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Market Update

09 Dec 2016

When investor sentiment changes it is a thing to behold. If you go back to important bear market bottoms, you can easily see the speed with which investors discard their old ideas that equities are too high risk and embrace the notion that stocks have suddenly become the place to be.

On Friday, March 6, 2009, stocks were still hated, especially banks. The S&P 500 opened higher that day but quickly succumbed to the rampant selling that had driven the index down 22% in just the previous month.

On Monday, March 9, everything changed. Banks rolled higher that day, putting in 15–20% gains. The S&P 500 finished up 6%. Sentiment had reversed over the weekend. And when you see sentiment change like that, you'd better get on for the ride or stay out of the way.

A similar thing happened after the surprise election of Trump Republican win. Sentiment for equities is reversing, and it's been off to the races. It's a little unusual to see such a powerful move come when equities have been trading at high price to earnings ratio. However when we look back to how investors felt about stocks a month ago compared to currently, the change is real.

Let's be clear negative sentiment today is not what it was March 2009. Pessimism had taken over the market due to China contracting, the EU and Brexit. Highly regarded market forecasters

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were calling for 2016 to be a recessionary year. Major global head winds and a high potential for another eight years of Obama style support for corporate America was not generating enthusiasm that is for sure. Economic growth remained weak, companies were not investing in their business, earnings growth was stagnant, valuations were on the high side, and the Federal Reserve was the most important element in determining market sentiment. More over Obama administration had set a somewhat adversarial relationship with Corporate America. Banks were targeted, and there was discussion of breaking them up. Corporate tax rates were left at their ridiculously high rate.

Consider the success of American businesses as part of national interest. Therefore, not a lot was happening to help business be successful. Trump is definitely viewed as business friendly. As I have stated over and over, policy drives market sentiment. At present a pro business administration represents a 180 degree turn. The shift in sentiment that occurred in the wee hours of Wednesday morning on November 10 produced an amazing rally. Bank stocks are the perfect example. They were vilified under Obama, and Trump says he wants to make things easier on them by reversing some or all of the Dodd-Frank banking regulations. That right there (along with an imminent interest rate hike) has pushed Bank of America up around 30%. Will Trump reverse the Dodd-Frank regulations? It is too soon to tell. Personally, I like the idea of letting the banks buy their way out of regulations by maintaining more Tier 1 capital which rewards good behavior. What is key here is that the current political climate would be a far cry from the last eight years. Trump has also said he wants to offer companies a tax holiday to bring offshore cash back to the America. Companies have simply left their profits in cash from doing business overseas in foreign banks. Why pay the 35% tax to bring it home.

Under the Obama administration 35% tax was the cost of doing business. Under the capital repatriation more than 2 trillion in cash sitting overseas is waiting for the new administration to allow the shift. Why not encourage companies to bring it back and put it to work. Earlier, I mentioned one of the main drives to economic growth is policy. The Federal Reserve has made it clear that it will

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raise interest rates higher and transfer the burden of growing the economy away from ultra low interest rates to fiscal stimulus. Infrastructure spending in the trillions and capital repatriation are the drives of fiscal stimulus. We have talked about the use of helicopter money as a tool by the Fed's in two distinct ways:

1) Funding of infrastructure projects directly and by pass the banks
2) Offer direct tax relief to those who invest capital to develop, grow and employ in America.

Once you cancel out all the noise coming from Donald Trump rhetoric the message is simple.

To sell to the American consumer you must develop, grow and employ in America. The days of off shoring are rapidly shrinking. It is not only America but also the EU looking to bring back corporations to the markets they supply.

Read the comments from Cisco's CEO. Currently Cisco has $60 billion overseas sitting on the side lines. If Cisco could bring profits sitting in cash back, it would raise its dividend, increase its share buyback, and spend on mergers and acquisitions.

Raise dividends, buyback shares and make acquisitions.

Under the strong republican mandate held by the up and coming leadership execution of fiscal spending is very doable and highly probable given the Trump Republican pro business stance. Prior administrations that had pro business mandates were Ronald Regan and Bill Clinton. Both of which fiscal spent their ways out of recession and brought about sustainable economic growth cycles.

The old European continent is under extreme term oil and may lead to the break up of the EU. The impact of Brexit is just starting to register as discussions push forward. Italy just lost their Prime Minister and golden boy Matteo Renzi. France's Marine Le Pen looks like she will pull off a Trump style win. Germany is headed for elections in late summer of 2017. Chancellor Angela Merkel will not be at the helm so expect to see more material change in Germany which is the uber engine of growth in the EU.

Oil and energy prices have more to do with scaring the market and forcing prices to rise. The reality of the situations is that again a pro business and energy republican platform will do all it can to allow American energy producers to grow back their market share and bring back into operation known but capped energy streams. At current prices levels American, Canadian and Mexican energy producers have the room not just for healthy profits but the ability to drive needed capital reinvestment. No matter what OPEC agrees to, Iran is willing to buy it's way back to the much cherished position of top energy producer, which it held for 3 decades before sanctions struck in 1979. Global consumption of energy is still declining to constant improvements in fuel efficiency and greener energy policies. The implementation of carbon emissions capping and trading off carbon credits will only continue to drive fuel efficiency. All you need to do is look at the latest government policy coming out of Germany. It looks to ban gasoline, diesel and natural gas combustion engines from automobiles, as primary engines are replaced with electric engines with batteries backed up by small combustion engines that would increase driving distance until the next electrical charge.

China is a ticking time bomb. Each and every sector that China has inflated over the last 30 years has collapsed. Other countries competing in this space ranging from minerals, resources, energy and nations relaying on Chinese export all have seen colossal drops. Look no farther than Canada and the collapse in mining, minerals and ore due to china's malaise. Desperation has lead the Chinese to rapidly devalue their currency and serious game playing to prop up the exporting sector.

Canada's Bank governor Stephen Poloz announced no change for interest rates. Expectations are that interest rates will not change till 2018. However, good news about economic growth was not the broadcast from Bank of Canada governor.

The real estate market is definitely at a slow down both in British Columbia and now in the GTA. It is too early to tell how the current mortgage reforms will affect housing prices.

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