The Market in Review

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This week's articles and insights

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"Democracy is two wolves and a sheep voting on what is for dinner."

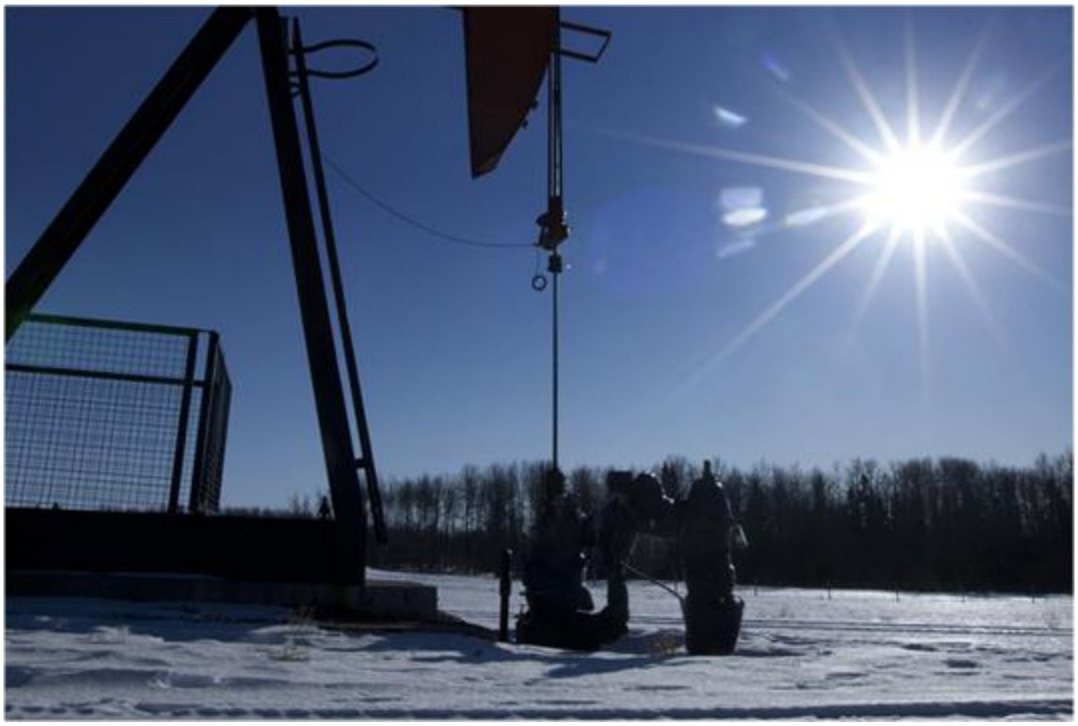
Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	31,493	+ 0.20%	+ 2.90%
S&P 500	3,914	- 0.06%	+ 4.20%
TSX	18,274	- 0.65%	+ 4.82%

Polar Vortex

The biggest news of the last two weeks was the arrival of the Polar Vortex from Canada's north. Americans always chortle at our horrible winter weather, until we send it their way. Then they curse us for it.

This one was particularly harsh. It dumped a foot of snow on Victoria, the Canadian city that is least able to handle snow, and yet still has plows and winter equipment on hand. This vortex reached all the way down into Texas and Mexico, which are regions that are not at all prepared for such weather. The snow clogged highways, froze pipelines, and cut power to hundreds of thousands of homes.



Much has been written about the frozen wind turbines unable to move in the ice, and how this affected power supplies in Texas. This is true, but an even bigger problem was that natural gas wells and pipelines also froze. The Lone Star State depends on natural gas even more than it does wind to warm its homes and keep its lights on.

Why was Texas so hard hit? In Canada and colder parts of the U.S., wells are winterized and wind turbines insulated to operate in sub-zero temperatures. Since this rarely happens in Texas, they have been slow to upgrade their equipment. Also, Texas is so blessed with ample natural gas from the giant Permian basin, they burn today what they pumped yesterday, and store relatively little. Not a good plan when all the wells freeze up. The Texas grid was designed for hot summers, not freezing winters.

Natural gas –the commodity - has been the biggest beneficiary of the cold snap. Frozen wells in Texas meant supplies from as far away as Canada had to be diverted south. Texas has since banned the export of natural gas to Mexico for the duration of the cold spell, prompting Mexico to consider shifting back to coal. Unlike natural gas, coal can be easily stored (see that big pile over there?) and fired up easily in just about any temperature.

Pandemics and Prices

A recent study by the Bank of England looked at all pandemics over the past 800 years. One of the defining characteristics they found was that inflation rose in the year following the pandemic (source: the Economist).

This makes sense, in that most pandemics see the population fall, which means fewer goods are produced and so scarcity occurs. Scarcity = higher prices = inflation. In a crisis like ours in 2020, we shifted our priorities from services such as travel, eating out, movies, and shopping to goods such as fuel, food, and raw materials.

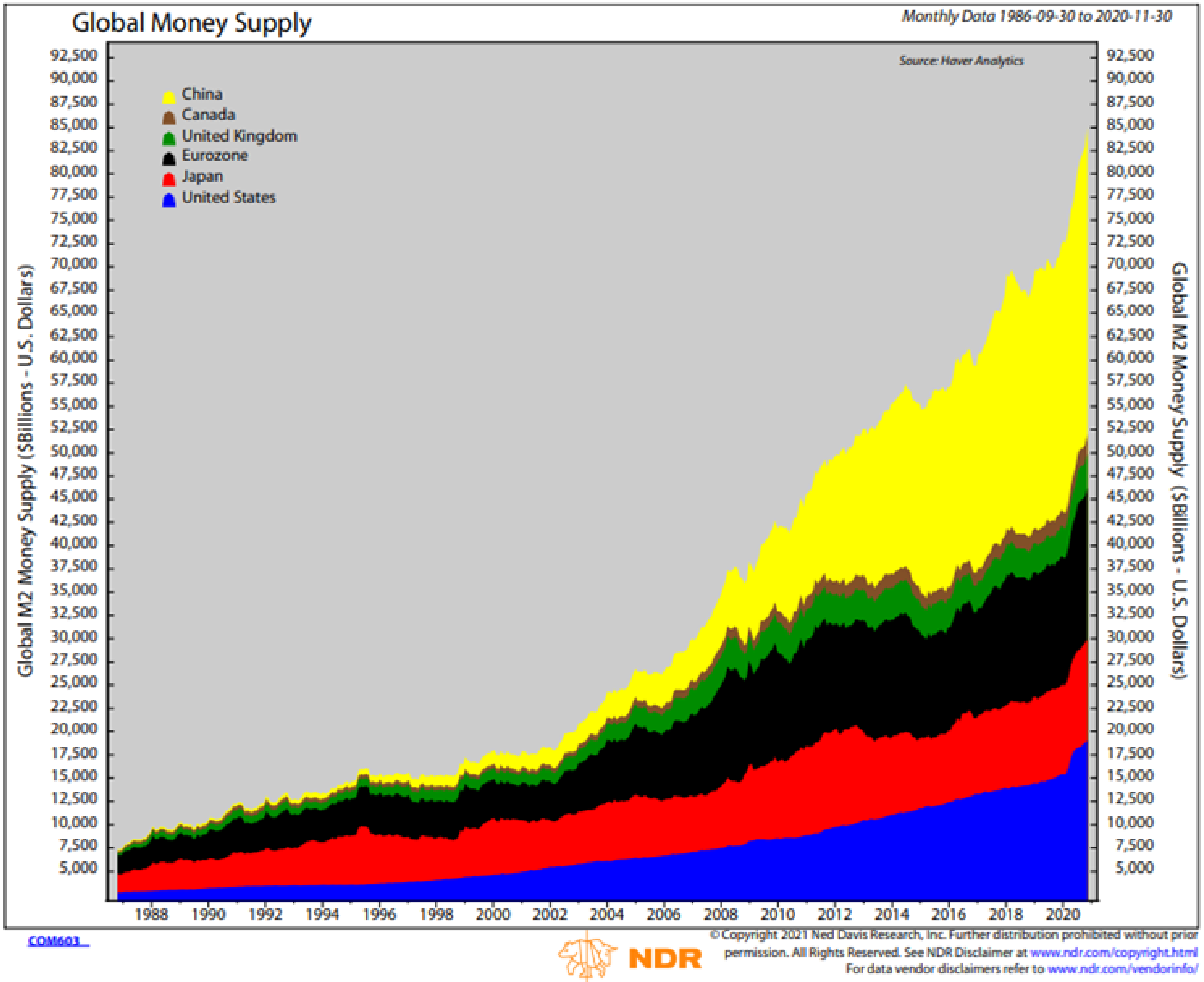
Or, in the case of Texas, natural gas to heat your home. The rising prices of goods may well lead to higher inflation now, just as it has in past pandemics.

The topic of inflation is both timely and important. Many commodities, from copper to corn, have risen in price since the pandemic struck a year ago.

Not a huge surprise, in hindsight. Mines closed and supply lines came to a halt. China was the first to re-open its economy and suddenly, almost every raw material was in shortage.

On top of this, global governments flooded the world with stimulus money. An estimated $13 trillion was printed globally to offset the money lost by lockdowns.

Money supply escalating globally



Not all of the new money was spent, however. We have seen savings accounts swell because of fewer vacations and dining out, to name just a few of the services most affected. Where has all the excess money gone?

Residential real estate has been a big beneficiary. You can buy much more home with a 1% mortgage rate than you can with a 3% rate, and so house prices have responded by going up.

The stock market has also done well, especially those companies with big growth rates and few profits. These companies – mainly “next generation” and “new era” companies tend to do well with interest rates close to zero.

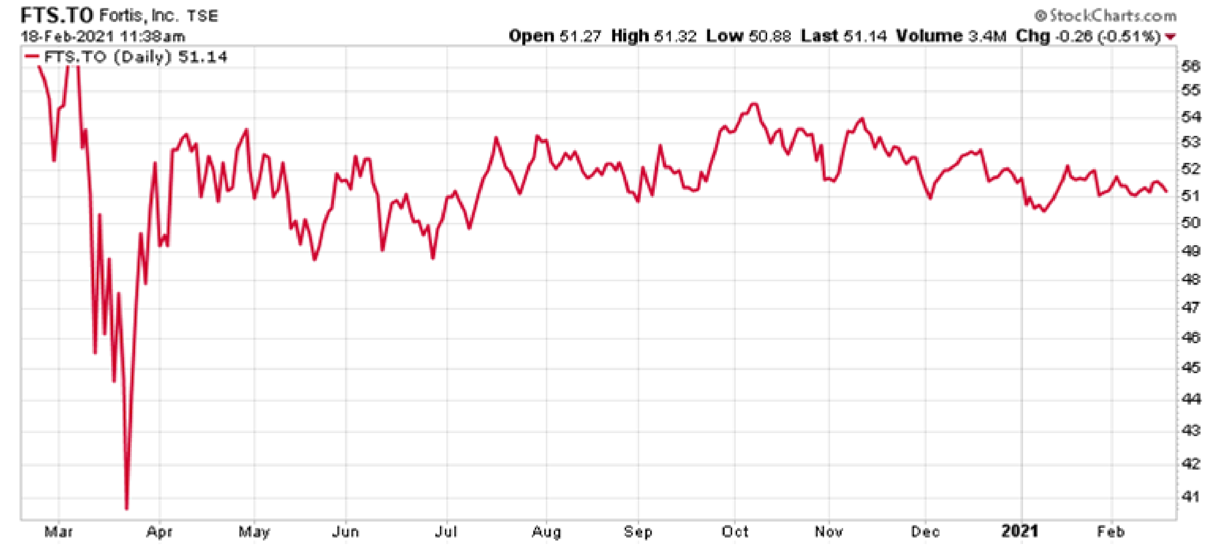
Interest rates are sneaking higher, though. The threat of rising interest rates could bring the long-anticipated correction in stock prices.

The Forgotten Beneficiaries of Electrification

Rising interest rates are not kind to boring, high dividend-paying utility stocks. Fortis (**TSX FTS**), one of Canada's largest electricity and natural gas providers, is the same price it was a year ago while the rest of the stock market has gone up.

The shares are flat, even as Fortis hiked its dividend by 6% last September, has doubled it in the past 12 years, and increased it every year for the last 47 years. It now yields 4% in a world where the best savings accounts get you 0.5%.

And yet, the stock is ignored.



The same can be said for all of Canada's (and the U.S.'s) utilities. Low-growth utilities typically do not do well during periods of improving economies and rising inflation, as we are seeing now.

We ignore the trend of electrification of the world and what impact this may have on these companies. In fact, they may be some of the prime beneficiaries, making electric utilities faster-growing companies than we think:

- The bitcoin network requires the same power annually as Switzerland to maintain itself.
- Electric vehicles could reach 20% of global auto sales by 2030.
- Global data centres and cloud storage now consumer approximately 1% of world energy. This could rise to 3-13% by 2030 unless we can become far more efficient (*On Global Electricity Usage of Communication Technology: Trends to 2030* by Anders S. G. Andrae)

As with the race between the hare and the tortoise, sometimes it pays to bet on the plodder (electric utilities) over the rabbit (bitcoin, Tesla).

Are U-Leaving?

Many of us remember moving out for the first time. You rented a U-Haul, crammed everything you owned inside, and headed for the big city. Most of the time, it was for school, but then we stayed in the city to work.

That's why cities are big: they are magnets for young people.

Except now, they aren't. The cost to rent the smallest U-Haul truck to Houston, Texas from Los Angeles is more than triple than going from Houston to Los Angeles. To rent a U-Haul truck from Phoenix to L.A. is $200 versus $1,200 from L.A. to Phoenix. The same dynamic is happening in Canada – it is triple the rate to rent a truck to go from Vancouver to the small town of Nelson than it is to go from Nelson to Vancouver.

The reason for the difference is demand – so many more are leaving New York, Los Angeles, Chicago, Vancouver and Toronto that trailer rates ***to leave*** have skyrocketed. Same in Canada. Over 87,000 people left Toronto, Montreal and Vancouver between July 2019 and July 2020 as mainly younger people moved to the suburbs, smaller towns and rural areas (source: National Post, Statistics Canada).

Some will say it is because of Covid-19, the attendant risk of living in crowded buildings and the new allure of working from home. Others say it is because of the high price of housing.

Home can now be anywhere. Why not move to Florida, where is it warm and there is no state income tax? Why not move to Victoria, the warmest city in Canada (in Canada, warmth is a relative term)?

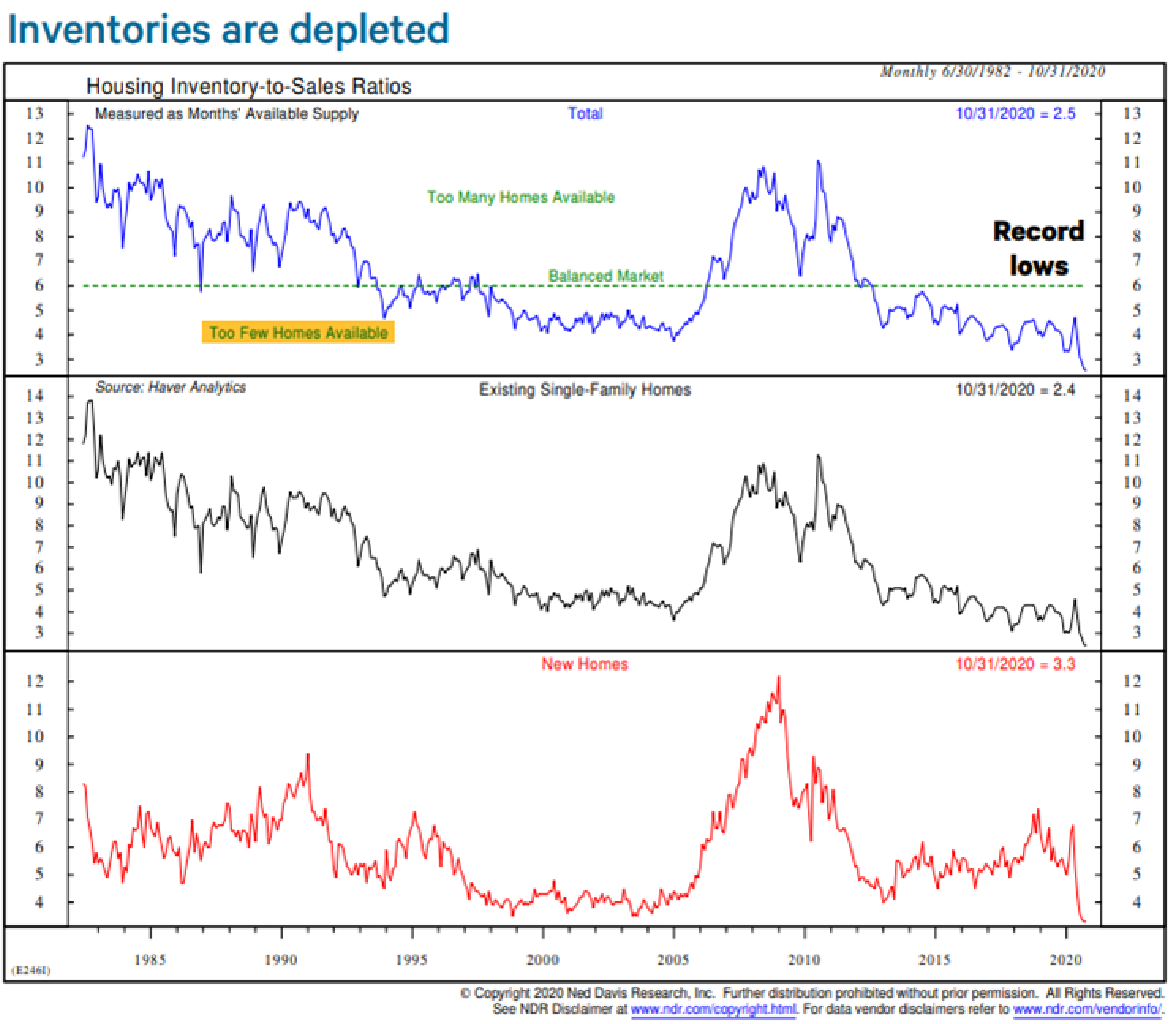
Some of this flight from the cities will reverse itself once the pandemic fades. There are many jobs that can only exist in skyscrapers, so they will fill up again.

But many of these trends, like work-from-home and social-distancing, could be longer lasting than we think. For example, the Bank of Nova Scotia (**TSX BNS**) announced this month that they are vacating the tops floors of Scotia Plaza in Toronto, the quadrangle of buildings named after the company. To those of us in the Canadian financial services sector, this is like the Catholics leaving the Vatican! Scotia Plaza has been the primest of prime real estate since the 1980s. Midland Walwyn, our firm in the 1990's, maintained a trading floor in Scotia Plaza and we were proud to pay the exorbitant rent just to brag about our address.

Banks and many other white-collar firms are rethinking their real estate needs. This started as automation allowed gradual downsizing, and has now been accelerated due to the pandemic. We haven't yet seen dramatic drops in office rents ***yet***, but we may, and this will affect landlords, building owners, and pension investors. Apartment rents too. Parts of downtown Manhattan are down as much as 45% from where they were just a year ago in some buildings. We have not seen this in Canada, thanks to lower virus counts and higher rent supports, but it is early days for landlords.

The flip side of this is the enormous housing shortage in both Canada and the U.S. The Millennial generation has been stuck in their parent's basement thanks to crushing student loans and a weak job market after the 2008-9 financial crisis. Add the 2020 pandemic to their list of roadblocks to owning a home. Many can no longer wait and are forming new households are an increasing clip. They have decided to move out and are bidding up the price of homes in the suburbs.

The Ned Davis Research firm estimates there is a shortage of over 3.7 million homes in the U.S., largely due to the cessation of building after 2008-9.



Throw in record-low interest rates and $6 trillion of stimulus money, and it is no wonder lumber prices are at all-time highs.

The good news for renters is that rent increases could cool off as demand normalizes for apartments in the cities. The apartment REITs we follow and own are doing fine through all this.

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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