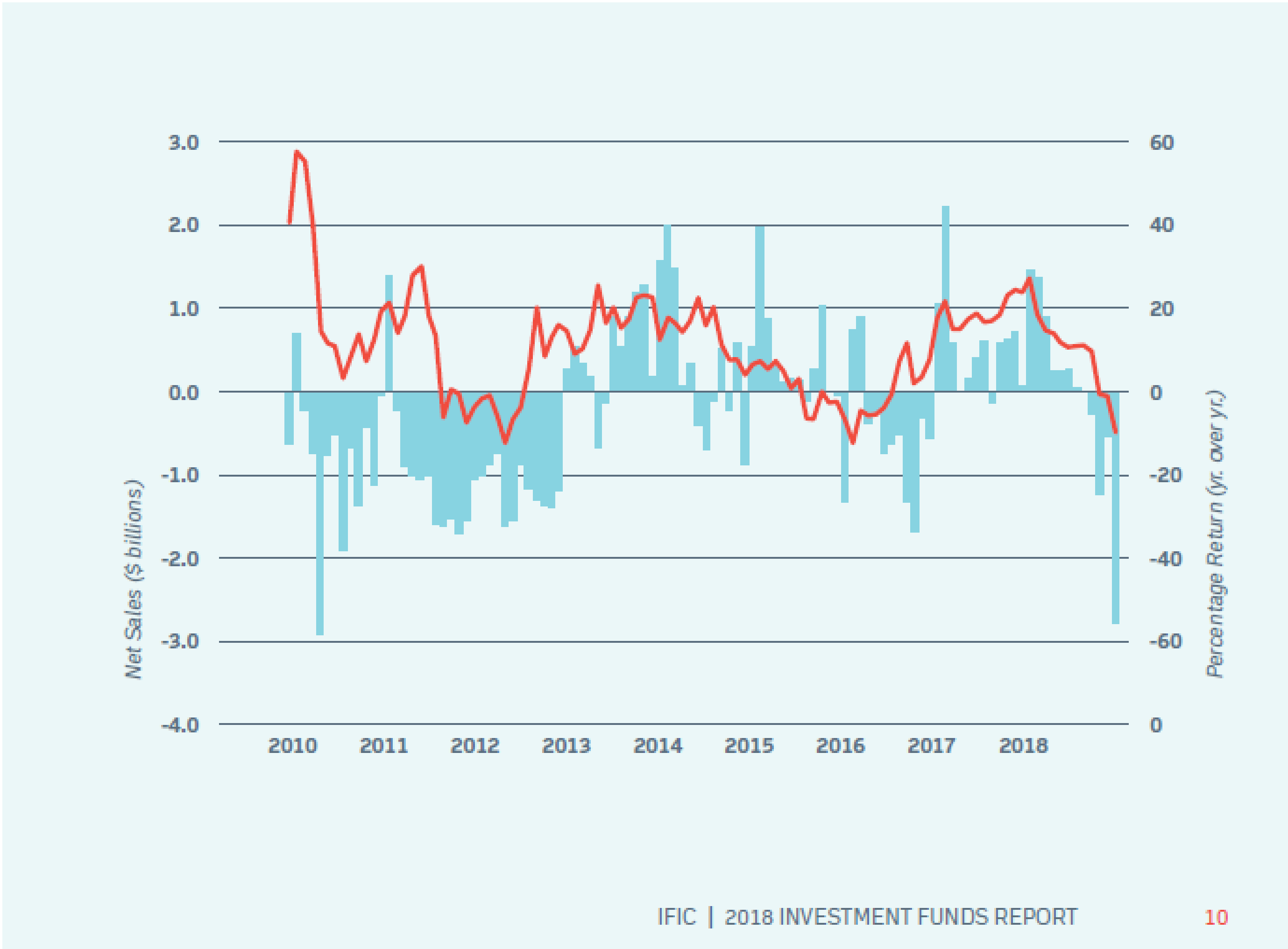
Even bonds were up approximately 3.9% for the quarter (Canadian bond category), thanks to the sharp drop in interest rates.

Typically, a strong year like this finishes the year strongly as well. However, it is not uncommon to have a “mushy middle” that includes a decline before the market recharges for a year-end run.

A weakening economy, plus geopolitical issues too numerous to mention, suggest the next three months will be less rewarding than the last three.

So, we remain patient when it comes to new buying. As the chart below shows, the investing public has a habit of buying high after a price rise, and selling low after a decline.

The chart shows the heaviest selling after negative return years (2011-2012, 2015-2016, and 2018), and the heaviest buying after good years (2014, 2015, and 2017).



Our goal is to do the opposite. It is not always as easy as it looks.

Where Did the Cash Go?

I arrive at work most days between 6:00 and 6:30 a.m. to watch the morning stock opening. It is an old habit of advisors of my generation – the office used to be full by 6:30 a.m. where today it is mostly empty. One thing I used to see every morning on the street of our building was two Brinks (**NYSE BCO**) trucks, surrounded by armed guards, loading bags of cash from the bank basement. Stopping to look got me threatening stares, so I never lingered long when I walked by. I did notice there was a lot of cash.

Today? No trucks. At least, not in the morning, and certainly not two anymore. Why? Less cash is in use.

If a bank today wants to move a million dollars, they wire it or send a draft. Or they send it through the credit card networks, via an electronic-funds transfer, or maybe even through bitcoin. But cash? Less and less.

I then began looking around at how use of cash has changed. There are fewer vending machines than there were decades ago. Pay phones have almost completely disappeared, and most street parking is done with smartphones. ATM machines may start disappearing soon as well, as 29% of Americans say they never even use them anymore (Transaction Network Services survey).

Even panhandlers complain no one carries cash to give them, though that hasn't seemed to lessen their numbers.

In a 2017 report by the site ForexBonuses.org, Canada is now ranked as the most cashless country, beating even Sweden. Our banks have been very early adopters of tap-and-pay credit cards, secure PINs (Personal Identification Numbers), and debit cards. In the US, another study showed just 11% of U.S. consumers prefer cash, while 75% prefer credit cards. Canada is likely even higher.

One group that is definitely happier with plastic over cash are restaurant servers. Most credit card devices default to tips of 15%, 18%, and 20% today, making it easier to tip than ever before – you don't even have to do the math in your head. And the machine even makes you feel a little guilty for not tipping. With cash, more thought has to go into the tip.

The media loves to terrify us about the future. The most recent scare is that robots are going to take over all our jobs and we will have nothing left to do but stare at our phones. Twenty years ago, we were told to be deathly afraid of a different threat – digital cash.

"The government is going to take your cash! They will know everything you spend it on and you won't be able to move it without their permission!"

Now we're there. Many Canadians now pay for almost everything electronically, and so what? It is actually safer than carrying wads of cash around and you get reward points, as an incentive. The government didn't take our cash away – we took it away ourselves. Moving it around has never been easier - when was the last time you wrote a cheque?

Robots and automated systems will arrive and society will change. Automated car washes and robotic floor vacuums are already here, and jobs have simply shifted around. 40% of the workforce in 1900 were farmers – today it is less than 2%. Jobs moved into manufacturing and services, and they will evolve again.

And Brinks? It is doing just fine. It services small businesses, as well as banks today, and is in dozens of countries. And they have found a new valuable commodity to move in their armoured trucks.

Marijuana.

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

http://www.dividendvaluepartners.com

We thank you for your business and your referrals and we hope you find our site user friendly and informative. We would welcome your comments.

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Prices shown are as of close March 28th, 2019.
