VERITAS

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DID YOU KNOW...

- BC represents 25% of all Smart cars sold in Canada.
- Despite the rhetoric that would suggest otherwise, more North American jobs have been lost to automation than to overseas manufacturing facilities.
- Google, now known by its parent company name "Alphabet", has gone from a start-up 20 years ago to being the world's third most valuable company.
- The illegal trafficking of animal parts is the fourth largest transnational crime after drugs, weapons and humans, and is worth a massive and unconscionable US $17 billion.
- Ocean going vessels, including tankers and container ships, carry 90% of the world's trade, but produce only 2% of its greenhouse gas emissions; the offset is that the ships burn heavy fuel, which produces the lion's share of global sulphur and, worse, nitrogen oxide emissions.
- The US Mega Millions lottery jackpot hit a record US $1.6 billion, but the odds of winning are almost as high at less than one in 300 million, yet it was won this morning by a single player.
- 80% of toys sold in the US are made in China.

CURRENT SITUATION

The third quarter once again told a tale of two very different markets. US stock performance, as represented by the S&P 500, was a strong 7%, enough to propel that index to a year to date gain of 9%, posting new record highs along the way. Strength was broad, with every major sector posting gains, largely as a result of strong second quarter profits (reported in the third quarter), strong economic data, especially in the labour market, and the resolution of the US trade dispute with Mexico. In Canada it was another story altogether. Our stock index declined 1.3% in the quarter, leaving us down just under 1% for the year. Our underperformance relative to the US has occurred despite the sustained increase in oil prices, a condition that would normally benefit us. But as we have commented previously, there is a pricing difference between benchmark oil prices, typically West Texas Intermediate (WTI) and ours because Canadian oil (WCS) is much heavier than WTI and requires more refining before it has the same level of purity and commercial quality. The differential has been increasing lately because of the lack of infrastructure to get our oil to end markets, and the lack of any clear solution to the problem. The result is a glut of our oil, which, while impacting our equity market, is also having a negative impact on the Canadian economy because of the foregone revenue, to the tune of $100 million per day, and the associated taxes thereon. To put the magnitude of the price differential in perspective, at the time of writing, WTI was being quoted at US $72/barrel versus WCS at US $26/barrel.

Further contributing to Canadian equity market weakness has been the concern that Canada was going to be left out of a North American trade deal. Fortunately, as has been widely reported, this was not the case, with a deal being hammered out on September 30th. NAFTA is officially dead, replaced with the US/Mexico/Canada Agreement, or "USMCA" for short. Enumerating the details of the agreement is beyond the scope of this letter, but suffice it to say that the USMCA does bear many similarities to NAFTA but, as expected, a few concessions were made by Mexico and Canada. But in the final analysis, having an agreement in place, concessions notwithstanding, removes significant trade uncertainties, in turn allowing businesses and governments to get back to work, which we would expect to show up in our economic numbers over the next several quarters. As a reminder, business investment, both domestic and foreign, had declined significantly over the last year because of uncertainties relating to trade and tariffs, of which many, but not all, have been addressed by the USMCA. Tariffs, especially on steel and aluminium,

remain a sticking point, but business and political leaders on both sides of our border have said they are hopeful that this will not remain the case given the terms of the USMCA, assuming it is ratified.

Turning our attention to other economic data, conditions in the US and Canada generally remain healthy for now, despite escalating trade tensions between the US and China. We acknowledge that unresolved, the spat will result in some US economic weakness as recently imposed tariffs work their way through the system, but for the moment, the effects have been muted. Employers, both here and in the US, continue to be challenged to find workers, which is fuelling a very strong North American jobs market. This translates to better conditions for workers inasmuch as the labour shortage puts employees in a stronger bargaining position for wages and benefits. By current estimates, there is now less than one person (0.9) available for every job opening in the US, an unsustainable condition. Sooner or later, either production suffers for lack of labour, and employers will require less of it, or inflation will set in, tempering consumer demand, again reducing the need for labour. In the interim, for as long as the labour market remains strong, corporate earnings continue to expand, and interest rates do not spike, the current economic expansion should continue. Growth will moderate as the economic cycle matures, and central banks continue to remove stimulus from the economy by way of interest rate hikes, but assuming current international trade tiffs are resolved, an economic contraction does not appear to be imminent.

Erratum: In this section of the last edition of *Veritas* we incorrectly referred to fiscal policy when monetary policy was intended. Our apologies, and thanks to our readers who brought this to our attention.

OUTLOOK

There is no definitive point at which we know for certain that an economic expansion is coming to an end, but there are always signs of its maturation. A sign we are seeing now is the cycle of interest rate increases in the US and to a lesser extent, here. The increases are not of immediate concern because they are coming from an exceptionally low base, and still have room to move higher before they become truly economically restrictive. Absent a significant negative financial event, we expect rates will continue to move higher through next year as central banks gradually bring rates back to neutral, where they are neither restrictive nor accommodative. Central banks have made it clear that they have no desire to shock the system with abrupt rate increases for fear of stalling economic growth. Nevertheless, rising rates are impacting stock markets as we would expect, by muting their advances amid increased volatility. Despite this, for as long as the economic expansion is in place, and interest rate increases remain relatively benign, overall, equities should outperform bonds.

STRATEGY

The modest strategic shift we made from cash to bonds earlier this year remains in place, but, consistent with our outlook, we have not reduced equity exposure in our clients' portfolios. We are, however, wary of the current investment environment, especially as markets continue to be unduly influenced by politics and sensational headlines. Our wariness causes us to frequently re-examine our investment philosophy and discipline to ensure that we are discharging our responsibilities to our clients. We always ask the question: is there something new that warrants introduction into our clients' portfolios, or a change in how we manage them? But despite, or perhaps because of, the hype that we have seen in the press of late for some of the "new" things, we remain very comfortable in keeping with our current discipline. We are not in the business of speculating or playing the market. Our clients rely on us to act in their interests based on their needs and objectives, and that mandate requires us to be measured and conservative. Thus, we will wait for "new" to become proven before considering it as an investment option.

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