THE RAE LIPSKIE PARTNERSHIP™ | PRIVATE WEALTH MANAGEMENT

December 2017 **Overview**

Random Gleanings

With the **U.S. Thanksgiving** weekend recently passed, it is worth noting the connection between a sense of financial wellbeing (e.g. consumer confidence) and the population's travel plans. This year, according to the AAA, the high level of the former meant that the weekend's travel, always the busiest travel time of the year, would reach levels not seen since 2005. Lots of trips to grandma's house.

The other big connection with Thanksgiving in America, besides actually giving thanks, is **football**. In an ironic twist to the weekend's ideal, there was a flurry of firings in the college coaching ranks… presumably another way of saying no thanks to well-paid coaches. So well paid, in fact, that USA Today estimates the 'buy-out' clauses in their contracts will cost the universities involved up to $60 million. A drop in the proverbial bucket, though, for U.S.-college sports' money machine.

Not too many people include taxes on their thank-you notes, at least not in Canada where governments are targeting the well-to-do, small businesses and any other available revenue source. In glaring comparison, the U.S. Congress is processing a bill, the **Tax Cuts and Jobs Act**, which relies on the quaint notion that lower business-tax rates might just lead to more jobs. If this bill is passed, maybe it will also simplify the current tax code which runs to 75,000 pages.

It is difficult to write these comments every quarter without including a nod to Elon Musk and his constant news bytes. The latest is the **Tesla truck**, an all-electric version of the ubiquitous diesel 18-wheeler. While there are skeptics questioning the truck's price (US$150,000), range (800 km), charging performance (60% in 30 minutes) and production schedule (2019), it all sounds impressive. And if it actually makes that zero to 100 in 20 seconds, it will be one hot truck.

Tesla's truck could be a big part of the demand factor for **automotive electricity** down the road. In a recent report, Morgan Stanley attempted to quantify just what that demand would be and concluded that the expected global electric fleet in 2040 would add demand equal to today's entire U.S. electricity usage and require US$2.7 trillion (yes, trillion) of electric infrastructure investment. The source of all this money is apparently "unclear".

Mr. Musk is no **Leonardo da Vinci**. Or maybe he is, given their shared attributes of extreme creativity combined with endless imagination and assisted by big brains. But there is nothing (so far) to suggest that the Tesla chief has a $450 million artwork in him like Leonardo did over 500 years ago. If that seems like a lot of money, look at it this way: an ascribed value of zero at time of painting results in only a 3% rate of growth to today's staggering price. Leo would have done better in the stock market.

Here is a news flash **for the ages**: The respected Journal of the American Geriatrics Society has concluded that the public connects aging with decline and deterioration. Who knew? As a result, the Journal has decreed that trigger words like "(the) aged, elder(s), (the) elderly and seniors" should be expunged from the publication to be replaced by "older persons". Older than what?

You have probably heard of the Economist magazine's Big Mac Index which measures the underlying value of global currencies based on the local prices of the iconic burger. Now, for those unable to relate to McD's pedestrian fare, the Wall Street Journal has developed an upscale version from Starbucks called the **Tall Latte** Index. With Starbucks about as omnipresent as McDonalds, it shouldn't be too surprising that they come up with similar results (the loonie is 12-15% under-valued relative to the U.S. dollar), even though they might attract different crowds. Coming soon: the Tim-Bit Index.

Finally, continuing on the libation theme, Budweiser has announced its intention to be the **brewer of choice on Mars** when the first explorers arrive in 2024 or so. In preparation, they are sending some barley seeds on the next SpaceX supply trip to the Space Station, apparently to check out their 'spatial' viability. We aren't sure, but the rationale may well be the recognition that settlers will need to be pretty well sloshed to endure life on the Red Planet.

THE LEARNING CORNER

What is a bond bubble?

Financial 'bubbles' throughout history have normally occurred when exorbitant demand overwhelmed the supply of an item, pushing its price to ridiculous heights, and beyond. Popular examples include Tulipmania in the 1600's (when one bulb could sell for the price of a house), the South Sea Bubble in the 1700's and, more recently, the 1980's property mania in Tokyo when prices went through the roof, so to speak, and the Dot Com craze in the 1990's . In all cases the bubbles lasted for a number of years and, eventually, ended badly for those on the wrong side of the trade.

The bond market is a little different because it tends to be measured in yield terms more than price -- when demand for bonds is low, yields are high and when demand is high, yields are low. We suffered through the first combination in a bubble of sorts back in the 1970's and early 1980's when interest rates were driven to incredible heights (in 1981 5-year Canada yields reached 19% and 3-month T-Bills were 21%). An investor bonanza you might think, but the common (and expert) view at the time called for higher rates still, and caution.

That was the top, an extraordinary time to buy long-dated bonds. Today, after 36 years of declining interest rates, we are at the opposite extreme. Those 5-year Canada's are at only 1.60% (having moved up from their 0.50% low) and the T-Bills are yielding an unappealing 0.90%, down 96% from that 1981 high. Interest rates are at historical lows and, in some countries, even provide negative yields. This condition might not signify a bond bubble, but when lenders are paying borrowers to take money off their hands it might be close. We recognize that inflation remains low and liquidity high, both supportive of low rates, but our bond stance remains cautious: unlike 1981, short is safer than long.

"These bitcoins things are backed by technology and the internet! What could possibly go wrong?"

CHARTING OUR TIMES

You might have heard some concerns expressed lately about the current 'flattening' of the yield curve and the potential for an 'inversion' of that same curve. By way of explanation, the yield curve is simply the pattern described by interest-rate levels from very short to very long. The normal pattern is upward sloping with longer rates higher than short rates, reflecting a time/risk premium paid to the long-bond investor. The curve can flatten and eventually move to inversion (short rates higher than long) if central banks raise short rates to control inflationary pressures and runaway economic growth (taking away the punch bowl).

Neither of these conditions appear imminent, but the curve is flattening somewhat as central banks raise interest rates in an attempt to 'normalize' rates and build a cushion for undetermined economic slowdowns in the future. As well, big institutional investors have a seemingly insatiable appetite for longer bonds to match their liability structure, thus also supporting the flatter curve. Still, equity investors seem to fret about the implications of an inverted yield curve even if it isn't due to scary inflation or too-rapid growth.

The table below might provide some relief to those worriers. It shows the historical impact of yield inversions on the S&P 500 stock index going back to 1965. While it is true that bear markets have eventually followed inversions, the table shows that there is usually both a significant time lag to their inception and, more importantly, a hefty gain in the market in the meantime. The median time lag has been 18 months and the median market gain an impressive 37%. None of this comes with guarantees, of course, only a cushion of comfort.

Yield Curve Inversions and the Stock Market

Inversion Date	Market Peak	Months between Inversion and Peak	S&P500 Return between Inversion and Peak
Dec-65	Feb-66	1.5	2.0%
Apr-68	Nov-68	7.9	17.2%
Feb-73	Jan-73	na*	na*
Jul-78	Nov-80	28.3	45.1%
Mar-86	Aug-87	17	41.9%
Dec-88	Jul-90	19	32.8%
Jun-95	Mar-00	58	185.2%
Nov-97	Mar-00	29	69.0%
Mar-06	Oct-07	19	20.2%

Data from FactSet and the Federal Reserve Bank of St. Louis

*na: S&P 500 had already peaked when the inversion occurred

IN THE OFFICE

This month, please meet Sarah Egan, Administrative Assistant.

Sarah joined The RaeLipskie Partnership in March 2015 and has been happily assisting Derek Rae and Dave Martin ever since.

She grew up in Goderich, and after high school, spread her wings and moved all the way to London to study Environmental Science at the University of Western Ontario. Unsatisfied with what 'city life' had to offer, she continued her travels, and career as a lab rat, to Vancouver.

After a few years, the travel bug hit again and she ventured into a three-month backpacking trip through Europe. Consequently, she pursued her desire to live abroad by becoming a British citizen and moved to the town where her grandparents grew up in England.

Following several years of living and travelling throughout the UK, she continued on her way to Seoul, South Korea, to test her skills as an English Teacher. It was there that she met her incredibly funny husband, Kraig, and after three fantastic years, they found their way to New York, Kraig's hometown.

With the unfortunate financial crisis in 2008, Sarah and Kraig made the difficult decision to leave their family in New York, to find a safe haven in Canada. They arrived in the Kitchener-Waterloo area and have called it home since.

Sarah has continued to pursue her career at The RaeLipskie Partnership by completing the CIM (Chartered Investment Manager) program and is currently working towards becoming a Portfolio Manager. When she's not busy relaxing with her husband and their two adorable cats, she finds time to increase her fluency in French, do crafts and practice yoga.

We are:

Ken Rae, CFA

Brian Lipskie, CFA

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Ted Brough, CFA

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

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THE BIG PICTURE

Here is an interesting thought exercise: Imagine yourself a year ago today. Not even a month into the Trump presidency. Mere weeks after the American President pulled out of the Trans-Pacific Partnership which was to have been Obama's signature trade deal. If we told you then that over the course of the year there would be escalating tensions between the United States and North Korea, an investigation by the Justice Department into possible Russian interference in the U.S. election, Theresa May losing an election gamble in Britain which put Brexit negotiations into question, deadly terrorist attacks in Las Vegas, Barcelona, and Texas, and natural disasters in the form of Hurricane Harvey and the California Wildfires, would you have said stocks would be higher or lower in December 2017? We would guess many folks would say "lower." Yet the reality is Global stocks are up over 19% year-to-date. In our opinion, this is an important reminder of stocks' ability to look past the noise and price in reality far better than any one person could.

It also shows that stocks are resilient and can surge even in an imperfect world. And to be sure, this isn't to say that none of the above matters. Trade policy matters. Election results matter. Lost lives, whether due to natural or manmade tragedies matter. But as investors, it is critical to refrain from letting emotional impulses guide your investment decision. The reality is that stocks largely move on global economic conditions, the political environment, and broad sentiment. Present conditions indicate modest but most importantly growing GDP, political gridlock which limits the type of game-changing legislation that has the ability to move markets, and optimism from both consumers and businesses. While markets can and will ebb and flow from day to day as a result of smaller type news items, it is the big three that largely guide the direction of the market.

So the next time markets are going down (and eventually they will), remember just how resilient stocks can be. Think of everything the world has endured and yet many markets are at their highest levels in history. We've gone through depressions, recessions, World Wars, currency crises, terrorist attacks. But markets, much like the human spirit, will always be resilient.

QUOTE of the DAY

"If liberty means anything at all, it means the right to tell people what they do not want to hear."

\- George Orwell