THE RAE LIPSKIE PARTNERSHIP™ | PRIVATE WEALTH MANAGEMENT

September 2016 **Overview**

Random Gleanings…

With the **Rio Olympics** fresh in our minds, it is worth noting that Nike has graciously agreed to offer to the general public their Zeiss-lensed sunglasses, designed especially for Olympic runners, at the low, low price of $1,200 (US). If you call now, they will send you two pairs for only $2,400. With these marvels on your head, maybe you too can shave a couple of hundredths off your 100-meter time.

Speaking of speed, the ever innovative **Tesla** car company has developed a new, higher capacity battery for its electric vehicles. Not only will this battery extend the crucial driving range to over 500 km but it will take the Model S family sedan, in Ludicrous Mode, on a heart stopping ride from zero to 100 in an absurd 2.5 seconds. Maybe even faster with those glasses on.

Time for that VCR to go. The last maker of VCRs, the Funai Corporation in Japan, has finally thrown in the towel and produced its last machine at the end of July. We believe this was the VHS version. Once the technological sensation of the 1980s, the ubiquitous VCR succumbed in the 1990s to DVD technology which, in turn, is being streamed and PVRd out of business. We live in a fast world.

Taylor Swift, current pop queen, streamed, strummed and sung her way to a phenomenal $170 million of earnings last year, taking first place in the entertainment business and well ahead of Katy Perry who earned only $125 million. These numbers pale in comparison, though, to boxer Floyd Mayweather who earned $300 million, most of it in a 36-minute fight. Inequality everywhere.

We don't think any VCRs were sold on **Amazon Prime Day**. This annual event, held on July 12th this year, provides Amazon Prime members with discounts on many of the website items. This year was a blockbuster with sales up 60% over 2015 and included some humungous numbers: 90,000 TVs, 2 million toys and 1 million pairs of shoes. The Amazon effect, all in one day.

The Amazon effect is one reason for the increasing presence of medical clinics in major shopping malls across the U.S. as space is freed up by failed Amazon competitors. In Los Angeles, the Cedars-Sinai hospital will offer outpatient services such as gynecology, pediatrics and obstetrics in a 32,000 square- foot mall space. Anyone for dinner, a movie and… surgical procedure?

Warren Buffett: "The babies being born in America today are the luckiest crop in history." Ever the optimist, Mr. Buffett sees even modest economic growth leading to significant gains in per capita prosperity for this generation. We agree.

Money managers are heavily exposed to cash and bonds, according to a recent Bank of America Merrill Lynch asset allocation survey. Cash holdings are at their highest in 15 years, bonds are well above normal and stocks are well below. This means that any move towards normalization will favour stocks.

This **bond buying enthusiasm** also helps to explain Irish government 10-year bonds currently sitting at a 0.4% yield. You might recall that only five short years ago, Ireland was one of the Is in Europe's financially desperate group of PIIGS (Portugal, Ireland, Italy, Greece, Spain), with lenders demanding over 12% yields for these very same bonds. Incredible.

The U.S. election (sorry). A recent survey asked respondents to describe each of the presidential candidates in one word. The most common word for Mrs. Clinton was 'liar' and for Mr. Trump it was 'idiot'. 'Nuff said.

THE LEARNING CORNER

What is Hyperloop?

Hyperloop is the trade name of a novel pneumatic-tube transportation system being developed by Tesla's Elon Musk through his Space Exploration Technologies Corporation (SpaceX). The idea is that giant near-vacuum tubes would carry capsules full of people or cargo, elevated above the normal traffic fray at very high speeds. Powered by linear induction motors and air compressors, the Hyperloop would get you to your destination at a speed approaching 1,100 kilometers per hour, even faster than Tesla's new Model S. One proposed/possible/dreamed route would take passengers from Los Angeles to San Francisco in a little over 30 minutes.

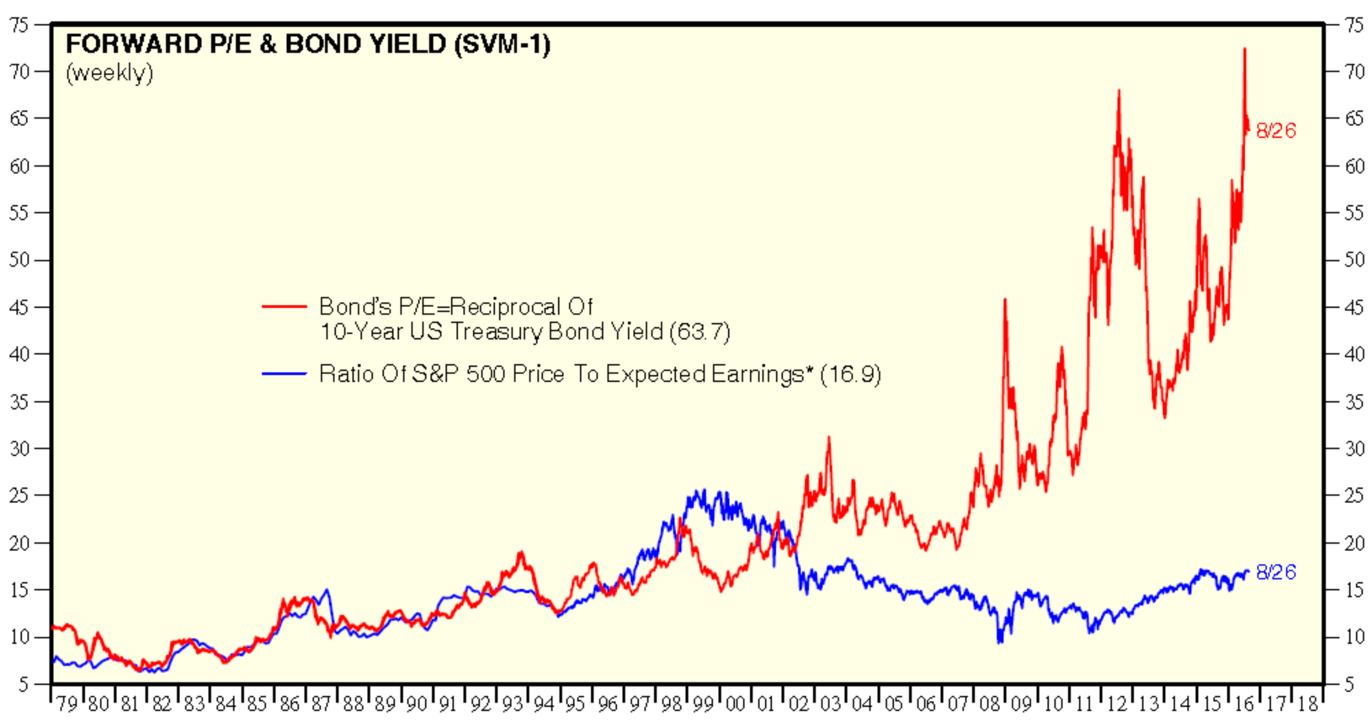
If this sounds a little too much like The Jetsons to you, you aren't alone. As with any new technology (actually relatively old, but new with the SpaceX involvement) there are lots of naysayers and the logistical and technical issues are certainly daunting. Still, Mr. Musk has built some credibility with Tesla so we should give him some benefit of the doubt. As well, Dubai has invited proposals for a Hyperloop transportation system and perhaps more convincingly, has initiated a feasibility study for a Hyperloop cargo mover that would move full-size containers from its hectic Jebel Ali port to an inland depot without affecting other surface traffic. Part of the study will look at moving containers directly from the water, thus saving valuable port space. Other countries are taking the possibility seriously as well so it may be that the future will be here before we think.

CHARTING OUR TIMES

You may have heard commentary that stocks are looking a little on the expensive side lately, with the U.S. market, as defined by the broad-based S&P500 Index, trading at roughly 17 times expected earnings, or "P/E Ratio" (the blue line in the chart below). Seldom referenced in those comments is a similar assessment of the valuation level of bonds. Bonds have a P/E ratio, you ask? Well, not exactly, but to the extent that the P/E ratio for stocks provides an indication of what investors are willing to pay now for earnings in the future, so too can bonds be assessed in terms of what investors are willing to pay now for the interest they will receive in the future. That comparable "Bond P/E" is simply the reciprocal of the current yield on bonds (the red line in the chart below).

On the basis of that comparison, with a Bond P/E of 63.7 on ten year US Treasury bond (the inverse of their current yield to maturity of 1.57%), the bond market appears dramatically overpriced relative to stocks. Conversely, one could say that stocks are dramatically undervalued relative to bonds. Of course, the stock market may be, and likely is, discounting an expectation of some normalization of interest rates down the road. The current gap in these valuation measures still provides plenty of cushion for stocks even if interest rates do move higher.

In Canada, the differences are even wider – our equity market trades at essentially the same P/E ratio as the U.S. market, but with ten year Canada bonds yielding just slightly over 1%, our comparable "Bond P/E" in Canada stands at 98 times! So while bonds may provide stability and certainty, and therefore still have a role to play in many clients' portfolios, they can't be said to provide much in the way of value.



* 52-week forward consensus expected S&P 500 operating earnings per share. Monthly through March 1994, weekly thereafter.

We are:

Ken Rae, CFA

Brian Lipskie, CFA

Ted Brough, CFA

Jo-Ann Carlisle, CIM

Taylor Echlin, F.C.S.I.

Jim Harper, FCPA, FCA

David Martin, CIM

Andréa Miljkovic, CFA

David Paleczny

Derek Rae, CIM

Duncan Smart, CFA

Rick Vandermey, CFA

Thomas Pick, M.B.A.

The RaeLipskie Partnership provides discretionary "fee-only" portfolio management for high net worth individuals, endowments and charities.

The RaeLipskie Partnership

20 Erb Street West, Suite 201
Waterloo, Ontario N2L 1T2
T 519 578 6849
F 519 578 7269
Toll Free 888 578 7542

1100 Burloak Drive, Suite 300
Burlington, Ontario L7L 6B2
T 905 336 8962
F 519 578 7269
Toll Free 888 578 7542

THE BIG PICTURE

The Economy is down. The Markets are up.

If we ever needed a reminder that the markets are a discounting mechanism, we are being provided it now. Canada's second quarter GDP value was recently announced at negative 1.6%. Operating profits of Canadian corporations meanwhile are down 15.3% year-over-year in the second quarter – their worst year-on-year performance since the Great recession. Although the bank stocks recently provided some pleasant upside surprises in their second quarter earnings reports with a 6.6% overall gain from the previous year, the Energy sector continues to be a drag on profits. Despite those apparent headwinds, however, the benchmark TSX Composite Index is up 15% year to date (total return) and has gained 27% (price only) from its low point earlier in the year.

This is despite a litany of worries that have distracted investors over the course of the year, including concerns about a "hard-landing" in China earlier in the year, the surprise outcome of the UK's "Brexit" vote in the summer, and the ongoing distraction of the venomous U.S. election process. We could reference the old saw about "markets climbing a wall of worry" (ok, so we did just make that reference), and that certainly was a factor earlier in the year, but perhaps more relevant now is the forward-looking aspect of the markets as a discounting mechanism.

While Energy sector profits have been decimated by the downturn in oil and gas prices and the Energy sector remains a meaningful weight in the TSX index, the market has been building in an expectation that the worst of that decline is behind us. With oil prices, as measured by the West Texas Intermediate, or WTI, benchmark price having recovered to the high $40s level, and natural gas prices up some 70% from their earlier lows, that expectation seems reasonable at this point. In addition to some degree of stability in the prices of those commodities, the industry has also taken measures to reduce their cost structure. While that has been painful for the job and housing markets in Alberta, it has helped propel the stocks to a gain of nearly 25% this year.

At the same time, the levelling out of the Canadian/US dollar exchange rate since the spring has provided a degree of stability to our manufacturing sector. Another rate increase by the US Federal Reserve Board in response to their strong job market would likely result in a resurgent US dollar and conversely weaker and more competitive Canadian dollar.

Forward-looking investors have voted with their money, saying that the current economic and profit background are pointing towards improved fundamentals which will justify the year-to-date gains and propel further advances. While investors have perhaps been somewhat enthusiastic at times in their anticipation of this outcome, we are not going to argue with the direction they are pointing.

QUOTE of the DAY

" Mass media is society's magnifying glass on the stupidity of mankind."

- R. Jeffrey