Investing Wisely

A Newsletter from Mike Wise

November 2022

"Turn out the lights; the party's over.

They say that all good things must end."

When I look outside, at all the brilliant white snow and the thermometer reading below -20c, I'd say that our magnificent Fall has definitely come to an end.

Carmen's recovery from her broken leg has turned out to be much slower than we had hoped. She visited her surgeon last week, and x-rays showed that the bone still hasn't fully knitted and the pins that hold everything in place have loosened up. He is reluctant to do anything until the bone heals a bit more; looks like closer to Christmas now. In the meantime, she has a physiotherapist coming to the house to help with exercises, and a home care worker comes twice a week to help her with bathing. As Jodie, the home care nurse said, she has had to become close friends with her walker!

Carmen and Mike at Kananaskis Village

Looking ahead, we'll be spending our Christmas at Fairmont Hot Springs for the first time. Our son from Ottawa will be joining us. His kids are excited over the prospect of skiing on some real mountains! Perhaps I'll join them on the slopes at least one day while they're here.

Grandson Eshan performed in *The Music Man* with a local repertoire company. He really enjoys the stage, and now has an agent, and is taking acting, dance and voice lessons to advance his potential career.

PORTFOLIO Strategies

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

Table 1
2022 Returns - Year to 31 October

	31 October Price	YTD Change
Equities		
TSX (CAD)	19471.19	-8.3%
S&P500 (USD)	3901.06	-18.2%
NASDAQ 100 (USD)	11102.45	-29.0%
Commodities		
Oil (WTI; USD)	$88.37	17.1%
Gold (Comex; USD)	$1648.30	-10.0%
Fixed Income		
DEX Universe Bond Index (CAD) - Total Return	1046.7	-12.1%
Govt of Canada 10-Yr Bond Interest Rate	3.258%	1.824%
Best 5-yr GIC Rate (rate as of Nov 7)	5.03%	2.73%
Exchange Rates		
USD/CAD	$0.7328	-$0.0584
EURO/CAD	$0.7377	$0.0419

Lest We Forget

Where We Are

Table 1 shows how stocks, bonds and commodities performed in the first 10 months of this year.

It has been 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 3.258%), causing the DEX Universe Bond Index to fall by 12.1%. (Bond prices move inversely to bond yields). The Bank of Canada raised its benchmark interest rate a few days ago by another ½%, and this caused all Canadian interest rates to jump. As of last weekend, the Universe Bond Index is now down -14.0% so far this year, while the Long Term Bond Index is down a stunning -25.4% this year!

The Canadian Prime Rate is now 5.95%. 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.

If there is one bright spot from the interest rate rise, it was less than had been expected. The market had expected a ¾% increase, rather than the actual ½% jump. The Governor of the Bank also softened his language about future rate increases. While the Bank remains committed to future raises in the hopes of cooling inflation, the Governor indicated that they are conscious about not crushing the economy unintentionally.

The US Federal Reserve raised the Fed Funds Rate by ¾% last week, bringing that rate up to 4.0%. The US Prime Rate tends to be 3% higher than the Fed Funds Rate, so the US Prime is now 7%. 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% this year. (Table 1 shows that the NASDAQ was

Eshan in *The Music Man*

down 29% at the end of last month). 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 mixture of stocks and bonds in a balanced portfolio. My Canadian Neutral Balanced Benchmark was down -9.9% to the end of October.

Opportunities

High Interest Investment Savings Account

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 3.80%, 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.

A Path in the Woods

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).

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 down -3.1% as of 30 September, while the S&P500 (50% hedged to CAD) was down -17.2%.

It is early days yet, but TERP seems to be fulfilling its promise of protecting the downside, while offering 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 November. Clients who wish to purchase TERP will have to have a Portfolio Strategies nominee account.

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 some environmentally-friendly technologies are worthwhile, and that there are some investment opportunities in the space. This might be one of them.

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%, and a high weighting ex-North America, at 57%. Technology is also low relative to most global equity funds at 19%, and energy is a miniscule 0.4% (no windmills or solar panels?). Industrials, materials, and utilities are the heaviest weightings in the portfolio. Their 3rd quarter commentary noted that European utility companies that have a large exposure to wind and solar are making a fortune from the high cost of energy in Europe right now!

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 is down only -6.1% this year (to Nov 8). Compare that to NASDAQ, which is down 33% YTD after the 1st week in November.

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.

Carmen at North Glenmore Park

Where We're Heading

Geopolitics

From Saudi-based e-newspaper *The National*, 27 October 2022: *China's President Xi Jinping is expected to visit Saudi Arabia in the near future, the kingdom's Foreign Minister, Prince Faisal bin Farhan, said on Thursday.*

The announcement of the visit, and summits between Middle East nations and the Chinese government, came after talks between Chinese Foreign Minister Wang Yi and Prince Faisal.

The talks were the fourth meeting of the political and diplomatic sub-committee under the China-Saudi Arabia high-level joint committee.

"Our meeting today comes at an important time, as it precedes the expected visit of the Chinese president to the kingdom …" Prince Faisal told Saudi TV outlet Al Ekhbariya.

President Xi seldom travels. There must be some important reason why he would make this trip to Saudi Arabia. My sources *speculate* that his visit will finalize a couple of important geopolitical developments. First, Saudi Arabia plans to increase its involvement with the BRICS nations (Brazil, Russia, India, China, South Africa) and at least partially leave the American orbit. This follows the Saudi snub of President Biden when they not only failed to increase oil production, but reduced production, after Mr. Biden had requested their assistance.

Second, and more important on the world stage, is that there are apparently moves behind the scene to establish a new BRICS currency, and that Saudi Arabia (the world's #1 oil exporter) and Russia (the world's #2 oil exporter) will price their oil *only* in this new currency. China, as the world's #1 oil importer, will support the move.

If successful, this move would effectively remove the US dollar as the world's reserve currency. Oil importers would no longer have to buy US dollars to pay for their oil. The US will resist this with all its power, with no restraints whatsoever.

This is all speculation right now, but the ill-advised economic sanctions placed on Russia over Ukraine, and in particular the embargo from the SWIFT payments system, has made this move all too plausible.

We in Canada aren't able to fully appreciate the damage that PM Trudeau's freezing of the Freedom Convoy's bank accounts, and the chartered banks' ready acquiescence to the order, did to foreigners' trust in the Western financial system.

Bowness Park

United States

The US mid-term election has come and gone. Sort-of. There are still some races in Congress and the Senate that need to be sorted out, but it looks as if Congress, and possibly the Senate, will be under the control of the Republicans for the next 2 years. It was a close victory, but a victory none-the-less.

The Democrats weaponized the Department of Justice and the FBI against their opponents during the past 2 years. Will Republicans now exact revenge? I have no idea, but many from the MAGA wing of the party want just that.

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 ¾% at its meeting last week, bringing this benchmark rate up to 4%. Let's quote from the Statement that accompanied the announcement:

…. The Committee anticipates that ongoing increases in the target range will be appropriate in order to

attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the pace of future increases in the target range, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments …

The Committee would be prepared to adjust the stance of monetary policy as appropriate if risks emerge that could impede the attainment of the Committee's goals.

News Flash!!

The US Consumer Price Index for October came in at 7.7% Y/Y, down from September's reading of 8.2% and beating analyst's expectations of a 7.9%increase.

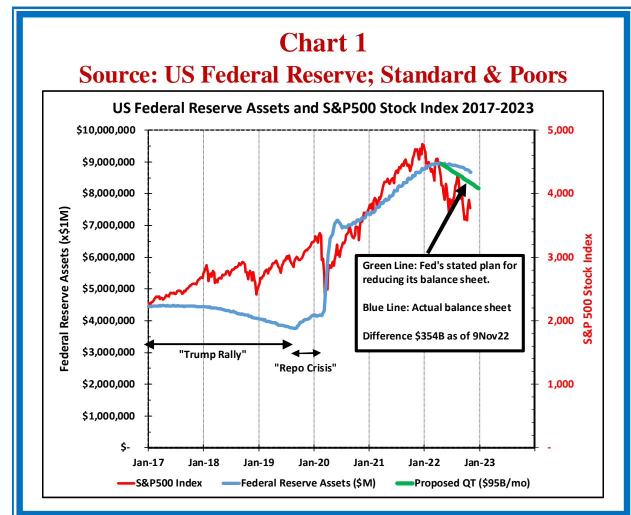
Stock markets had their biggest one-day jump since April 2020 on the news. The S&P500 gained 5.5% and the NASDAQ was up a whopping 7.4%. Even Toronto got into the action, with the TSX gaining 3.3% on the day.

The market generally interpreted the statement as meaning that the Fed will reduce the size of future interest rate increases, topping out at around 5% in mid-2023.

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. The recent Statement confirmed the Fed's resolve to continue Quantitative Tightening (QT). 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 $354B!

I've written previously that in my view the Fed's money-printing has sustained the stock market (see Chart 1). I watch the Fed's balance sheet like a hawk, watching if there has been any slowdown or reversal of their bond-buying policy. It doesn't look to me that the Fed's assets on its balance sheet are going to go down any time soon.

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

I'm not going to present all the charts and figures in this newsletter, but corporate earnings and dividends remain strong. Employment also remains at healthy levels, as is manufacturing overtime and employment at temp agencies. Both are leading indicators of economic activity.

Housing is sensitive to mortgage rates, and is one sector that is showing a significant slowdown.

All-in-all, the Fed likely sees no reason to slow down its policy of raising interest rates to fight inflation. Whether their policy will drive the US into recession a year from now is anyone's guess.

Europe

The great investor Sir John Templeton is reported to have said that the best time to invest is when there is "blood in the streets".

If you are the type of investor who is looking for bargains, as was Sir John, Europe may well be the best place in the world to look right now. Great companies with a global reach are currently selling at bargain prices.

The Canadian media are strangely silent about all the turbulence going on in western Europe, but the continent might be getting pretty close to the point where there literally is "blood in the streets". There are demonstrations numbering in the tens of thousands in almost every capital, and Dutch farmers continue their protest over the government's plan to force the culling of up to 70% of livestock herds because their waste is harming the country's natural areas.

Riots in Paris:
"Yellow-vest" Demonstrators 26 March 2019
Photo courtesy of *The Star*

French President Macron must be mindful that his countrymen once stormed the Bastille! Europe *will* have "blood in the streets" if this winter is a cold one.

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

Canada

The story in Canada is much like that of the US, minus the frenzied political 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.

I mentioned earlier that the Bank of Canada raised its benchmark interest rate by ½% about 10 days ago. This raised the Prime Rate, which is the rate charged by banks for loans to their best customers, up to 5.95%. It also meant that savers can get a better rate on savings accounts and GICs. Table 1 showed that on Nov 7 an investor could buy a non-redeemable 5-year GIC yielding 5.03%.

In a speech on Nov 10, Bank Governor Tiff Macklem made the extraordinary claim that lockdowns, massive government deficits and money-printing on an unheard level had nothing to do with current inflation. It is all due to such a robust Canadian economy that demand for workers exceeds the supply:

The COVID-19 pandemic impacted the labour market in three phases:

1. ***The shock of pandemic shutdowns*** *plunged us into the deepest recession on record. Millions lost their jobs or saw their hours cut. Those working in the services sector were hit especially hard.*
2. ***The recovery that came with re-opening*** *was swift and robust. The supports that governments offered played a big role in keeping workers attached to their employers*

and businesses afloat. The Bank also cut interest rates and introduced quantitative easing to reduce borrowing costs. This supported spending.

3. ***The current environment of excess demand*** *means the economy's need for labour is greater than its ability to supply it. The Bank began raising interest rates in March to cool this overheated economy.*

… Achieving better balance in the labour market involves two elements—supply and demand:

- *Demand is what the Bank influences with interest rate increases. Our analysis suggests that because the labour market is hot and we have a high number of vacant jobs, we can afford to cool the economy without causing the surge in unemployment that we experienced in previous recessions.*
- *Supply can't be influenced by the Bank's policy tools. Governments, businesses and workers all have a role to play in boosting the supply of labour so we can grow the economy sustainably - without creating inflationary pressures. More immigration, better training and expanding the workforce through digitalization and flexibility can help achieve this. But enhancing supply takes time. It also creates new demand. Increasing supply, while valuable, is not a substitute for using monetary policy to curb spending and restore price stability.*

… We are resolute in our commitment to return inflation to the 2% target. To get there, we need to rebalance the labour market. This will be a difficult adjustment.

Governor Macklen has made clear that the rate increases will continue until inflation falls to its target range of 2%. Magically, he hopes to reduce the demand for labour without causing unemployment of the most vulnerable.

Statistics Canada reported on Oct 7 that employment increased by 21,000 jobs in September, reversing 3 consecutive months of declines. The unemployment rate fell from 5.4% to 5.2%.

Fall Colours

Housing is more sensitive to interest rises in Canada than in the US. It is possible to get a mortgage with a 30-year term in the US. According to *Barron's*, a 30-year fixed mortgage in the US is available at a rate of 6.91%. In Canada we typically have 5-year terms, meaning that our mortgage comes up for renewal, at then-current mortgage rates, every 5 years. According to www.ratehub.ca, a home buyer 5 years ago could get a 5-year fixed mortgage at an interest rate of 2.64%; the same homeowner would have to renew currently at 5.24%. The difference in monthly payment (for a $500K mortgage and a 25-year amortization period) is $715/mo.

The extra $715/mo could sink many over-stretched homebuyers, particularly in places like Toronto or Vancouver. TD Bank estimates that Toronto house prices could fall by as much as 25% if interest rates (and mortgage rates) continue to rise.

Bridge at Sandy Beach