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TINA IS BACK IN TOWN

Since the financial crisis investors have had little choice but to allocate more money to equities. With interest rates hovering at historical lows, traditional fixed income investors have been increasing their allocation to stocks as bonds and guaranteed investment certificates (GICs) offered paltry yields. The investment community has come up with an acronym for this phenomenon TINA—*There Is No Alternative.*

Late in 2018, investors were convinced that interest rates where finally headed higher and that central bankers were going to normalize interest rates. In fact Federal Reserve Chairman Jerome Powell indicated to market participants that rates were a long way from neutral, in the now infamous interview on October 3rd, the following day markets began their decline cumulating in the Christmas Eve meltdown.

As I have stated in this publication numerous times, the stock market often behaves like a spoiled child, crying and screaming until it gets what it wants. What it wants is for rates to stay lower for longer. Earlier this year Mr. Powell caved into the market's demands. He signalled that not only was he done with the rate hikes, but that he was also open to stopping the quantitative tightening program.

This is not the first time that a Federal Reserve Chairman has appeared to have the market's back. However, the 180 degree turn from early October to early January is nothing short of stunning. As a stock holder and professional investor, I can not say I am disappointed that the most powerful central banker on the planet is looking out for my client's interests. However, it does make me wonder about the long term implications of these policies.

Until now inflation data has been tame, giving added flexibility to central bank policy makers. However, the fact that ten years after the financial crisis, the world economy still cannot handle normal rates, is troubling. Such abnormally low rates can create problems. When money is cheap (i.e. rates are low) capital may be used inefficiently or can simply create bubbles (housing). Corporations have been borrowing money to buy back their own shares instead of investing in capital equipment. This has increased earnings per share (as there are fewer outstanding shares), however productivity gains have slowed.

If, on the other hand, inflation data trends higher, the central bank will have no choice but to increase borrowing costs. This will pose a real threat to equity markets as participants will recognize that their friend's hands are tied.

continued on back

Al Rizk, BBA, CIM
Portfolio Manager
Tel: 514-286-7242
al.rizk@nbpcd.com

Mark A. Stairs, B.Eng., CFA
Portfolio Manager
Tel: 514-286-7334
mark.stairs@nbpcd.com

RS Wealth Management
BMO Nesbitt Burns
3200 - 1501 McGill College Ave.
Montreal, Quebec, H3A 3M8

FIXED INCOME: Monetary Malpractice

In January we learned, beyond a shadow-of-a-doubt, that the Powell Put is alive and well. Indeed after suggesting that the central bank's key policy rate was "far from neutral"; that there would likely be "three more rate hikes in 2019"; that it's program to shrink its bloated balance sheet was on "auto pilot", the markets promptly followed a tough November with an absolutely vicious slide in December, marking the worst December on record since 1931!

More Heroin Please: Fed Caves to Market Pressure
However, in January's post-meeting press conference, the Chairman of the world's most influential central bank, gave the cheap money addicts the medicine they so dearly desired. Mr. Powell, did a complete about face, declaring that the Fed intended to be "more data dependent"; that "future rate hikes were not assured"; and that the next rate move could even be down depending on the data. He also stated that he Fed was inclined to "keep a bigger balance sheet" than previously indicated and that the Fed's monthly bond sales (shrinking of the balance sheet) were not fixed at 50B/mth. What followed was an immediate Pavlovian response by markets.

Global Economy Buckles with Fed Rate at 2.25%!!!
Despite this being the most gradual tightening cycle ever, it seems that our debt laden global economy can not handle a Fed Funds Rate of even 2.25%, a rate that barely exceeds the current inflation rate of 1.9%. Indications are that all major spheres of the global economy are decelerating as we head into 2019, Europe, China and the USA. The question is, has the Fed already raised rates too far, thus making a recession in 2019/20 inevitable, or can Mr. Powell's recent monetary pivot guide us to a soft landing prolonging the current cycle?

Embarrassed for the Fed
With the financial markets now dictating policy to the Fed, I have to say that I am a little embarrassed for Mr. Powell. I had held out some hope that he might move us, and indeed lead central banks around the globe back to rational policies. Policies that actually encourage & reward savers, discourage excessive borrowing and curb market speculation, but alas I was wrong. I am somewhat sympathetic to Mr. Powell's predicament, having inherited a massively leveraged system and not wanting to be *the guy that popped the bubble*. Nonetheless, I remain quite concerned about this highly experimental monetary policy initially kicked-off by Dr. Greenspan and perpetuated by Dr.'s Bernanke and Yellen: at some point kicking the can down the road one more time fails to work and the everything bubble simply implodes under its own weight. Maybe Mr. Powell's thinking like President Trump, that he'll be gone before the *s—t* hits the fan.

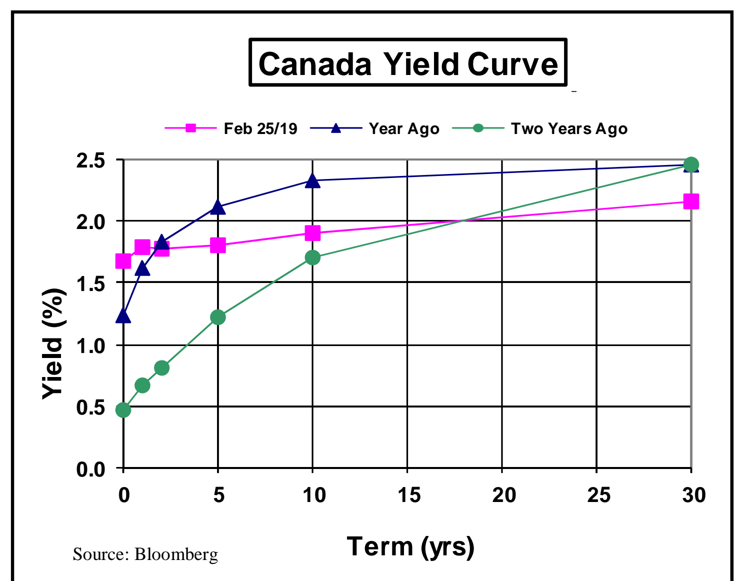
Prepare for Another Decade of Financial Repression
So now what? We attempt to avoid a hard landing at all costs by simply putting interest rates back to zero and re-starting QE (printing money to buy government debt) for another decade? It should be obvious to all by now that these policies don't work; they do not generated economic growth; they do not result in real wage increases for workers; they simply inflate asset prices. And since 20% of the population owns 80% of the assets, the wealth divide simply grows, leading to more populism and more bad policies on the fiscal front, like cutting corporate taxes (a good idea) but funding them with debt rather than budget cuts (a bad idea). Even my 12 year old niece can grasp the concept that today's deficits are tomorrow's tax hikes.

Is their no end in sight to the monetary madness of these bankers? Currently 10 trillion of sovereign debt still yields less than zero, albeit down from 12 trillion in 2016! Ten years post crisis how can this be? How banks, insurance companies and pension funds are coping with this is uncertain, but I suspect not so well.

So far, those who refused to contemplate the idea that our ridiculous monetary policies were leading us to *Japanification,* have been proven wrong. Indeed, Europe now has its first lost decade under its belt. The continent has seen little to no growth since the credit crisis of 08/09, while their interest rates remain at or near zero and like Japan their banks are nothing more than zombies.

There are those who believe that the U.S., despite currently being the cleanest dirty shirt in the hamper, is headed for a similar condition of low inflation, perpetual zero rates and no growth: I hope they are proven wrong. However, so far it appears that the late stages of the current debt super cycle is taking all of our economies in that direction.

Central bankers do not have your best interests at heart, buy gold and keep your bonds short, sincerely Mark.



STOCK TALK: A New Uranium Bull Begins

After nearly a decade of bull market it's hard to find either sectors or individual names that represent real value. Furthermore, since we are late in the cycle, there is a tendency for managers to look for defensive names, especially the kind of value names that might act in a strong counter-cyclical fashion. This refers to the type of investment that can actually go up in value, while most are heading south, as is the case during a recession fueled bear market.

Uranium, I believe could be one of those assets, because it marches to the beat of its own drum, rather than to the drumbeat of the economic cycle. It's one sector that could buck even a strong downtrend in the market (economy). Indeed, the demand for uranium is so completely inelastic that even a 14x increase in its price during the last cycle did not deter power producers from making purchases. After all, what choice did they have? There is simply no substitute for uranium, thus it is demand inelastic regardless of price.

Epic Bear Market

After peaking in mid 2007 at $140/lb, this most useful metal has been in a steady slide for 12 years. Attempting to establish a new uptrend off its 2010 low of $40/lb, uranium tried to rally in early 2011 only to have its recovery abruptly reversed following the tragic tsunami that crippled the Fukusima Daiichi power plant in Japan.

In the aftermath of Fukusima, Japan took all 42 of its nuclear plants off-line for multi-billion dollar safety upgrades, extending the uranium bear market for many more years. Not only did Japanese utility companies stop purchasing new fuel supplies, but they also put much of the supplies they had on hand back into the spot market, exacerbating an existing supply glut.

Even eight years post Fukusima, the Japanese government has only issued nine re-start permits to power plants. But Japan, a country without hydrocarbon resources of its own, is now importing vast amounts of coal, oil and gas to power the nation, resulting in a serious shortfall to its Kyoto Climate Agreement commitment. Twenty-six restart applications are currently pending, most of which are likely to be approved over the coming decade.

Global Reactor Fleet Expected to Grow

Despite the expected decommissioning of reactors in Europe and America over the coming decade, new builds predominantly in India, Korea and China should result in modest net additions to the operational global reactor fleet each year. There are currently roughly 50 reactors under construction worldwide.

Out of Business

At the peak of the last cycle there were approximately 500 companies operating in the uranium space, today there are maybe 50, most of which hold non-operating assets on care-&-maintenance, waiting for higher prices. Even the low cost producing dominant market share players such as Cameco (15%) and Kazatomprom (21%) took steps in 2017-18 to address the overhang of inventory by slashing production.

Indeed, Cameco has mothballed indefinitely its McArthur River mine, which produced 11 million pounds of product in 2017, or about 8% of global production. While Kazatomprom announced in 2017 that it would cut production between 10-20% over the coming years.

Potential Severe Shortage Now Anticipated by Mid 20s

Barring another Fukusima type accident, most analysts are now forecasting uranium shortages in the not too distant future. Furthermore, most believe that potential production shortages will be significant enough that attempts to ramp up production, even under a highly incentivized pricing regimes, may not solve the looming shortage problem.

The bottom line is, in order to build a new mine today, of any type, copper, gold or uranium now takes approximately 10 years from discovery to first production. This means that those with current production and those with fully licensed facilities on standby may enjoy a prolonged period of high prices with limited competition.

Already the spot market is pricing in production cuts and near term supply constraints as indicated by uranium's recent price rise from its 2017 cycle low of $18/lb to the recent $28/lb, an almost 50% increase in the past 18 months, albeit from a very depressed level. Low cost producers such as Cameco should benefit first, as the average breakeven point for new production globally is estimated to be in the $50-60 range.

The two best ways for Canadians to participate in the long term uranium cycle is either via a major producer such as Cameco(CCO-TSE) or a metal holder such as Uranium Participation Corp(U-TSE), which doesn't actually do any mining, but rather simply buys product for storage to be sold in the future, presumably at much higher prices. While this eliminates mining risk, it provides less upside leverage to rising prices, however, both are good.

Go green, go nuclear, sincerely Mark.

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The Fed's dovish stance is precisely what the world economy needs. Higher U.S. interest rates tends to raise the value of the American dollar vis-a-vis other currencies. Since global economic trade occurs in dollars, an expensive dollar is a drag on economic growth. Much of the angst related to the market's decline in the fall was linked to the greenback's strength which itself is tied to the divergence in the economic prospects of the U.S. compared to the rest of the globe.

The rally in risk assets since Christmas Eve has been impressive. It is based on the realization that the market has a powerful friend and hopes that a trade deal between the U.S. and China can be achieved. At the same time the world economy is still facing serious challenges. Europe is going through a difficult time, German economic confidence is near a ten year low. It is clear that American economic growth is slowing, it remains to be seen if the U.S. is headed for recession or if a soft landing can be engineered. In fact recent U.S. economic data (retail sales, industrial production, etc.) has been relatively weak. For the moment at least the stock market is choosing to ignore the bad news, perhaps looking past it, seeing a recovery ahead: time will tell.

If a recession can be avoided and inflation remains tame, we could see a strong move in equity prices. Valuations are not excessive, especially in light of the low interest rate alternatives. Furthermore, any positive surprises will likely result in higher prices. If things do take a turn for the worse, then we will need to be defensive in both asset allocation and security selection.

Given the various moving parts and economic uncertainties, I think it makes sense to be somewhat cautious. While I believe in buying great companies at reasonable prices and holding them for a long time, I am not averse to making some tactical moves within portfolios in order to maximize returns and reduce volatility. In late December, I invested the cash raised in early October. I have since locked in a portion of those profits as I felt that the bounce off the December lows may have been a little too much too fast given the cross currents. I am currently holding an above average cash position in preparation for opportunities that may arise in the coming weeks and months.

A big challenge for investors looking for income and stability in this environment is picking the right stocks. Since the credit crisis, stable dividend paying companies, the kind a conservative investor might opt for instead of bonds and GICs, have become very richly valued. Historically, consumer staples have provided consistent earnings and dividends for investors. However in my opinion many well known companies in this sector now sport nose bleed valuations along with anemic growth, not a great recipe!

In contrast to consumer staples, some financial stocks appear particularly undervalued. They sport valuation metrics that are compelling in my view. Many also offer dividend yields that exceed that of bonds or GICs. Furthermore, many energy companies also appear to offer good value. While investors fear the sector because of oil price volatility, some companies have healthy balance sheets, free cash flows that will permit them to buy back shares and even increase dividends for many years to come.

Over the past decade investing in American equities has been a good choice for Canadians. The strength of the greenback generally and vs. the loonie in particular, has been a nice tailwind for Canadian investors. Looking ahead it appears the U.S. economy is still the most stable and dynamic in the world. However, the pressure exerted by the strong American dollar on many emerging market currencies and equities has created an interesting opportunity in my opinion.

The TSX has been a poor performer over the last ten years. Many mutual fund, as well as buy-&-hold index investors have made little to no money in the last decade! This shows the importance of an active approach: trading when opportunities present themselves. In addition to the poor environment, mutual fund investors have been burdened with excessive management fees which have further eroded their paltry returns.

Investors are facing a challenging environment, there are many crosscurrents, potential opportunities and dangers. Nonetheless, currently I am finding some compelling values in the Canadian market for which I believe patient investors will be rewarded.

The good news is: at least TINA is back! Sincerely, Al.

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