Assante® WEALTH MANAGEMENT

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Chris has a BA in Economics from UBC, and a business degree from Western (now Ivey MBA). Before joining Assante in 1992 he was Treasury Manager for a Fortune 50 firm where one of his responsibilities was Chair of the Investment Committee of the $65 million pension fund.

Chris provides financial planning, investment planning and full implementation services to about 100 families.

We are pleased to welcome new clients. New clients should have $1 million or more of investable assets.

2018 Unpleasantness
2019 Outlook

The last quarter of 2018 was a rough ride for investors, as you will no doubt have seen from your statements. From the all-time high in June, a bruising in October was followed by a reprieve in November before a global market selloff in December took the US market (S&P500) down a gut-wrenching 19.7% to the December 24th low. News media relished the scary but irrelevant factoid that it was the worst December since 1931.

The US market (S&P500) lost 4% in 2018; however, the 8% decline in the Loonie more than offset the US investment loss, resulting in a gain of 4% in the S&P500 to a Canadian investor. The subindexes comprising the US market varied from gains of 6% and 4% in Health Care and Utilities, to losses of 15% and 18% in Materials and Energy respectively. Financials, Telecom and Industrials each lost about 13%.

The Canadian markets fared worse: the TSX lost 9% for the year. The subindexes comprising the TSX also varied widely, from small gains of 2% in Consumer Staples and Real Estate, to losses of 16% and 18% in Consumer Discretionary and Energy respectively. Small companies saw their share prices decline 20%.

The investment gods timed the market gyrations to wreak psychological havoc on your yearend statements. Because the decline ran from October to December 24th, its full, most unpleasant impact was captured on your Q4 statements. Many clients (including your advisor's) returns were down 10 – 20%, and full year returns in the 0 to -10% range. No case of Chablis for your advisor this year.

However, as is often the case, the bad news may be over almost as quickly as it happened. As I write late-February the S&P500 has already recovered more than half its peak to trough decline and now sits a little over 2800 - virtually identical to the January 2018 opening level. So in less than a month most of the Q4 decline has been erased (see chart below).

Markets were concerned about three main things: rising interest rates in the face of declining inflation expectations, a trade war between the world's two strongest economies, (spurred by a disturbingly erratic and aggressive White House), and the slow-motion train wreck of Brexit and the EU.

These things were discussed in the November letter: rising interest rates in the face of low inflation which risk a self-induced economic stall, the danger to global prosperity presented by Trump's hostility to Beijing, and the persistent policy vacuum in Europe.

Conclusion: The US political dysfunction has little effect on markets, at least in the short term. Earnings are holding up well, and markets are now on the bargain side of valuations. Now, given the persistently low inflation, US equity markets are quite cheap. The US economy is firing on all cylinders.

Today

A couple of notable points: The decline in the Canadian market in 2018 has taken it below where it was before the financial crisis in 2007. This dismal result - zero progress over more than 11 years stands in stark contrast to the US market, which is about 80% higher than its pre-crisis high.

Remarkable too because Canada did not suffer the financial or economic (i.e. housing market) damage that the US did. Not only has the US market completely absorbed the impact of the financial crisis, but US income per capita is still about 30% higher than Canada's (equivalent currency)[1]. Unemployment is lower, growth is higher, too – but I digress.[2]

Head for the hills? Outlook for 2019 and beyond.

Normally a 10+ year period of zero return attracts professional investors' attention hunting for bargains, and today is not an exception. The low prices now prevailing in Canada provide compelling value in many stocks, and your managers are taking advantage of opportunities where share prices of good companies are dragged below intrinsic value.

However, it will take political courage – currently nonexistent in Ottawa, BC and Alberta - to unlock the obstacles to energy and mining investment – the largest drivers by far of the Canadian economy. Petroleum and related products[3] generated more than twice the export revenue than autos, the next highest export; together with minerals the export revenue is more than 3x autos.

These industries operate at the highest global standards, and generate tens of thousands of very high-paying jobs, yet we can't build a pipeline to get the products to market or get a new mine approved. (The Vancouver Sun newspaper apparently published a letter last year from an American, thanking us for doing them the huge favor of not building pipelines, thereby allowing Americans to sell an additional $100 million of oil per day to global markets.)

We have been underweight Canada for at least 5 years and my advice is to remain so until some catalyst for change becomes visible. A Canadian federal election in October may not be quite sufficient…

Conclusion: maintain Canadian holdings, but no rush to add to them.

1 Adjusting for equivalent purchasing power the US GDP/capita is 25% higher. Data from The Economist, World Figures 2018.

2 Why is US economic performance so much better than Canada's? The US economy is much more efficient. Workers are more mobile, which means it is easier to change jobs; unemployment benefits aren't as generous, which means Americans have less "unemployment enjoyment" and greater incentive to find a new job. Taxes are lower, so people keep more of their earnings. We Canadians often seem smugly superior to our neighbors, but by all measures they're better off.

3 Related products include the raw material for plastic and rubber; export revenues per The Economist, 2015 data.

Bonds and Interest Rates

Markets have long worried that the US Federal Reserve would increase short term rates too fast or too much. This worry became acute in October 2018 as the yield on the 10-year bond – a market-driven, independent indicator of inflation expectations – reversed course and began to decline, thereby indicating that the economic expansion was threatened (inflation is commonly associated with economic growth)[4].

The bond market is much larger and is regarded by investment pros as more intelligent and less emotional than the equity markets. So when the bond market revered course - from an economically optimistic increasing inflation expectation to decreasing – the equity markets took notice, and we hit the Q4 downdraft.

Bond markets are signalling that the Federal Reserve's interest rate hikes have probably gone far enough. Technically, the flattening yield curve (the decreasing difference between long and short term interest rates[5]) is telling us that future inflation expectations remain muted; inflation is not on the horizon. We expect a pause in Federal Reserve rate increases.

Bonds continue to provide important short term diversification against equity market volatility, even if low yields are insufficient to generate decent retirement cash flow.

Conclusion: don't be afraid to hold bonds, but hold them only for diversification; younger retirees should own as few bonds as possible, and people under 50 should own no bonds.

US Policy and the White House

The final rock that the markets seem to be chewing on (mixed metaphor, sorry) is the erratic and aggressive White House. The question is whether the President will derail the US economy.

My answer: the jarring antics from the White House seem out of place to a normal person, and certainly seem to erode respect for the office. But the abrasive style does seem to be an effective negotiating tactic, having brought Canada to a new trade deal and China to the table.

Time will tell whether the President's personality will damage the US economy, but at the moment my bet is not. A trade deal with China is very strongly in both countries' interests.

Conclusion: The US economy is in very good shape, and the markets are on the cheap side of valuation norms. Most important, skepticism is high and fear of markets still runs close to the surface. Good time to own stocks.

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4 Inflation is not always associated with economic growth: the 'stagflation' of the 1970's saw low growth and high inflation. But the financial crisis brought the risk of deflation; so today, markets are looking for modest inflation because it indicates we are not falling back into deflation.

5 The yield curve is the difference between short and long term interest rates. Long term rates are usually higher than short rates, because inflation corrodes the value of money over time. Short rates are managed by the central bank, whereas long rates are set by markets. A 'steep' yield curve is when short term rates are much lower than long term rates. An inverted curve is when short rates are higher than long rates. Steep curves usually boost economic growth; Inverted curves are often followed by recession.

Book Review

Factfulness, Hans Rosling

Rosling is famous for his TED talks, in particular ‘200 countries 200 years, 4 minutes’ which chronicles the remarkable improvement in living standards since the Industrial Revolution, (a must-see, especially for your anticapitalist friends). His genius is in his simple way of speaking and writing; it almost tricks you into thinking he is simplistic, which he isn’t. His devotion to data – facts – leads to surprising places.

Factfulness takes a refreshingly apolitical look at a number of big picture global issues: public health, girls’ education, the gender pay gap, economic progress, and the general negativity of news, and demonstrates how the data show that things are not nearly as bad as we think.

Rosling doesn’t deny the world’s problems; he quite clearly recognizes them, and yes, some are serious. But he demonstrates that things are getting better: over time, small improvements add up to magical advances.

One key point of the book is to show how the same data can be presented different ways to produce quite different perceptions. News media will always show the data in the most alarming or disturbing way, and it is important to look at data different ways to see the truest message.

The gender pay gap, for instance, is so deeply entrenched in our consciousness as fact that to question it is to invite PR disaster. Rosling, however, demonstrates how the usual way of presenting the data tricks us into misperceiving the issue as being much worse than it actually is…. A definite mind-expander, and politically incorrect to boot.

Rosling died in 2017 of pancreatic cancer; the book was finished posthumously by his wife Ola and daughter in-law Anna Rosling Ronnlund

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