The Market in Review

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July 23rd, 2021

This week's articles and insights

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"Do something you really like, and hopefully it pays the rent. As far as I'm concerned, that's success."

- *Tom Petty*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,823	- 0.47%	+ 13.78%
S&P 500	4,367	+ 0.17%	+ 16.28%
TSX	20,098	- 0.43%	+ 15.28%

Venting About Renting

My son, Ray, pointed out an article that said workers making minimum wage can't afford to rent a two-bedroom apartment in any state in the U.S. In fact, most can't even afford a one-bedroom apartment, let alone ever buy a home (source: CNBC).

Workers need about $24.90 per hour to rent a two-bedroom unit, compared to the $18.78 per hour an average U.S. hourly worker makes. The official U.S. federal minimum wage remains stuck at $7.25 per hour, which shows how out-of-touch it is with reality.

Ray asked what we should do. Or rather, what I should do, since it is my generation that so parsimoniously controls the purse strings. My reply was that the market may be solving this problem even as we speak. My reply, as outlined below, also serves to highlight the ongoing inflation question, and whether it will decline to the subdued levels we are used to, or erupt into something worse.

The Wage Gauge

Do you remember what you made at your first job?

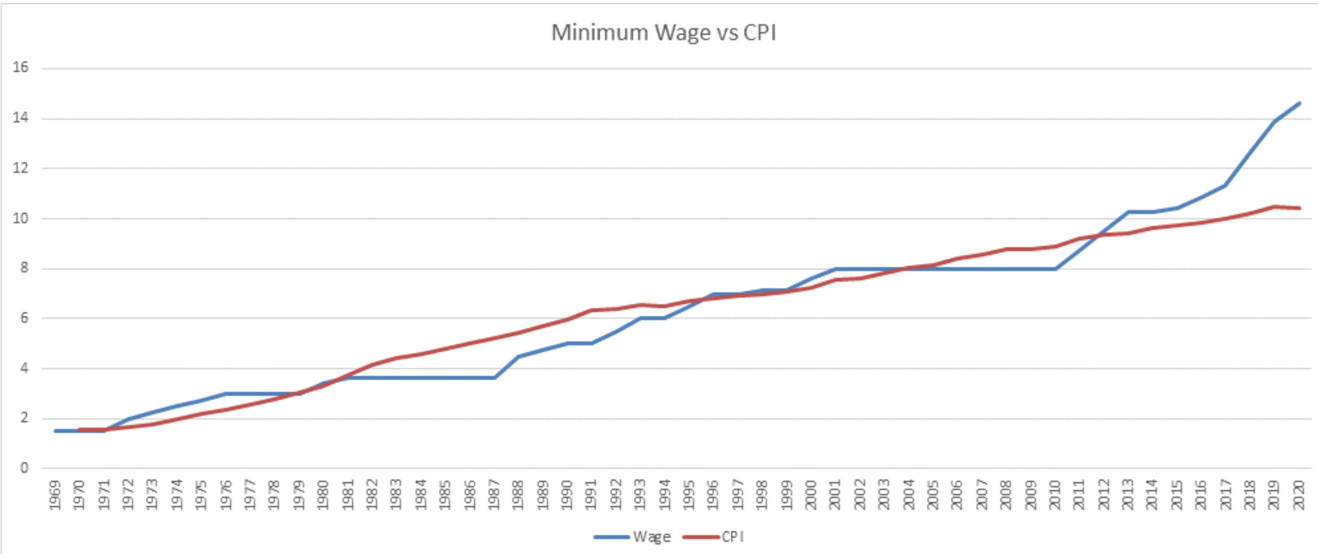
The minimum wage was first introduced in British Columbia in 1918. You may recall that 1918 was a pivotal year, both because of WW1 and the Spanish Flu pandemic. This caused a shortage of men in the workforce, causing women to seek employment in droves. Apparently, they weren't paid well. The first minimum wage was actually a woman's minimum wage, which was fixed at 26 $^{9/16}$¢ per hour.

That's just over $2.00 per day.

My first job was at Flintstone's Bedrock City in Kelowna where I was paid $2.10 per hour in 1974. I loaded people into log boats, drove the train, and wore a 90-lb. Dino the Dinosaur costume for pictures with kids. The provincial minimum wage was $2.00 so the extra ten cents meant I had a generous employer! What was interesting was how quickly it rose. By 1976, my wage had risen by 50% to $3.25 per hour.

The province was humming, and inflation was on fire. The emerging Baby Boom generation demanded housing, cars, and everything that went into family formation. Millions of young people scrambling to buy at the same time drove prices higher.

After the surge that defined the 1970s – a period which saw wages rise by 100% in just 10 years – the minimum wage stayed relatively flat for years. You can see by the graph how flat 1980s wage growth was:



Source: Province of B.C. wage data, Government of Canada inflation data

If the Baby Boomers were partly responsible for the inflation of the 1970s, today's Millennials may be making themselves felt in a similar way. And the pandemic is partly to blame.

I talked about dogs and pets in the last letter, and mentioned the price of puppies has doubled during the pandemic. Are dog prices likely to stay high? Probably not. Breeders are responding quickly with more litters to cash in, and people may start selling their pets once they realize "return to office" doesn't mean "return to office *with Rover*."

Lumber prices rose to U.S. $1,700 in May and then crashed to under $600 as high prices crushed demand. It is a vivid example of transitory inflation because of temporary shortages.

However, inflation in prices for 'things' is often temporary, or transitory, which is the current buzzword. Where inflation gets sticky is in wages. Once you raise a person's wage, it takes a bad attitude or an even worse recession to lower it. In fact, the B.C. provincial minimum wage has never declined since it was first introduced.

Progressive governments have long wished for a higher minimum wage. Along came the pandemic, and lo and behold, we got exactly that. Or, a higher minimum wage in a different form. In Canada, a program called CERB (Canada Emergency Response Benefit) was unveiled and in the U.S., the American Rescue Plan.

In some cases, people found themselves paid more to <u>not</u> work than they were paid before the pandemic. And now that jobs are re-opening, some workers are arguing that they won't return to work unless they are paid even more. So, in a very roundabout way, the national minimum wage has been hiked without official legislation.

A valid question is does inflation cause wages to rise, or do rising wages cause inflation? It is a chicken-and-egg question, and perhaps it doesn't even matter: they move in tandem, regardless. Have a look at the chart above again – what are rising wages telling us about future inflation?

It isn't just higher wages - a shrinking labour pool is also to blame.

Higher wages may "pull" workers to come back, and there is also a simultaneous "push" of older workers into retirement. Baby Boomers have been a rather selfish generation, in that we clung to our jobs longer than we were expected to. This has caused many younger workers to be stuck in lower positions for longer. The pandemic caused many older workers to rethink their careers. Why stay working when Covid-19 might get me?

Anecdotally, we have never had so many retirement discussions with people at, or close, to retirement.

So, mix a shortage of workers due to retirements into higher wage expectations due to generous government payments, and what do you get?

Wage inflation. Companies are having to pay more to attract people, especially in low-end physical jobs. And as we said at the beginning, wages go up far more easily than they go down.

The end result is that part of the surge in inflation will subside. Yes, inflation is now the highest in 10-15 years due to shipping bottlenecks and shortages, but these will fix themselves. The other part – wage inflation – is likely here to stay, and may even get worse. Inflation won't decline back to the old levels of 2012-2020 because of higher wages, and higher wages won't decline due to the shortage of workers.

Circling back to Ray's affordability question: we need workers, and they need to live somewhere. Wages will rise to meet the rent needed.

And don't forget that house prices have had a few setbacks along the way. People who thought house prices would never fall in 1979 were brutally reminded first in 1982 and again in 1990 that real estate can get cheaper. In a hurry.

Rising wages are also negative on corporate profits. Companies today have enjoyed wide profit margins, thanks to stable wage growth and the ability to outsource to cheaper foreign nations. Both of those factors will change in the decade ahead.

Markets This Week

We are now at the halfway point of the year, and 16 months into the recovery from the Covid-19 recession. This was the shortest recession on record, by the way. In the official records, it lasted just from March to April of 2020. It sure felt longer than that.

Markets suffered a sharp loss on Monday of this week, with the Dow Jones Industrial Average falling over 900 points. By Thursday, we had recouped almost all of it. Last week, we were concerned that the new Delta variant of Covid-19 would lead the world back into lockdowns. By Thursday, we saw data that, while infections are climbing, deaths among the vaccinated are not. The vaccines work, in other words, and so the market decided Covid is over.

At least for this week.

Earnings so far this year have been great. Some of the best increases in years, in fact. Rising earnings make us feel better about stocks being too expensive – they may just look that way because sales stopped for a year, and now they are getting back to normal.

That said, we have to be mindful that just about everything that can go right for stocks has already gone right. We have low interest rates, improving sales, and lots of free money. If things move from “great” to merely “good” over the next few months, markets could see more days like Monday. We could well run into a few months where stocks end up making little as we transition to a slower pace of re-opening growth.

In fact, this may already be happening. The U.S. market is being held up by just the Big Six technology stocks. Six stocks out of the 500 in the S&P 500 now account for 25% of the index. Since June 1st, the S&P 500 index has returned +4%, but the “unweighted” S&P 500 index (where each stock is weighted exactly the same) is slightly negative. A healthier market has more stocks rising than just six.

We remain positive through the end of the year, but again, there may be a period where stocks churn and return little for a few months.

And if there is a correction in stock prices? Central banks will probably stimulate again and lower interest rates to make them go back up. There is likely a Canadian election happening later this year, and the U.S. has mid-term elections in 2022.

Politicians want happy voters, after all.

Notable Notes

- The Canadian dollar fell over 4¢ in the last month, a decline of almost 6%. We can thank oil prices for the rout. Canada's biggest exports are oil and gas, and any decrease in those two is felt in our currency. The long-term direction is still higher against the U.S. dollar, but we were certainly reminded this month that the Canadian dollar is a tiny puppet controlled by a few strings of energy.

- Many older investors have enjoyed the generous dividends of preferred shares for many years. However, "pref's" as we call them are rapidly becoming a vanishing species. There have been approximately $5 billion in net redemptions in 2021 so far, with almost zero new issues. Companies are using bonds or other cheaper forms of borrowing instead.

  So, if you own them, enjoy their generous dividends while they last.

- The road to a Green Future will be a complicated one. And it will likely involve nuclear power. Take Japan for example.

  Japan's new green plan is to reduce coal and natural gas as power sources by 2030. How are they going to get there? Hydrogen and ammonia are expected to make up 1% of power generation by 2030, up from 0% today. That's not going to do it. Japan is not a terribly sunny country and it doesn't have the empty landmass for wind or solar.

  Before the Fukushima disaster of 2011, Japan had close to 40 nuclear reactors. Today, 34 are still functional - 9 are back in operation, with 24 still offline. Nuclear energy currently provides just 6% of Japan's power, and the plan is to bring this to 20-22% of electricity by 2030. This is very bullish for the nuclear industry.

Some in the public don't want nuclear back, but many are coming around to its zero-emission benefits. Canada is a key world producer of uranium, so we should see a net benefit.

Thank you for your referrals this month! They are always handled with great care and discretion.

http://www.dividendvaluepartners.com

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