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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.

Happy New Year 2018

The year 2017 turned out very well for patient and brave equity market investors.

Of the 80 or so markets in the world, only 4 fell – Karachi, Qatar, Muscat, and Dubai. All the major markets were up, with Europe as a whole rising around 25%, including Athens up 43%, Dutch stocks up 33%, while the UK lagged at 23%. Just for fun, the Ho Chi Minh and Jamaica indexes rose 51% and 55%.

The US market gained about 22%. Closer to home, Canada's narrow little market was tracking a loss as late as September but managed a 6% gain due to a 4th quarter surge by energy, metals, and consumer stocks.[1]

We'll have a closer look at returns in the next newsletter shortly, after all the returns are calculated and published.

In the meantime, my goal today is a big-picture review of what's going on in markets.

One notable thing about the last 2 years is the mini-panic of January 2016. Remember the first 6 weeks of 2016? Widely touted as 'the worst first 6 weeks of any year since 1929', investors were alarmed by worldwide headlines forecasting a 'cataclysmic 2016' and advising investors to 'Sell everything except high-quality government bonds'[2] . That correction was the second in quick succession as world markets reacted to a deflationary tremor from China, and a worldwide surplus of oil.

Turned out that little downward jiggle – actually a decline of about 12% - was the beginning of a wonderful equity market run, wonderful not only for its magnitude, as I write the market sitting about 50% higher than that low of February 2016, but for its wonderful defiance of the pessimists.

1 All returns local currency, FPost, December 30, 2017
2 Andrew Roberts, UBS Bank, Daily Telegraph and others, January 16, 2016

US Stock Market

Source: GlobeFund

Crazy Optimistic? No, and yes.

As is often the case, there is more than one thing going on here. First, the market is responding to a rare, synchronized worldwide economic expansion. European manufacturing appears to be growing at the strongest pace since the Euro began in 1999, leading an overall economic expansion of 2.4%, well ahead of the expected 1.7%.[3] Europe and the Euro are by no means out of the woods yet, but getting the economic machinery running again is the first and most important step to keeping the Euro beast together.

Economic expansion is driving both corporate earnings and employment income. Earnings are the primary long-term driver of equity market prices, and as mentioned in the last letter, 85% of US companies announced Q3 revenue and earnings surprises to the upside. So the main reason markets are going up is earnings are growing.

Earnings are the real deal. The IMF, after many years of revising forecasts down, has revised its global growth forecast to 3.6% for 2017 and 3.7% for 2018, a significant improvement over the 3.2% in 2016.

3 Financial Times, January 3, 2017

In the US, everyone who wants a job has one: unemployment is 4.1%. The Wall St Journal reported real household income is up over 3%, on top of a 5.2% jump the prior year; 6 million Americans have risen out of poverty since 2014; even better, blacks and Hispanics' income rose 5.7% and 4.3% respectively, vs 2% for whites. Employment income drives the economy.

Cautionary Notes

Within this picture of healthy worldwide economic activity are a couple of little whirlwinds that in my estimation are not likely to end well. They aren't particularly threatening to our investment strategy, but we'll look at them for fun – and perspective (the media will go nuts, so you can be ready).

The first and more important to investors is the fact that one quarter of the aforementioned lovely rise in US stock market prices in 2017 can be attributed to the surging prices of the big tech stocks, led by the FANGs: Facebook, Amazon, Netflix, and Google[4] . The S&P Technology Subindex is up about 38%, vs the S&P500 as a whole up about 20%.

It may seem a familiar movie, because you've seen something like it before. Jeff Bezos, founder of Amazon, blew past Bill Gates and Warren Buffett to become the World's Richest Man.

The internet is truly revolutionizing many industries. The FANGs and others are wildly profitable, and growing at fantastic rates by expanding revenue within existing business lines and also by bursting into completely new business, for instance, Amazon's purchase of Whole Foods, a grocery chain.

Is it another tech stock bubble? No. This tech stock phenomenon will be quite different from the previous one.

How will it end? Short answer: Not in a vaporization of value like last time. After all, it is different this time.

My guess is that a political and social backlash will drive a fairly radical restructuring of the technology industry. These changes will mark its transition from wildcat oil well and California gold rush to a more orderly and mature industry. Here's how:

One key aspect of the current technology revolution is the gathering and control of vast quantities of very personal data by a very small number of very large and influential companies. The data already allows the very precise identification of very specific things about individual people. Whether this data is misused by the companies themselves, or hacked and then misused, such as the recent Equifax hack, remains to be seen.

To a student of investment history, the rapid rise of such large, profitable, and monopolistic companies is clearly reminiscent of the Seven Sisters (see book review below).

Another key aspect of the tech revolution is the power to influence public perception. A web platform such as Facebook wielding such enormous social, political, and propaganda power, while claiming zero responsibility for the source or content of the messages, will soon be unacceptable. All governments in all countries have recognized the potential danger with past technologies such as newspapers, radio, and movies, and have moved to curtail or control their power.

For example, Hollywood studios' 1934 Motion Picture Production Code curtailed the depiction and/or glamorization of crime, drugs, sex, and the ridicule of government; the Code was voluntarily enacted to avoid direct government intervention.

4 FT, December 20, 2017

In each of these previous episodes the timeline from initial unregulated chaos to regulation varied; the patent medicine scams went on for years, sheltered by newspapers addicted to advertising revenue, while meatpacking was regulated overnight when lurid stories ran into a President inclined to regulation. (see book review below)

How will this tech thing end? As one of your managers said to me, 'It's hard to say how this one will end, but when it does, we won't be anywhere near it, because my portfolio doesn't have any of it'. This is what you pay your managers for.

Bitcoin

The second – and less relevant - whirlwind is the exuberant bubble in cryptocurrencies. Bitcoin is a speculative trinket; it can be traded, like tech stocks in 1999 or tulip bulbs in 1636; if you are quick and lucky you may make a little money. But Bitcoin is most definitely not a currency.

Bitcoin is not a currency because a currency is a medium of exchange to buy and sell other things, such as cars or airplane tickets. A currency that increases in value 15-fold in one year is useless as a medium of exchange: imagine if you'd taken a mortgage in Bitcoin to buy a house a year ago – today you'd owe 15 times more!

Bitcoin's primary use seems to be shifting money around the world below the radar of taxation authorities.

Bitcoin today is an early indicator of the speculative excesses that creep in as a bull market unfolds. After 5 decent years of market growth, the great wheel of human emotion turning 'exceedingly slowly' as it does, the fear begins to recede, and people begin to feel bolder. We have a long way to go before we get to a speculative blow-off top like 1999, but to an experienced investor, Bitcoin is a sign that the wheel is turning.

I've had several conversations with young people who either own or are thinking of putting money into Bitcoin. None of them had even heard of the tech stock crash. Ahh, yes, history: who said 'Those who do not know history are destined to repeat it'?

However, the potentially revolutionary and useful thing about crypto-currency is the blockchain technology used to track the number of coins and their ownership. Blockchain allows independent verification of a sequence of transactions or events, so it may have important uses tracking things in a virtual world.

Blockchain could allow, for instance, tracking and ranking or verification of someone's web postings over time, so that a Yale professor's comment in her subject of expertise could be identified as more credible than some activist opinion.

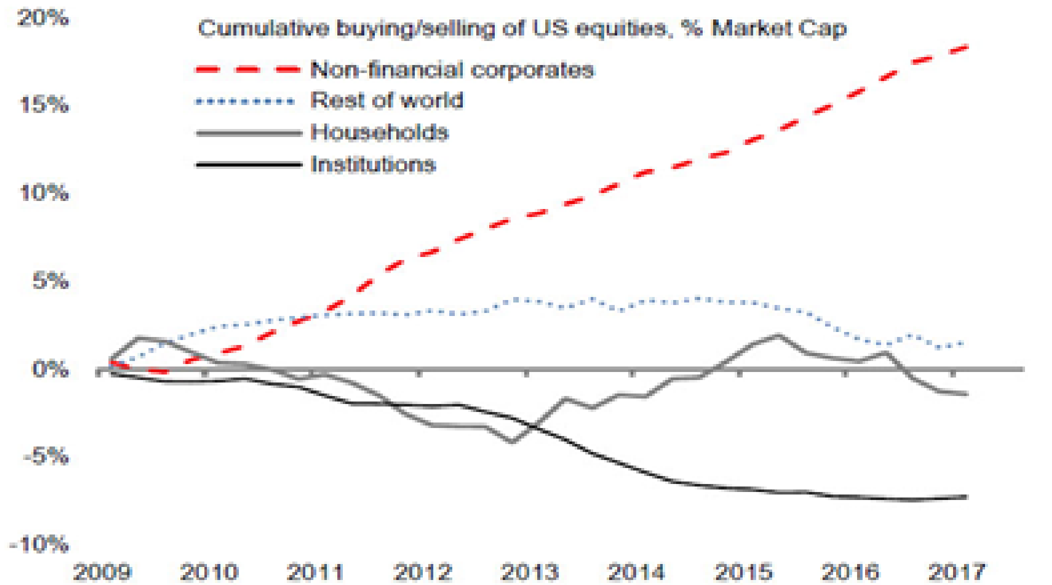
Back to Markets

Yes, markets went up again in 2017. But, because my clients tend to not talk with friends very much about their personal financial matters, you may not be aware of how unusual your positive experience of the past 5 or 6 years has been.

The chart below shows who has been buying and who has been selling US equities since the bottom of the financial crisis in 2009. US households and institutions (pension funds, banks) have as a whole been net sellers of equities. **They have missed the entire recovery and bull market.**

Who have been the biggest buyers? Companies buying back their own stock. A company buying its own stock with its own cash might seem odd. But, if the stock is undervalued, buybacks are an efficient use of capital; they are a way to return cash to shareholders, much like a dividend.

Figure 63: The corporate sector has been the main buyer of US equities since the market low



Source: Thomson Reuters, Credit Suisse

The point is that the presenting symptom among the great preponderance of investors these 8 years since the crisis has been fear, not greed. Households and fearful pension plans have been ‘de-risking’ by selling equities and buying bonds (at the height of the 35-year bond market!). Fear is an indicator of a market bottom, not a top, so this market has a way to go yet.

A closing observation: The Nobel Prize in Economics was awarded in October to Richard Thaler, Professor of Economics at Chicago. Thaler’s contribution, in the field now called ‘Behavioral Economics’, was to help trash the notion of people as ‘rational economic actors’ - one of the typical assumptions of classical economic theory.

Thaler helped show that the human mind does not handle uncertainties well. We use mental shortcuts called ‘heuristics’ that lead to consistently incorrect perceptions, called ‘fallacies’, that lead in turn to illogical or incorrect decisions.

The chart above shows one of the most powerful perception errors, called ‘recency bias’: people, including households and notoriously fearful pension fund trustees, tend to make investment decisions based on incorrect extrapolation of the recent past – instead of looking forward to see what’s coming, they look back and see what happened. So they sell after the market has gone down, and they wait until after the markets have gone up before they buy.

Your advisor’s primary value is to give you the courage, based on a rational assessment of the future, to buy when others are selling, and to be careful when others are chasing bubbles.

Book Review

Bhu Srinivasan: ‘Americana: A 400 – Year History of American Capitalism’

Srinivasan emigrated to the US from India at age 8 with his younger brother and mother (PhD in physics) in the mid-1980s. This excellent book began 20 years ago as a history essay assignment to weave his family history into that of the United States.

Each very readable chapter centres on one aspect of US history: the staggering story of the Mayflower, canals, railroads, and slavery, to film, shoes, and the internet, is packed with the personalities, as well as insightful observations about how the story fits into the overall picture.

The stories provide excellent perspective, often with poignant observations by the author. For instance, data from an 1859 slave auction pegs the total value of slaves at $2.8 billion, far greater than the value of US railroads, the next most valuable asset in the country at the time valued at $1 billion, or the federal government budget at $69 million. This context illustrates, as repugnant as it may be from our distant vantage point, that ‘for slavery to unwind itself on the basis of morality or righteousness was a tall order’.

Also interesting - in this age of whining about inequality - is how so much of economic progress was driven by individual initiative, with no grand plan other than striving for something better. If it sounds heroic, much of it is.

Cornelius Vanderbilt, for instance, eventually the richest person in America, got his start as a young uneducated man ferrying people across the Hudson singlehandedly in small sailboats, a very physical and difficult job. He was able to see firsthand that the new steamboats, able to sail in a straight line and in all weather, would eventually replace sail; he got a temporary job as captain of one, and worked his way to owning it. Another thread is how Vanderbilt absorbed so much tough-mindedness not from his parents but from the owner of the steamboat.

The stories allow people to see that capitalism, widely vilified today by so many people who yet benefit so tremendously from its productivity and progress, is the sum of individuals coming up with novel ideas and overcoming obstacles to do new things.