Investing Wisely

A Newsletter from Mike Wise

September 2024

I noticed that the poplar trees in our neighbourhood started turning yellow almost exactly on September 1. I guess Fall will soon be here. We need to take advantage of every warm day until the inevitable snows arrive.

Is it only my imagination, or did the poplars start changing colour in early August in years gone by?

Carmen and I didn't do anything particularly noteworthy over the summer. Our big event is coming soon: our cruise to Greece and Turkey. We start and end in Athens, and after wandering around several Greek islands we'll stop in Istanbul for a couple of days, then back down the Turkish coast (Ephesus in particular) and return to Athens.

I'll be away for close to 3 weeks at the end of September and early October, and will be essentially incommunicado. However, I will arrange for a colleague to cover for me if you have any emergency financial matters that need attention.

I'm also about to head off for what I call my Grand Tour of BC. I have a number of clients in the Interior and Lower Mainland that I try to meet with every year before the snow flies in the mountain passes.

Our TV mogul daughter is about to start a shoot for some new show here in Calgary. We don't have any further info. She was in Ireland and eastern Europe for other projects earlier this summer.

PORTFOLIO STRATEGIES

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Table 1
2024 Returns - Year to 31 August

	31 Dec 2023 Price	31 Aug 2024 Price	YTD Change
Equities			
TSX (CAD)	20958.44	23346.18	11.4%
S&P500 (USD)	4769.83	5648.40	18.4%
NASDAQ 100 (USD)	15011.35	17713.62	18.0%
Commodities			
Oil (WTI; USD)	$71.33	$73.65	3.3%
Gold (Comex; USD)	$2071.80	$2535.90	22.4%
Fixed Income			
DEX Universe Bond Index (CAD) - Total Return	1121.5	1147.5	2.3%
Govt of Canada 10-Yr Bond Interest Rate	3.128%	3.160%	0.032%
Best 5-yr GIC Rate (rate as of Sept 6)	4.10%	3.73%	-0.37%
High Interest Savings Account (rate as of Sept 6)	5.00%	4.50%	-.050%
Exchange Rates			
USD/CAD	$0.7549	$0.7410	-$0.0139
EURO/CAD	$0.6840	$0.6708	-$0.0132

Where We Are

Table 1 shows how stocks, bonds and commodities are performing this year. Most of my clients have a balanced portfolio. My pension-style Canadian Neutral Balanced Benchmark is up 8.2% so far this year (to September 1). This is an after-fees benchmark with a weighting of 60% equities (2:1 CAD/US) and 40% fixed income.

I wrote in my January newsletter that bond managers were predicting that interest rates would fall by 1.5% this year, and that this was the most aggressive stance ever taken by bond investors. I disagreed with this consensus. While I was right for a while, the Bank of Canada has since been very aggressive in lowering Canadian interest rates, and by extension the Prime Rate and GIC rates. The BoC has already dropped rates by ¾%, and the expert consensus is for another ½% cut before the end of the year. The Prime Rate now stands at 6.45%

The European Union and the United Kingdom have also started on a rate-cutting cycle.

The US is a different story. The US Federal Reserve has so far declined to start dropping short term rates, and is receiving a lot of heat from pundits because of this stance. I still think that there will be rate cuts; there's a US election coming up, and the US Federal Reserve is overly Democrat. I expect a rate cut this month that will help the Democrat's chances.

I wrote in my May newsletter that "we'll also likely see some fudged economic data over the summer to help make the Democrat's economic case". It turns out that the Bureau of Labour over-estimated employment by over 800,000 jobs this year – the largest such revision in history. So much for boasting about stellar job growth; Bidenomics might not have been so wonderful after all!

Interest rates remain inverted, which means that short term interest rates are higher than longer term rates. You'll notice that the 10-year Canada bond hasn't moved this year; only short-term rates have declined. 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 4.50% to my clients. (I expect this rate to go down to 4.25% shortly.) This rate is for a standard bank savings account, CDIC-insured, with interest credited monthly. The supplier is one of the Canadian Big Banks.

Stock markets have been positive this year. Toronto continues to lag the US markets, mostly because of the lack of Technology exposure. As you can see from Table 1, gold has been the big winner this year!

Where We're Heading

The uproar connected to the US election gets all the headlines, but I think that the main driver of markets over the next few months will be the decline in interest rates. As I wrote in the previous section, this is a global event.

Central banks tend to decrease interest rates when they are worried about recessions. Recessions typically occur when interest rates get too high, and companies can no longer afford to borrow money in order to grow, and consumers can no longer afford to purchase a mortgage or buy a car on credit. Banks no longer offer credit to everyone who walks through the door.

Interest rate policy works on the economy with a huge lag, measured in months if not years. Central bankers are typically well behind the curve of the economic cycle. This being the case, the fact that central banks have begun a rate-cutting cycle is a worrying sign of future distress. They are hoping for a soft landing, i.e. resumed economic prosperity without the pain of high unemployment. Unfortunately, a soft landing is a somewhat mythical beast, kind of like waiting to see a unicorn fly past the living room window.

Canada

In Canada, the Bank of Canada cut its policy rate by another ¼% last week. This was the 3rd such cut this year, and brings the policy rate down to 4 ¼%. The Big Banks immediately cut their Prime Rate, offered to their best customers. The Prime Rate is now 6.45%. The Bank justified its move by saying that broad inflationary pressures are easing, and specifically that "excess supply in the economy continues to put downward pressure on inflation, while prices in shelter and some other services are holding inflation up".

BoC Governor Tiff Macklem, in a press conference following the BoC announcement, said that "as inflation gets closer to target (of 2%), we want to see economic growth pick up to absorb the slack in the economy". And "it is reasonable to expect further cuts in our policy rate". And "the unemployment rate has risen over the past year to 6.4% (*Ed. note: the August number was 6.6%*) … The slack in the labour market is expected to slow wage growth, which remains elevated relative to productivity".

The Canadian stock market has consistently under-performed the US market by around 10% annually over the past decade. The last time that the TSX and the S&P500 indices were at parity (ignoring the exchange rate) was 23 Sept 2011. Table 1 shows that the YTD underperformance for 2024 is 7%.

A fair question to ask is whether this disparity is permanent, or if there is some combination of events that would cause the 2 markets to return to parity. It will be difficult, because most of the large public companies in Canada are also listed on the US market, so are subject to the same market-wide forces that US companies are subject to. It will also require some sort of Tech meltdown in the US, in combination with a resurgence in TSX-listed Resource companies. It is not impossible, but it is unlikely. Will a Conservative government help? Maybe.

I was at a fund manager presentation earlier this year. The speaker compared the stock market performance of the big Canadian banks vs the big US banks. The US banks did better. He then compared the performance of the big Canadian resource companies, to the big US-based resource companies. Once again, the US companies did better.

We need to be very wary of "home country bias" when we invest!

United States

The US, alone among the Western democracies, has not yet begun to reduce interest rates. Are they well behind the curve of the economic cycle? We'll look at a few leading economic indicators over the next few paragraphs.

Fed Chairman Jerome Powell spoke at the annual Jackson Hole Symposium, attended by all the world's heaviest economic hitters. According to ABC News, he sounded confident that the Fed would achieve a soft landing – containing inflation without causing a recession: "There is good reason to think that the economy will get back to 2% inflation while maintaining a strong labour market", he said.

Chart 1
US Treasury Bond Rates
Source: US Federal Reserve

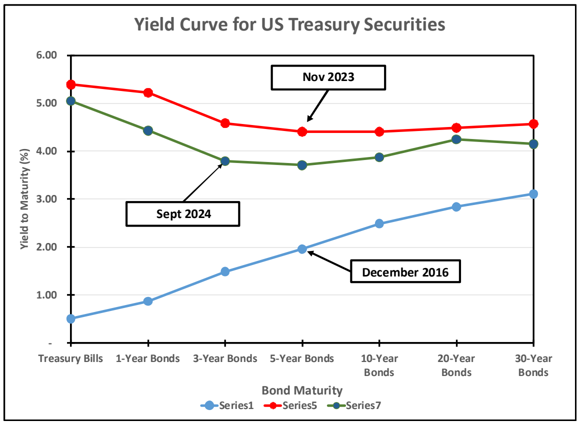


Chart 2
Total Private Employment and Manufacturing Overtime
Source: US Department of Labor

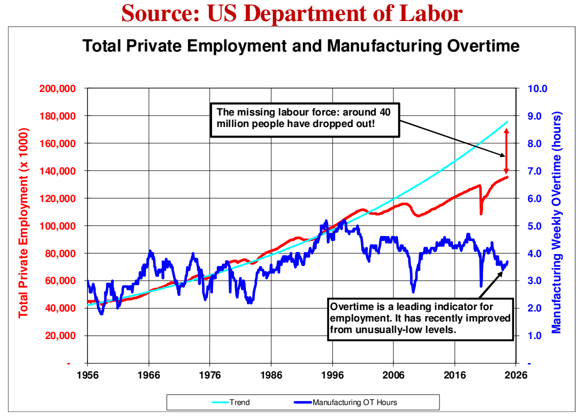
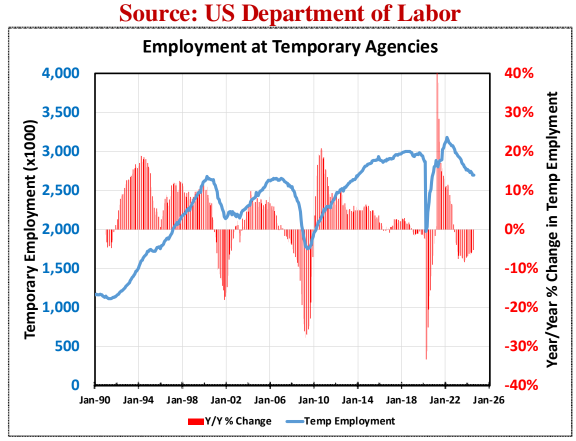


Chart 3
Employment at Temporary Agencies
Source: US Department of Labor



Powell also strongly implied that rate cuts are on their way, probably starting this month. I would not be surprised if the first cut, this month, is a whopper of maybe ½% or even ¾%. Never forget the political angle when you are dealing with the US government and its agencies!

Now on to leading economic indicators.

I've mentioned many times that the inverted yield curve is the single best forecaster for approaching recession. The delay between inversion and onset of recession is often 12-18 months. There are 2 curves that analysts use: the difference in rates between bonds that mature in 2 years vs those that mature in 10 years (the 2/10 curve) and the difference in rates between 3-month Treasury Bills, and 10-year bonds (the 3mo/10yr curve). Analysts seem to switch between the two, depending on the narrative they want to spin. The 2/10 curve went negative on 9 July 2022, and the 3mo/10yr curve went negative on 12 November 2022. So a recession is overdue if we rely solely upon the inverted yield curve forecaster.

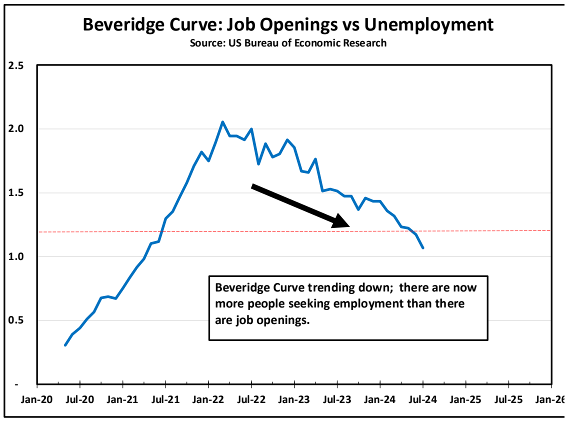
Chart 1 shows the current yield curve for US Treasury bonds. The 2/10 curve is now slightly positive, while the 3mo/10yr curve remains negative, by 1.3%. The Fed has a lot of room to cut short-term rates if it wants to force down those 3-month T-bill rates!

I mentioned in an earlier section that the US Department of Labor had to make the largest revision in its history a couple of weeks ago, lowering its estimate of employment by 800,000. The next few graphs look at the US job market after this revision.

There are a couple of things shown on Chart 2. First, the red line shows that total private employment has fully recovered from the Covid downturn. However, the gap between labour force growth and recorded employment continues to grow (pale blue line). These people still need to eat; this gap might represent the gig economy, plus in part the exponential growth in disability claims.

The dark blue line in Chart 2, and the pale blue line in Chart 3 show two leading indicators for employment. Employers will reduce overtime, and decline to hire temporary office help during hard times, rather than let their good employees go. Chart 2 shows overtime hours of blue-collar workers in the

Chart 4
Beveridge Curve
Source: US Bureau of Economic Research



manufacturing sector; Chart 3 shows employment of white-collar temporary help. Both charts show that employers have reduced overtime hours to unusually-low levels, and employment through temp agencies has gone down by an astounding 500,000 from the post-Covid high.

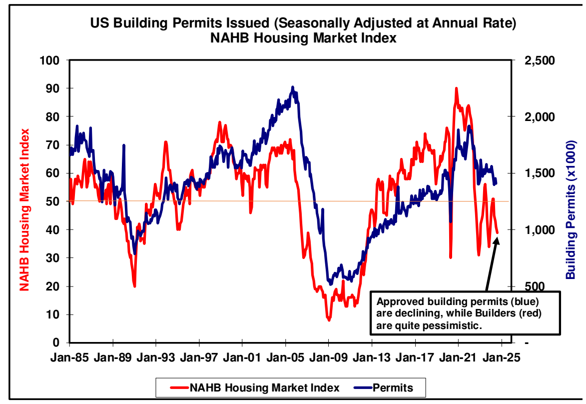
Chart 4 is the final labour-related chart. It shows the Beveridge Curve, which is the ratio between Job Openings (the JOLT report) and the Unemployment Rate. The JOLT data comes from the US Bureau of Economic Research, while the unemployment data is from the Federal Reserve Bank of St Louis.

The labour market is considered to be in balance when the Beveridge number is at 1.2, meaning there are 1.2 potential jobs for every unemployed person (in the US, only those actively seeking work are considered to be unemployed; this is different from Canada). The Beveridge Curve is currently below 1.2, and the trend is decidedly downward. This is not good news for whoever wins the US presidential election!

The final thing I want to look at is the housing market, and new home construction in particular. The US has the same problem as Canada, in that there are insufficient homes being built to accommodate the increased population.

Chart 5 shows that building permits (blue) have fallen to a low level after a brief burst post-Covid. High interest rates are almost certainly to blame.
The red line in Chart 5 is a sentiment survey conducted monthly by the National Association of

Chart 5
Building Permits and the NAHB Builder's Sentiment Survey
Source: National Assoc of Home Builders & US Census Bureau



Home Builders (NAHB). A reading above 50 indicates that builders are optimistic about their prospects; a reading below 50 indicates pessimism. The responses have been quite volatile over the past few months, but it seems on average that home builders are an unhappy bunch. Once again, I'd put the blame on high mortgage rates. There could be a rapid improvement in sentiment and building permits once interest rates begin to fall.

Hungarian Partridges ("Fool Hens")

"Good Money", Gold and Bitcoin

Gold has the reputation as the ultimate store of value. It has had that reputation for thousands of years. It is a top performer this year, and has done very well for a decade now. But some pundits are saying that crypto currencies, of which bitcoin is by far the largest, will be the new gold.

The following is an essay written by Doug Casey, iconoclastic founder of *Casey Research*. I had previously printed this essay back in 2021, and it remains valid and worth reading today.

It's an unfortunate historical anomaly that people think about the paper in their wallets as money. The dollar is, technically, a currency. A currency is a government substitute for money

Historically, many things have been used as money. Cattle have been used as money in many societies, including Roman society. That's where we get the word "pecuniary" from: the Latin word for cattle is pecus. Salt has been used as money, also in ancient Rome, and that's where the word "salary" comes from; the Latin for salt is sal (or salis). Some Native North American tribes used shells. Cigarettes were used during WWII. So, ***money is simply a medium of exchange and a store of value****.*

By that definition, almost anything could be used as money, but obviously, some things work better than others; it's hard to exchange things people don't want, and some things don't store value well. Over thousands of years, precious metals have emerged as the best form of money. Gold and silver both, though primarily gold.

There are very good reasons for this, and they are not new reasons. Aristotle defined five reasons why gold is money in the 4th century BCE (which may only have been the first time it was put down on paper).

According to Aristotle, a good money must be all of the following:

- ***Durable:*** *A good money shouldn't fall apart in your pocket nor evaporate when you aren't looking. It should be indestructible. This is why we don't use fruit for money. It can rot, be eaten by insects, and so on. It doesn't last.*

- ***Divisible:*** *A good money needs to be convertible into larger and smaller pieces without losing its value, to fit a transaction of any size. This is why we don't use things like porcelain for money – half a Ming vase isn't worth much.*

- ***Consistent:*** *A good money is something that always looks the same, so that it's easy to recognize, each piece identical to the next. This is why we don't use things like oil paintings for money; each painting, even by the same artist, of the same size, and composed of the same materials is unique. It's also why we don't use real estate as money. One piece is always different from another piece.*

- ***Convenient:*** *A good money packs a lot of value into a small package and is highly portable. This is why we don't use water for money, as essential as it is – just imagine how much you'd have to deliver to pay for a new house, not to mention all*

Forget Me Not Pond

the problems you'd have with the escrow. It's also why we don't use other metals like lead, or even copper. The coins would have to be too huge to handle easily to be of sufficient value.

- ***Intrinsically valuable:*** *A good money is something many people want or can use. This is critical to money functioning as a means of exchange; even if I'm not a jeweler, I know that someone, somewhere wants gold and will take it in exchange for something else of value to me. This is why we don't – or shouldn't – use things like scraps of paper for money, no matter how impressive the inscriptions upon them might be.*

*Actually, there's a sixth reason Aristotle should have mentioned, but it wasn't relevant in his age, because nobody would have thought of it… **a good money can't be created out of thin air.***

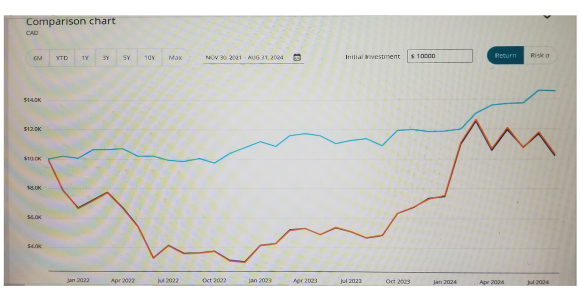
Not even the kings and emperors who clipped and diluted coins would have dared imagine that they could get away with trying to use something essentially worthless as money.

These are the reasons why gold is the best money. It's not a gold bug religion, nor a barbaric superstition. It's simply common sense. Gold is particularly good for use as money, just as aluminum is particularly good for making aircraft, steel is good for the structures of buildings, uranium is good for fueling nuclear power plants, and paper is good for making books. Not money. If you try to make airplanes out of lead, or money out of paper, you're in for a crash.

That gold is money is simply the result of the market process, seeking optimum means of storing value and making exchanges.

I believe that my clients should have a little bit of gold as part of their savings. Think of it as insurance, not an investment. It is there …. *Just In Case.*

Chart 6
Gold and Bitcoin Funds: Nov 21 – Aug 24
Source: Equisoft



My favourite gold bullion fund is the Ninepoint Gold Bullion Fund. It contains nothing but gold bullion, stored at the Royal Canadian Mint in Ottawa. It mirrors the gold price in Canadian dollars, with a management fee of less than 1%. The light blue line in Chart 6 shows the fund's performance since November 2021. A nice and steady upward track; a good holding if you want to sleep well at night.

What about bitcoin? Is it "good money"? Let's go back to Aristotle's 5 tenets, and Casey's 6th, of what makes good money.

Bitcoin is definitely not durable, as it exists only as electronic bits in a massive database, which itself is ephemeral. Bitcoin is divisible, consistent and is growing in convenience as more and more businesses accept bitcoin in exchange for goods or services (Note: other cryptos don't have this property yet!). Is it intrinsically valuable? There is definitely a demand for bitcoin, or the price wouldn't keep going up. Is that an intrinsic demand, or an artificial demand based upon the madness of crowds? Finally, can bitcoins be created out of thin air? The answer here is definitely yes. It takes effort, a computer with massive computing power, and a few Kw of electricity, but a teenager with the right equipment can create a new bitcoin in his parent's basement.

So, on balance, the question of whether bitcoin is good money is mixed: 4 yeses and 2 nos.

Here's another test: if you had to flee the country due to war or revolution, would bitcoin have value? Here I think the answer is a definite YES. All you'd need is your password hidden discretely in your shoe

Canada Goose Family

or sewn into the lining of your underwear. This beats even gold, which in larger amounts is bulky and can be stolen.

Bitcoin is wonderful if you are into international money laundering. No need to carry undeclared cash or other valuables worth more than $10,000 through customs.

My concern is the volatility of bitcoin. Its price (relative to currency) fluctuates wildly, so that its purchasing power also fluctuates wildly. I don't see how "good money" can vary so much in purchasing power over short intervals of time.

We have 2 mutual funds on our shelf that hold nothing but Bitcoin: Fidelity Advantage Bitcoin ETF Fund and CI Bitcoin Fund. (while there are Bitcoin ETFs out in the marketplace, Portfolio Strategies has not approved any for offering to clients). Both have a MER under 1%, both hold nothing but bitcoin, and both started in late 2021. Their performance has been identical. Chart 6 (previous page) seems to show only 1 orange line, but there is actually a dark blue line underneath the orange line – the 2 funds literally have the same performance.

I rate bitcoin as highly speculative, suitable only for my most risk-tolerant clients, and even then suitable for only a miniscule part of a client's overall portfolio. Consider Mr. Hare, who bought one of the bitcoin investment funds at its inception. It promptly went down by 55%, and has only now recovered to his original buy price.

There are lots of "geniuses" advertising their wares over the Internet. Every one of them had the foresight to buy their bitcoin position in late 2022, at the bottom of the market (see Chart 6). Hmmm.

Chester

Chester's Twin
(from a poster at Aritza in Chinook Mall)

Lilacs in River Park

Alpine Meadow