Happy New Year!

Investing Wisely

A Newsletter from Mike Wise

January 2023

I hope you had a joyful holiday season. Certainly, the weather cooperated for us and let us enjoy the outdoors.

Now comes the long cold 3 months of a Calgary winter. I'm not looking forward to that. We don't have any plans to get away to a warmer climate.

Carmen's broken leg is not healing as quickly as we'd have liked. She is under good care from her doctors at the Cast Clinic at Foothills. She had to undergo 2 additional operations just before Christmas, and that set her recovery back. She'll be starting intensive physiotherapy next week. We hope for the best, but fear that she'll have a permanent disability despite everyone's best efforts.

Mike with Zoe and Avi

Christmas at Fairmont Hot Springs was a great success. We rented a condo in addition to our own timeshare, and having 2 units gave us lots of room for David and his family from Ottawa. The warm weather allowed them to do lots of skiing and soaking in the hot pools up at the Lodge. They chose to stick to the ski hill at Fairmont – it is cheaper than the big hills like Panorama but was perfect for Zoe and Avi. And the Fairmont ski-and-swim package is a distinct benefit! I went skiing one day, for the first time in perhaps 20 years. They say that it's like riding a bike in that you never forget. That might be true, but one thing that had changed was my confidence. I stuck to the bunny hill. Once was enough.

E-Signatures

Port Strat has implemented a new do-everything back-office system. After some growing pains it is working quite well and I'm happy with it.

Part of the new system is the ability to handle e-signatures, so that we don't have to meet to take care of routine business.

With this app, called DocuSign, I can prepare the documents that might be needed and send them to you via DocuSign for your e-signature; once you have signed, they'll automatically be sent back to me for my e-signature, then on to the office for processing.

PORTFOLIO STRATEGIES

11 Lenton Place SW
Calgary AB T3E 5C7
Tel: 403-616-3434
mikewise@wiseword.ca
www.wiseword.ca

2022 RRSP Contribution Limit: $29,210.
Last Day for Contributions: 1 March 2023
2023 RRSP Contribution Limit: $30,780.

2023 TFSA Contribution Limit: $6,500.
Cumulative Contribution Limit: $88,000.

2023 Income Threshold Before OAS Clawback:
$86,912. (line 234 on your tax return)

You can review the document(s) but not make any changes. The system will flag where you are supposed to e-sign, using either a system-generated signature or your own signature from a file.

We've tried it out a little bit, and it seems to work well. Clients who have used it say it worked smoothly and they liked it.

One warning: Portfolio Strategies MUST have your correct email address on file! Let me know immediately if that's not the case so that we can do a KYC update.

Where We Are

Table 1 shows how stocks, bonds and commodities performed last year.

It was a rough year for stocks, but especially for bonds. As shown in Table 1, the Government of Canada 10-year bond has more than doubled in yield (from 1.434% to 3.316%), causing the DEX Universe Bond Index to fall by 11.4%. (Bond prices move inversely to bond yields).

The Canadian Prime Rate is now 6.45%. The Prime Raye serves as the basis for all variable rate mortgages and consumer loans. On the plus side, it also serves as the benchmark for GICs and other insured savings instruments. According to CANNEX, as of Jan 14 Royal Bank offered the best rate for 5-year GICs among the Big Banks, with a rate of 4.25%. A few smaller banks and credit unions offer rates above 5% for 5-year GICs. I can offer you a High Interest Savings Account from a Scotiabank subsidiary at 4.25% with full liquidity and interest calculated daily and paid monthly.

"I can offer you a High Interest Savings Account from a Scotiabank subsidiary at 4.25% with full liquidity and interest calculated daily and paid monthly."

Table 1
2022 Returns - Year to 31 December

	31 December Price	YTD Change
Equities		
TSX (CAD)	19384.92	-8.7%
S&P500 (USD)	3839.50	-19.4%
NASDAQ 100 (USD)	10466.48	-33.1%
Commodities		
Oil (WTI; USD)	$80.51	6.7%
Gold (Comex; USD)	$1830.10	-0.02%
Fixed Income		
DEX Universe Bond Index (CAD) - Total Return	1054.5	-11.4%
Govt of Canada 10-Yr Bond Interest Rate	3.316%	1.882%
Best 5-yr GIC Rate (rate as of Dec 31)	4.10%	1.80%
Exchange Rates		
USD/CAD	$0.7378	-$0.0724
EURO/CAD	$0.6894	-$0.0093

The US Federal Reserve raised the Fed Funds Rate by ½% in December, bringing that rate up to 4.5%. The US Prime Rate tends to be 3% higher than the Fed Funds Rate, so the US Prime is now 7.5%. More on US interest policy in a later section.

On the stock side, there has been a massive switch in investor sentiment from "growth" to "value". Tech stocks are the poster child for growth stocks, and the NASDAQ index in the US is weighted towards Tech. It is already in bear territory, being down more than 20% last year. (Table 1 shows that the NASDAQ was down 33% last year). The S&P500 index is in corrections territory (a correction being down -10% from a previous high). This major market index is weighted towards the Tech giants like Facebook (Meta), Google (Alphabet), Amazon and Apple.

The Canadian TSX Index is considered to be more of a value index due to its heavy weighting in resources and financials. The TSX only fell into negative territory during the last week of April, and isn't officially even in "corrections" territory.

Most of my clients have a balanced portfolio. My Canadian Neutral Balanced Benchmark was down -10.3% in 2022.

So Far This Year …

US market watchers have developed a number of easy rules of thumb, one of which is that the direction of the market in the first 5 days of the year will indicate the direction of the market for the year.

Well, I'm writing this letter in mid-January, and so far this year bond interest rates have fallen, which means bond prices are rising. The DEX Universe Bond Index is already up 3.1% this year. What a change from 2022!

On the stock side, in just 2 weeks the US S&P500 Index is up 4.1%, the NASDAQ Index is up 5.9%, and the Canadian TSX300 is up 5.0% in 2023.

Will the market watchers be right in their prediction? I guess we will find out in just 11½ months. (In their favour: another tried-and-true rule of thumb says that the 3rd year of the US presidential cycle is the best year for stocks. President Biden is now in the 3rd year of his 4-year term.)

Opportunities

This is an update from November's newsletter, but the 3 investments that follow remain my top choices for your portfolios.

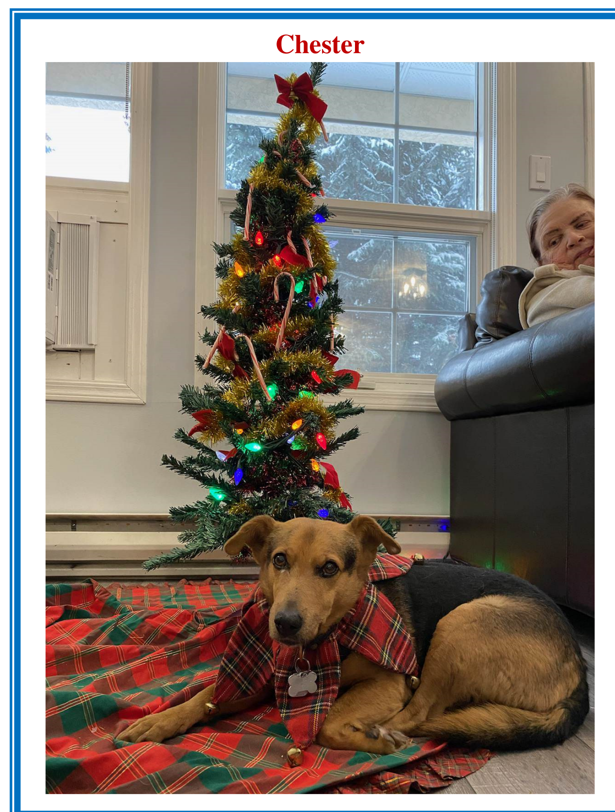
High Interest Investment Savings Account

I mentioned this in an earlier section, but it bears repeating.

A subsidiary of the Bank of Nova Scotia is offering "advisor-only" interest rates on a regular bank savings account. This is a CDIC-insured account, not locked-in with daily liquidity, and is available only to clients of financial advisors. The rate offered just went up to 4.25%, and might go higher if the Bank of Canada continues to raise its benchmark rate.

Interest is calculated daily and paid monthly on the last Friday of each month.

Chester



Purchase and redemption are through Fundserv using code DYN5004, exactly the same as a mutual fund transaction. There is no need to have an account at BNS, but you will have to have a Portfolio Strategies nominee account (described in previous newsletters). Clients who have a Dynamic client name account can also purchase this HISA, but with a slightly lower interest rate.

A US Equity Fund that is Different

A new fund company, True Exposure Investments Inc. (TRU-X) introduced their brand-new US equity fund at Portfolio Strategies' recent national conference. It was sufficiently interesting that I followed up with the principals of the firm, and invested a few pennies of my own money into their fund.

The fund (with the awkward name of *TRU-X Exogenous Risk Pool*, or TERP for short) makes use of ETFs based on 2 of the S&P500's 11 industry sectors. Their research indicated that during bear markets the Consumer Staples sector (think groceries; Walmart; Costco) always out-performed the broad market, while Consumer Discretionary (think cruise lines or luxury apparel) always under-performed.

The fund is therefore based on the relative strength of Consumer Staples vs Consumer Discretionary. According to their theory, when Discretionary is out-performing Staples the fund is invested in the overall market; when Staples is out-performing Discretionary, they are in defensive mode.

The fund inception date was 18 January, and it went into defensive mode shortly thereafter, where it remains. Since inception, TERP was *up* 4.7% as of year-end, while the unhedged S&P500 (USD) was down -12.7% from 18 January to the end of 2022. The S&P500 (50% hedged to CAD), which TERP uses as its benchmark, was down -12.1%.

It is early days yet, but TERP seems to be fulfilling its promise of protecting the downside. We still haven't seen whether it can offer full exposure to the upside of the US equity market.

The managers are offering a discounted Management Fee of only 0.3% to initial investors. This will rise to 0.7% at the end of January. Clients who wish to purchase TERP will have to have a Portfolio Strategies nominee account. The minimum commitment is $2500.

A Global Equity Fund that is Different

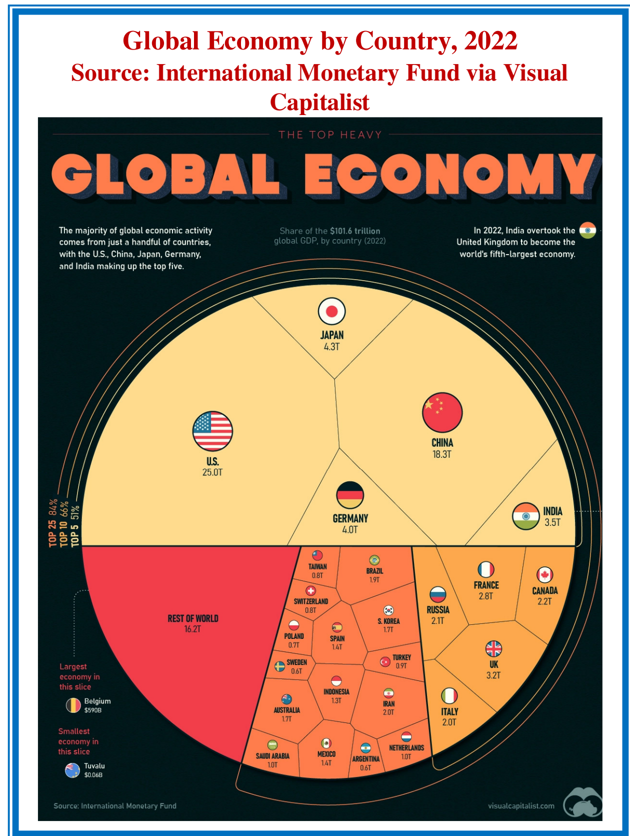
I might not be a "the end is nigh" kind of guy when it comes to global warming, but I can recognize that many environmentally-friendly technologies are worthwhile, and that there are some investment opportunities in the space. This might be one of them. I've put a few pennies into this one too.

Mackenzie Investments acquired Greenchip Financial Corp in 2020 and shortly thereafter started the *Mackenzie Greenchip Global Environmental All-Cap Fund*. Greenchip has more than 15 years of investment management in the environmental field, catering to institutional clients. The Mackenzie fund is diversified, both by sector and geographic region. Unlike most global equity funds, it has a relatively low weighting in the US, currently only 21%. Technology is also low relative to most global equity funds at 17%, and energy is a miniscule 0.7% (no windmills or solar panels?). Industrials, utilities and materials are the heaviest weightings in the portfolio.

As far as performance is concerned, the fund has a return profile similar to a pure technology fund that leaves more diversified global equity funds well behind. Unlike pure tech plays, however, the Mackenzie fund was down only -4.1% last year. Compare that to NASDAQ, which was down 33.1% in 2022.

The *Mackenzie Greenchip Global Environmental All-cap Fund* is available to clients who have a Portfolio Strategies nominee account, or who have a Mackenzie client name account. T-SWP class is available for those who need tax-efficient income. Dollar-cost averaging is available for those who prefer to tip-toe into the market.

Global Economy by Country, 2022
Source: International Monetary Fund via Visual Capitalist



Where We're Heading

Geopolitics

I'm going to go out on a limb a little bit, but I predict that within a decade the US dollar will no longer be the world's reserve currency. The path to this result will be messy, as the US will resist the move with all its power, *with no restrictions whatsoever*.

Increasingly, the US and the European Union are being isolated into one bloc, with the rest of the world forming another. Canada and the United

Kingdom are caught in the awkward position of being small mice that might be trampled in this grand transformation.

There are a number of moves going on right now that support this prediction:

- The CPTPP (Comprehensive Progressive Agreement for Trans-Pacific Partnership) is growing rapidly. It currently has 11 members, of which Canada is one, while 6 more countries (including the United Kingdom – the first non-Pacific applicant) have their applications in the works. Another 3 countries are considering application. Current members represent 13.4% of global GDP. China is one of the applicants but will have trouble meeting the rules regarding state-owned enterprises. The US has formally rejected membership. Evan Ambrose-Pritchard, writing in the *London Daily Telegraph*, speculates that the CPTPP will grow and eventually supplant the World Trade Organization (WTO) as the primary framework for global trade.
- I mentioned in my November newsletter that Chinese President Li Jinping visited Saudi Arabia and the Gulf Emirates. Details of what transpired are not available, but we can guess the subject when you consider that Saudi Arabia is the #1 oil exporter, China is the world's #1 oil importer, and neither particularly likes the US right now.
- Last weekend, Russia and Iran signed an economic co-operation agreement. Both countries have been heavily sanctioned by the West.
- The West's big advantage in the world has been supremacy of the Rule of Law. This has been torn apart by several recent moves:
    - The West cut Russia off of the SWIFT international payments system.
    - Estonia, with the enthusiastic backing of EU members, is preparing to confiscate assets of the government of Russia.
    - The US has seized a mega-yacht owned by a Russian oligarch even though the yacht was not in US territory, and the oligarch's only crime appears to be that he and President Putin are buddies. This used to be called piracy.
    - Canada is trying to do much the same thing, by trying to seize assets in Canada owned by another Russian oligarch.
    - The Canadian government froze bank accounts of political protestors through use of the Emergency Act. The Big 5 banks enthusiastically supported the move.

  Governments and individuals outside of the US and EU look at these moves with horror: why would anyone put their financial assets in a Western bank if they could be seized or frozen because of different political beliefs?

Carmen with Ottawa Gang: Avi, Kelly-Anne, David and Zoe

United States

The US mid-term election has come and gone. The House will be under the control of the Republicans for the next 2 years, while the Senate and Presidency, remain under the control of Democrats. Just to cheer you up, the 1st primary for the 2024 Presidential election is only a year away, next January!

Incidentally, the markets like a divided Congress. It is much less likely to do dumb things, at least when it comes to legislation.

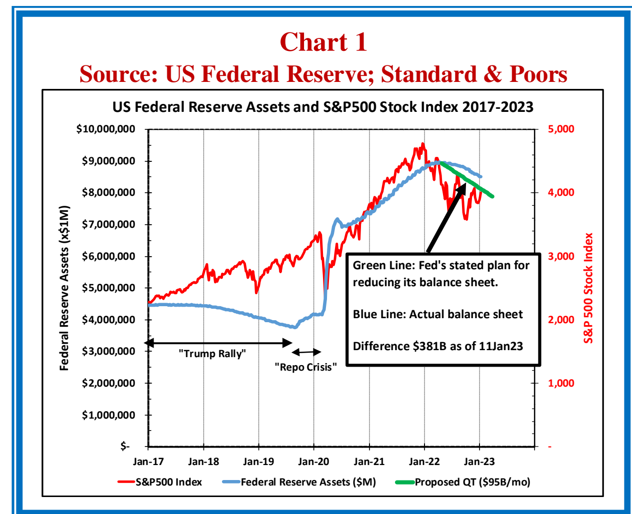
The Democrats weaponized the Department of Justice and the FBI against their opponents during the past 2 years. The House Republicans have already set up a committee to examine what happened and exact revenge.

Turmoil in Washington is likely to continue. In the real world, life goes on.

I'd be considered a monetarist in economic terms. I believe that the policies of the US Federal Reserve (the Fed) are extremely important in the economic life of not only the US, but around the world. The US runs on debt. Even mortgage interest is a tax-deductible expense; there is no incentive for ordinary homeowners to pay off their mortgage and live debt-free. Since debt, and living beyond one's means, is an American tradition, it follows that the nation is very sensitive to the Fed's interest rate policy.

On the stock market side, I'm a believer in **"Don't Fight the Fed!"**

The Fed raised its Federal Funds Rate by ½% at its meeting in December, bringing this benchmark rate up to 4.5%. Future rate rises are likely to be in the ¼% - ½% range, until the Fed is happy that inflation is down to the 2% level (I think that is wishful thinking!). Markets were overjoyed that the official year-over-year Consumer Price Index for January was only 6.5%. Things people actually buy, like groceries, were up twice that on an annual basis.



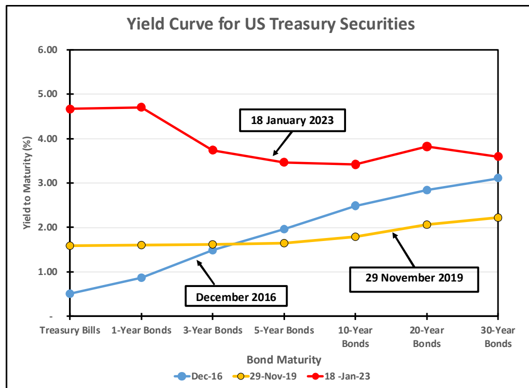
The big take-away for stock or bond investors is that while the size of the individual rate increases might be smaller, overall interest rates will still be going up for a while yet. **Don't Fight the Fed!**

The other arrow in the Fed's quiver is whether it is a net buyer or seller of government and agency-backed debt. The Fed has made a big show of vowing to be a net seller, thereby pulling excess cash out of the US economy. However, Chart 1 shows that the Fed might be talking the talk, but is not walking the walk. Its publicized intention has been to sell off $95B of bonds each month for the foreseeable future. This quantitative tightening (QT) would have the effect of pulling money out of circulation. However, there is a substantial difference between what the Fed says they are going to do, and what they have actually done. If you look closely at Chart 1, there is already a large gap between intention (green line) and reality (blue line). That gap is already $381B!

I've written previously that in my view the Fed's money-printing sustained the stock market (see Chart 1) until 2022. The Fed's tightening, such as it is, has dried up the fire hose of new money gushing into the stock market, but instead is forcing Mr. Market to go onto a diet – not a starvation diet, but more like what plus-sized comedian Gabriel Iglesias likes to say: "I drink Diet Pepsi so that I can have chocolate cake after the show".

If my theory is correct, we might not see much in the way of new money flowing into the stock market, but

Chart 2
US Treasuries Yield Curve as of 18 Jan 2023
Source: Barron's



we also won't see much money being sucked out of the economy through Quantitative Tightening (QT). On balance, we are likely to see very unstable financial markets because it will be more difficult for valuations to increase across the broad market. Individual company valuations (earnings and dividends, for example) might start to matter!

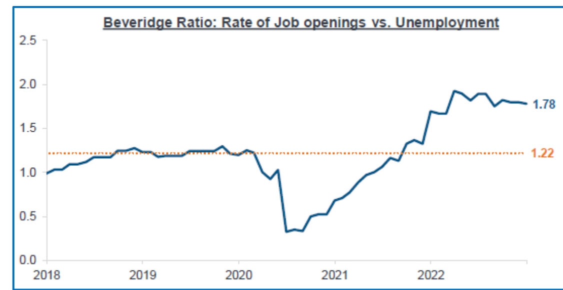
I can't see that the Fed will stop its program of raising interest rates while the US economy remains strong and inflation remains a problem.

Let's look at a few economic indicators.

First, the interest rate yield curve is the single best predictor of future economic activity and recessions. Recession typically starts 12-18 months after the interest rate charged by 90-day Treasury Bills becomes higher than the rate charged by 10-year US Government Bonds. Banks make their money by playing the spread between lending at long-term rates and paying depositors based upon short-term rates. They can't make money when the rates are inverted, so they stop lending. Chart 2 shows 3 curves: a strong positively-sloped yield curve at the end of 2016; the curve just before the outbreak of Covid in November 2019, and the current negative-sloped yield curve for US Treasuries. As of January 18, the 10-year yield is 3.418%, while the 3-month yield is 4.667%.

Central bankers are concerned that in this post-Covid world the demand for labour exceeds supply.

Chart 3
Ratio of Job Openings vs Job Seekers
Source: Barron's

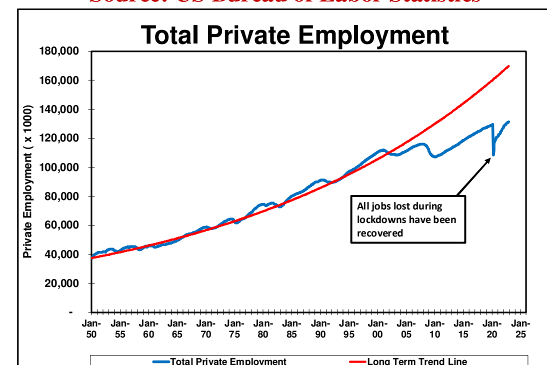


Obviously, businesses that need new employees are having to offer higher wages as an inducement for prospective employees to sign up, and to keep their current employees. The bankers, with their secure jobs and heady salaries, aren't worried about their own incomes going up; they apparently prefer that the proles who do the actual work in the economy don't get paid enough to even keep up with inflation. Chart 3 shows the labour situation in the US. The ratio shown is the relationship between job openings and unemployment – a high number indicates an excess of available jobs over job seekers.

The Fed won't stop raising rates until it crushes the economy and gets that curve shown in Chart 3 pointing downward.

That doesn't seem imminent. The US employment numbers continue to look good. The Bureau of Labor Statistics job report showed net gain of 641,000 private sector jobs (blue line on Chart 4) and almost 750,000 total non-farm jobs (this includes

Chart 4
US Private Sector Employment
Source: US Bureau of Labor Statistics



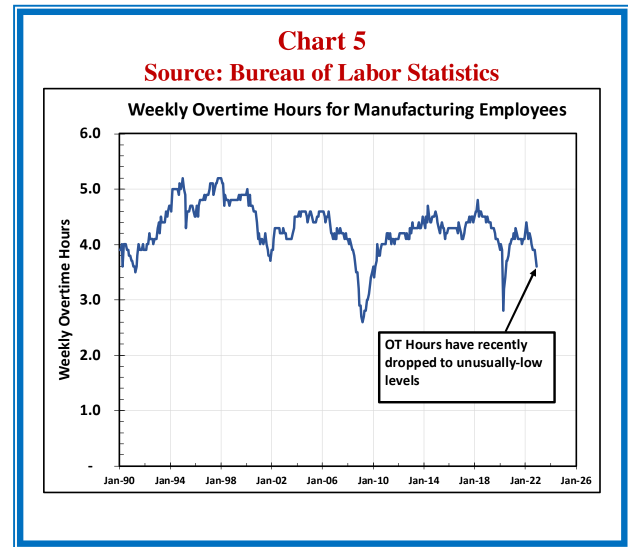
government) in the 4th quarter of 2022. All jobs lost during the Covid lockdowns have been recovered. The official unemployment rate is only 3.5%. As *Trading Economics* wrote: “The latest jobs report came on the heels of a sharp decline in weekly jobless claims to three-month lows and a smaller-than-expected decrease in the level of job openings in November, pointing to a still-tight and strong labor market, which could mean the US central bank will continue hiking interest rates for a while.”

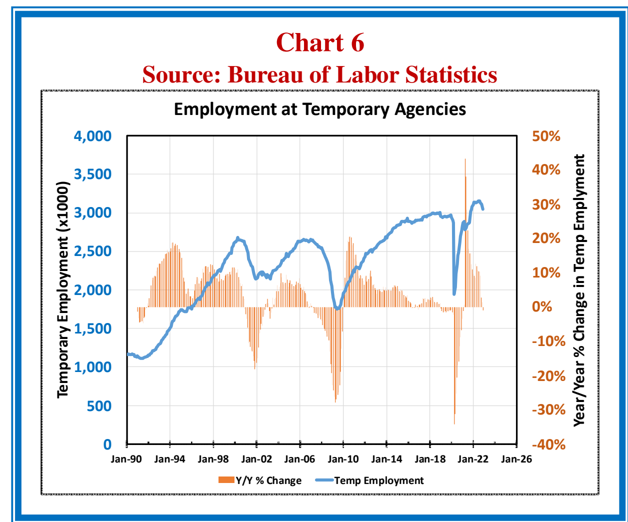
Burrowing deeper into the employment data gives the first look at a couple of leading economic indicators that seem to point towards future trouble.

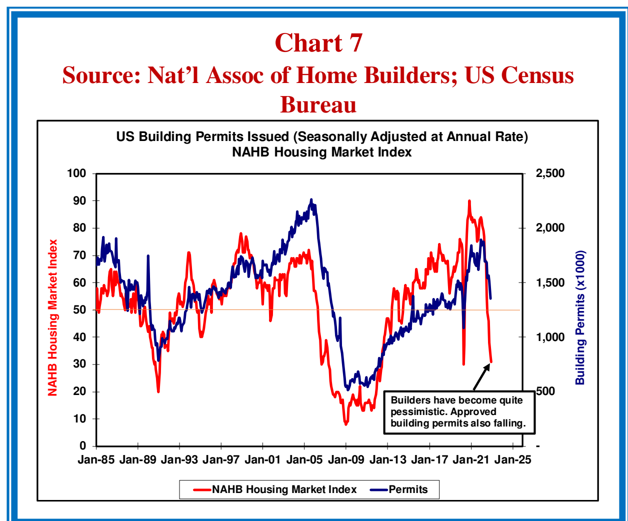
Manufacturing overtime gives me a glimpse of the demand for blue-collar workers, while employment at temporary agencies does much the same for white-collar workers. In both cases, they act as surge capacity: when times are good employers will ask employees to work overtime (or hire temp workers) rather than hire new employees; in hard times they will reduce or eliminate overtime (or lay off the temp workers) rather than let their core employees go.

Manufacturing overtime is a leading indicator for the health of the manufacturing sector. Overtime in the manufacturing sector has fallen substantially over the past few months, to a level seen only rarely and in the midst of major downturns. See Chart 5. The so-called labour shortage doesn’t appear to be in the manufacturing sector! Perhaps the shortage of semiconductor chips has affected the people that make the widgets?

Another leading indicator for employment is employment through temporary agencies. This looks at mainly white-collar jobs. Chart 6 shows how temp employment in doing. The blue line shows that employment at temp agencies has started to fall recently from a record high in 2022. It is hard to see in Chart 6, but the year-over-year change in temp employment (gold bars) is also negative now. That doesn’t happen very often, and is often a precursor to much greater job losses in the sector.







Housing is a sector of the economy that is very sensitive to interest rates. Higher mortgage costs and more stringent lending terms can really hamper the sector. It is therefore no surprise if this sector is showing signs of weakness. Chart 7 shows this is happening, at least in residential housing construction.

New housing construction is an important component of the overall economy. The actual construction is one thing; then there are all the extras that go into a new house, like carpeting and window furnishings, furniture, appliances, and landscaping. A couple of leading indicators for the health of the residential construction industry are the builder's confidence survey that is conducted monthly by the National Association of Home Builders (NAHB), and the number of new building permits issued. A builder needs a permit before construction can begin.

Chart 7 shows that builder's confidence (red line) has plummeted to a depth most recently experienced in the middle of the Covid lockdowns. Permits (blue line) haven't fallen to the same extent, but having a permit doesn't necessarily mean that construction will follow.

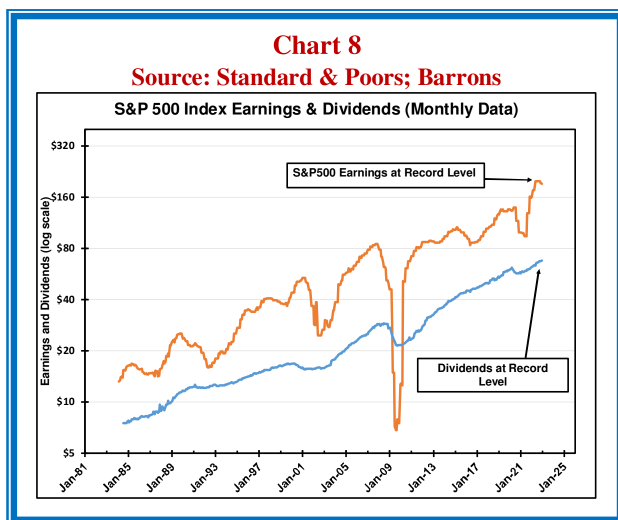
Finally, let's look at corporate earnings and dividends. These are the things that drive the stock market over the long term. Chart 8 shows that they are at record levels. No sign of a slowdown there!

Summary

In summary, then, we have a mixed bag of rules of thumb and economic indicators. 2023 is likely to be unusually uncertain for an investor.

I think it is safe to say that short term interest rates will be going up for quite some time. My guess is that we'd be looking at the latter half of the year before we can expect a pause. Therefore, I cannot get excited over the prospects for Bonds at this time. There will be a time – maybe late this year – when the Fed stops raising rates. That will be the time to jump into bonds with both feet! In the meantime, something like the High Interest Savings Account that I discussed earlier looks to me to be a good safe harbour.

Chart 8
Source: Standard & Poors; Barrons



As for Stocks, the "first 5 trading days" and "3rd year of the Presidential cycle" are 2 rules of thumb that traders love. Both are positive. Earnings and dividends still look good. The Fed seems concerned that the economy is too good, so that a labour shortage and wage demands are fueling inflation … a nice situation to be in, in my opinion.

On the other hand, the yield curve is negative, and the leading indicators of manufacturing overtime and employment at temporary agencies are both troubling. High interest rates are hammering the construction sector. The US Prime Rate is already at 7 ½%; how much higher does it have to go before consumers stop spending? **I remain a believer in "Don't Fight the Fed!"**

> ***"There's an old saying that whenever the US sneezes, Canada catches a cold."***

Canada

This newsletter is already too long, so I won't spend any time on Canada or the rest of the world.

Suffice it to say that the story in Canada is much like that of the US, minus the frenzied political

Hoar Frost

atmosphere. The economy is currently doing well, but there's a danger that high inflation, and the Bank of Canada's resolve to fight it through interest rate increases, could crush it and drive Canada into recession. There's an old saying that whenever the US sneezes, Canada catches a cold.

Carmen and Mike
Christmas 2022

Hoar Frost