Investing Wisely

A Newsletter from Mike Wise

January 2024

Happy New Year!

Carmen and Mike – Christmas 2023

Well, it looks as if Old Man Winter has finally arrived in Calgary. I sure hope that he doesn't stick around town for very long! But we need the snow badly to put moisture into the ground for farmers. And we need a good snowpack in the mountains; that's our reservoir for the summer.

Liz, Edgar and Eshan ended up driving from LA for Christmas. We celebrated Christmas in Edmonton with Edgar's sister, and Edgar cooked up a magnificent roast beef dinner. And yes, we walked over to West Ed Mall (their house is only 2 blocks away) a few times. That mall is an amazing place! It was sad to see them leave and head back south.

Liz is now Head – Scripted Programming for the CW Network. The sign on her desk says *The Buck Stops Here* as she has total responsibility for the success of her division. Her first project airs this week – I sent out a blast email earlier – called *Wild Cards*, a light-hearted detective drama that is a co-production with CBC. It will soon be followed by a detective thriller co-produced with CTV. She'll be travelling to Serbia soon to negotiate the contracts for yet another project.

Carmen's leg is slowly improving. She still needs her walker for longer forays, for example shopping at the mall, but can use a cane, or sometimes no aid at all, for times when little or no walking is needed.

We had a big breakthrough with our Costa Rica house. Starlink finally became available in Costa Rica and we installed it just before Christmas. It works like a charm, and we now have high-speed Internet at the house (first speed test was 173mbps download – better than I have here on this computer). Work-from-home is now possible in Paradise!

I'm not sure if we can make it down to Costa Rica this winter, so the house is available for rent if you'd like a long-term escape from Winter. Check out https://www.airbnb.ca/rooms/19363038.

Where We Are

Table 1 shows how stocks, bonds and commodities performed last year. Most of my clients have a balanced portfolio. My pension-style Canadian Neutral Balanced Benchmark was up 8.35% in 2023.

PORTFOLIO STRATEGIES

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Table 1
2023 Returns - Year to 31 December

	31 Dec 2022 Price	31 Dec 2023 Price	YTD Change
Equities			
TSX (CAD)	19384.92	20958.44	8.1%
S&P500 (USD)	3839.50	4769.83	24.2%
NASDAQ 100 (USD)	10466.48	15011.35	43.4%
Commodities			
Oil (WTI; USD)	$80.51	$71.33	-11.4%
Gold (Comex; USD)	$1830.10	$2071.80	13.2%
Fixed Income			
DEX Universe Bond Index (CAD) - Total Return	1054.5	1121.5	6.35%
Govt of Canada 10-Yr Bond Interest Rate	3.316%	3.128%	-0.188%
Best 5-yr GIC Rate (rate as of Jan 1)	4.10%	4.10%	0.00%
High Interest Savings Account (rate as of Jan 1)		5.00%	
Exchange Rates			
USD/CAD	$0.7378	$0.7549	$0.0171
EURO/CAD	$0.6894	$0.6840	$0.0054

Everything changed in late October, when the US Federal Reserve signalled that it wouldn't be raising rates anytime soon, and might even begin lowering rates before too long.

Prior to that date, both bond and stock markets had bounced around, without much conviction one way or the other. After that, bond interest rates fell (see Table 1), raising bond prices (bond prices move inversely to interest rates) and stock prices on every market in the world. It was a synchronized market move that confirmed that all financial markets around the world are now inter-connected through some vast computer network.

Technology dominated. The "Magnificent 7" (Apple, Microsoft, Amazon, Tesla, Alphabet (Google), Meta (Facebook) and NVIDIA) produced something like 90% of the gains of the entire S&P500 stock market index. The top 5 represent over 25% of the market weight of the S&P500, with Microsoft and Apple together exceeding 14½%.

On a more positive note, the other 495 stocks in the index had the same relative return as the top 5 over the last 2 months of the year – the "breadth" of the market expanded to include everything.

Interest rates remain inverted, which means that short term interest rates are higher than longer term rates. We see this if we look at something like TD GIC rates: TD offers 1-year GICs at 5.00%, and 5-year GICs at 4.15%. The other Big Banks offer GICs at similar rates; some smaller outfits can give better rates. I quote B2B Bank (part of Laurentian Bank) in Table 1. Table 1 also shows that my favoured supplier of a High Interest Savings Account offers an "advisor-only" rate of 5.00% to my clients. This rate is for a standard bank savings account, CDIC-insured, with 24-hour liquidity and interest credited monthly. The supplier is one of the Canadian Big Banks.

In Praise of Value

The stock market is now dominated by **Momentum**: buy anything going up *because* it is going up. A lot of investors are attracted to **Growth**: buy stocks of companies for which revenue is going up and which have a great story of ever-increasing sales.

Left behind are **Value** stocks. These tend to be older, low-growth companies that offer consistent dividends instead of sexy growth stories. But if you are interested in income, particularly once retired, and are willing to look at your bank statement rather than your broker statement, you might want to have your portfolio filled with boring old **Value** companies. Jeff Opdyke makes the case:

*"… I want that continual stream of monthly income spilling into my account. I want to own quality, dividend payers that will supplement my monthly pension. I don't want to draw down my nest egg too quickly. I'd much rather own stocks like ***** that are consistently sending me money… and which are consistently increasing their payouts over time.*

"A lot of the world pays attention to momentum stocks, trying to find the next Apple, the next Tesla… or some AI stock that's supposed to rule the world, or whatever. And maybe that strategy pays out.

"But for my money—for my retirement—I want boring hamburger flippers. I want dull companies that do nothing more exciting than move petroleum products through pipelines. I want tobacco companies everyone hates for moral reasons, because the world ain't kicking the smoking habit anytime soon and I'll gladly take the huge payout every quarter.

"That, to me, is the best way to prep for a retirement that's far too close at this point. ***I want to have peace of mind in my retirement."***

Bowness Lagoon – New Year's 2024

Dividend mutual funds and ETFs have under-performed Mr. Market over the past decade because the market is now dominated by Momentum and Growth stories. The S&P500 is now a Tech index. Good value companies languish unloved in those 495 under-performing stocks on the S&P500. The Canadian TSX300 is considered a Value index due to its heavy weighting to Financials and Materials.

Will that change? I don't know. Global dividend fund managers, trying to defend their turf, have added around a 20% Tech position to their funds to boost performance (Apple and Microsoft are among the Tech giants that pay a dividend), but at the trade-off of lowering the dividend yield of their overall portfolio. Perhaps a good compromise, but not necessarily great for someone who needs a high stream of dividend income.

Where We're Heading

I think it is fairly safe to say that 2024 will be a year of great uncertainty. Geopolitics might overwhelm financial matters this year.

According to Deutsche Bank, something like 46% of the world's population will be going to the polls this year to elect governments. Big policy changes might result.

The biggie that will take up all the space in Canadian media will be the US election. Former President Trump will almost certainly be one candidate, but I remain unconvinced that current President Biden will be the Democrat standard-bearer. I wrote in my November letter that I thought Michelle Obama will be the Democrat nominee, with Gavin Newsom and Kamala Harris as outside possibilities.

The Democrats refused to allow Robert Kennedy Jr to run for their party; now there are efforts to prevent him from running as a 3rd party candidate.

If it is a Trump-Biden contest, current polls indicate that President Trump will be re-elected with a majority of electoral college votes, and possibly even a majority of all votes cast. Michelle Obama could win if it were a Trump-Obama contest.

A House in Edmonton

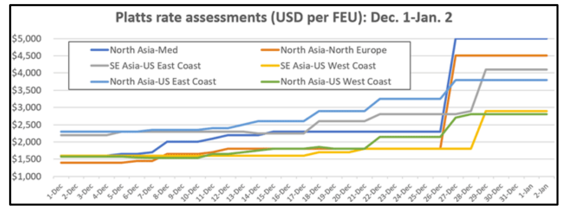
I'll concede that I have a bad case of TDS – Trudeau Derangement Syndrome. My costs for replacing TV screens have gone way up, as I throw my shoes at the TV every time his face appears on the set. Or even worse, his dreck of a Finance Minister and Deputy Finance Minister, Chrystia Freeland! Is there anyone in the Liberal cabinet who has even a hint of competence?

I hope there will be an election in Canada, too, but I guess that all depends upon Jagmeet Singh, and his supporters within the federal NDP caucus. Rumours continue to circulate that Mr. Singh and his caucus need to qualify for their federal pensions before we can have an election.

Overseas, the war between Russia and Ukraine grinds on, with its attendant appalling loss of life on both sides. Sitting here in Canada, all we can do is pray that the parties eventually come to their senses and put an end to the carnage.

I support the Canadian government position that Hamas is a terrorist organization, and I support Israel's response to the October 7 attacks on Israeli civilians and subsequent atrocities and hostage-taking. There hasn't been a single Jew in Gaza for almost 20 years. All the aid that has poured into the region could have turned Gaza into another Singapore as it sits near the end of the Suez Canal. Something like 30% of global trade passes by its door. Instead, all that money was spent on arms and fortifications, all designed to push Israelis "from the river into the sea". Yet polls (for whatever they are worth) indicate that Hamas has something like 75% support in Gaza. The destruction going on right now is a result of their own making, and could be stopped instantly if Hamas wanted it to stop.

Chart 1
Shipping Rates as of 1Jan24
Source: freightwaves.com



Nevertheless, I recognize that bombs and bullets can't stop an ideology based upon hate.

In the meantime, the Houthi rebels in Yemen (apparently financially backed by Iran) continue their war against a Saudi-backed government. I have no idea what their cause might be, but the fact on the ground is that they hold a position right at the south end of the Red Sea, and now are essentially blockading maritime traffic to the Red Sea and the Suez Canal. It seems to me that Egypt is the country most impacted, as it has lost the revenue from the passage of cargoes through the Suez Canal, and that Egypt should be the country taking the lead at negotiations aimed at reopening the Canal. But that doesn't seem to be happening, and now shipping between Asia and Europe has to take the long way around the Cape of Good Hope at the tip of Africa.

Chart 1 shows how shipping costs for a forty-foot equivalent container (FEU) have gone up everywhere, but have tripled for the Asia – Europe run.

While on the subject of Europe, there is a fair bit of political dissent going on there, too. In the latest flare-up, farmers in Germany are undertaking a mass protest. The immediate source of their discontent is (apparently) the elimination of an exemption on payment of the fuel tax on diesel, which of course is used to power tractors and other farm vehicles.

Farmers' protests in the Netherlands also continue, as the government continues to feel that environmental concerns regarding agricultural practices warrant reducing the numbers of farms.

Further East, truckers continue to block the Poland-Ukraine and Slovak-Ukraine borders. I'm not sure what their specific concern is, but one item on the agenda are proposed EU rules regarding preference for Ukrainian farm products into the EU market.

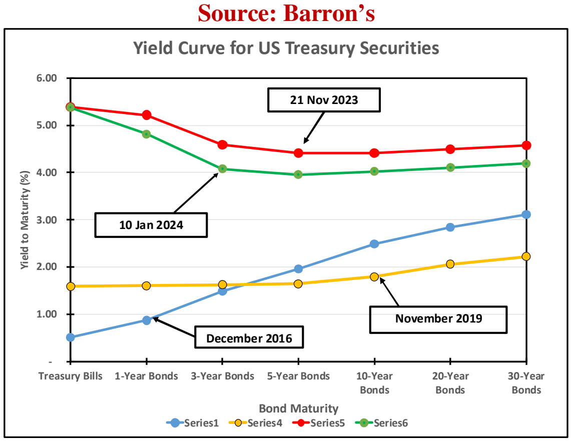
The other issue simmering in the background of Europe is immigration, and specifically immigration from Muslim countries. There is a huge disconnect between what government officials (the "elites") want, and what the public will accept. Normally peaceful Ireland is the latest country to have violence, while in the Netherlands the Party of Freedom, led by Geert Wilders, came out of nowhere to become the most-popular party. All 4 parties in the previous coalition lost support. Other countries in which Muslim immigration is a hot topic include France, Denmark, Sweden, Poland and Hungary.

Immigration is likely to be a hot topic in the US election as well. In Canada, it is one of those topics that "the elites" don't want to talk about. The Conservatives have joined the Liberals and NDP in silence, while the media labels anyone who wonders whether 1 million immigrants a year might be a tad too many as a right-wing extremist. Only the Peoples Party dares talk about it.

Interest Rates

Official inflation rates have fallen over much of the developed world, to the point where central banks announced that the cycle of raising rates to counter inflation is now over. The normally flinty-eyed bankers immediately shouted "Hallelujah" and went on a massive bond-buying buying spree, driving the yield of longer-dated bonds down. This has increased the inversion of the yield curve. See Chart 2. As I've mentioned many times, an inverted yield curve is the most reliable forecaster of future recessions.

Chart 2
US Treasuries Yield Curve as of 10 Jan 2024
Source: Barron's



According to Tyler Mordy of Forstrong Global, futures markets are now projecting that the Fed will be cutting short term rates by 1.5% this year. The Bank of America's Global Fund Manager Survey says that managers view bonds as their most-favoured asset class, and are positioned with the largest over-weight to bonds since 2009.

Flash: The Bank of Canada announced on January 5 that it is contributing $30B to support the overnight Repurchase Agreement (REPO) market.

The REPO market is an ordinary part of the banking system. Quite often, a major bank might have made more loans or received less in repayments than expected in any given day, such that it is short of sufficient cash to balance its accounts. Alternatively, another bank might have the opposite problem of having more cash than needed at the end of the day. The 2 banks make a REPO agreement: the bank with surplus cash lends cash to the bank with insufficient cash, with the amount borrowed covered by good collateral, generally government bonds or mortgage securities. There is a modest interest charged for the service, and repayment is made the following day.

The Canadian REPO market is quite substantial, amounting to $10-20B each day.

Problems can arise if one of 2 conditions occur: there isn't any bank with sufficient surplus cash to cover the other bank's shortfall, or the banks with cash won't accept the collateral offered by the other bank.

One of these conditions has occurred within the Canadian banking system. We don't know which one, and we don't know what bank(s) are affected, but it is serious enough that the Bank of Canada has had to intervene on the side of accepting the collateral and taking on the role of lender of the needed cash, to the tune of $5B per day since Jan 5.

My guess is that it has to do with the Canadian mortgage market. Overstretched borrowers might be starting to skip their mortgage payments.

Fund managers clearly think that inflation is dead, and will be back to below 2% within the year. That seems to be a very aggressive bet on the direction of the market!

Stock Market

Past history shows that US stock market performance in presidential election years tends to be flat until later in the year, then starts to rise once the outcome of the November election becomes more certain. It doesn't matter which party proves to be the ultimate winner; market behaviour is roughly the same.

I'm trying, without success, to figure out the reasoning why markets would anticipate a drop in inflation below 2%, and a decrease in the Prime Rate of 1.5% this year. We seem to have avoided the "hard landing" economic outcome, as economic growth and employment continue to be strong. There's still a shortage of workers, so the bargaining power of labour remains strong as they seek to regain the lost earning power from last year's inflation. I'd also put the chances of escalation of the Middle East wars to be quite high, and since Iran is a major instigator of the strife this could easily mean closure of the Persian Gulf, and sky-high energy prices.

Shipping costs have gone up due to closure of the Suez Canal. While this impacts Europe most strongly, Chart 1 shows that the cost of shipping between Asia and the east coast of North America has also jumped. This is inflationary as well.

There are also a few decades-long transitions that will continue through 2024, supporting continued economic growth.

Carmen and Mike with Eshan

Chart 3
Hourly Wage Rates in China & Mexico
Source: TACNA

Covid revealed that sourcing production in cheaper overseas countries can result in shortages of tiny but critical links in the final product. Pharmaceuticals, lithium, and computer chips are prominent examples. Moves are well underway to home-source production. Mexico now not only has lower wage rates than China (see Chart 3), but Mexico doesn't require ocean transport to ship the final product. Mexico is now the US' top trading partner (Canada is #2).

The shift to de-carbonize the energy economy is a trend that won't end anytime soon. A lot of this might be driven by government regulation, but there is also a good economic case to be made for increasing energy efficiency. The simple example that I frequently use is the shift from incandescent light bulbs to LEDs.

The Military Industrial Complex is quite happy to keep the Ukraine-Russia war going as long as possible. Modern warfare churns up equipment as well as lives, and all that armour and ammunition needs to get replaced. A European government just placed an order for 1000 Patriot missiles, at a cool $4M each. President Biden wants to give $61B to Ukraine. This money will all be spent in the US for the

Bow River in Banff

purchase of US-made armaments that will end up being destroyed in Ukraine.

The Gaza war is a bonus for the MIC. Next on their agenda will be Taiwan.

I’m not sure about the economic impact of Artificial Intelligence. It might have huge impact a decade from now, but for now companies and governments are likely to be spending relatively small amounts exploring how it might apply to their business.

To sum up, there are a lot of mega-trends in operation that are likely to keep moving forward. These will support continued economic activity throughout 2024. I can’t see why there would be a huge drop in inflation and a significant drop in interest rates.