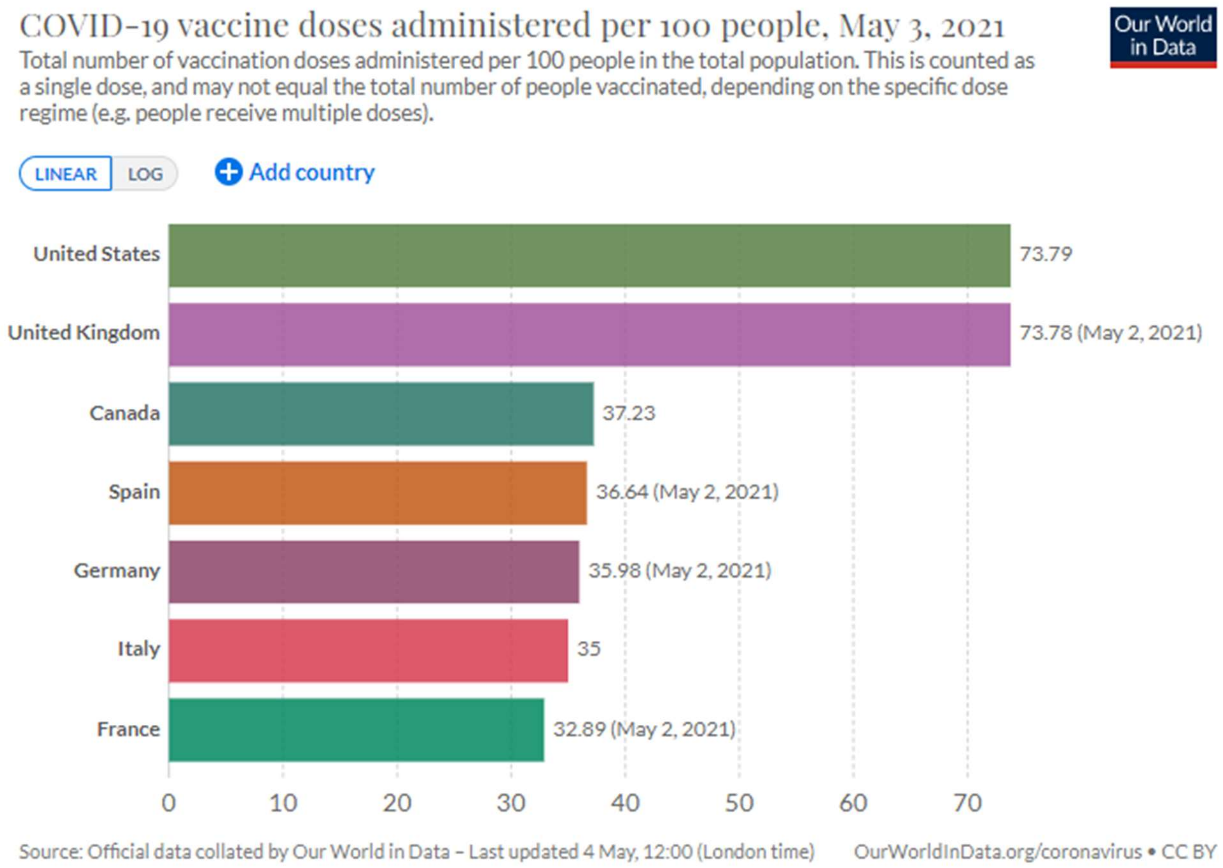
Weekend Reading for Friday May 7th: The Little Red Hen Edition

If you baked your own bread, you get to eat it first.

The problem with 'Just In Time' inventory (JIT) supply chains:



Countries that manufacture vaccines (SURPRISE) vaccinated their populations first. COVID-19 demonstrates that JIT ultimately relies on the kindness of strangers.

The Little Red Hen, sowed the wheat, tended, harvested, ground it into flour and baked her own bread. Her 'friends' let her do so unaided. When it came time to eat, their hands out and empty. As they didn't offer to pay for it, she ate it herself. If they had offered to pay for it, she might, or might not have agreed to sell (some) to them.

Clever inventory management (just-in-time-inventory or JIT) has permitted an improvement in productivity. The reduction in warehousing and inventory costs, more accurate matching of inventory to demand has meant reduced costs, some of have been passed to consumers. Profits have ballooned. Whole new industries have been created (Amazon). Shipping has become sexy. JIT has helped keep a lid on inflation. Is it the cleverness after all?

JUST IN TIME INVENTORY ASSUMPTIONS:

- There always will be an excess supply of whatever you want to buy. Careful supply/demand inventory controls can reduce the excess, but you still need it. The rise of SE Asian manufacturing made this happen.
- You are the dominate buyer. Your buying decisions aren't competing with others.
- There will always be an efficient <u>and declining cost</u> transit system. As goods are always flowing, particularly if moving long distances (Vietnam to Vancouver), an optimized inventory system could use the shipping container as a 'warehouse' reducing the need for a distributer's onsite storage. Sell that old building!
- If there are purchaser delays, somebody else (IE the manufacturer or shipper) is stuck with the inventory so has no choice but to hold it for you.
- The buyer gets to choose when and how that supply lands on their doorstep.
- The manufacturer believes they will eventually be able to sell their stuff, and wont' get stuck with it for too long. They put up with this risk. If the manufacturer is based in a centrally planned economy where jobs are more important than profits, stuff will be produced regardless of buyers (profits).
- For supply from underdeveloped countries, the local population is not able to compete for the goods.
- Underdeveloped nations remain underdeveloped. Slack demand/excess. The basic materials (the underlying 'dirty' stuff) like oil extraction, mining, heavy industries are somebody else's problem. Not many steel, paper mills or aluminum smelters in British Columbia.
- The cost of the basic materials is not rising sharply.
- Supply.
- There are no geopolitical risks.

Amazon exists on these principles.

Then Donald Trump happened, initiating an 'easy' trade war with China. One was likely to happen anyway, and it was never going to be easy.

If the above list starts to shift this doesn't mean JIT is dead. It could mean JIT is no longer a 'deflator'. Inflation could result. We're watching this one.

'Fresh fruit in February: Quebec's premier about to test a cherished commandment of economics' – Financial Post May 6, 2021

This week Quebec Premier Francois Legault went Little Red Hen announcing a plan to make Quebec self-sufficient in four food groups including a plan to heavily invest in greenhouse grown produce.

https://financialpost.com/news/economy/fresh-fruit-in-february-quebecs-premier-about-to-test-a-cherished-commandment-of-economics

Past greenhouse food dreams have proved ethereal. Advances in hydroponics (thank the illegal marijuana industry for figuring that one out) could mean this kind-of works. Assuming this idea is successful and that having control (note: control) of the Province's own food source became necessary, and that neighboring Provinces did not follow the same path, then what? Does one Province then control its borders with others to support its local industry? Oh wait! We already have that.

Given the cost disadvantage of Canada growing strawberries in January vs. in Mexico the only way this plan could even pretend to work is via regulations, tariffs, taxes and subsidies. Lots of subsidies. Unless Quebec decides to subsidize the cost of strawberries down to the point of parity with Mexico, (IE borrows money to make up the difference) or drive up the cost of Mexican strawberries landing in La Bell Province, Quebec greenhouse-grown strawberries will remain much more expensive than those from Mexico. Driving up the cost is more politically convenient. Simply apply a tariff on Mexican strawberries. *"Those Mexicans are stealing our strawberry jobs, destabilizing our food supplies by unfair trade and labor practices"* In short to drive UP the cost of strawberries to sum Government mandated cost, giving consumers no choice but to pay more for strawberries to support the local industry. Remember this whole idea is the result of a Government policy, not an open market result. Inflation in strawberry prices is the result. This sounds familiar.

George Bush's 2007 '*Energy Independence and Security Act'* pledged to make America 'energy self-sufficient' by enforcing use of fuel ethanol, touting renewable/sustainable ethanol grown from corn (sun-powered cars was a favorite term). The need for energy independence was brought to mind after the US invaded Iraq for the second time, disrupting Middle-East oil supplies, a second time.

The sustainable corn-ethanol program proved unsustainable. Corn is a heavy feeder, requiring lots of nitrogen fertilizer. As US farmers shifted to growing corn, fertilizer prices spiked. The largest suppliers were outside the US (Canada and Russia are majors). 3rd-world farmers couldn't afford the prices, disrupting local food supply. US quest for energy independence caused a US dependence on nitrogen.

https://en.wikipedia.org/wiki/Ethanol_fuel_in_the_United_States

The US shale-oil revolution is what made the US truly energy independent. Note that much of that expansion was under Mr. Biden's watch as Vice-President from 2008 to 2016. Shale oil happened with little government intervention.

Back to supply…

Metals price rally could hamper switch to green energy — IEA

https://www.mining.com/metals-price-rally-could-hamper-switch-to-green-energy-iea

A client asked this week, "What's driving the Loonie?"

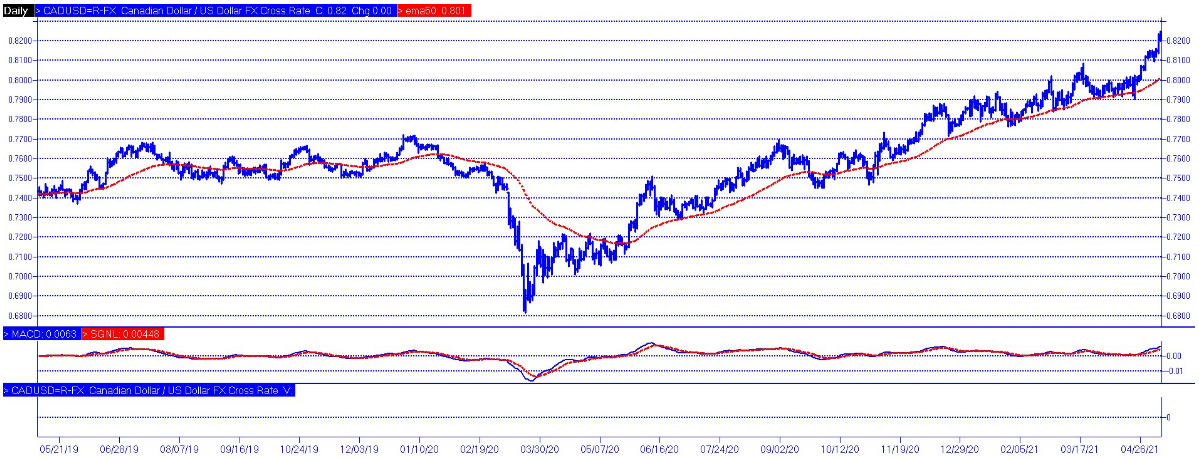
Remember those shameless calls for 60 cents Loonie in April/2020?

'Rosenberg says brace for a 60 cent Loonie. Downgrades Canada' BNN April 24, 2020

Apparently being a media influencer is more important than being right.

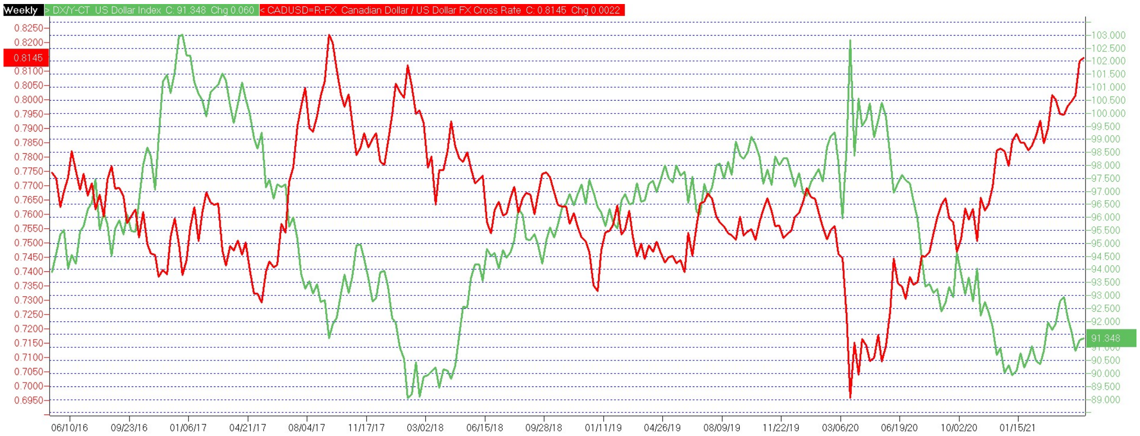
https://www.bnnbloomberg.ca/rosenberg-says-brace-for-60-cent-loonie-canada-downgrades-1.1426740

Loonie $0.8230 USD: daily ranges 6-mos.



See that dip to $0.69 in March/2020? In April/2020 Pundits were predicting the past. That happens a lot. Why did the Loonie rise instead?

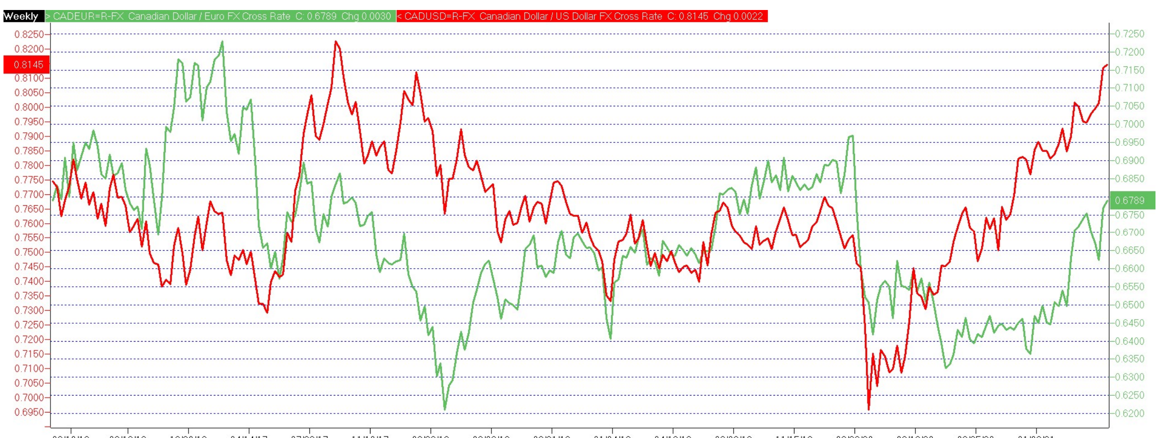
US Dollar Index (green) vs. Loonie priced in $USD (red) – weekly ranges – 5 years



The relationship is inverted. A generally strong US dollar means a generally weak Loonie.

A weaker US dollar vs. global currencies (beggar thy neighbor?) equates to a strengthening Loonie. Some say this is all there is to the Loonie's rise. Not so.

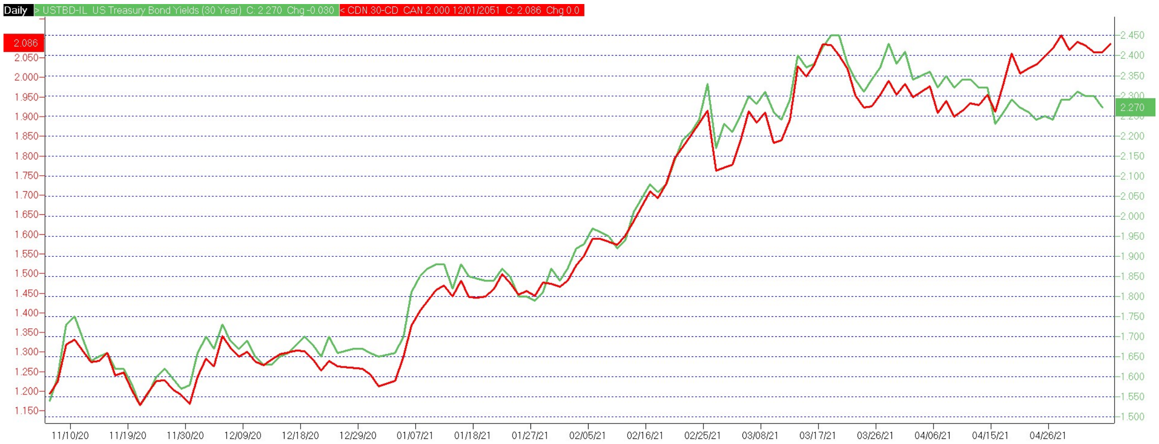
Loonie priced in Euro (green) vs Loonie priced in USD (red) weekly ranges – 5 years.



Steve's Take: The correlation between the Loonie priced in Euro and Loonie price in USD tells us the Loonie is strengthening against most of our major trading partners and not just due to perceived weakness in future US fiscal prudence. Something else other than a weaker USD is driving the Loonie.

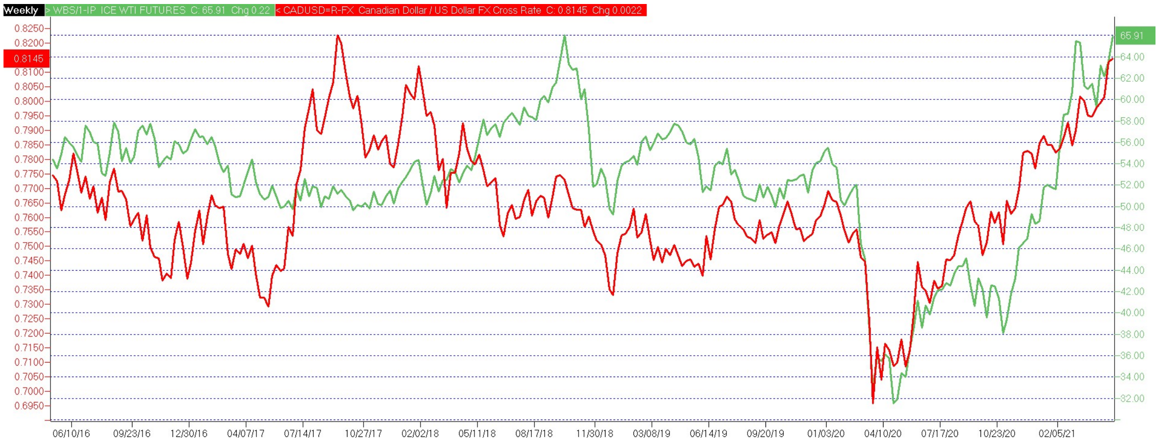
Here is what I believe some of those drivers are.

Canadian Fed Govt 30-year Bond yield (red) vs US 30-yr T-Bond yield (green) daily ranges 6 mos.



Steve's take: Suddenly Canada is having to pay more than the US. There are number of reasons why. Higher yields attract money, driving up the Loonie.

WTI Near-term contract in $USD (green) vs Loonie priced in USD (red) weekly ranges - 5 years



Steve's Take: The tightest correlation factor for the Loonie is oil prices. Despite activist and politician's predictions, international money continues to price Canada as an oil producer begging the question 'What happens if we're no longer one?" Lately the Loonie/oil price correlation has been very tight. When the US demand for Canadian oil looked to be on the way out (the shale revolution) that correlation started to break down. If (when?) the shale-oil economics starts to fail, combined with Govt's changing the regulations regards internal US supply, Canada is a not so obvious beneficiary. The markets seem to know this. I believe oil/commodities are the main reason the Loonie is up.

Moving on to Renewable Energy. We've maintained that the developing world will be the true test of renewable energy. Given a lack of embedded infrastructure, and small to no budgets, starting with new technology that can be scaled at incremental costs, can be an advantage…provided the resulting infrastructure is productive and costs less than conventional hydrocarbon powered energy.

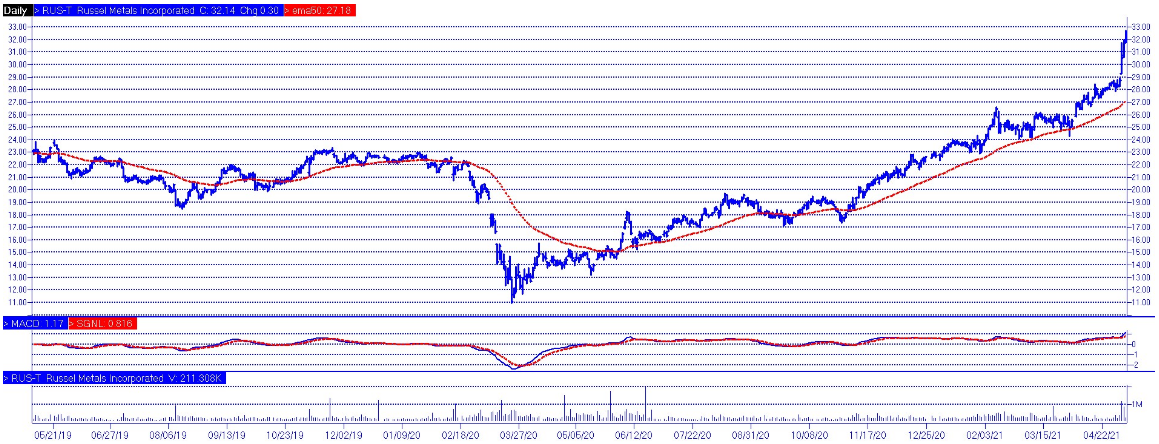
'Africa's Solar Street Lights Offer Glimmer of Potential' – Bloomberg May 4, 2021.

https://www.bloomberg.com/news/articles/2021-05-04/uganda-embraces-the-power-of-solar-street-lights

Steel prices have tripled. Now Bank of America is sounding the alarm - CNN

https://www.cnn.com/2021/05/06/investing/steel-shortage-stocks-bubble/index.html

Russel Metals (RUS-TSX-$32.14) – daily ranges 2 years



Lack of steel supply is driving up the price and the market value of North American producers.

Russel Metals is a Canadian-based manufacturer/fabricator of steel in Canada and the US. One of their product lines is heavy pipe used in the pipeline industry. Donald Trump's steel tariffs, worries over pipeline politics and COVID-19 had investor's panicking fleeing the stock, driving the price down to lows of $12.34 during the 3rd week of March/2020 (slide on the chart). At that price, the $1.52 dividend bore a 12.3% yield. We were buyers in March/2020.

What a difference a year makes. Russel Metals hit a new 52-week high this week of $32.70 for a 2.6-fold gain (take that Tesla!). The share price is approaching the all-time high spike in May/2007 of $34.47. At today's prices the dividend yield is a reasonable 4.65%. While we still like the story, as with our comments on Caterpillar last week, it may be time to do some trimming.

DISCLOSURE: I hold Russel Metals personally, for family members and for clients over which I have trading authority. We have traded in the security within the past 60 days.

May 7, 2021

See 'Weekly Economic Watch' NBF in the PDF links section

It's May. Investors see the end of COVID coming and are tired of being depressed. Investors have spring in their step. Is a likely very strong economic rebound already priced into stocks? If they're a bit ahead of themselves is it time to panic? Yes to the first, No to the second.

Steve & Anna Hilberry

Have a Great Weekend!

FOR THE RECORD May 7, 2021

DOW INDUSTRIALS:	34,713
S&P 500:	4,234
S&P/TSX COMP:	19,434
WTI:	$64.95
LOONIE IN $USD:	$0.8230 $US

Sent by

Montreal office
National Bank Financial
Wealth Management
1155 Metcalfe 5th Floor
Montreal, Quebec H3B 4S9
Phone: 514 879-2222

Toronto office
National Bank Financial
Wealth Management
130 King Street West Suite 3200
Toronto, Ontario M5X 1J9
Phone: 416 869-3707

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