VERITAS

Fall 2017

DID YOU KNOW...

- **V** At 50 million people, the US has more Spanish speaking residents than Spain, whose total population is 46.3 million.
- **V** Inflation in Venezuela is estimated to average 720% this year, and to peak at 2,000% in 2018, primarily due to the massive devaluation of the Bolivar, and a 30% contraction in that economy—in 2017 alone.
- **V** For our social media savvy readers, hashtags, or the "pound" sign for the rest of us, were proposed for use in Twitter posts 10 years ago.
- **V** China is the largest automobile producing country in the world, with annual production roughly equal to that of the US and Japan combined.
- **V** Cigarette taxes in Australia are being hiked dramatically, bringing the price of a pack to US $32, in part accounting for why, at only 13% of the population, Australia has the lowest smoking rate in the rich world.
- **V** Downtown Seattle has 52.9 million square feet of office space inventory, of which Amazon occupies 10.4 million square feet, or just under 20% of the total.

CURRENT SITUATION

Another quarter has passed, and another series of record highs have been set by the US stock markets, as evidenced by the broad S&P 500's quarterly gain of 4.5%, bringing it to a year to date appreciation of 14.2%. Canada's stock market's quarterly gain of 3.7% was not far off that of its US counterpart, but because of its lacklustre second quarter performance, year to date gains are a modest 4.4%. As mentioned in the last edition of *Veritas*, Canada's relative underperformance can be attributed to the mid-year decline in energy prices, and Canadian bank stocks pulling back on concerns of widespread declines in the Canadian housing market in response to government intervention therein. What has changed for the better over the last few months are firmer oil prices, above the psychological US $50/barrel level, and evidence that while the housing markets in Vancouver and Toronto are moderating, at least in the single family detached homes market, the overall market is not collapsing after all, and bank stocks have rallied in response.

Despite the recent recovery in the TSX, and the new record high it recently tested, it is worth noting that our index is trading at levels today that are barely above levels that were reached in 2008, before the credit crisis. This has been referred to as Canada's own "lost decade" in the markets, but it also reminds us that, especially in Canada, the "market" is not the economy. In fact, as we have mentioned before, it has only been quite recently that Canada's stock market has started to reflect a less skewed picture of our economy, with the portion of our market represented by natural resources declining in favour of technology and industrial stocks. Mitigating the market's lacklustre 10 year growth is the fact that dividends were growing all the while, so total return over the period has averaged near 3.5% per year, a reminder that dividends are a powerful, and often overlooked contributor to investment returns. While they do not have the visibility that strong share price appreciation does, they are the typically stable component of stock returns that work away in the background, rewarding investors for waiting for share prices to catch up to undervalued corporate fundamentals.

Dividends represent the profit a company has, in excess of that which it requires to reinvest in its business for its continued growth, that is available for return to its shareholders. A great deal can be learned about a company's health and management by its historical dividend payment policy. Typically, a mature, financially healthy and well managed company will have a consistent history of paying dividends, and a fairly predictable pattern of increasing them. Contrast this with a similar company that pays dividends only sporadically. Holding all else equal, this company would be viewed by investors as being weaker, with a greater risk of not having a sustainable business, and investors, not traders, would naturally gravitate towards purchasing shares in the first company. Smaller, younger, start up companies and those in high growth businesses are a different matter because they typically must reinvest all their profits back into their business to maintain their early stage growth, and generally they are not expected to pay regular dividends until much later in their lives.

Turning briefly to global economic data, in general terms they are good and improving. Canada's economy especially seems to have woken up recently, largely due to improvements in business spending, most notably in the energy sector, which had been dragging on Canada's GDP for the past couple of years since oil prices collapsed. Firmer global growth has increased the demand for our exports, and even with the uncertainty of how NAFTA negotiations will end, our trade with the US remains robust, as the economy there continues to expand. We should note that even if the US economy slows, and newly negotiated NAFTA terms are punitive to Canada, with our trade with the rest of the world increasing, and European economies showing increasing strength and stability (with the odd exception), our economy should be able to expand for some time to come, absent some significant global shock akin to what we experienced in 2008.

OUTLOOK

Accurate short term forecasting is almost impossible to accomplish, and is at odds with the traditional goals of investing. Longer term directional forecasting, on the other hand, has the benefit of time to support it. With this in mind, we reiterate our comfort with our long term positive outlook for North American stocks because of evolving macroeconomic conditions, and our negative outlook for bonds prices as a consequence of rising interest rates. Heading into year end, however, the call is harder to make. It would not surprise us if US stock markets remain range-bound, or even pull back, given their strong performance this year, coupled with US policy uncertainty. Conversely, we suspect Canadian markets will play some catch up if oil prices remain stable, and as the Canadian banks benefit from incrementally higher interest rates. Central banks, in the US particularly, will continue to raise rates, putting further pressure on bond prices. The benefit of rising rates will be felt by retail savers in the form of higher deposit rates, and those like us who are looking for buying opportunities in the bond market. As we head into the "escape winter" travel season, attention will turn to the CAD as thoughts of the desert and beaches abound. Unfortunately, for as long as the BOC does not raise rates in step with the Fed, the CAD will remain weak against the USD. Given this, consider Mexico, as our dollar remains strong against the peso.

STRATEGY

With our clients' long investment horizon, and our long term investment focus, generally there is no significant change in our investment strategy from quarter to quarter, and this last is no exception. Changes in strategy evolve over time, and are often triggered by some small, but potentially far reaching event or piece of news. An example of this is the recent BOC rate hike, and the several hikes by the US Fed, but it is not so much the hikes themselves that piqued our interest, but rather their implications, and some of the commentary that accompanied them. The result is not yet one that will cause a change in our investment discipline as it applies to selecting companies for inclusion in our clients' portfolios. It is, however, taking us to a point where we are re-evaluating how we are allocating capital between the broader asset classes in the portfolios. Managing our clients' portfolios is a perpetually evolving process, with the constant goal of improving returns and reducing risk. The current environment, despite what we read in the press, might be providing a new opportunity to do both. Please feel free to call to discuss.

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