The Market in Review

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

September 24th, 2021

This week's articles and insights

"We were just here! What was the point of that? Why didn't we just stay here? We would have been first!"

- *What Horses Think after a race around the track, by Jerry Seinfeld*

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%

What Was the Point of That?

We feel like Jerry Seinfeld's racehorse this week. We had an election and wonder "what was the point of that?"

In the shortest election allowed by federal law (36 days), Canada's national election saw the lowest percentage of voters turn out in decades. And the result? Prime Minister Justin Trudeau was re-elected with the slimmest share of electoral support in Canada's history, and the new parliament is virtually the same as the one that was dissolved.

Less $612 million for election expenses, of course. Covid single-use pencils cost over $200,000 alone.

"It was an election nobody wanted and nobody got what they wanted."

I have always maintained there are only two political parties: the party of Free Ice Cream and the party of No! Everyone loves free ice cream, until they start to feel sick and an adult shows up to take it away. Free ice cream always leads to No! over time, and then the adult shouting No! softens until we are back at Free Ice Cream. Politics swing back and forth like a pendulum.

We are definitely in the Free Ice Cream part of the political cycle today.

Last year, the government estimated Canada would run a federal deficit of $154 billion in 2021-2022 (source: Department of Finance). That would have been the biggest deficit in our ***history***, if you didn't count the pandemic blowout of 2020 when we spent about $330 billion.

However, elections are a time of bold and generous promises. This year was no exception, with the winning Liberals promising even more deficit spending - an additional $78 billion on top of the $154 billion already planned. Free ice cream, anyone?

Our parliament is once again a minority government, which means it can be toppled at any time if the smaller parties gang up. Minorities tend to last for shorter terms than majorities, so more money and promises are distributed to stay in power. We expect bigger spending and more borrowing in the annual budgets ahead.

Who pays for all this? Taxpayers, of course, but there are a few business sectors that stand to be hit harder this time around:

- Canadian **banks and insurance companies**. The banks stopped dividend increases as profits soared last year, so there were expectations that big dividend hikes lay ahead. Not so fast. The ruling Liberals want a special dividend paid into government coffers, as well as a hike in the business tax rate for this group.
- **Energy companies** are facing steep increases in carbon taxes in the years ahead. These could get even steeper.
- **Telecom companies** have been vilified for too-high cellular and internet bills. Expect legislation to either tax their profits, or legislation to limit these increases.

Banks and energy stocks are already undervalued, so they may not feel the sting as much. As well, higher borrowing could weaken the Canadian dollar. This benefits Canada's commodity and export industries.

As a result, it may be a different group of Canadian stocks that leads the pack in 2022 than those that led in 2021.

Markets This Week

September is known as the worst month of the year for stocks, and it lived up to its reputation for the first three weeks. The Dow Jones Industrial Average and Canada's S&P/TSX both fell about 5% from their highs before recovering this week to only about -2% for the month. To be honest, we expected worse.

The U.S. Federal Reserve continues to stimulate markets with its bond buying program. It spoke about reducing this program this week without specifying a date. Stocks like stimulus and they like procrastination even more. The Chinese central bank was also at work injecting cash this week to cushion the Evergrande bankruptcy (see below).

Like the Canadian election that changed nothing, markets seem to prefer a "steady as she goes" path of central bank stimulus.

The Real Price of Real Estate

Imagine a neighbourhood where your house had a For Sale sign placed on the front lawn every single day. This sign would display what your house was worth if you wanted to sell it, and what someone would have to pay if they wanted to buy it.

Once a day.

How would owners behave with such information? Would they pay more attention to the price? Very likely. In the 'olden days' of the stock market, most people checked their share values in the daily paper once a day. Many mutual funds were only valued once a week. As soon as TV started showing quotes, and then the internet and cellphones followed, day-trading exploded.

It is expensive to move due to the 'frictional' costs of buying and selling, such as the B.C. Property Purchase tax, B.C.'s Provincial Sales Tax (PST), and the national Goods and Services Tax (GST) on various parts of the transaction. Most people remain in the same home or condominium for about 10 years (source: zolo.ca) in Canada.

How often are most people even aware of what their house is worth? Homes are valued annually with the Assessment Notice, which determines how much property tax you pay. Other than if your neighbour sells, the annual assessment is the only time most people get notified of what their home might be worth. Because people don't think about price changes, they don't think prices really change at all.

But they do, and by quite a lot. In the early days of the pandemic, with almost no buyers allowed inside to view, your home price could have dropped 10% or more. Judging by the value of publicly traded real estate (Real Estate Investment Trusts), the price might have fallen even more:

Home prices are not valued annually so people don't think about it. For those real estate investors in REITs who can see their prices daily, many panicked and sold out.

The more frequently we view the price of things, the more we engage our emotions of Greed, Fear, and Hope.

- Greed, when prices are rising
- Fear, when prices start falling
- Hope, when prices keep falling

The allure of real estate is that it never declines in price. And if it does, it almost always recovers. We believe this because we don't get to see the daily oscillations, focusing instead on the gradual rise due to inflation. As well, most real estate can be rented out for income. In all likelihood, home transactions would increase if we knew our home prices daily. When people are reminded of something daily, we tend to act (and react) more often.

Large company stocks aren't really much different. They almost always recover in price eventually, and most pay dividends. And yet we fear these daily declines and sell to avoid them.

In my 35 years in this business, I have experienced hundreds of declines in the market. When the stock market falls 10%, we call it a “correction” and 20% is a “bear market.” Even small ones can be scary and the largest declines are terrifying.

Capital Group studied the U.S. market and estimated we have seen about 50 of these 10% corrections since 1949.

Declines are a normal part of the investment cycle

Standard & Poor’s 500 Composite Index (1949-2020)

Size of decline	Average frequency	Average length	Last occurrence
-5% or more	About three times per year	43 days	February 2020
-10% or more	About once per year	112 days	February 2020
-15% or more	About once every three and a half years	262 days	February 2020
-20% or more	About once every six years	401 days	February 2020

Sources: Capital Group, RIMES, Standard & Poor’s. Frequency and length as of 12/31/19. Last occurrence reflects 2/19/20 market peak and the correction is still ongoing as of 3/23/20. Average frequency assumes 50% recovery of lost value. Average length measures market high to market low.

And here is the interesting realization: every single correction and bear market eventually ended with even higher prices. It is fair to say that no investor in the broad stock market should have EVER sold during the last 70 years.

Of course, individual stocks can go to zero, just as a poorly built house can decline in value, burn down, or be wrecked by a tenant. But a broadly diversified portfolio won’t go to zero.

As we watch the typical September decline – we were -5.5% from top to bottom so far this month – it is worth thinking about stocks like real estate. Watch them less and let time heal the declines.

Ron Baron is a U.S. money manager. He is 78 and has been managing money for about 50 years. He’s personally worth close to U.S. $5 billion. He doesn’t care who is in power politically – he just looks at the long-term averages:

“Stocks on average increase 7% or 8% a year. Real estate is 4% or 5% a year. Gold is 2% or 3% a year.

The bottom line is there's going to be inflation. You're going to make money worth less. Stocks are a hedge against that.”

- *Ron Baron, John Mauldin interview*

Evergrande


(source: Unsplash)

China is an interesting place to be a real estate investor today.

The Chinese Communist Party (CCP) made it a goal decades ago to move rural people into the cities, and the country has been on a building boom ever since.

Economy too cold? Build more apartments.

Economy too hot? Build more apartments.

China uses approximately 15% of the world's steel, most of it in its housing sector. Some have worried that China is overbuilding because of the massive debts that have built up in the housing and banking sectors.

Chinese real estate is somewhat different than ours. Most purchases are 'new-builds' as opposed to 'used' homes, as they are over here. Relatively few previously-owned homes go on the market, so the gains many investors perceive may or may not be there. Also, all real estate in China is owned by the state. Developers buy 99-year leases which then carry over to apartment buyers. Are these leases safe and secure? We will see in due course.

Despite term leases and excessive government rule, Chinese investors understand and trust real estate much more than the stock market. Most serious money is invested here.

A company called Evergrande is the largest housing developer in China. It is in big trouble because it has taken deposits to develop close to 1.4 million new housing units it has yet to build, but has already spent that money on homes currently under construction. It is now basically bankrupt. As a comparison, the city of Los Angeles has about 1.5 million homes, so that is the scale of how large a developer Evergrande is.

The company owes approximately US $300 billion to banks and investors. Like most real estate companies, it has hard assets in the form of the real estate it owns. So, there is likely to be a workout where banks receive real estate instead of cash. However, investors in Evergrande shares will see a complete loss, while its bonds may fetch pennies on the dollar.

A bankruptcy as large as this could shake global markets, and the market did wobble on Monday of this week when it looked like it would default on its bond payments. The Chinese government wants to stop the price of homes rising by cracking down on greedy corporations, and so are making an example of Evergrande. The construction industry is a house of cards, however. Hurt one and you could hurt them all. Many banks in China own Evergrande bonds as well as some foreign investors (we checked and could find no managers we own that did). But any defaults are likely to impact China primarily and should be contained inside the country.

A final note on this. By Thursday, the government had “persuaded” local governments to take over a number of Evergrande’s projects at discounted prices, which gave Evergrande enough cash to pay its bondholders for now. All this does is shift debt to local governments from Evergrande, which is how bailouts work. We do have to remember that excessive debt started the Asian Financial Crisis in 1997. It was downplayed by just about everyone until money panicked. The crisis affected every Asian country and eventually spread to Russia. China is far larger than Thailand and Russia, of course, but what was seen as a global crisis on Monday became a yawn by Thursday.

Time will tell how big an issue an Evergrande bankruptcy becomes.

It could put a damper on future new building. The Chinese property business is known to be over-leveraged, meaning one bankruptcy could lead to others. This could affect steel, copper, and cement prices if a building slowdown results.

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.

How to contact us:

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

(250) 405-2417

Disclaimers

The information contained in this newsletter was obtained from sources believed to be reliable, however, we cannot represent that it is accurate or complete. It is provided as a general source of information and should not be considered personal investment advice or solicitation to buy or sell securities. The views expressed are those of the authors, Paul Siluch and Lisa Hill, and not necessarily those of Raymond James Ltd. Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. This newsletter is intended for distribution only in those jurisdictions where Raymond James Ltd. is registered as a dealer in securities. Any distribution or dissemination of this newsletter in any other jurisdiction is strictly prohibited. This newsletter is not intended for nor should it be distributed to any person in the USA. Raymond James Ltd. is a member of the Canadian Investor Protection Fund.

Raymond James does not accept orders and/or instructions regarding your account by e-mail, voice mail, fax or any alternate method. Transactional details do not supersede normal trade confirmations or statements. E-mail sent through the Internet is not secure or confidential. We reserve the right to monitor all e-mail.

Any information provided in this e-mail has been prepared from sources believed to be reliable, but is not guaranteed by Raymond James and is not a complete summary or statement of all available data necessary for making an investment decision. Any information provided is for informational purposes only and does not constitute a recommendation. Raymond James and its employees may own options, rights or warrants to purchase any of the securities mentioned in e-mail. This e-mail is intended only for the person or entity to which it is addressed and may contain confidential and/or privileged material. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information by persons or entities other than the intended recipient is prohibited.

This email newsletter may provide links to other Internet sites for the convenience of users. Raymond James Ltd. is not responsible for the availability or content of these external sites, nor does Raymond James Ltd endorse, warrant or guarantee the products, services or information described or offered at these other Internet sites. Users cannot assume that the external sites will abide by the same Privacy Policy which Raymond James Ltd adheres to.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. There can be no assurances that the fund will be able to maintain its net asset value per security at a constant amount or that the full amount of your investment in the fund will be returned to you. Mutual funds and other securities are not insured nor guaranteed, their values change frequently and past performance may not be repeated.

Prices shown as of September 23rd, 2021

You are receiving this message because our records indicate that you have requested this information. If you no longer wish to receive research from Raymond James, please reply to this message with unsubscribe in the subject line and include your name and/or company name in the message. Additional Risk and Disclosure information, as well as more information on the Raymond James rating system and suitability categories, is available at www.rjcapitalmarkets.com/Disclosures/Index.
