The Market in Review

Paul Siluch, Lisa Hill, Peter Mazzoni, and Sharon Mitchell
Financial Advisors
Raymond James Ltd. – Victoria BC

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This week's articles and insights

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"You know what your problem is, it's that you haven't seen enough movies - all of life's riddles are answered in the movies."

- *Steve Martin*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,765	+0.04%	+ 13.59%
S&P 500	4,449	- 0.55%	+ 18.45%
TSX	20,462	- 0.68%	+ 17.37%

The Hunt for Red October

When September is a weak month for markets, October often starts weak as well. Down markets are said to be "in the red" while rising markets are "in the black". We've been waiting months for "red" weakness, and maybe this is it.

Hence, our "hunt for red October."

In the 1990 movie "The Hunt for Red October", based on Tom Clancy's novel, a Soviet submarine captain defects with an ultramodern Russian submarine. In the race to get the giant vessel to America, there are chases, evasive maneuvers, and explosions under the surface. Viewers are made to feel the wrenching action and high speed turns of submarine warfare. However, the reality is a bit different. "Boomers" – the massive missile-carrying Ohio-class submarines – are as long as two football fields and can take a mile to turn around. Submariners wear rubber-soled shoes to minimize noise, so the action is quiet and slow. There is movement underwater but you never really get to see it until the vessels break the surface.

The action in the stock markets has been similar to submarine warfare: lots of churning underneath, but calm on the surface. Most stocks have been weak for months, starting with the outbreak of the Delta variant. Canada's

S&P/TSX index and the S&P 500 in the U.S. have stayed aloft due to the "boomers" – the giants like Apple (**NASDAQ AAPL**) and Microsoft (**NASDAQ MSFT**) in the U.S., and RBC (**TSX RY**) and Shopify (**TSX SHOP**) in Canada – while the majority of small and medium-sized stocks began declining in July. September marked the point when big stocks finally joined the decline.

When the giants finally do fall in price, it tends to be dramatic and hit the headlines, as we have seen the last two weeks. Amazon (**NASDAQ AMZN**) fell 10% in just two weeks, which is a very big move for such a giant. Not to worry – Christmas is coming. Amazon will do just fine. However, something fundamental has changed.

Under the Magnifying Glass

The technology sector has enjoyed unrestrained growth for almost two decades. We have seen social media, e-commerce, electronic payments, and software of all kinds spread around the world. The influence of the internet giants grows with every new user who signs on and adds pictures or comments, and billions did just that.

For example, Alphabet (**NASDAQ GOOGL**) analyzes every word in G-mail to refine its search engine, sell advertising data, and to test its language translation programs. Facebook (**NASDAQ FB**) runs every user through algorithms designed to hook them into more articles, advertisements, or behaviours that encourage more time on its site. Are you reading political websites that make you angry? Algorithms direct you to other articles that will make you even angrier, something called *algorithmic amplification*. They hook you, in other words, in ways very similar to tobacco.

This week, a former Facebook employee came out as an official whistleblower. Armed with thousands of secret documents, the woman testified before Congress about what Facebook does to alter user's behaviour. The uproar is not dissimilar to what happened in China between the government and Alibaba (**NYSE BABA**) over its dominance in the payments industry. The Chinese government is wrenching power back from its internet giants, and the U.S. government is about to do the same thing.

Some have compared this moment to 1964 when the U.S. Surgeon General announced a definitive link between cigarettes and lung cancer, putting Big Tobacco on the defensive for the next 50 years. They fought every step of the way, but they were gradually forced to restrict sales to minors and to reveal the threat their products delivered.

Facebook stock fell in price as senators railed against the power of the internet giants, but there's a big difference between retreating and surrendering. The battle has only begun.

The key question is if there still is growth ahead for these companies. Governments everywhere have technology companies in their gunsights and legislation is bound to follow. Like the automobile, tobacco, and industrial companies before them, nothing grows to the sky. Companies grow big and get regulated.

Rather than being at the end of their growth phase, it is far more likely they have entered a new, *slower* growth phase. Their talent pools are as deep as that of any industry, and they have more money than most countries.

Look at what happened to the tobacco companies after the Surgeon General's game-changing report:

- They paid fines that looked expensive, but then simply raised their product prices and made even more back. Even the $200 billion settlement in the 1990s is forgotten today.
- Increased government scrutiny made them monopolies. Who, in their right mind, would ever start a new tobacco company?

- When governments restricted advertising, the tobacco companies saved billions. These were addictive products, after all. Not unlike social media today.
- They diversified around the world and bought alcohol companies, sports teams, and paper companies, to name just a few. Today, they are buying marijuana companies.
- Fifty years after tobacco was declared harmful, tobacco stocks were still hitting new highs.

Expect to see increased scrutiny, investigations, and fines for the global internet giants. This will cause the prices to gyrate, and occasionally fall. Patient investors can take advantage of this. Charlie Munger, Warren Buffett's partner, recently purchased $45 million of Alibaba, the beleaguered Chinese internet company. Its shares have been cut in half as the Chinese Communist Party demanded curbs on its finance arm. Munger is a sharp-eyed value buyer who obviously believes internet use in China will be more regulated, but never stopped.

Panic at the Pump

Continuing the movie theme, "Jurassic Park" is a nice summary of what is happening in the energy world today. Just when we thought we were safe, old monsters rise up and cause havoc.


Photo from Pixabay

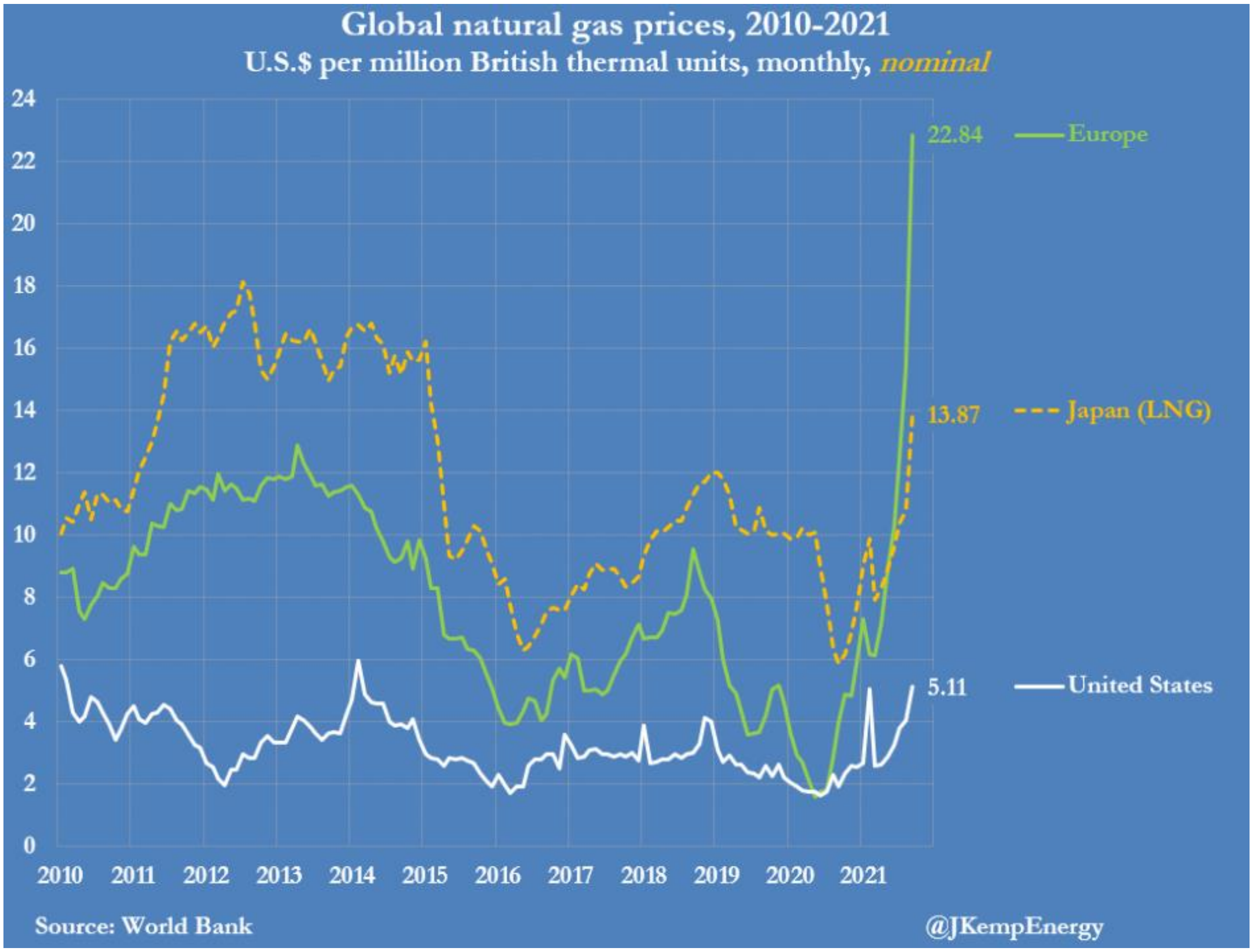
That's pretty much what is happening in the energy industry today.

In the race to go green, countries closed coal, natural gas, and nuclear plants. They replaced them with solar panels, wind turbines, and hydro dams, as well as wood waste and geothermal. Young people fled the energy business, convinced it was a “dinosaur” industry such that fewer and fewer young people are employed in resource industries. The average age of truckers to haul fuel in the United Kingdom is 55 with just 1% under the age of 25. The average age of people in the forest sector in Canada is 61. And they are getting older even faster - the pandemic sent many on-the-edge Baby Boomers into retirement, with no one left to take their places.

Thanks to many of these sudden shifts, the energy dinosaur has struck back, in a very big way.

China has a big drought, meaning its dams are producing less electricity than needed as the economy recovers. Germany’s new solar panels don’t get enough sunlight and they closed all their nuclear reactors. India stockpiled less coal than it needed, thinking the price would drop. It didn’t. The UK is short 100,000 truck drivers to deliver fuel to its petrol stations, and Europe is facing a shortage of 400,000 drivers (CNBC). Drivers are often paid less than supermarket cashiers and so many have left the industry to become Amazon drivers instead (UK Institute for Government).

And these are just a few of the examples. The world is bouncing back from the pandemic, but energy supplies haven’t. We are blessed with cheap fuel here in Canada partly because we have too few pipelines to ship it out, causing a mini-glut here. The U.S. has some of the lowest natural gas prices in the developed world, but Canada’s are even cheaper:



Natural gas prices in Europe are moderating due to promises by Russia to ship more. We will see how that promise holds out.

Markets have a way of levelling prices. European prices will likely decline, but Canada's prices are bound to rise. The reality is that the world is a very energy-hungry place. We will need every form of energy – conventional as well as renewable – to power everything in the years ahead.

And China? The country is buying coal by "whatever means necessary" at any price to keep the country warm this winter.

Who knew coal would outperform gold by 50% in the last three years?

Source: Trading Economics

Markets This Week

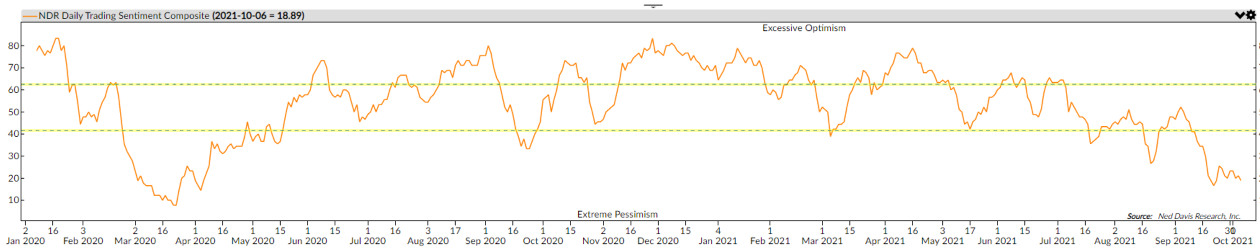
Since September 20th, we have had 6 days of big declines and 7 days of sharp increases. All this movement has put us right back at the exact same spot as we were three weeks ago.

One catalyst for one of the larger rallies was a new Covid-19 pill from Merck (**NYSE MRK**) that saw its testing halted because it was so successful. The pill was administered to patients with moderate to medium cases of Covid-19, and the disease was slowed or stopped in all cases. Hospitalizations dropped sharply and deaths from Covid-19 went to zero. In other words, it worked better than hoped. Airline stocks, hotels, and everything travel related jumped in price.

It is early days for this new treatment, but it could become a significant new tool in the pandemic arsenal. For Merck itself, it could represent up to 15% of additional annual revenues, if the projections hold up. Not insignificant at all. Merck shares jumped 10% on the news.

Market "churning is often what happens when stocks are adjusting to new data. In this case, it is higher oil prices, persistent inflation, and ongoing issues with property developers in China.

The result is that sentiment among investors is at the lowest point since the pandemic of 2020.



This is actually good news, in its own way. When everyone thinks it is time to sell, markets often do just the opposite, as my all-time favourite cartoon demonstrates:

Kevin Kallaugher artwork

Who Panics Most?

Men panic most in market downturns. Specifically, men over 45, with children, and who have experience in the stock market.

Many of us with long records in the industry know this. Women are often better long-term investors because they watch their investments less and so don't tend to react when markets fall. A recent Massachusetts Institute of Technology study details exactly this.

Men see themselves as protectors, and when they have a family, it appears this instinct is elevated. Other research shows men react on their impulses more, and the stock market has a way of bringing this behaviour to the fore. Actions to lower risk (through selling) during downturns can have the opposite effect. We make things worse, in other words.

"Clearly, these are people who are trying to protect themselves," said Amanda Clayman, a financial therapist in Los Angeles.

The study says women are more likely to seek confirmation through discussion before acting; whereas, men just act. This may have worked better for men when chased by lions on the savanna a million years ago, but not so much in the complex situations of today.

This study aligns with a large one done by Vanguard several years ago that showed investors who use an advisor tend to do better over time. Why? Not because we are brilliant as a profession, but because we provide a pause button to evaluate, discuss, and curtail panic urges.

"Most of us freak out way more than we think," said Clayman.

Another male weakness…as if men needed more.

The full story can be read at:

https://www.cnbc.com/2021/09/27/panic-sellers-during-stock-market-dips-are-often-married-men-with-kids.html

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How to contact us:

paul.siluch@raymondjames.ca
lisa.hill@raymondjames.ca
peter.mazzoni@raymondjames.ca
sharonmitchell@raymondjames.ca

(250) 405-2417

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Prices shown as of October 7th, 2021