The Market in Review

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This week's articles and insights

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"The way to crush the bourgeoisie is to grind them between the millstones of taxation and inflation."

- Vladimir Lenin

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	31,730	-3,55%	-12.68%
S&P 500	3,930	-4.69%	-17.54%
TSX	19,699	-4.53%	- 7.18%

Intermission is Over

I saw this posted on the old Orpheum theatre in Vancouver last week.

It reminded me that the "life intermission" due to the pandemic is over. The work-from-home, we're-all-in-this-together, Emergency Relief Benefit cheque party is now a distant memory.

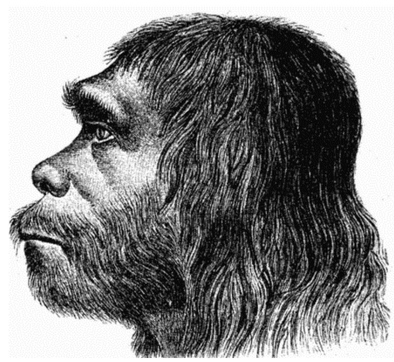
The pandemic saw interest rates slashed and record amounts of stimulus thrown at the economy to preserve jobs. This free money sloshed around the economy while people had nothing to do, driving prices of stocks, used cars, house prices, and cryptocurrencies through the roof.

It is back to some semblance of normal, except in China, that is, where an estimated 41 cities and 290 million people are in full or partial lockdown (Nomura Securities estimate). China's vaccines are less effective and it has a more elderly population, so leaders there feel they have no choice but to pursue a 'Covid-zero' strategy.

Loss Avoidance

Investors feel the pain of a loss at twice the joy they feel for an equivalent gain.

This is an innate condition wired into our Neanderthal brains called loss avoidance. We react to danger more than pleasure because that's what kept us alive back on the savannah.



And today's savannah is often the stock market, in terms of perceived risk.

And there is not just one, but three areas of the brain stimulated by loss and fear, so it is a complex process.

In number terms, this means an investor with a -5% return is as sad as a second investor with a +10% return is happy. Or, if you lose $5, it will take finding $10 to get you emotionally even.

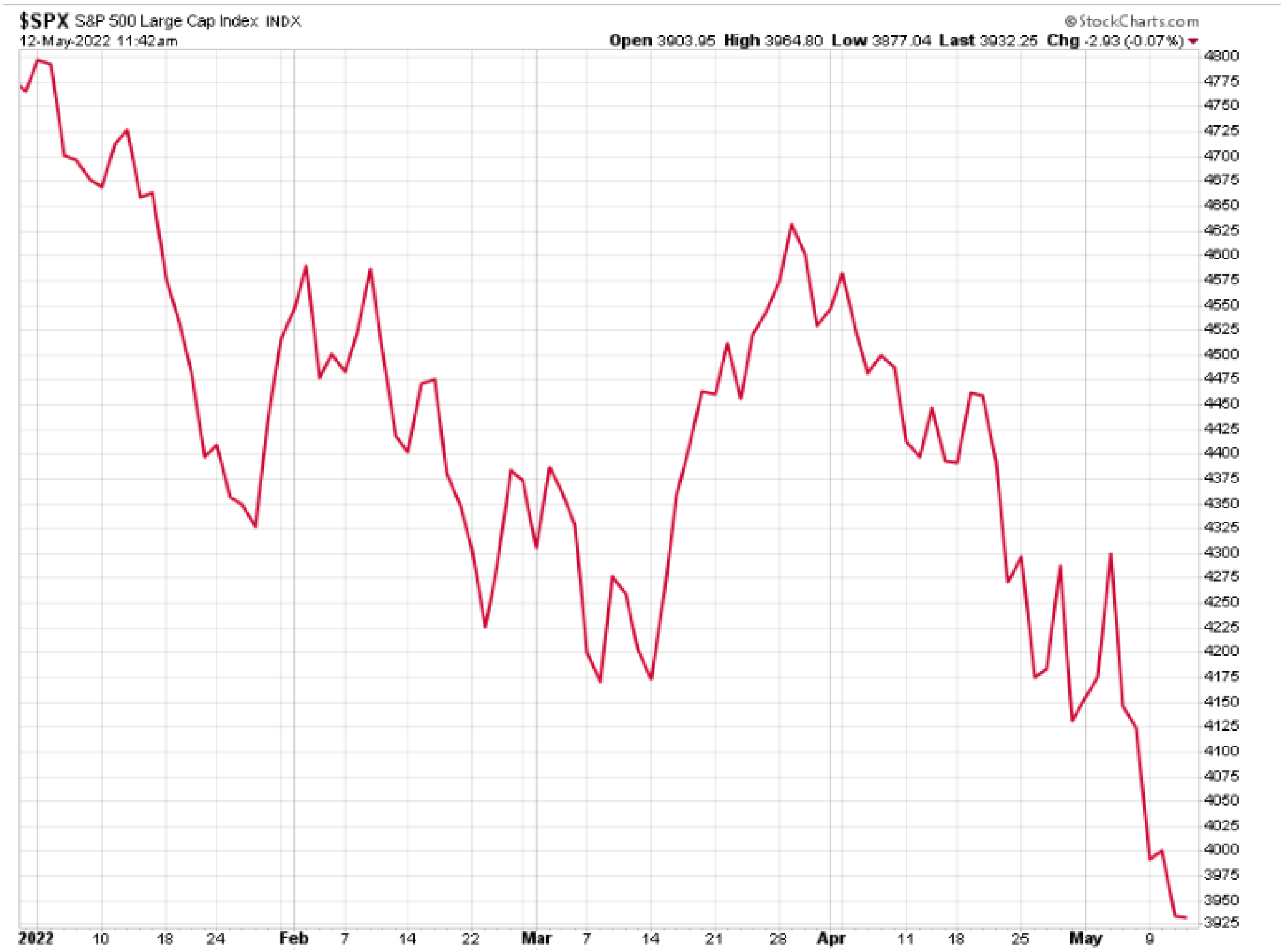
So, if you are feeling unhappy because markets are negative so far in 2022, it is perfectly natural. Panic does not have to follow, though. Quality companies can have bad years, but they have always recovered in the past.

We've seen sell-offs like this before. Panic only works if you are brave enough to buy everything back at a lower price. Few ever do.

A Terrible, Awful, No Good, Very Bad Year

2022 is off to a horrid start, in case you hadn't noticed. Bonds are off to their worst start since at least 1976. Stocks have been even worse.

In fact, it is the worst start for the largest index in the world – the S&P 500 – since 1939. The S&P 500 is -13.3% to the end of April, and has since widened this to -17% as of May 11th.



$SPX S&P 500 Large Cap Index INDX
12-May-2022 11:42am
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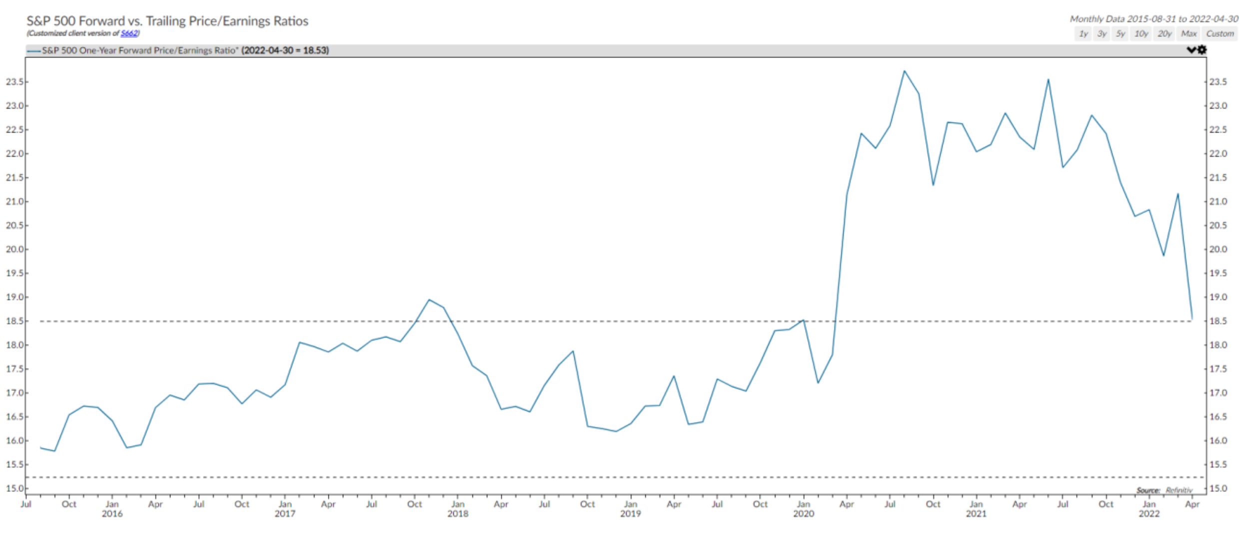
Open 3903.95 High 3964.80 Low 3877.04 Last 3932.25 Chg -2.93 (-0.07%)
4800
4775
4750
4725
4700
4675
4650
4625
4600
4575
4550
4525
4500
4475
4450
4425
4400
4375
4350
4325
4300
4275
4250
4225
4200
4175
4150
4125
4100
4075
4050
4025
4000
3975
3950
3925
2022
10
18
24
Feb
7
14
22
Mar
7
14
21
28
Apr
11
18
25
May
9

Canada's index, the S&P/TSX, is "only" down -6.5% in the same period, thanks to oil, fertilizer, and minerals. We had been positive for the year until the lockdowns in China curtailed China's appetite for coal, oil, and steel.

Where To From Here?

Stocks generally move on strong earnings and 2022 has seen excellent results from most companies. In April, earnings for the 1st quarter were +6.6% from the previous quarter, and were actually improving even as stocks fell (source: FactSet).

Last year, stocks traded at around 23x forward earnings. That was high compared to the 5-year average of 18x. Because of the improved earnings, the price/earnings ratio of the S&P 500 has fallen to 18.5x forward earnings – exactly the 5-year average. So, not overvalued anymore.



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But stocks aren't focused on earnings right now. Interest rates being raised to combat inflation, and the pool of money is being drained, like a bathtub emptying. This is causing a washout in the most speculative areas of the market and the question is how deep this washout of excesses is going to go.

And boy, were there a lot of excesses.

As Grandmother Helen once said, speculation is like sex: every generation thinks they invented it.

- The Baby Boomers started speculating in the 1970s with the *Nifty Fifty* stocks (Macdonald's (**NYSE MCD**), Polaroid, Kodak) before moving on to oil and *gold*. These went parabolic and then fell like rocks.

- Generation X embraced the *dotcom* stocks of the late 1990s, sending JDS Uniphase, Nortel, AOL, buy.com and pets.com to the moon, only to see them all crash back to Earth.

- The Millennials are taking their turn by jumping on the *marijuana* bandwagon (which fizzled two years ago) and then leaping with abandon into *crypto-currencies* like bitcoin. Bitcoin is down 60% since November. An estimated $200 billion was lost in cryptocurrencies alone this week.

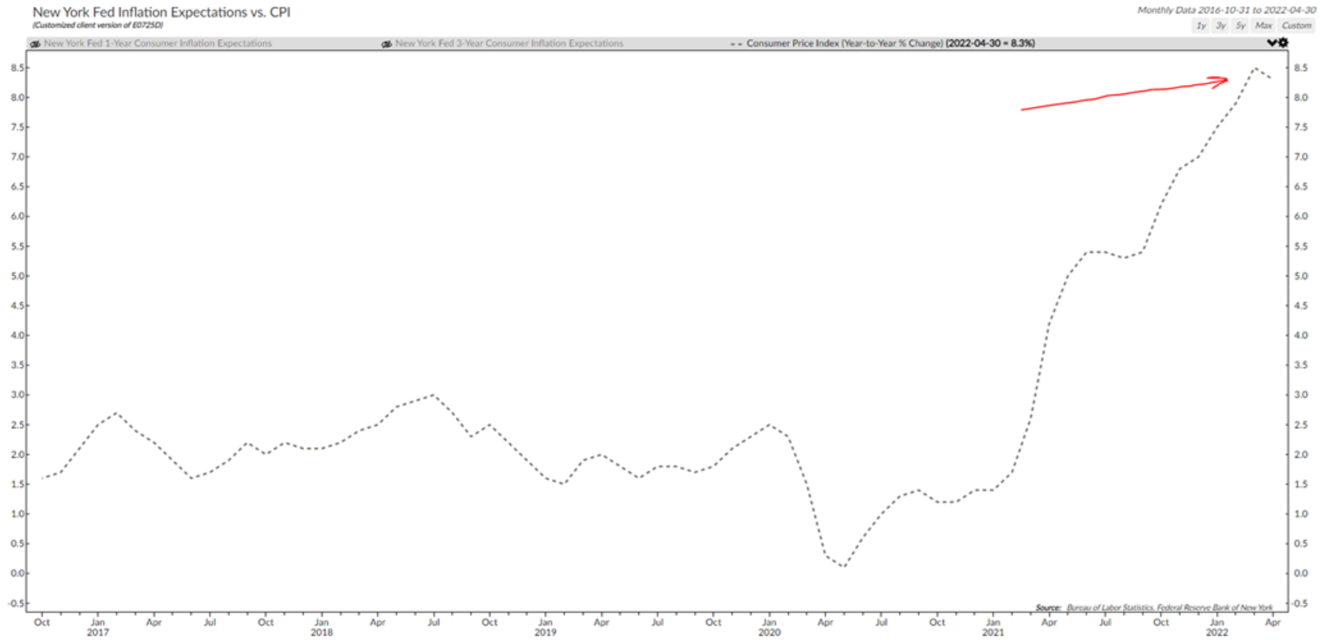
While we don't invest in cannabis stocks or cryptocurrencies, many hedge funds do using leverage. Those loans are now being called and, with prices falling, they are being forced to sell everything. This is hitting growth stocks like Tesla (**NASDAQ TSLA**), Amazon (**NASDAQ AMZN**), and Apple (**NASDAQ AAPL**) that they also hold.

Is the pain over?

No, but we are getting close. Stocks markets have fallen enough that have now adjusted for many of the risks out there – the Ukraine war, rising interest rates, and inflation.

The key right now is inflation. It is awfully high and central banks have only one tool to bring it down: higher interest rates. Expect at least a few more hikes in the months ahead.

There is some good news if you squint. In March, U.S. inflation rose 8.5% year over year. In April, it rose 'only' 8.3%. It was still high, but we may have seen the peak:



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Looking back on history all the way to 1926, there were 13 years when the market started off weak in the first 4 months of the year. Just 3 of these continued to lose money. The other 10 years with negative starts rallied in the final 8 months of the year.

Bad starts usually don't end badly

S&P 500 Index During Weak First Four Months of the Year				
Year	**Thru April 30 (%)**	**April 30 - Dec 31 (%)**	**Cyclical Bear?**	**Bear End Date**
1926	-8.2	15.1	No	N/A
1932	-28.2	18.2	Yes	July 8
1938	-8.1	36.2	Yes	March 31
1939	-17.3	14.4	Yes	April 8
1941	-12.0	-6.7	Yes	Next year
1942	-11.9	27.6	Yes	April 28
1960	-9.2	6.9	Yes	October 26
1962	-8.8	-3.3	Yes	June 26
1970	-11.5	13.0	Yes	May 26
1973	-9.4	-8.8	Yes	Next year
1977	-8.4	-3.4	Yes	Next year
2020	-9.9	29.0	Yes	March 23
2022	-13.3	??	??	??
Mean	-11.9	11.5		
Median	-9.6	13.7		
% Positive	0.0	66.7		

*See T_202 for NDR cyclical bull and bear market criteria. Source: S&P Dow Jones Indices.

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Past performance is no guarantee of future results, as they say, but the odds of markets calming down in the months ahead are in our favour.

What's Up with Gas Prices?

Remember when oil prices went negative because no one was driving or flying? Oil refiners lost their shirts during the pandemic.

Now, the opposite is happening. Inventories fell to the bottom of the proverbial barrel as refiners cut back, only to watch driving and travel come roaring back just as Russian oil sanctions hit. Europe imported every drop of diesel we could ship them and so refiners are producing as much diesel as they can at the expense of gasoline.

Europe is slowing down, though, and China remains in lockdown. So, the refiners will start to catch up with gasoline production as summer starts.

We have been reluctant to trim Suncor (**TSX SU**). As a major Canadian refiner, it is finally making big profits from this division after several years of breaking even. And with oil prices likely to stay in the $100 range for the foreseeable future because solar, wind, and nuclear can't hope to replace

Russian oil for years to come, Suncor looks like it will continue its very profitable ways.

Raymond James Father's Day Run/Walk for Prostate Cancer

Raymond James is once again sponsoring the Father's Day Run for Dad in support of the Island Prostate Centre here on Vancouver Island. All dads get a chocolate medal and everyone gets a free pancake breakfast after the walk/run. It is the best deal for Father's Day you will find these days!

One in three men will get prostate cancer in their lifetimes but many can survive with early diagnosis and treatment.

I am a prostate cancer survivor, thanks to an early diagnosis years ago.

100% of funds raised through this event directly support programs and services offered through Island Prostate Centre; serving men and families facing prostate cancer, right here on Vancouver Island. Raymond James will match all donations raised up to $15,000!

Please sign up to walk or run with us, or sponsor us if you feel generous.

https://www.islandprostatecentre.com/fundraising-events/

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Prices shown as of May 12th, 2022

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