The Market in Review

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This week's articles and insights

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"Inflation is just like alcoholism. The good effects come first."

- *Milton Friedman*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,549	+ 1.43%	+ 12.88%
S&P 500	4,202	- 0.23%	+ 11.86%
TSX	19,291	+ 0.18%	+ 10.66%

The Roaring 2020s

Every pandemic in history has been followed by a period of hedonism. Some pundit said something along these lines this week.

Is this true? People abandoned their houses to 'make merry' after the Black Plague in the 1300s. The Roaring 20's followed the Spanish Flu of 1918-1920. It should come as no surprise that there would be delirious freedom after months or years of quarantine. In fact, many behaviours can change in the aftermath of a pandemic.

For example, by 1920, 21% of the U.S. workforce was made up of women. This was because many men had died or were wounded in WWI and the Spanish Flu was even more deadly to the returning soldiers. Women helped to fill the labour gap and were finally granted the right to vote in August of 1920. That was a huge political change that can be linked to that era's pandemic.

Prior to women entering factories, a predominant fashion was the corset, a very restrictive undergarment that did not afford much comfort or movement in an assembly line. Women shed them in favour of looser clothing, which led to the boyish "flapper" look common in the 1920s.

On May 5th of 1921, the world was introduced to the world's most iconic perfume: Chanel No. 5. Along with the change in fashion, Chanel No. 5 helped usher in a new era for women. It was a brand new fragrance made by a woman for women, and was unforgettable to all who smelled it. The story goes that ten samples were presented to Coco Chanel, and she chose the fifth one, and hence named it No. 5.

Coco Chanel prized cleanliness above all things, and preferred to wash with soap rather than cover up odors with the heavy smell of perfume, which was the common way back then. Aldehydes had just been invented, which were a strongly-scented compound made from alcohol. They lasted a long time on the skin and some smelled like soap. Coco Chanel added jasmine, rose, sandalwood and vanilla, and the perfume "like nothing else - a woman's perfume, with the scent of a woman" was an instant success.

It helped usher in the Roaring 20's, a phrase we are hearing more and more of today.

The parallels between 1921 and 2021 are:

- Similar booms in the stock market
- Pent-up demand for travel, entertainment, and mass gatherings
- Easy money policies that define both eras

America of the 1920s was also the emerging global superpower, and America of the 2020's is the first "winner" in the race to end the pandemic. This is due to vaccine miracles, as well as three rounds of stimulus putting money in everyone's pockets. Savings rates are the highest in decades - a recent Scotiabank survey of 1,500 Canadians found that most planned to hang on to the extra savings they have accumulated.

But not everything is similar between 1921 and 2021.

America in 1921 had a debt-to-GDP ratio of 10%. The country of 100 years ago could afford to spend, borrow, and build. America today has a debt-to-GDP ratio of 129% (source: Federal Reserve Bank of St. Louis) – higher even than the 106% ratio hit at the peak of WWII. Governments today are heavily in debt.

The big question is, will the "Roar" last a year or a decade? This is a vital question, because so much money today is being positioned for a long "supercycle". If this wave turns out to be just a ripple, all bets are off.

One of the biggest unknowns is inflation. 2% inflation has been an impossible target of central banks for many years. They have tried – through lower interest rates and new borrowing – to induce inflation of 2% each year.

Why would we even want to have a policy that devalues our currency from $1.00 in January to $0.98 by December? That's a good question for another day.

Meanwhile, inflation today is trending closer to 3% than 2%. We can certainly see why – prices of some materials, such as lumber, have quadrupled (source: Trading Economics):

Labour is also in short supply in the U.S. With expanded unemployment benefits, some sidelined workers are making the equivalent of $22 per hour compared to the minimum wage of about $13.50 in the highest-paying states. Why go back to work for that? One in eight Americans are still receiving government support payments.

The word we will be reading more and more of is ***transitory,*** as in temporary. We know lumber prices are high because everyone decided to buy, build, and renovate all at once. This collided with closed mills in Canada, the lingering effects of the mountain pine beetle, and low inventories. The exponential rise in lumber in the chart above is ***transitory*** – it will not last because it can't. No one could afford to build at that price. Or, we will switch to mud huts. And benefits will end, meaning people will have to go back to work eventually.

So in that sense, some of the inflation we are seeing will be transitory.

What stocks do best if inflation retreats? If inflation goes back down, we should all go buy technology stocks again. They do best when there is little growth and low inflation – just like in 2020.

But technology stocks are struggling right now, which may suggest inflation will be more than transitory. If inflation lingers for longer, as a result of demand and infrastructure projects, then we need to own a different sort of stocks. We will want railroads, banks, and commodity producers such as Nutrien (**TSX NTR**), the fertilizer giant. Just like in the 1920s and the 1970s.

Companies like Coca-Cola (**NYSE KO**) and Proctor & Gamble (**NYSE PG**) are raising their prices due to higher plastic and sugar costs. Do they see inflation as transitory? Doesn't seem like it.

The counter argument is that all this 'pent-up' demand is already 'spent up'. How many times can we remodel our kitchen, buy a house, or trade up to a new car? Some cautious economists are saying that growth could stutter back to 0% by the end of this year when this surge ends. And all that money sitting in bank accounts? As the Scotiabank survey above says, most people plan on hanging on to it, or will use it to pay down debt.

Other surveys show that most investors believe inflation will stick around for longer. We have to admit, it does feel that way.

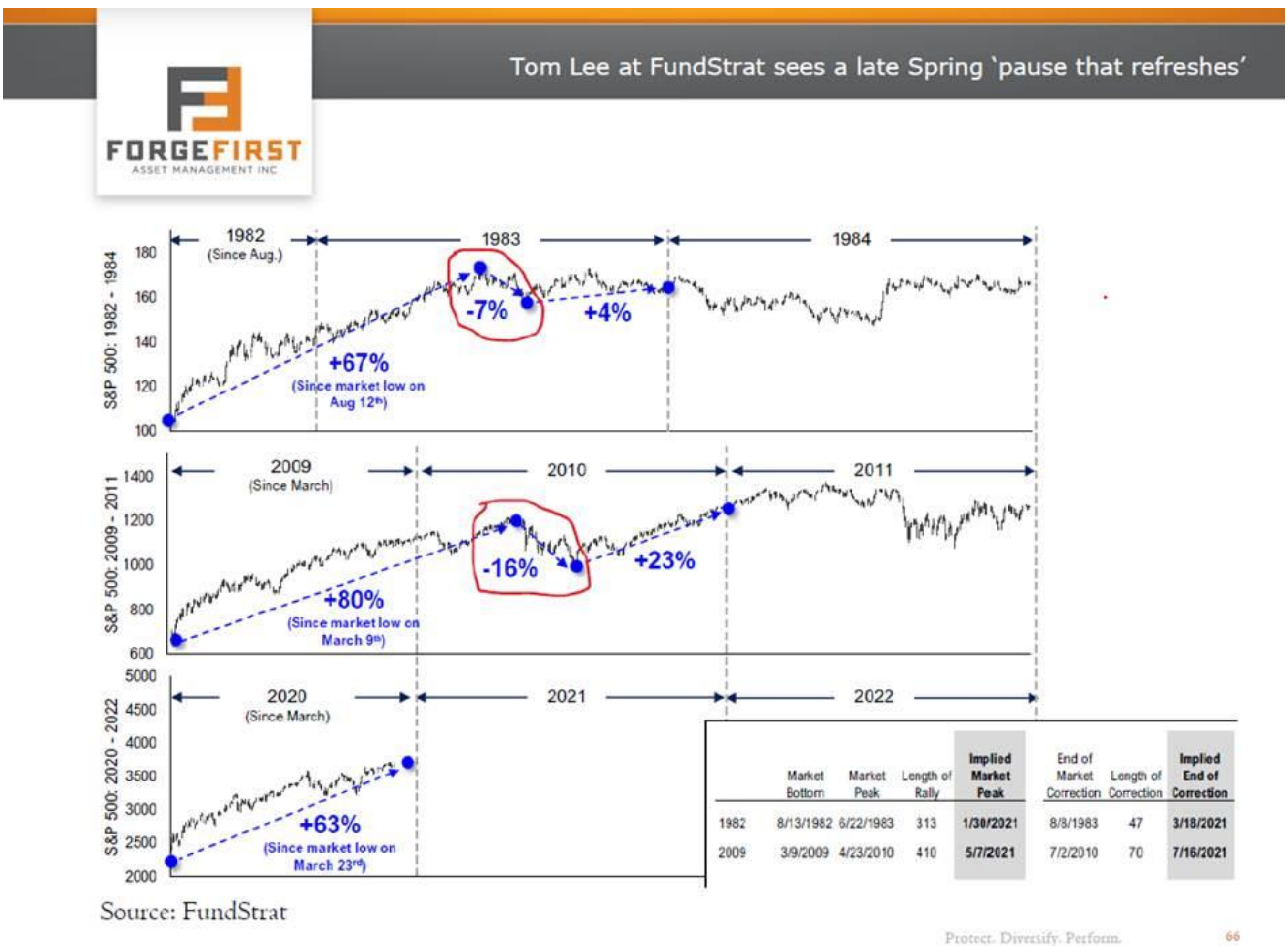
After reading everything we can on inflation and what comes next, we are left with these conclusions:

1. Inflation will not reach the crazy levels of the 1970s, when it touched 10%. ***Some*** of the price increases we see today in lumber, steel, copper, and food cannot last. They should fade by the end of the year.

2. However, the world is fragmenting into trading blocs, which means fewer jobs will be shipped overseas to low-cost foreign countries. This means higher labour costs here at home. And the labour force is gradually shrinking anyway, due to an aging population. How

many people decided to retire during the pandemic? Quite a few. So, inflation is likely to persist more than the deflationists expect. There could be echoes of the 1970s.

3. As the question of ***transitory inflation*** or ***lingering inflation*** gets answered, expect to see a churning in the markets this summer that follows the path seen in 1982 and 2009 – a mid-year period of ups and downs that follows the giant rebound rally we saw in 2020:



	Market Bottom	Market Peak	Length of Rally	Implied Market Peak	End of Market Correction	Length of Correction	Implied End of Correction
1982	8/13/1982	6/22/1983	313	**1/30/2021**	8/8/1983	47	**3/18/2021**
2009	3/9/2009	4/23/2010	410	**5/7/2021**	7/2/2010	70	**7/16/2021**

Disruption in Outer Space

A disruptive technology is a new way of doing things – something that turns old industries on their heads. And sometimes puts them out of business.

Think of Apple's (**NASDAQ AAPL**) iPod introduced twenty years ago. The idea that you could buy individual songs for $0.99 each and store thousands on a pocket device was revolutionary. It upended the music industry completely and ushered in the way we listen to music today. iTunes became something every young household could not do without…until iTunes itself was upended by streaming services like Spotify (**NASDAQ SPOT**).

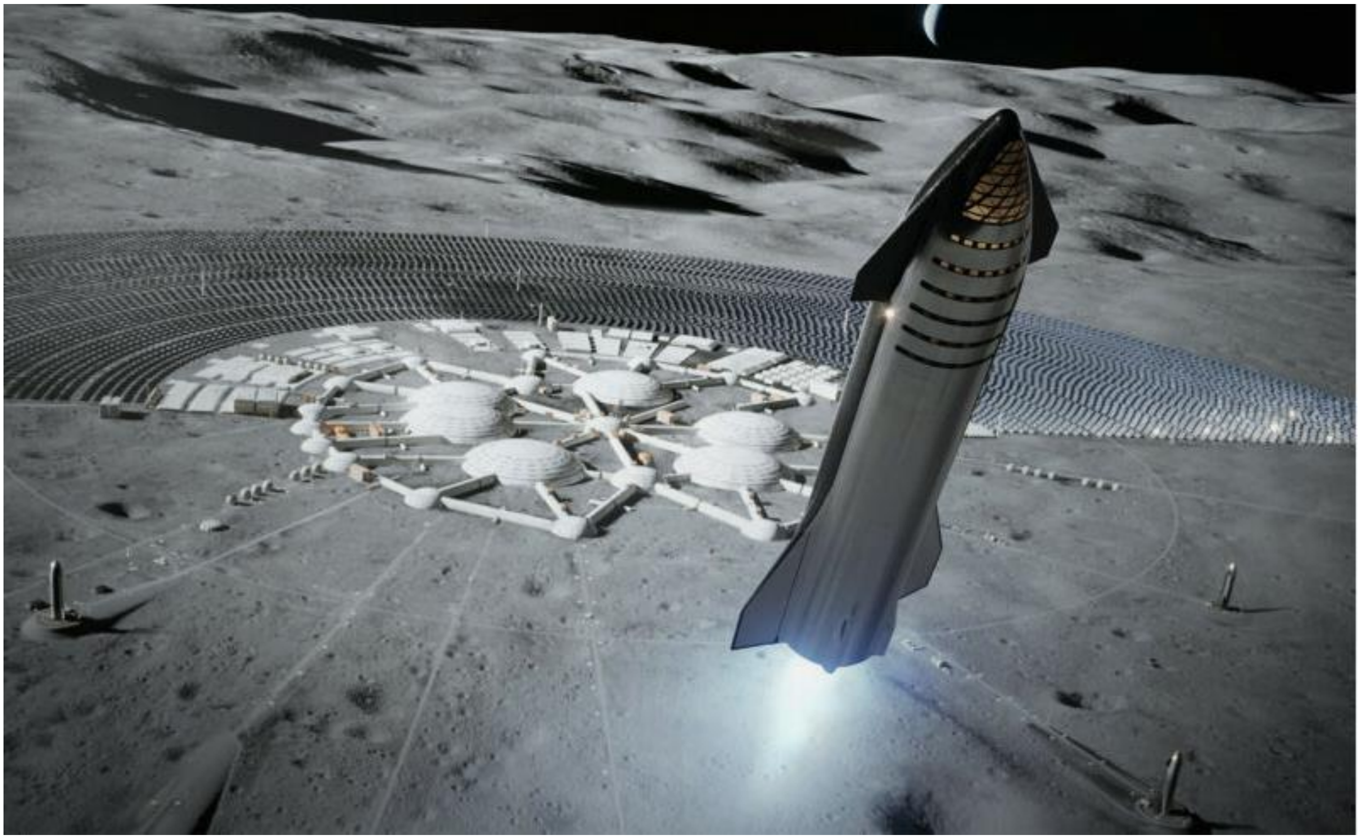
Another industry witnessing massive disruption is the space business. Long dominated by the defense giants such as Boeing (**NYSE BA**), Lockheed Martin (**NYSE LMT**), and government agencies like NASA and the European Space Agency, a little start-up called SpaceX threatens to make all of them uncompetitive. SpaceX's reusable rockets make their all-in costs only 1/3 of those of European and American competitors.

Elon Musk, the founder of Tesla, is not stopping there. SpaceX is targeting a second major industry, one even larger than space. And he got to this point because he figured out how to re-use his rockets.

Until SpaceX came along, the idea of reusable rocket stages was science fiction. It was eventually going to happen, but in ten years? Twenty?

Elon Musk and his devoted 20-hour-a-day workforce pioneered rocket stages that land themselves, to be used over and over. This cut the price of launches to the point that SpaceX grew from 0% market share of worldwide launches in 2012 to over 60% in 2018 (source: Popular Mechanics). SpaceX recently won the NASA contract to build a lunar spaceship, a contract that should have been split with a Boeing consortium until SpaceX proposed Starship - something completely different.

It is a reusable rocket "bus" that will carry over 30 people at a time. And at less than 1/10th of the cost Boeing first proposed.


SpaceX rendering of Starship

Meanwhile, SpaceX has launched the first 1,500 of the planned 12,000 satellite "necklace" of the new Starlink company. Starlink will be able to deliver fast and continuous Wi-Fi from space around the entire world eventually, which is not good news to the global telecom companies, their copper wires, and numerous cell towers. Starlink's service is more expensive than what we pay today, but wait a few years. Unlimited bandwidth and free phone calls from anywhere, beamed to space and back, will become a reality.

Disruption in Inner Space

Disruption is not limited to space. It is happening at the microscopic level as well.

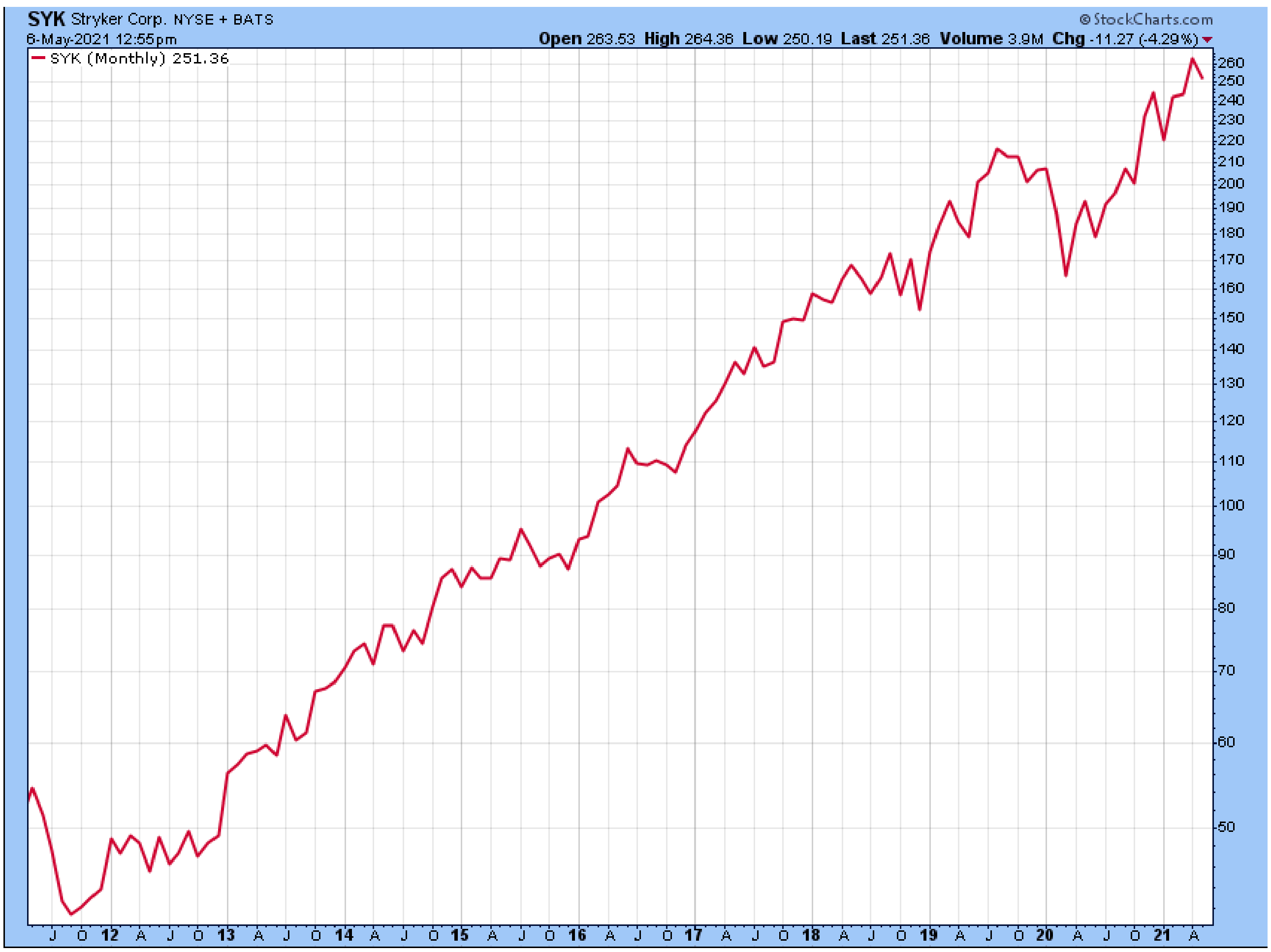
Consider robotic surgery. Only 5% of medical surgeries today are done using robot assistance with 95% still being done by hand. One analyst calls this the "digital" versus "analog" curve – the same one seen when digital cell-phones took over from analog telephones. It is only a matter of time until all surgeries are done with robotic assistance, this analyst proposes.

One company embracing this change in our portfolios is Stryker (**NYSE SYK**), the world leader in hip and knee replacements. In 2013, Stryker saw the writing on the wall and purchased a company that made robotic systems for knee surgeries. These robotic arms are controlled by the surgeon but allow far more precise movements, as well as real-time CT scans while operating. Their Mako system is now a leader in hip and knee joint replacement. It was expanded to include shoulder replacements and just approved for spinal surgeries.

Stryker is also expanding into "soft" implants for the brain, heart, and just bought a company that will give them much more capability in ankle and foot repair.

As you can see by the steady growth of Stryker, the business of precise and painless joint replacement for an aging population is a good market to "operate" in.

It remains a core holding.



Does Money Buy Happiness?

Poverty increases the amount of worry, sadness, and stress that people feel. This should come as no surprise to anyone. As your income rises, you are able to satisfy your basic needs and make improvements to your life - you definitely become happier with more money. Again, no surprise.

But beyond basic needs and comforts, does more money make you happier?

A study in 2010 involving 450,000 U.S. participants attempted to answer this question. And not with just a “yes or no” answer, but with a more accurate measure of “how much”?

The lead author of the study was Daniel Kahneman, a Nobel Prize-winning economist. Not a tabloid reporter, in other words – a serious social scientist.

The study began by defining happiness to be the result of two things: how you feel about your life in general (your life evaluation) as well as how you feel day to day (your emotional well-being). Most studies that involved money and happiness focused more on the first question, along the lines of “how satisfied are you with your life as a whole these days?” This study sought to also capture the daily experience: the experiences of joy, fascination, anxiety, sadness, anger, and affection that determine our happiness in the moment.

The survey took place over two years involving a wide strata of people and income levels. The goal was to determine when unpleasant emotions decrease the most and when happiness peaks. The study wanted to know if there was point of maximum income where things levelled out.

The conclusion of the 2010 study identified $75,000 as the income where emotional well-being measures peak. In other words, stress, sadness, and general happiness level out around this income level. More income than $75,000 brings slight improvements in most categories, but not the large jumps many expected.

In other words, people aren’t that much happier day-to-day making $150,000 than they are making $75,000.

However, the anomaly was in the “life evaluation” category. This measured how confident, inspired, interested, and proud you feel in the longer-term. In this case, there is virtually no limit – these measures continue to climb as your income rises. If you judge happiness by <u>confidence</u> and <u>pride</u> (although some rich people are way too confident and proud), then money does indeed buy happiness – and more with each dollar. If, however, you instead judge happiness by less stress, smiling more every day, and general enjoyment, then more money beyond a healthy salary is not the answer.

“Low income is associated both with low life evaluation and low emotional well-being”, while “high income buys life satisfaction but not happiness,” Dr. Kahneman’s study concluded.

Cost and inflation will have something to do with these studies. $75,000 in 2010 is now $91,000 in today’s dollars. Update your happiness targets accordingly.

Does what we spend our money on make a difference?

It certainly does. <u>Doing</u> things makes us happier than <u>buying</u> things, and especially doing things with other people. Why? Buying an experience leaves us with much more satisfaction than buying a possession. While a new car will rust in time, the memory of renting a convertible with a loved one to drive down the coast of California only becomes rosier with time. A dollar invested in a *memory* grows, while a dollar in a *possession* shrinks.

One of the biggest elements of happiness is people. Surveys by the University of Chicago’s National Opinion Research Center showed that those with five or more close friends were 50% more likely to be “very happy” than those with fewer friends.

This may explain the explosion in mental health issues since the pandemic lockdowns came into effect. Dinner out with friends or a shared family vacation are the perfect kind of experiences to enrich the soul, yet both are largely prohibited these days. Hopefully, not for much longer.

Challenging experiences, such as a new book that demands your attention or music lessons that stretch your abilities, are also keys to happiness. We crave variety, both at home and at work. Ask anyone who works on an assembly line how happy they are - our brains thrive on interesting experiences.

It's been said that money buys time and freedom, but not necessarily happiness. It turns out this is not quite true. Money does buy you happiness, but only up to a point.

What you do with it – and who you do it with – makes much more difference than the amount you have to spend.

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Prices shown as of May 6th, 2021

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