The Market in Review

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This week's articles and insights

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"People never lie so much as after a hunt, during a war or before an election."

- ***Otto von Bismarck***

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	29,298	+ 1.18%	+ 2.66%
S&P 500	3,317	+ 1.29%	+ 2.66% (+ 3.15% in $CDN)
TSX	17,485	+ 1.45%	+ 2.47%

2020 Vision

It is now 2020.

2020 is a Leap Year. It is also a U.S. election year, as the two almost always coincide.

Numerically, it is also a unique year. 2020 is a number when the first two digits match the second two digits, which only comes once in a century. The last was 1919 and the next is in 2121 – 101 years away.

What defined the last decade? The 2010s limped out quietly, with nothing Earth-shattering to remember it by. The world became more ecologically-conscious, we changed how we listen to music (we used to play CDs or buy songs – now we just stream) and how we watch TV (Netflix **NFLX** instead of cable). The Middle East was its usual mess and people got very hot and bothered about elections in the U.S. and Canada. Nothing new, in other words.

20/20 is also a term for perfect vision. It means you can see objects clearly from 20 feet away. There are many predictions about the year ahead, all expecting to be clearly right 12 months out. Few ever are. As Yogi Berra said, “It's tough to make predictions, especially about the future.”

At the end of 2018, many analysts were quite negative about 2019. Even the most bullish failed to predict the year would deliver the best returns since 2013. Their opinions were coloured by the negative return that 2018 delivered, especially the sharp decline of the final three months of that year. This is something psychologists call *recency bias*, which is the tendency to expect what happened most recently to happen again.

Today, most analysts are positive on the year ahead, with returns in the 5-8% range. This is a safe prediction. You’re not going to lose your job if you predict “average” and the world delivers “below average” or “above average”. We do know that markets are generally positive in a US election year, as 2020 is. We also know that markets tend to do well after a strong year. Like Newton's Law of Motion, markets in forward motion tend to stay in forward motion. Since 1950, the S&P 500 has ended the year in the same direction as it began the year in 82% of presidential-election years since 1950 (Dow Jones Market Data). So far in 2020, the S&P 500 is up over 2%, suggesting a positive year ahead.

I spent some time thinking about market predictions over the holidays. I have been in this business for almost 35 years now and, despite the world becoming more complicated, I am trying to simplify my thought processes. Also, I want to remove my own biases, which form a big part of how I make personal predictions. With 35 years of hindsight, here is my list of what really affects the stock market most, and what we need to pay attention to when gauging how our investments are about to behave, in reverse order:

4. Wars, Elections, and Policy

Nothing fills the news more than these items. Yet, over the long-term, they have the least affect. Yes, major wars will have major impacts (WW2), and huge electoral swings can change everything (Reagan in 1980), but mostly they don't. Libya, Crimea, Iraq, and Syria all had little bearing on the direction of stocks this decade. Oil rose, then fell back. Headlines about impeachment roared and warned, but the after-effects have been small. The tax cuts of President Trump goosed corporate earnings for up to a year, before the "sugar high" wore off. We pay the most attention to these headlines when assessing the stock market, when we really should be watching other factors more.

3. Trade

Does trade matter? For close to 30 years, we have been opening our borders to global trade. Most of our stuff is now made in Asia and we didn't think twice about it. Suddenly, trade agreements like NAFTA are being torn in two and tariffs in the hundreds of billions were slapped on China by the US administration. Entire industries (farming, autos, energy) were impacted during 2019 due to trade restrictions. Trade did not used to matter much. Now it certainly does. Global markets have been affected for two years by trade frictions:

SOURCES: MSCI, RIMES. As of 11/30/19. Returns are cumulative since the U.S. presidential election on 11/8/16. Returns are in USD.

2. Earnings

The profit a company makes is the bedrock of how we value it. Some companies can grow for years without making much money (i.e. Amazon **AMZN**) but, at some point, something positive needs to hit the bottom line. Surprisingly, earnings for the overall US market barely budged in 2019. Stocks rose by simply becoming more expensive. They cannot do that every year, especially now, with valuations high. Earnings are expected to grow about 5% in 2020.

1. Interest Rates

“Don’t fight the Fed” is an old market saying that matters more today than it ever did. The 20% decline in markets at the end of 2018 was caused by one thing: the US Federal Reserve raised interest rates four times that year, and threatened four more in 2019. The reason the market rose so quickly in 2019? The US Federal Reserve not only backed off on its threat, it actually cut rates three times. Then, starting in September, it injected close to $440 billion in new reserves to the system. Much of that appears to have found its way into stocks, although it is expected to end around April.

So where do these four indicators leave us today?

4. Wars and Elections – Unless the Iran spat turns much larger, this is a blip. And the US election is shaping up to have a moderate Democrat candidate facing off against President Trump. The market is positive that the most left-leaning candidates are fading and the Middle East conflict is confined to the Middle East. The impeachment hearing could sway the US election, although it has had little effect so far. **Neutral**.

3. Policy – The tax cuts are in place until 2025. The election will determine if there are to be any major tax or spending changes. **Neutral**.

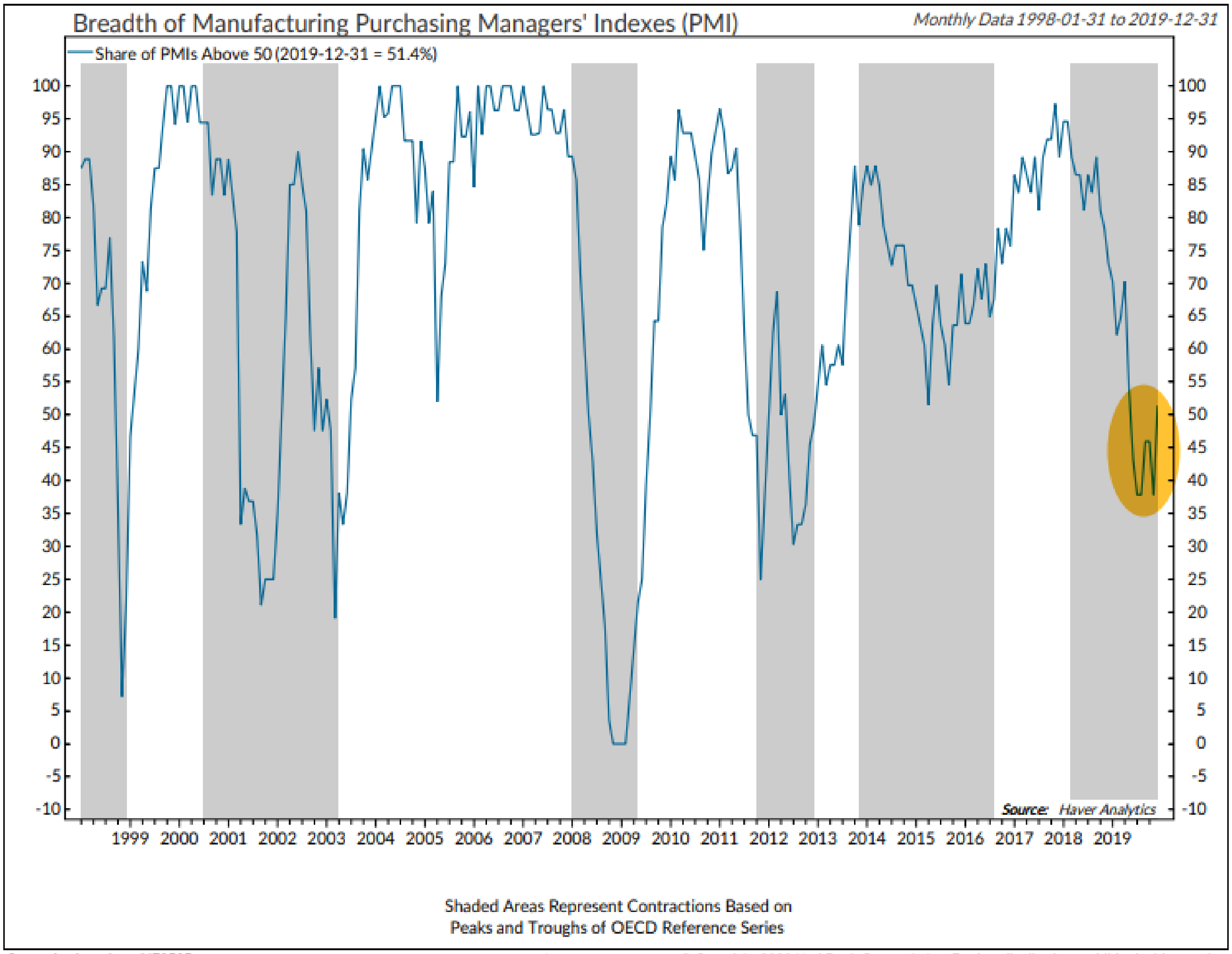
2. Trade - The US and China just signed a trade deal. The US, Canada, and Mexico are just signing the new USMCA trade deal. Even with their warts and blemishes, these agreements signify a lessening of trade tensions. **Positive**.

1. Interest Rates – US interest rates are on hold. Canadian interest rates are on hold. Money continues to be injected into the banking system, though this may end by April. A “friendly Fed” is **Positive** for the markets.

Our conclusion?

Now that the first truce has been declared through an initial trade deal, we are seeing world manufacturing start to turn upward:

More than half of countries are expanding



The anticipation of a trade deal, as well as US central bank stimulus, has sent markets on a tear since October. There has not been a single day with a decline of over 1% in the last three months.

As a result, markets are overdue for a pullback. It could happen and should happen. Beyond that, the conditions above remain relatively positive for stocks, leading us to (somewhat reluctantly) agree with the average consensus:

Stocks are likely to return 5-8% this year, including dividends. Expect more bumps and swings, however.

The Year Ahead

We spoke with Manulife's chief strategist recently, and he offered his forecast for 2020:

- He sees no recession before 2021.
- Canada is relatively more attractive that the US today. He has cut his global exposure for US stocks to 15% (neutral is 50%) in favour of Canada and international equities.
- The Canadian dollar should end the year higher – around $0.79 US. Our interest rates are higher than those in the US, and firm oil prices should push our dollar higher.
- The surprise region of the year could be Asia. China is turning upward, and 6 of 7 Asian countries saw their manufacturing sectors improve last month.
- Electric car sales are growing, but sales as an overall percentage are still tiny. Assuming exponential growth, electric vehicles will only make up 35% of overall auto sales by 2040. In other words, it may be too early to bet against oil.

The Decade Ahead

The decade ahead is going to be an interesting one. Technological improvements are increasing at an exponential rate, to the point that we barely notice any longer.

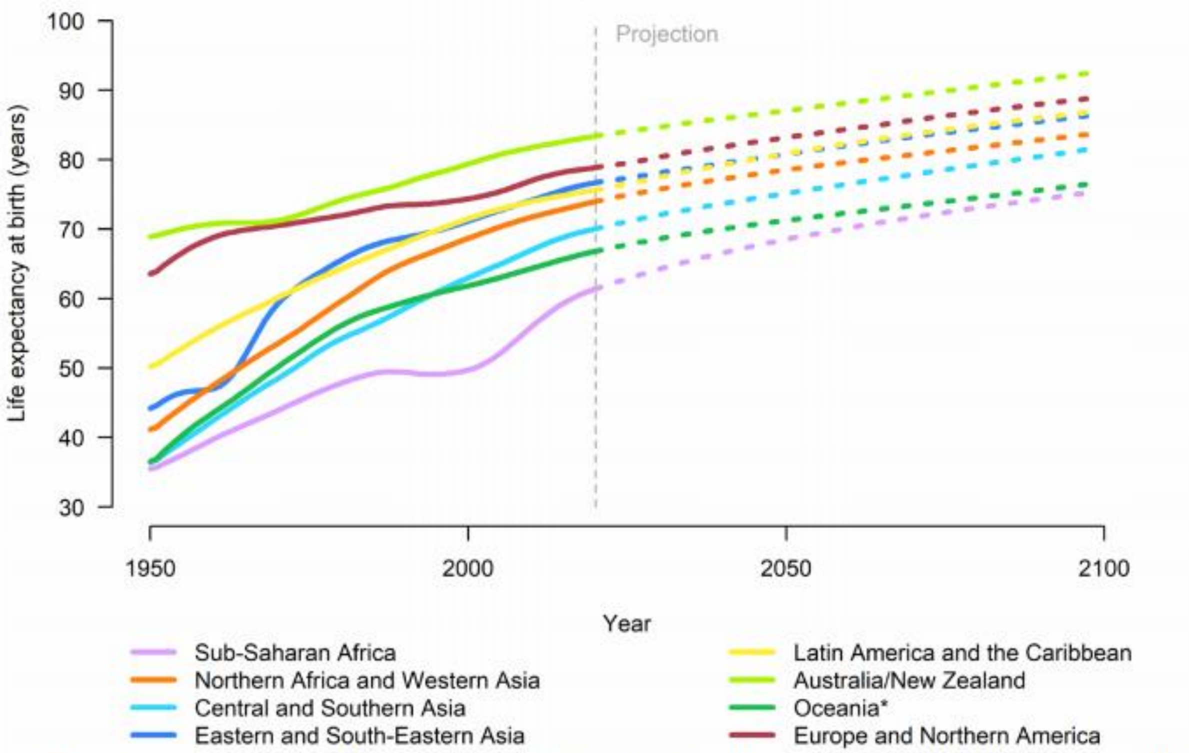
Take speech recognition. Years ago, this was the Holy Grail of artificial intelligence. It took computers the size of dishwashers to convert even a small amount of verbal speech into written text.

Today, you can dictate texts to your phone, talk to your car while you drive, or control your house through smart speaker systems such as Amazon's Alexa or Google (**GOOG**) Home. We are also seeing rapid discoveries of new therapies as we unlock the secrets of DNA, proteins, and even smaller molecules that make up our bodies. Average life expectancy is expected to continue to increase throughout the world, as a result.

This UN graph assumes gradual improvements in life expectancy over the next century. What if we find ways to extend the human lifespan dramatically?

Figure 20. Estimated and projected life expectancy at birth for both sexes by SDG region, 1950-2100, according to the medium-variant projection

Considerable progress has been made towards closing the longevity differential between countries, but wide gaps remain

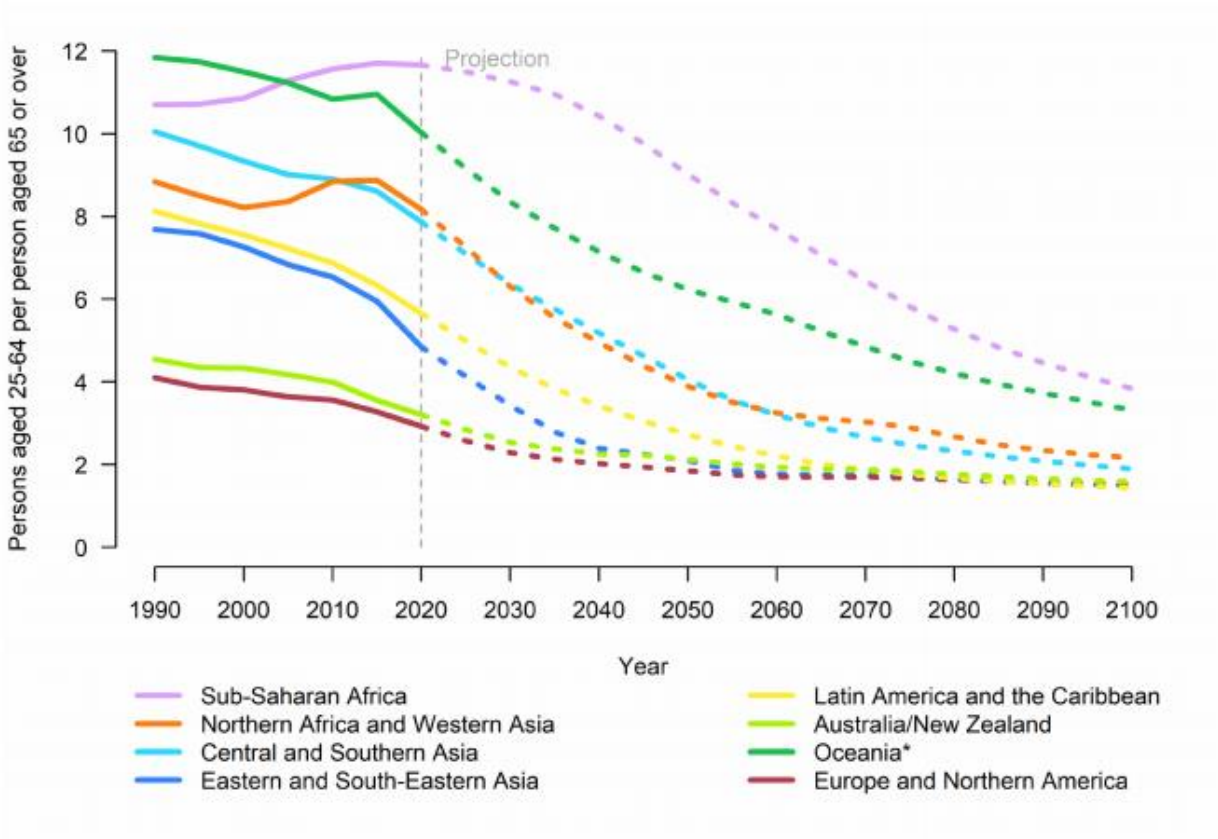


Data source: United Nations, Department of Economic and Social Affairs, Population Division (2019). *World Population Prospects 2019*.
* excluding Australia and New Zealand

Until we do, though, the world will continue to get older and older, making the aging of humanity a major theme of the 2020's. It will affect everything from health care to pensions. The imbalance is stark. For example, Canada now has more people over the age of 65 than under the age of 15, yet we have over 2,400 pediatricians (doctors for children) compared to just 300 gerontologists (doctors for the aged).

Figure 14. Estimated and projected potential support ratio by SDG region, 1990-2100, according to the medium-variant projection

Population ageing leads to a decline in the potential support ratio, which describes the number of working-age persons relative to the number of older persons in the population



Data source: United Nations, Department of Economic and Social Affairs, Population Division (2019). *World Population Prospects 2019*.
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An older world is a slower world, which helps explain why the growth rate of most developed countries now hovers around 1-2% per year compared to 3-4% in the 1970s. The peak year for population growth was 1968 when the world population grew at a 2% per year pace. Today? The developed world's population growth is now flat at 0.1% per year, with world population slowing to just 1% per annum. Interest rates are low, inflation is low, and both are likely to stay low for the foreseeable future, as a result.

Other major themes include:

ESG – The Environmental, Social, and Governance movement is changing the way we invest. More and more investors, as well as corporate executives, are embracing ESG and fossil-free mandates. Agree with it or not, it is an enormous tide of money moving in a very specific direction.

5G – Imagine internet speeds 100 times what they are now over your phone. Enormous amounts of data will be transmitted by every device, which means many more cell towers, more powerful phones, and millions more “smart” devices (home security, health-monitoring watches) will begin talking to one another.

Autonomous cars – These are late, but they will arrive eventually. Many thought we would have fully autonomous cars (Level 5 – Full Automation) by now, but we are just on the edge of cars that can steer for you on a highway (Level 3 – Conditional Automation). When your car becomes able to drive itself, our worlds will change dramatically. For seniors losing their licenses, it will be a godsend.

It will be another interesting year ahead, and an even more interesting decade.

Sharon Steps Up

About a year ago, we changed our official name from Siluch-Hill Management to Dividend Value Partners. Why? It is the name of our flagship portfolio and method, and the name will also outlive the two of us when (and if) we retire. Time and tide wait for no man, goes the saying. We are no different.

While we have no plans to retire anytime soon, we do understand the invigorating effect of younger blood. We welcomed Peter Mazzoni as a partner a number of years ago, who has been with us for 19 years. He has certainly earned his stripes. As of February 1st, Sharon Mitchell will also become a partner in our group. She has been with us 5 years now, and is a Certified Financial Planner. Sharon brings a different skill set to the team, and a wonderful manner.

For clients, nothing changes. For Sharon, she now gets to enjoy the ups and downs of ownership. We are thrilled to welcome her as a partner!

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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