The Market in Review

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This week's articles and insights

"What a year last week was."

- Larry Adams, Raymond James strategist

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	28,426	+ 2.19%	- 0.40%
S&P 500	3,447	+ 1.95%	+6.69%
TSX	16,535	+ 2.16%	- 3.10%

Boom Times, Then and Now

My wife and I just returned from a "staycation" trip to Nelson BC, taking a route littered with historic mining towns. Many roads were new to us, even though we have lived in the province collectively for 90 years. We saw many towns that boomed a century ago, then became ghost towns. Residents in 1900 surely thought the good times would never end, but all booms end. We have to remember that.

This is Nelson B.C. from Pulpit Rock.

A little history first.

At the end of the American Civil War in 1865, the United States stood bloodied but unified. The southern half was in shambles, but the north now had a very large standing army, as well as an increased sense of America's Manifest Destiny. This was the belief that the country would expand its dominion and spread democracy and capitalism throughout North America. The United States had already grown through the Louisiana Purchase from France in 1803, the Florida Purchase from Spain in 1819, and was itching to grow further. The nervous northern territory of Britain was in its crosshairs, which spurred Canada's declaration of nationhood in 1867. We had just four provinces then, compared to ten provinces and three territories today.

British Columbia had yet to declare itself in or out. The Alaska Purchase from Russia was completed in 1867, which hemmed B.C. in from two sides. We are a territory larger than the state of Texas and so were highly coveted by both Ottawa and Washington. British Columbia finally agreed to join Canada in 1871 under the promise of a national railway to be built within the next 10 years.

The years from 1881 to 1919 were good ones for a province as rich as B.C. Copper, silver, and gold enjoyed boom years as railways were built across the continent. Prospectors scoured B.C. and found rich veins everywhere.

We passed historic mining towns named Rock Creek, Midway, Copper Mountain, and Greenwood to name a few.

One town was named New Denver because its silver mines were going to make it larger than Denver Colorado. Today, it has 400 people. It kept the name, though.

While British Columbia has grown faster than most provinces over the decades, it has been boom-and-bust growth across a wide variety of industries. Logging and forestry replaced mining after WW1, only to decline in recent years as forests depleted. We are building the Site C dam today - one of the largest dams under construction in the world right now – yet it will only rank as the 4th largest in BC when completed. The boom years for hydro-electricity were the 1960s.

Time marches on, and you either make the most of your town, or you become a ghost of a town. Landlocked by mountains and lakes, there is not a lot of room for many of these towns to grow, so they have had to make the most of what they have. Many have remade themselves as light industry, retirement, and tourism centres in recent years, among other things. Nelson, for example, prospered nicely because of the illicit marijuana business brought north by all the U.S. draft dodgers of the 1970s. There were a lot of “ornamental ferns” hidden under the spruces and larches back in those days!

Ymir Mountain, near several abandoned gold and silver mines, near Nelson B.C.

It will be interesting to watch the mining industry in BC in the years ahead. With electric cars and batteries in hyper-growth mode, could we see another mining boom? B.C. has plenty of undiscovered copper, lead, manganese, nickel, and other metals necessary for the transition from oil to electricity.

Markets This Week

As we mention at the start of this letter, last week was one heck of a year.

Start with the U.S. Presidential debates, where an overly-aggressive performance sent President Trump's polling numbers straight down. He began the week with a 47% chance of returning to the Oval Office, but is down below 35% today.

And if that wasn't enough, he caught Covid-19 and was hospitalized. Markets fell on the news, then rallied. Why did they rally?

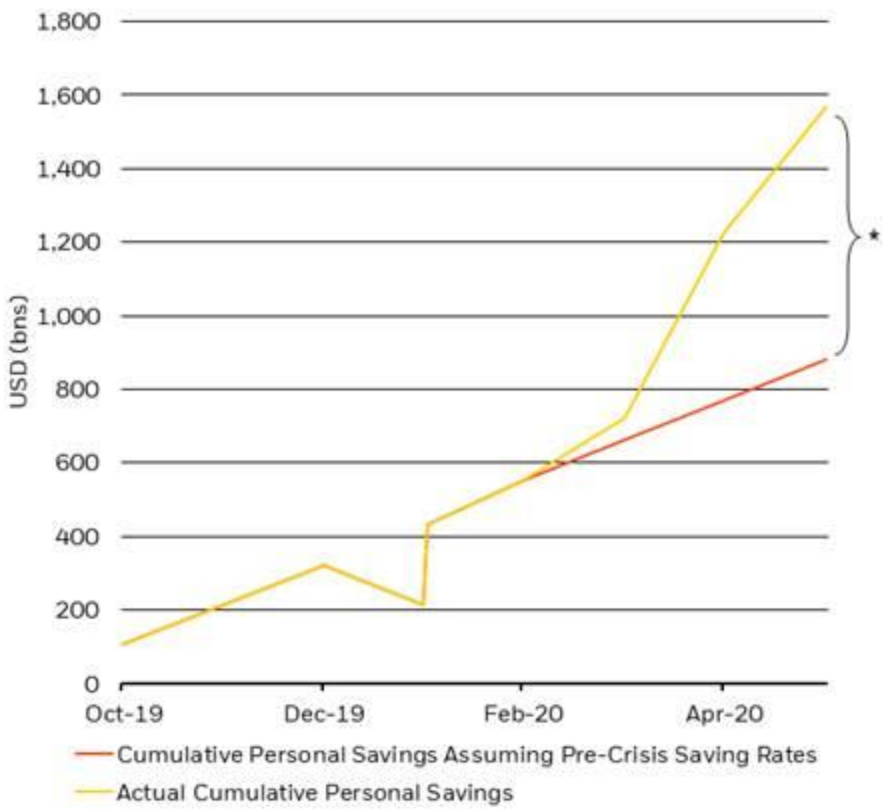
The prevailing fear has been that President Trump may not accept the results of the election if it is close. The last time we saw a contested election (Bush and Gore in 2000), it led to months of churning markets. With polling numbers pointing to a Democratic sweep, some pundits see a smoother transition, which markets would be much happier with. They are calling this the "Biden Bump".

Governments everywhere are weak because of their pandemic response, or strengthened because of it, and are now taking advantage. Here at home, we had a B.C. election called – one nobody needed – and avoided a Canadian election – one nobody wanted.

To cap things off, a second round of stimulus in the U.S. was pulled off the table. Most nations around the world have delivered extra unemployment and support cheques to counter the second wave of the virus. The U.S. also needs the stimulus, but because of the election-led infighting, there is no agreement. Yet.

That said, there will be another huge dose of money coming, and that is what stocks are excited about. Whether it is $1.6 trillion (what the Republicans are offering) or $2.2 trillion (what the Democrats want), some of that money will end up in the stock market. As Blackrock showed in a recent report, close to $700 billion that was sent out as support payments is now held in personal savings as cash or investments. This will only grow larger with another round.

Figure 1: U.S. personal savings (through May) was $688 billion higher due to stimulus



Sources: Federal Reserve, Bloomberg and BlackRock, as of July 17, 2020.
*Uses a linear fit of pre-crisis savings rates over time to project implied savings.

Effectively, we have transferred trillions of dollars worldwide from governments to individuals, almost like a giant credit card withdrawal. With interest rates so low, few are worried about the short-term costs about paying for so much debt.

Eventually, today's party becomes tomorrow's hangover. But that is tomorrow's problem.

October is seasonally a weak month for stocks. When a Republican incumbent loses office, it has historically led to a weak year-end rally. With the promise of more stimulus cushioning the market, stocks have weathered this traditionally weak period quite well so far.

It Is Different This Time

One of the most dangerous phrases in investment lore is "*It's different this time*." This is because, over the decades, stocks follow proven rules. They prosper when the economy is growing and when the underlying companies are profitable. Stocks benefit even more when they share these profits through dividends. Shares of companies also trade in line with the firm's assets, be they factories, buildings, or patents.

But this time really is different. Interest rates have never been held at zero before, or even below zero, in the case of Japan and Europe. In 1995, you could make 5% a year from a 100% bond portfolio with little risk. Today? You are lucky to make 1% a year – an 80% drop. And, there is so much money sloshing around from government stimulus finding its way into the stock market. All of these factors make traditional valuation methods seem outdated.

Here are a few ways they have been distorted:

- Stocks are often valued off bond yields. Today, stocks look extremely expensive. Stocks have historically sold at a P/E ratio around 15 times. Now they sell at double that - 28.6 P/E. Perhaps stocks are expensive because we are comparing them to bond rates of years ago. Compare them to today's 1% bonds and they don't look nearly as expensive.

- Bullish advisory services. If there are too many investors "in the pool", the market is too bullish and it is often time to get out. Today, advisory services show 3x as many bulls as bears - historically too bullish. But, what is the alternative? With cash and bond yields near zero, stocks become one of the few alternatives left.

- Assets are different today. Apple (**NASDAQ AAPL**) owns a few factories and stores, but most of their production is made under contract in China or other emerging markets. Their tangible assets are a fraction of the company's $2 trillion valuation. They are valued highly because of Apple's brand loyalty. In the most recent Piper Sandler Teen Survey, 86% of teens now own an Apple smartphone, and 89% of teens said their next phone will be an Apple product. Other companies like Nike (**NYSE NKE**) and Starbucks (**NASDAQ SBUX**) have equally powerful brands. A company's "economic moat" - how hard it is to copy a company – is another intangible asset. Many have tried to copy Google search (**NASDAQ GOOG**) only to fail. And how about non-paying active users? Facebook (**NASDAQ FB**) has 2.7 billion active accounts, none of which pay a cent.

All of these factors have made valuing stocks much different today than in decades past.

Looking at the high rate of money flowing into the economy from government assistance, stock markets are likely to stay elevated. With bond yields below 1%, stocks are one of the few alternatives for the year ahead.

Dragging Drugs

A recent study showed the average lifespan in Canada is now 83 years. This has important ramifications for the financial planning industry – we need to plan for close to 20 years of life for someone retiring at age 65. The average American will live to age 79.

The same study also said 1 in 5 Canadians will be retired by 2026. We are becoming a nation full of old people, even as we are one of the youngest countries (153 years old this year) on Earth.

As we age, we take more drugs and visit the pharmacy more. So, it would seem that drug stocks – and pharmacies – should be doing very well. In fact, they <u>are</u> doing very well, in terms of profitability and increased dividends. However, elections are not good for the pharmaceutical sector.

"*We want lower drug prices*!" is the rallying cry of politicians on both sides during every election, and drug stocks slide as a result. Who wants to hold shares in a business with politicians demanding lower prices and profits?

Except, what happens every time is that politicians soon realize how hard it is to make this happen. Research is expensive - a new drug can take a decade to discover and evaluate to be safe. This leaves precious few years left on its patent to make up the costs. In Canada, we <u>do</u> get lower prices, but we also accept more generic drugs, shortages, and longer waits for new treatments.

From an investment point of view, drug stocks often suffer during an election, and then recover nicely in the year following. For example, Morningstar Research, which we use, rates a few of our holdings quite highly:

Merck $80.60 today, yield 3.03%. Target price $100.00 (**NYSE MRK**)
AbbVie $87.55 today, yield 5.39%. Target price $ 97.00 (**NYSE ABBV**)
CVS $60.05 today, yield 3.33%. Target price $ 92.00 (**NYSE CVS**)

October 22 Zoom Call

Our next letter will be an in-person discussion with our team.

We will be hosting a Zoom presentation for readers of this letter on Thursday, October 22nd, at 3 p.m. We have a U.S. election to discuss, as well as many other timely topics. It will be recorded and placed on our website for those unable to attend.

Mark your calendars and watch for an invitation.

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 welcome your comments.

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Disclaimers

Prices shown as of October 8th, 2020