The Market in Review

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This week's articles and insights

"The market is not a sofa, it is not a place to get comfortable."

- *Jim Cramer*

Your Index Report

	Current	Last Week	Year-to-Date
Dow Jones Ind. Avg.	34,715	-3.87%	- 4.47%
S&P 500	4,483	-3.78%	- 5.95%
TSX	21,058	-1.10%	- 0.78%

That '70s Show

Mark Twain said history doesn't repeat, but it rhymes. And boy, does today ever rhyme with the 1970s.

Source: National Archives

Now before you go digging out your red satin shirt and white disco suit (full disclosure, I owned both), I am referring to economic and political events.

For example, the 1970s featured:

> The U.S. exiting a long, expensive, and unpopular war. Photos of people clinging to helicopters defined the hasty retreat.
>
> *The Afghanistan exit was just as messy, with desperate Afghanis clinging to the side of a C5.*
>
> The departure of an unpopular president (Nixon), followed by the "malaise" term of Jimmy Carter from 1977 to 1980.
>
> *Trump and Biden could fit into these categories, at least so far.*

A surge in oil prices as OPEC tightened its grip on global supplies. Oil prices doubled from 1973-1974, held steady, then doubled again from 1978 to 1980.

Today, OPEC+ includes Russia, and their control over global energy is almost as strong as OPEC's was in the 1970s. The west has more domestic oil today than it had in the 1970s, thanks to the shale revolution, but production is hampered by environmental restrictions. Oil prices have doubled since the lows of 2020.

The 1970s marked the passing of one large generation to the next - the Silent Generation to the Baby Boomers. As Baby Boomers upended fashions and surged into homes, they caused price gyrations everywhere.

Today, Baby Boomers are retiring en masse and being replaced by Millennials, who are beginning their own family formation years. Such a transition comes with the same increased demand for housing and "stuff" as we saw in the 1970s. The real estate boom today is at least partly due to this generational shift.

The Millennials may have more in common with the Silent Generation (born 1928-1945), though, as the Silents grew up in the McCarthy era and were characterized as hesitant to speak out because of fears that what they said could come back to haunt them – we call this "cancel culture" today.

Inflation began to rise in the 1970s due to many of the factors above. The Federal Reserve was hesitant to raise interest rates fast enough and inflation just got worse.

We are experiencing the highest rates of inflation since the early 1990s today. Much is due to clogs in the supply chain, which will clear as the year progresses. But higher wages, rents, and energy costs are not going away.

> The 1970s saw regional wars pop up all over the globe. 1973 was a grim year for the Middle East, Vietnam fell in 1975 as the U.S. pulled out, and Russia invaded Afghanistan for "regional stability" in 1979.
> *The Middle East, with Israel and Iran facing off over Iran's nuclear ambitions, is just as tense as it was decades ago. And Russia is back threatening invasion, in Ukraine this time.*

Debbie Boone's "You Light Up My Life" was a #1 hit single in 1977 which, in hindsight, was an interesting signpost of how expensive it had become to ***actually*** light up your life in 1977 – oil prices hit all-time highs in 1977.

1977 also marked the introduction of the TSE 300, Canada's answer to the Dow Jones Industrial Average. The price was set at 1,000 on January 1st of 1977 to coincide with the 1,000 price of the Dow Jones Industrial Average on the exact same date. Here is where it gets interesting.

Today, the TSE 300 is known as the S&P/TSX Composite Index, and it trades around 21,000. The Dow Jones Industrial Average at about 35,000 has almost doubled the TSX over the decades, and particularly since the China Boom for commodities ended around 2012.

The Dow Jones Industrial Average has outperformed Canada's S&P/TSX by 2 ½ times since 2012:

Yet in late 1985, when I started in the business, the TSE 300 was at 2,800 versus the Dow Jones at a lowly 1,500.

In other words, Canada's resource-heavy, inflation-loving stock market had doubled the Dow's performance from 1977 to 1985. During the deflationary years that followed, Canada's index was eventually passed by the Dow in 1995, and the Dow has never looked back. We can thank the technology revolution – and the end of inflation and flat commodities - for that.

The era of innovation isn't over, and America has structural advantages in technology that every nation in the world envies. But inflation is a genie that central banks won't get back into the bottle anytime soon, and years of underinvestment in hard assets like nickel, oil, and fertilizer mean Canada's strengths may shine in the years ahead.

One thing this could affect is the value of the Canadian dollar. Yes, the Liberals spent *liberally* during the pandemic, but our tax receipts have come roaring back more quickly than in most countries. Some experts see Canada raising interest rates as many as 6 times in 2022 versus 3-4 times in the U.S. Such actions could lift our dollar higher, and faster.

A large global bond manager – Manulife – is positioning its portfolios for a stronger Canadian dollar this year. Perhaps we should all take note.

Waiting for Godot…and the Re-Opening

We are all waiting for things to return to normal. Or, at least, closer to normal than the last two years have seen. A lot of things have happened that no one expected.

For example, the largest condom maker in the world – Karex, based in Malaysia, and the maker of the Durex brand – expected the lockdowns of 2020 to lead to a sharp rise in business. Instead, they experienced just the opposite – a wilting in revenues of 40% over the past two years. The closure of hotels, sexual-information agencies, and the general malaise of people trapped at home with their partners led to more "*not tonight, honey*" than they ever expected.

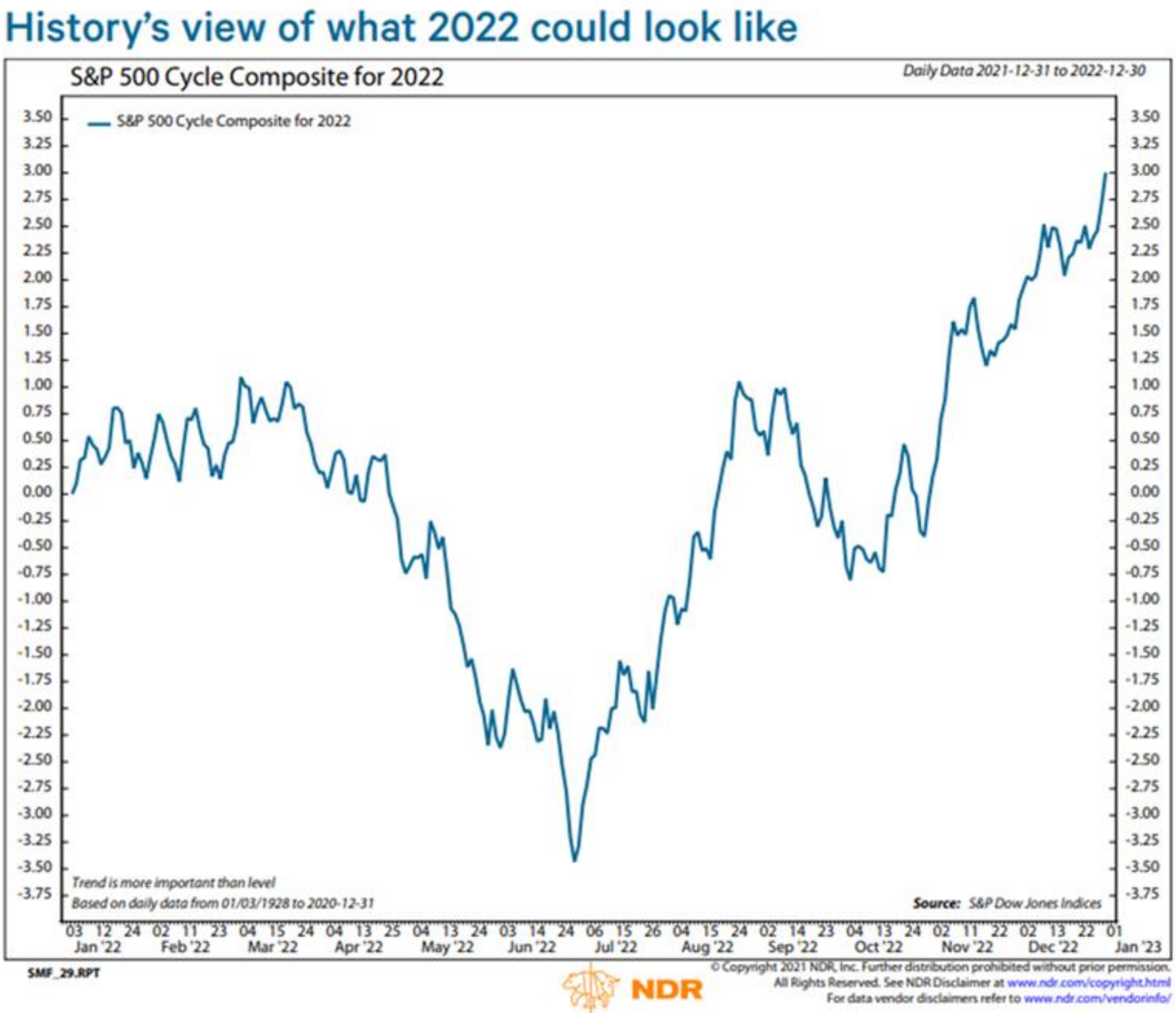
To stay afloat, Durex is pivoting to rubber gloves. Manufacturing gloves is virtually identical to making condoms, and the bonus is you get to sell four gloves to every couple instead of just one condom. Four versus one? That's smart business math.

Admittedly, we didn't foresee this particular side of lockdowns, and obviously neither did Karex. Another knock-on effect is that many marriages start at work. Colleagues become friends over the water cooler, then some move on to marriage. With millions working from home, these potential meet-ups are no longer happening, leading to fewer marriages and, ultimately, a dip in the birth rate.

We discussed the aging of the global population in our last letter, and the rapid decline in condom sales is just another brick in the wall of the slow-moving "grey tsunami" washing through the world's population.

The "great re-opening" has started and stopped several times, this last one due to the Omicron variant. This one is hitting markets at a tough time, because stimulus cheques and low interest rates are now yesterday's news. New lockdowns plus tightening financial conditions have led to weak stock markets to start 2022.

We showed this chart in the last letter. It shows that U.S. mid-term election years often start slowly and end strong:



In his webinar on Thursday, our strategist Larry Adam showed a similar chart:

Instead of saying "I made 3% in 2022" you might actually have to experience -3.25% through June and then +6.7% from July to December to get the same result.

"It's an environment where investors need to temper expectations a little bit, as it's likely to be a more typical year, but probably with more wobbles."

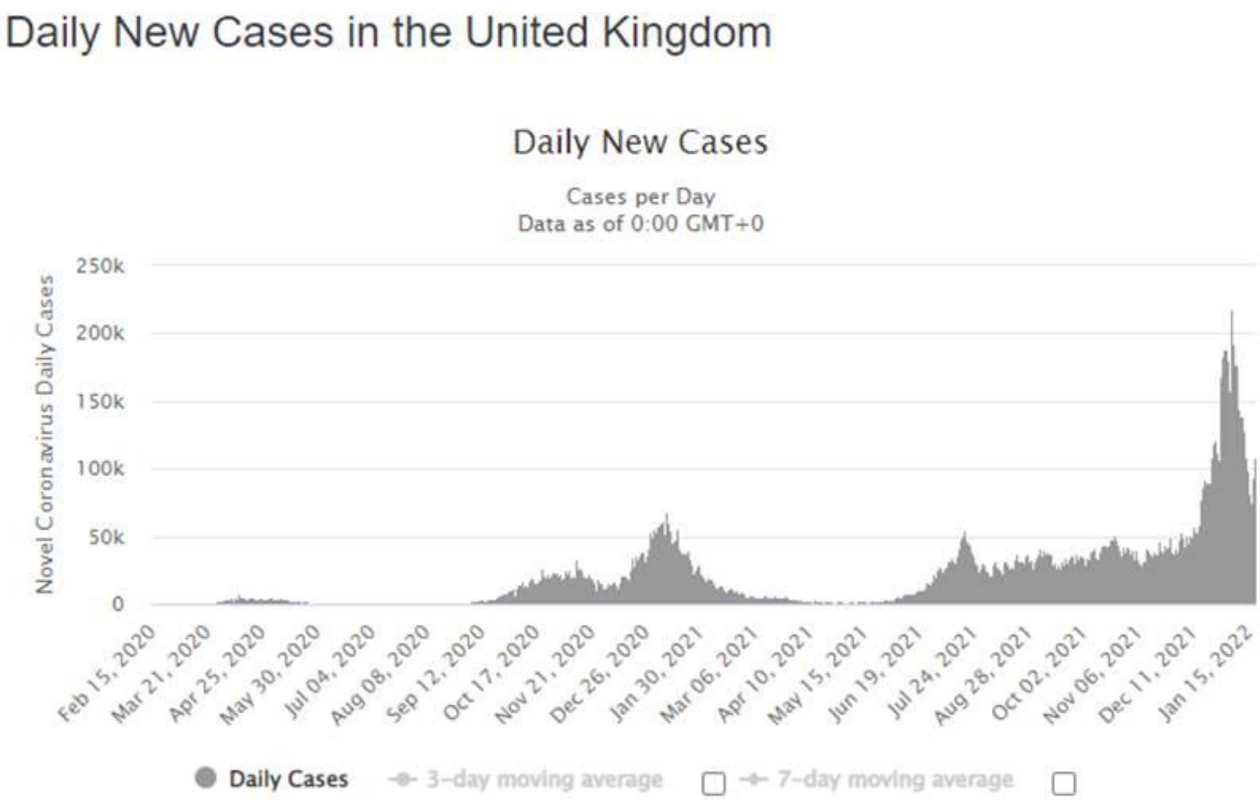
- *Julien Timmer – Fidelity Investments*

The NASDAQ index is already down -9.5% in January alone.

On the Rebound

Are there rebounds that could happen in the other direction? The good news is that the Omicron variant causes more, but shorter and less virulent, illness. This suggests the "Great Re-Opening" could actually happen later this year, with many postponed events finally allowed to take place.

The UK has announced that all remaining COVID restrictions in England will be lifted next week. No mask mandates, fewer rules and restrictions, and close monitoring of the hospitals. They see their Omicron wave as past its peak:



Source: Worldometers

As we navigate 2022, we will try to focus on where the world is going, as opposed to where it is now.

For example, Peloton (**NASDAQ PTON**), the exercise bicycle company. With lockdowns ending, sales have plummeted such that they are slowing production due to lack of demand. The shares have fallen from $130 in July to $24 today. We have (mostly) avoided companies like this.

As the world re-opens, there should be a number of beaten-down sectors that do the opposite:

Gold. Gifts of gold are very big at Indian weddings, which have been deferred for two years. The summer of 2021 saw a bump in the sale of wedding bands, only to be cut short by the Omicron wave.

Car parts. Used car prices are high because the chip shortage has hampered new car sales. Chip production should resume fully this year, leading to more new car sales and more car parts demand.

Travel. Yes, there will finally be an increase in travel, and this should spur renewed demand for jet fuel. Morgan Stanley sees low oil inventories and little spare capacity by the second half of 2022, and forecasts $90 per barrel oil for the third quarter.

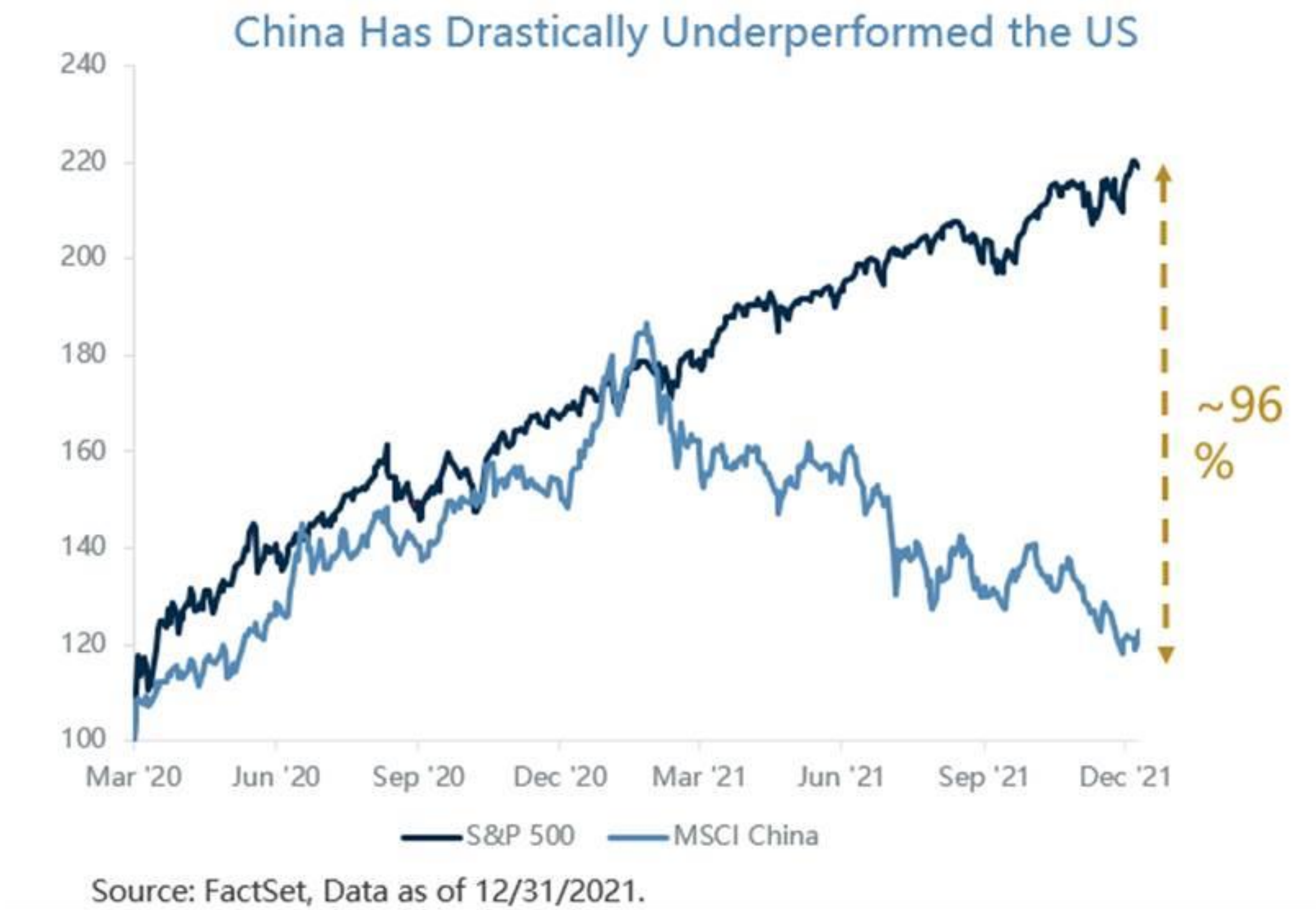
There are a lot more categories, from cosmetics to beer at sporting events – so many sectors have been held back and are ready to break out.

Our Dividend Value portfolios have added to oil storage through Gibson Energy (**TSX GEI**), beer through Molson Coors (**NYSE TAP**), and semiconductor manufacturing through Taiwan Semiconductor (**NYSE TSM**) in recent months in preparation.

Final Thoughts

1. Volcanic eruptions can impact global temperatures for up to two years. The recent eruption in Tonga has launched an enormous amount of ash into the atmosphere, although it is not yet known if the volume is significant enough to hamper agriculture. A cooler climate could lead to higher heating oil use, as well as increased need for fertilizers to help struggling crops.

2. China’s economy has been cooling all year and their stock markets have underperformed those over here:



As a result, the Chinese central bank is cutting interest rates to stimulate growth while we are raising rates to slow down. The People's Bank of China lowered mortgage and lending rates twice this week to boost post-pandemic growth in the world's second largest economy.

Interest rate cuts are generally positive for stock and bond markets, so we could see China’s stocks rise even as ours struggle.

Another date to watch is the Chinese general election in the autumn. President Xi would like an unprecedented third 5-year term, which means he probably wants an economic recovery by late summer. Watch for more stimulus measures between now and summer to make this happen.

China's moves toward more stimulus are the opposite of what we are seeing over here.

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

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Prices shown as of January 20th, 2022

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Prices shown as of January 6th, 2022
