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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.

Market Correction and Update

This September marked the 10th anniversary of the great financial crisis of 2007-9. The bankruptcy of Lehman Bros, a US investment bank, on Sept 15, 2008 set off a spectacular cascade of financial interruptions that brought the modern economies to the brink of complete stoppage.

Its reverberations are still being felt around the world…

Your advisor was at a conference in Vancouver recently, discussing with several colleagues the correction of this Sept/Oct. We were comparing this nit (so far, anyway) to the bottomless free-fall of 2009. The blank look on the younger person's face told me that he had no idea what we were talking about. As he explained, in 2009 he was in high school.

Time flies. The crisis was so severe because it was the end of a decades-long era, not only of financial and banking practices but also the social and political zeitgeist that unwittingly supported the numerous faulty practices.

Long-established principles - such as lending standards - exist for good reason, and ignoring them for progressive politics or easy money is begging for trouble, and it's only a matter of time before the gods comply. See 'Brief History of the Credit Crisis' www.chrishoran.ca.

But even as the crisis of 09 fades into the fog of memory, or worse – no recollection at all - it forms the backdrop to the situation today.

Also in Vancouver your advisor was fortunate to be at a small breakfast meeting with Eric Bushell, CIO of Signature Investment Advisors. Below are perspectives on 5 of the most pressing questions investors face today.

One: Rising Interest Rates

The dominant reverberation from the crisis is interest rates. Rising interest rates will drive profound effects on various assets (notably Sydney, Vancouver, and Toronto real estate). Discerning these effects, and consequent positioning of investment portfolios, remain the key determinant of investment results for the next 3, 5 years and longer.

Interest rates are rising because the central banks are mopping up the artificial flood of money that stemmed the crisis. Interest rates as measured by 10-year bonds in the US have risen from 2.3% to 3.3% in the 12 months to October 2018. Canada's 10-year rise is similar, from 1.8% to 2.8% over the same period.

Rising rates are not good for bonds. Because bond prices respond inversely to interest rates, Canadian bonds have returned a miserable 0.9% and global bonds 0.5% over the 3 years to September.[1] October 2018 ended an uncomfortable and unusual 3-month period as both stocks and many bonds declined at the same time: Canadian government bonds fell almost 1% and Canadian stocks fell more than 8% in the 3 months ended October.[2]

However, the recent rise in bond yields (and drop in prices) has brought bond valuations more in line with inflation and economic growth than they were three years ago. Bonds therefore can now begin to provide a degree of protection to a portfolio in the event of a surprise negative jolt to equity markets.

In a serious stock market fall, bonds would go up in price and thus dampen the portfolio fall. As I've said in many meetings, 'You hold bonds for protection because a bad year in bonds is way better than a bad year in stocks'.

Diversifier maybe, not good value.

This brings me to an important distinction: the prospects for bonds are not as bad as they were three years ago, but they still aren't a compelling value. A yield of 2 or 3% before taxes with inflation of 2.5% still doesn't support a long-term withdrawal of say 4% to live on.

Those unfortunate retirees who are unwittingly following yesterday's investment precept – by holding 75% of their portfolios in 'safe' bonds – will get a nasty shock when they see how little money is left after 10 or 20 years of retirement withdrawals.

Will rising rates hurt my portfolio? Short answer: not much, because we are holding as little in bonds as necessary to mitigate volatility.

Longer answer: equity markets are not mechanically tied to rates like bonds are. Rising rates reflect a robust economy, which is positive for corporate earnings, and equity markets follow earnings. Earnings growth provides solid underpinning for equity markets. Interest rates and equity markets can both go up for a long time. More on this below.

Two: Europe

The EU project to socialize Europe may die a slow death, says Bushell (and I agree). The surge of the so-called populists in the polls around the world is driven by retiring baby-boomers who are now penny-pinching, and are tired of self-serving professional politicians.

1 Globe Canadian Bond Peer Index, Citigroup World Government Bond Index
2 Source: Tacita Investment Counsel, Asset Class returns, Oct 2018.

This right-shift to political and financial conservatism is seen around the world. Jair Bolsonaro in Brazil, Rob Ford, Donald Trump, Doug Ford, Emmanuel Macron, and Mauricio Macri in Argentina: all of them trounced lifetime politicians. They have been elected because they are not politicians.

Apparently Steve Bannon is in Italy coaching the populists towards the May elections there. In Britain there is no consensus to leave the EU, but there is a Euro-wide fear of being overwhelmed by refugees. As Margaret Thatcher pointed out, you can't be a democracy and take orders from somewhere else.

Absent a surprise political miscalculation, the slow demise of the Euro integration project is not likely to derail the world economy, whose centre of gravity is now between the US and China.

Three: China

China did the world a favor by stepping up to the plate in 2009 with a 5-year capital spending boom that supported world trade and allowed Canada and Australia to sail through the world recession. Now, in Bushell's turn of phrase, 'Trump may have thrown the Chinese a faster pitch than they were anticipating' with US attempts to rebalance trade.

The demonization of China by the US and others goes beyond trade; it is unfortunate and quite unnecessary. The Financial Times, a London newspaper, is picking up the anti-China drumbeat with a recent article on 'The Future of War: How the US Will Take On China'.

China will push hard for 'technology transfer' i.e. stealing technology, as any emerging country can be expected to try, and the West has every right to push back hard. But war?

Four: Energy

The expanding global economy, driven by India and China, is steadily increasing demand for oil by about 1.5 million barrels per day, while low oil prices in the past few years has discouraged the investment of about $1 trillion in exploration and development of infrastructure such as pipelines. Eric Bushell sees global investment potential in oil and gas companies, although less so in Canada.

Canadian oil companies are only able to sell their oil at a shocking 65% discount from the world price: Alberta oil was below $20 in late November, against a world (Brent) price of $60 because of our inability to build pipelines to get the oil to markets. Thousands of very high-paying Canadian jobs are missing as a direct result of our pandering to irrational environmental radicalism (driven BTW, by US lobbying).

Five: Technology

Every business is having a 'Holy s**t!' moment as it sees the digital disruption train coming down the track. Amazon in groceries, Microsoft in the cloud, Waymo charging its first customers for driverless car rides. All of it is driving a secular boom in technology spending in all aspects of life from design and programming to social and emotional relationships, particularly in young people.

Companies such as Apple have the cash and the customer information to become banks: knowing everything about you allows them to make highly accurate loan qualification decisions at precisely the same time as you shop online for your next car or house.

Market correction, October 2018

The market sell-off of October could well be over by the time you read this. Or not. Most client portfolios will be off less than about 6% in the month, and mildly positive year to date. In any case, at this point (early November) so far, it seems a perfectly normal correction: the US index is off a little more than 10% from recent highs; the stocks that have fallen the most are generally the ones that had gone up the most in the past year or so.

The US equity markets had been led in 2017 and 2018 by the top ten consumer technology stocks. The FANG stocks (Facebook, Amazon, Apple, Netflix and Google) dominate the S&P500 index because their market value is so large: Apple's market value was over $1 trillion in September, the highest of any company in history.

Most indexes are capitalization-weighted, which means the constituent companies influence the index in proportion to their total market value. The larger the company, the greater impact it has on the index. For instance, Apple's contribution to the S&P500's return was greater than all of the companies in the financial, consumer staples, energy, utilities, real estate, materials and communications sectors combined.

This means that if you didn't own these top ten tech stocks in 2017 and 2018, you would have had trouble keeping up to the index.

Bitcoin and Bubbles

The tech stocks today are not the bubbles they were in 1999. Today companies like Apple, Amazon, and Google have locked-in customers wallets and are wildly profitable. Web-based commerce is as useful today as it promised in 1999. Some of these companies: Apple, Google, and Facebook for instance, meet your managers' stringent investment criteria, so, unlike 1999, you will actually find some of them in your own portfolio.

But the only way to outperform an index in the last 3 years was to own a very large basket of the most popular stocks. And professional money managers know the potential folly of concentrating a portfolio in a small number of hot stocks (remember the tech crash?).

If some of the tech stocks are profitable but pricey, we are seeing much more dangerously speculative bubbles begin to creep back into markets. Dangerous to the naïve investor, that is: Bitcoin is one (now trading at ¼ its high of a year or so ago). Cannabis is another.

These speculative bubbles are straws in the wind to seasoned investors, telling us that there are naïve investors willing to pay silly prices for silly stocks. Speculative little bubbles tell us that we are along the way a bit in the investment cycle, and we are wise to have a degree of caution. See bond diversification above.

Looking Forward

The US economy today is firing on all cylinders, in spite of the terribly polarized and dogmatic politics. Unemployment there is at 1960's levels, with more job openings in the US than there are unemployed people to fill them.

The cycle of economic renewal continues: entire industries exist today, employing literally hundreds of thousands of young people, such as Google, Facebook, and Amazon, that were only figments of imagination 10 years ago! All the angst about unemployed youth, gone in an Instagram.

At the same time, established industries such as Boeing are at full capacity, today sitting on all-time order backlogs as the rapidly progressing economies such as China reach the point where their people can afford air travel. Of course there are problems in the world today, and you don't need me to tell you what they are, but this is normal, folks.

The overall equity market is well-supported by earnings, and is trading at reasonable valuation levels. Based on consensus S&P500 2019 earnings of $178, compiled by Ed Yardeni Research, the S&P500 at 2700 today represents a P/E multiple of 15.2x, below its 30-year average of 17x and perfectly reasonable in a world of sub-3% inflation. While we can always have a surprise, epic bear markets do not begin at a 15x multiple.

If earnings grow at the long term average of 10%, and the P/E multiple in 3 years is the 30 year average of 17x, that implies an S&P500 at 3660, or 36% higher than today's 2700. In 3 years. This is not far fetched.

US tax cuts boost valuations

The Trump tax cuts have provided a huge boost to profits, which has brought market valuations down significantly. In addition, the cuts are allowing US companies to repatriate the mountain of cash that they had been holding offshore, away from US tax. This capital can now be put to work investing in new and efficient plants and equipment, as well as dividends and share buy-backs.

Conclusions:

One: don't be afraid to own bonds. While they are not likely to generate a significant long term return, they are now able to provide meaningful diversification to a portfolio. Bonds are not as bad an investment as three years ago.

Two: the October/November 2018 correction is a classic pause. A much more negative surprise is necessary to turn the trend to negative from this point. Equities are in a long term bull market driven by synchronized global growth, reasonable valuations and very low inflation. Value opportunities exist in energy, and your managers will likely buy the dips in technology and energy.

Three: One danger is the US Federal Reserve raising short term rates too far too fast. If short term rates rise above long-term rates, history shows that a recession usually follows. Hopefully Jay Powell has studied enough history to avoid this policy error…

Books Review

‘Educated’, by Tara Westover
‘Hillbilly Elegy’ by J D Vance

Tara Westover was born to fundamentalist Mormon anti-government survivalists in rural Idaho. Her birthdate is unrecorded, and she was home-schooled, which she says is another word for not schooled.

Her memoir is a troubling (to me, anyway) story: growing up with 7 siblings, at least one of whom was extremely violent, (almost drowning her in the toilet). Their father was a manic-depressive nutbar who ran a junkyard and prepared for the end of the world by stashing thousands of gallons of fuel and tons of fruit preserves in the hills behind their home. How she made it to Brigham Young University in Utah and then to Cambridge and Harvard is almost unbelievable.

J D Vance was born in Middletown, Ohio to an alcoholic drug-addicted mother. He and his sister were raised primarily by their grandparents. Vance’s grandmother was pure hillbilly, defending her grandchildren in the most aggressive ways, (like threatening to ‘shoot your foot off’ with her .45). Yet she also provided Vance with the confidence and motivation to ‘get out of here and make something of yourself’.

In one case, 10-year old Vance was asked to leave the local drugstore because he was walking the aisles touching all the toys on the shelves. When his grandparents returned to find him outside the store, they walked inside, and confronted the manager. They went on a rampage, pulling toys off the shelves and smashing them on the floor. The shocked manager said they could stay in the store if they stopped smashing things. They stopped, and continued shopping as if nothing unusual had occurred.

The interesting thing – actually disturbing - about both books, is the authors readily describe how both the cultures – hillbilly and crazy white rurals, among others - are so strongly and willingly self-perpetuating.

The idea of self-perpetuating misery is taboo to the mainstream victimology prevalent in much of society these days, where poor people are poor because someone or something has done something to them. They don’t see education as a way out of their miserable existence; they see education as ‘someone else forcing their ideas on us’.

There’s a tribal ‘us and them’ perception. And educated, successful, well-adjusted people - are ‘them’.

Deeply disturbing, because of the fact that Westover and Vance’s struggles were as much againt their own families, who were proponents of their own miserable hopeless cultures as against the actual obstacles that the cultures presented. It’s tough enough to go to school, get a job, and meet normal people; but when your own brother practically drowns you in the toilet because he doesn’t like your college-bound boyfriend, how are we supposed to help?

TFSA Annual Contribution Limit Increased

The Canadian government has increased the annual contribution limit for TFSAs to $6,000 for 2019, up from $5,500 this year.

The TFSA's annual contribution limit amount is indexed to inflation, and rounded to the nearest $500, using the consumer price index provided Statistics Canada.

With the TFSA contribution limit rising to $6,000 for 2019, the cumulative TFSA contribution limit in 2019 will be $63,500 for a Canadian who has never contributed to a TFSA, and who was 18 years old or older in 2009, the year in which the program was launched.

Important Information:

Your December fund company statements for non-registered accounts contain yearend tax information, including capital gains or losses and your advisory fees which may be deductible. Please keep your December statements so you can find them at tax time.

The deadline for RSP contributions is March 1st, 2019. The maximum allowable amount for 2018 is $26,230. RSP contribution receipts are mailed out weekly through RSP season, so please watch your snail mail. Or you can get all contribution receipts online by logging into your Assante InvestorOnline account at www.assante.com. The login ID and account numbers can be found on your statements.

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