Bread and Circuses

'The Bond Market is Waking up' – Scott Grannis Oct 21, 2021

We've been harping for months on rising costs for everything due to commodity demand/ supply destruction/supply chain problems translating into inflation. We've pointed to the potential of inflation driving up interest rates. We've examined how rising borrowing costs might impact investors, focus on the future prices for bonds (down), houses (not up), and equity markets (stocks can ignore rising rates…up to a point). This week, Scot Grannis updates his interest rate view. NOTE: I find Mr. Grannis' economic views prescient. I do not agree with his politics.

It looks like the bond market is beginning to wake up to the reality of higher inflation. Yields have moved significantly higher in recent days, and inflation expectations are rising. That the stock market is taking this in stride—so far—suggests that higher interest rates are not necessarily bad for the economy. I think we are still in the early innings of the adjustment to higher interest rates. There's a lot more to this story that will play out soon.

Chart #1

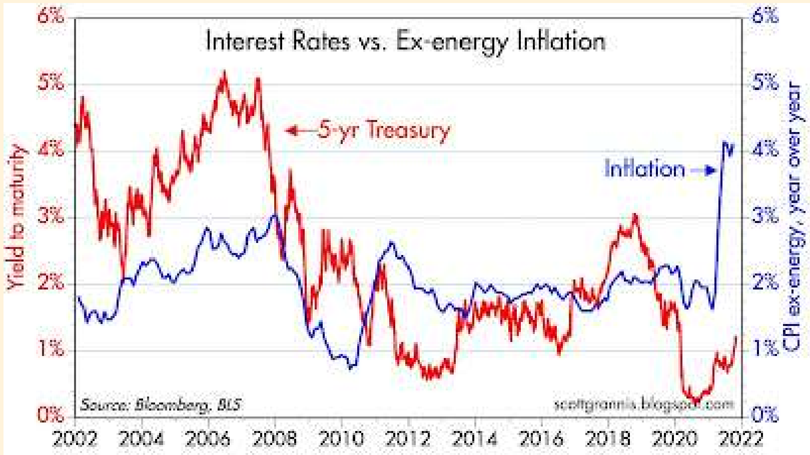


Chart #1 compares the nominal yield on 5-yr Treasuries (which is roughly equivalent to what the market expects that the Federal funds rate will average over the next 5 years) to the ex-energy rate of consumer price inflation (I remove energy because it is by far the most volatile component of the CPI). Despite recent jumps in yields, the chart strongly suggests that the level of yields is still way below what it "should be" given the current level of inflation. But yields are moving in the right direction.

http://scottgrannis.blogspot.com/2021/10/the-bond-market-is-waking-up.html

staying with interest rates…

‘The Great Normalization’ – Charlie Bilello Oct 19, 2021

Mr. Bilello compares current Central Bank rate policies around the globe (easy money) and makes predictions of the direction of rates to come (up).

https://compoundadvisors.com/2021/the-great-normalization

‘Paying the Covid Bill’ – Matthew C Klein Oct 19, 2021

https://theovershoot.co/p/paying-the-covid-bill

Continuing last week’s ‘Get A Job’ notes.

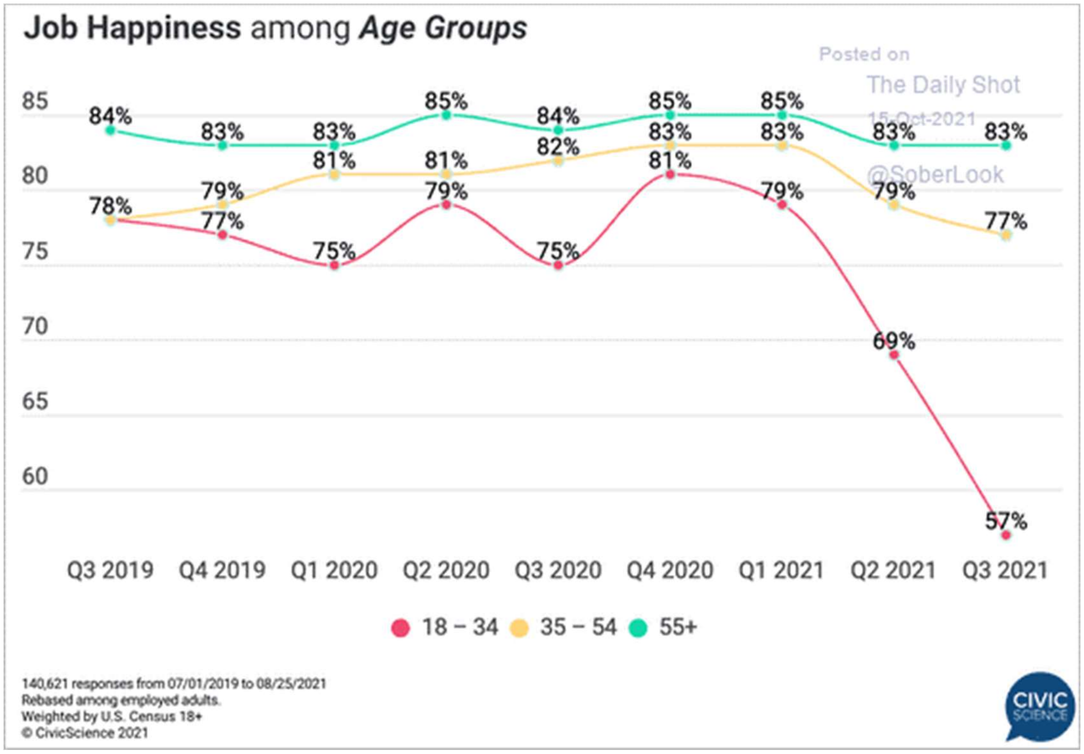


Chart source: WSJ Daily Shot for Oct 15, 2021 - CivicScience

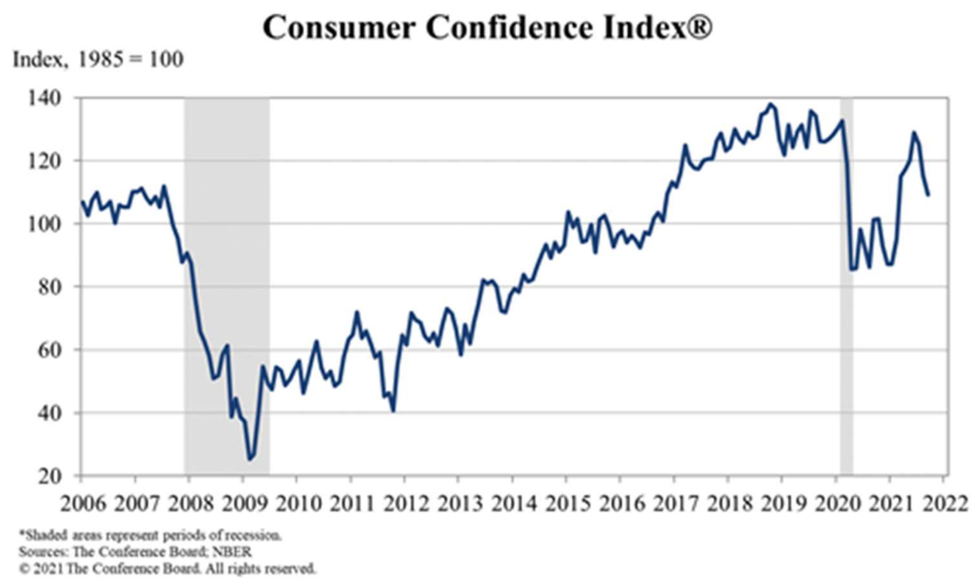
Entering the work force rarely sees one finding their dream job at age 18. Happily, for the rest of us, younger workers soon tire of entry level positions and strive to improve their lives, just as most Canadians do over a career. 18 to 34 year-olds, often in front counter customer-facing service positions, have been the most likely to bear the brunt of COVID policies, grumpy clients, protestors, TV camera's, restricted public transport, all for low pay. Little wonder they're dissatisfied. The real question is how will they react once COVID relief measures expire this Saturday? Will they just pout on Mom and Dad's basement couch to play video games and surf Tic-Toc? History says cathartic events and tough times bring out the tough in Canadians. 'W*hen the going gets tough, the tough get going'* is trite, and it's true. I predict we're about to see a bloom in new ideas, improved skills and job creativity. I'm not willing to bet against the Millennials wanting a better life. There's a LOT of them!

https://www.statista.com/statistics/797321/us-population-by-generation/

'US Consumer Sentiment down this month'

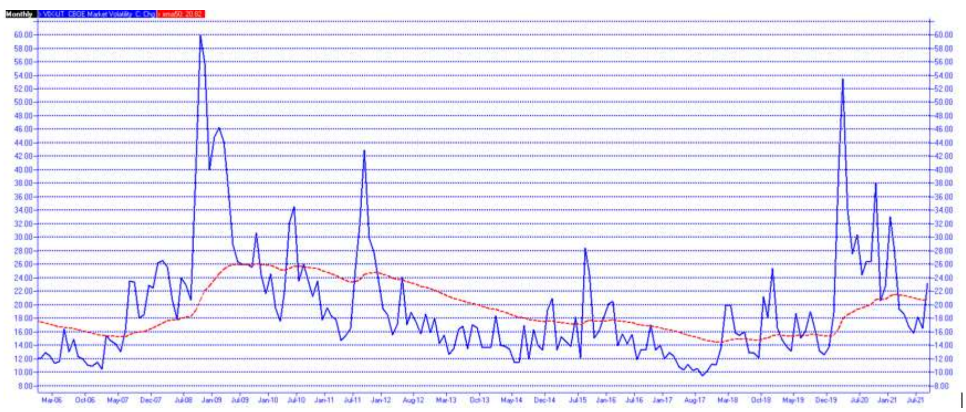
Headlines screamed doom and gloom from US consumers this week.

Investors should pay attention to such things…and do the opposite.



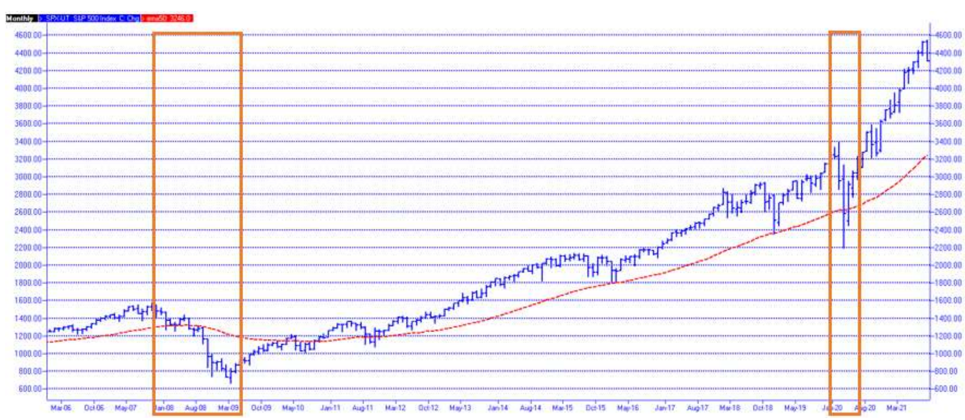
https://conference-board.org/data/consumerconfidence.cfm

CBOE Market Volatility Index 2006-2021



Compare the Consumer Confidence Index to Stock market volatility. Note how consumer sentiment lags stock market volatility

S&P500 Jan2006-Oct/2021 monthly closes. Boxes = recessions.



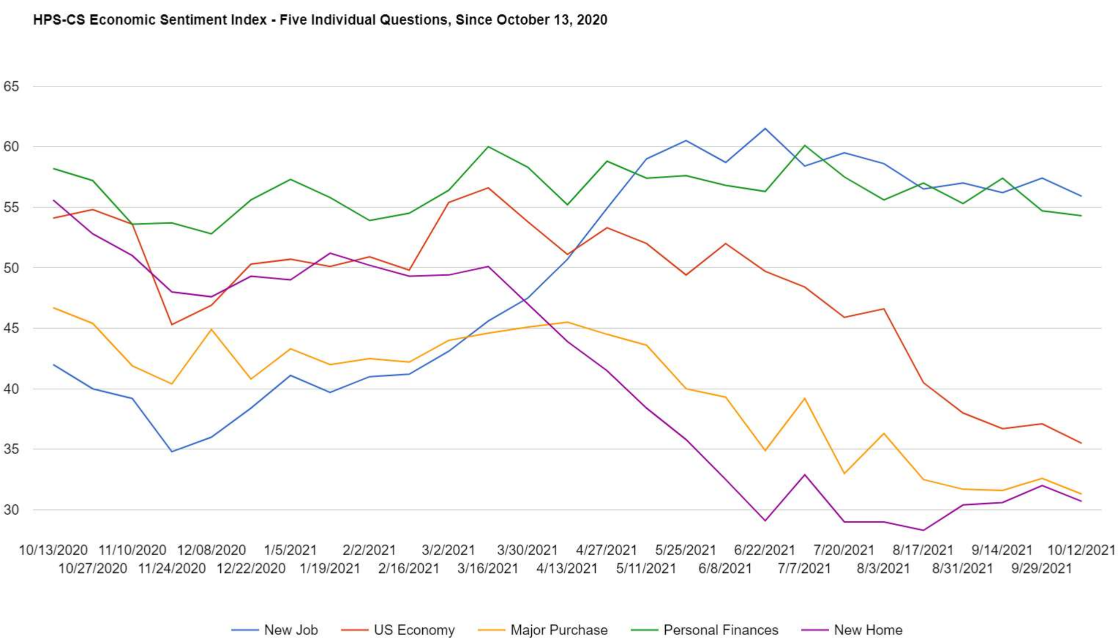
Comparing the last three above charts tells us Consumer Confidence is a lagging indicator and tends to reflect market volatility in a feedback loop. Low confidence readings are not good SELL signals. Yet that's what most investors want to do. When stock prices fall, investors get nervous. The more prices fall the more nervous they become, the herd panics for the exits, leaving few bidders in the auction house. In our experience, a sharp decline in confidence (rise in fear) paired with a spike in volatility is a strong contrarian BUY signal. A rising trend of confidence/low volatility is mildly supportive of higher stock prices but doesn't signal peaks in broad markets. Rising/high confidence is not an effective SELL signal. It is a 'more of the same' trend signal. Given the early stage of this business cycle, more-of-the-same is fine with us. We continue to like dividend paying stocks.

At this writing Friday Oct 22 mid-session, the Dow Industrials Average sits at 35,595. The highs in May, 2021 were 35,091 for a barely-budged +1.4% since. The S&P500 is up roughly 10.4% since May. The US FANG index hit a new all-time high this week but that high is a modest +3.5% from the Feb/2021 highs. The S&P500 outperformance vs. the larger-cap/dividend-oriented Dow and the FANGS, for once was due to the rebound in the energy sector. Go figure. We don't believe it's 'too late' to buy large-cap dividend payers.

Staying with the US consumer…

***'One of these things is not like the others. One of these things just doesn't belong'* - Sesame Street.**

Civic Science HPS-CS Economic Sentiment Index Oct/2020 to Oct/2021



https://civicscience.com/with-no-end-in-sight-to-covid-19-economic-sentiment-continues-to-decline-with-confidence-in-overall-u-s-economy-reaching-historic-low/

A recent Civic Science survey concludes US consumers are bum on the US Economy (orange line), are reluctant to make large purchases (yellow) or buy a new home (purple). This poor sentiment is at odds with their notions of their own job security (green) and finances (blue). Consumers are perhaps watching too much doom and gloom TV. It's tough to imagine continued confidence in one's own condition (green/blue sideways) matched with continued/worsening pessimism in everyone else's. ***One of these things is not like the others.*** One will change.

NOTE: The Civic Science website headliner is '*Economic Sentiment Continues to Decline With Confidence In Overall U.S. Economy Reaching Historic Low*". While this may reflect Civic Science's data collection history, it does not agree with the US Conference Board readings since 1985 (base 100 – current 109).

In the early spring of 2020, as COVID raged and panic ensued, we assigned as required reading *'The Great Influenza'* by John Barry. (https://www.amazon.ca/Great-Influenza-Revised-John-Barry/dp/0143036491). We reminded clients the Roaring 20's followed the 1918 Spanish Flue Pandemic. We believe a similar post-pandemic pattern is about to unfold.

I believe we're seeing an overabundance of pessimism today. I believe economic growth will blow away these pessimistic expectations. The stock market will move much higher. Investors are not positioned for this. Oil prices are already telling us the demand is coming.

NOTE: Oil prices are also reflecting restricted supply. We've been harping on this for months. While a lack of development has many factors, one can't help but notice that higher oil prices/less supply is stated Govt policy goal (no new oil & gas permits for exploration on US Govt lands, suppression of pipelines in Western Canada, gasoline taxes in BC, Canadian and EURO carbon taxes, 'climate emergency parking' policies in Vancouver, etc.) I've been wondering how consumers (voters) will react. The Oct/2022 US Mid-term elections could be interesting. Maybe the Federal Liberals weren't so crazy after-all spending $610 million on an election that produced little change. Was putting off the legislated requirement for another election to Oct 20, 2025 the real win?

'It Sounds Crazy' – Collaborative Fund Oct 14, 2021

https://www.collaborativefund.com/blog/it-sounds-crazy/

How can stocks go up 14.7% and be 11.6% cheaper?

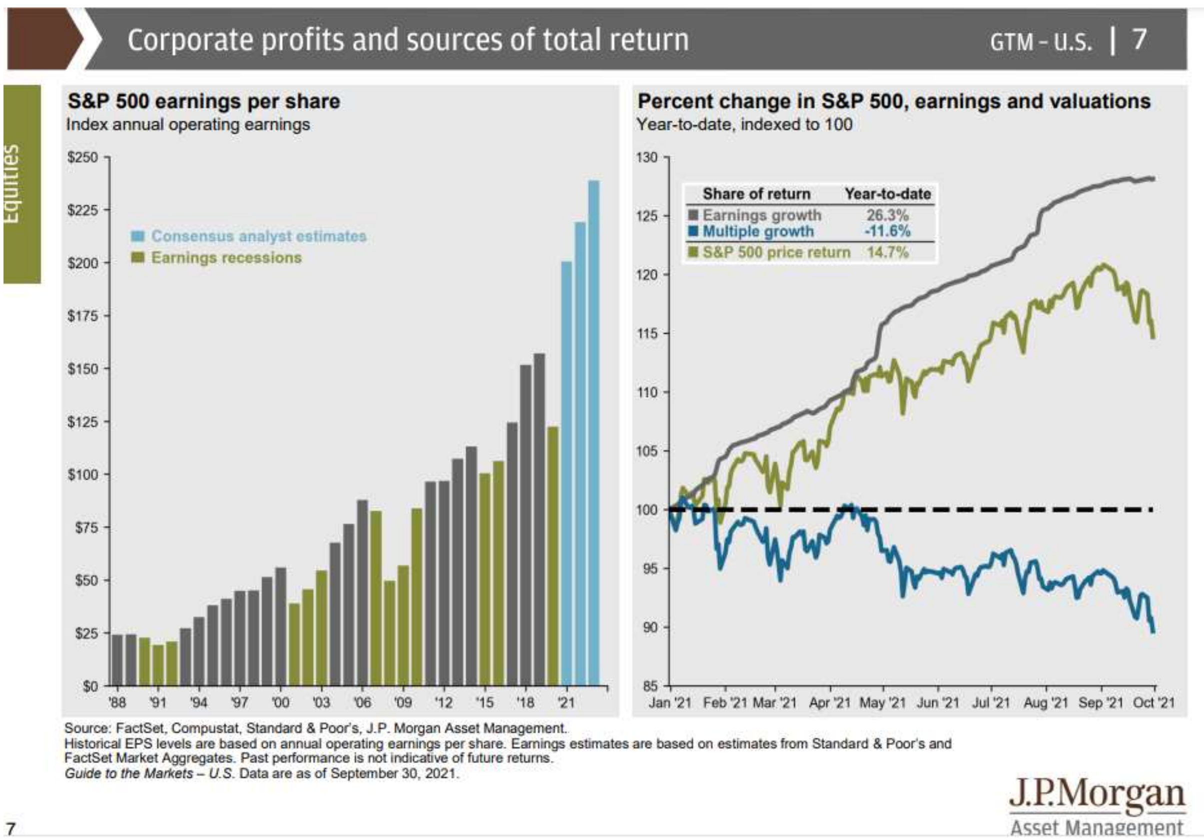
'Guide to the Markets' – Sept/2021 JP Morgan

JP Morgan updates their views on the economy and impact on the stock markets in 71 pages (sounds of groaning). Yes, class, it's a large document and no you may not skip it to watch 'Squid Game' or 'Maid' on TV. IT will be on Monday's test.

https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/market-insights/guide-to-the-markets/mi-guide-to-the-markets-us.pdf

JPM notes on pages 4, 5 & 6 that the S&P 500 is not 'cheap' and that the next few years annual % gains may not match the past two years (duhh!). That doesn't mean stock prices will crash. CAVEAT: Comparing prices to history to draw conclusions of the future relies on history repeating. Happily (so far) the future is unknown. The human condition in capitalist, democratic, checks-and-balances economies has surprised to the upside. Betting against those economies has been a mistake for both investors and dictators.

This next chart from page 7 of JPM's report explains why stock prices go up, why they're up in a pandemic and why they're cheaper now than was the case at 2020 year-end.



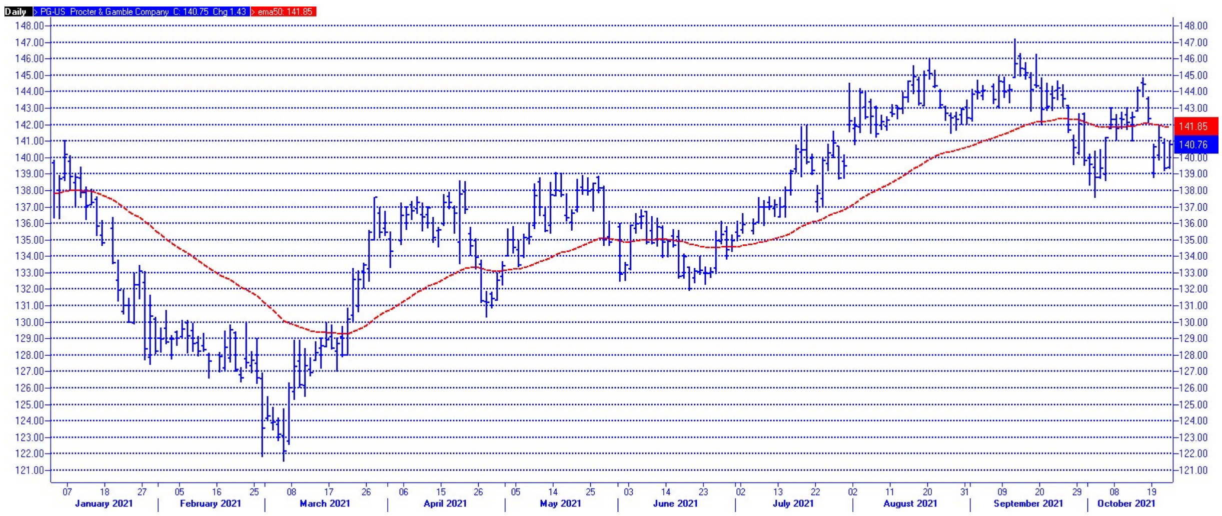
The left-hand chart plots S&P 500 constituent annual operating earnings since 1988. If companies make more money, they're worth more. The right-hand chart compares YTD S&P price return +14.7% (green) to the earnings growth +26.3% (black). As prices haven't matched earnings growth the 'multiple' (IE ratio of price to earnings) has declined by the 11.6% difference (blue). The relative price underperformance to earnings growth has been a trend all year. Stocks are 11.6% 'cheaper' than they were in Dec/2020. This implies investors are A) generally still nervous, B) unsure of how much tax they'll pay on gains, C) doubtful that 2022's earnings growth will be as strong or may even contract. This doesn't mean stock prices must rise 11.6%. If GDP continues to grow…***one of these things is not like the others.***

Page 14 breaks down S&P500 sector contribution to total index performance year to date and from the previous market cycle peak (Feb/2020-Spe/2021). From last market top, Energy is +4.3%, Technology +48%. Communications +41% and Consumer Discretionary +38% (Amazon and Tesla are labelled **Consumer Discretionary**. Google, Netflix and Twitter are in **Communications Services**. Apple and Nvidia are **Technology** constituents).

When up is still down.

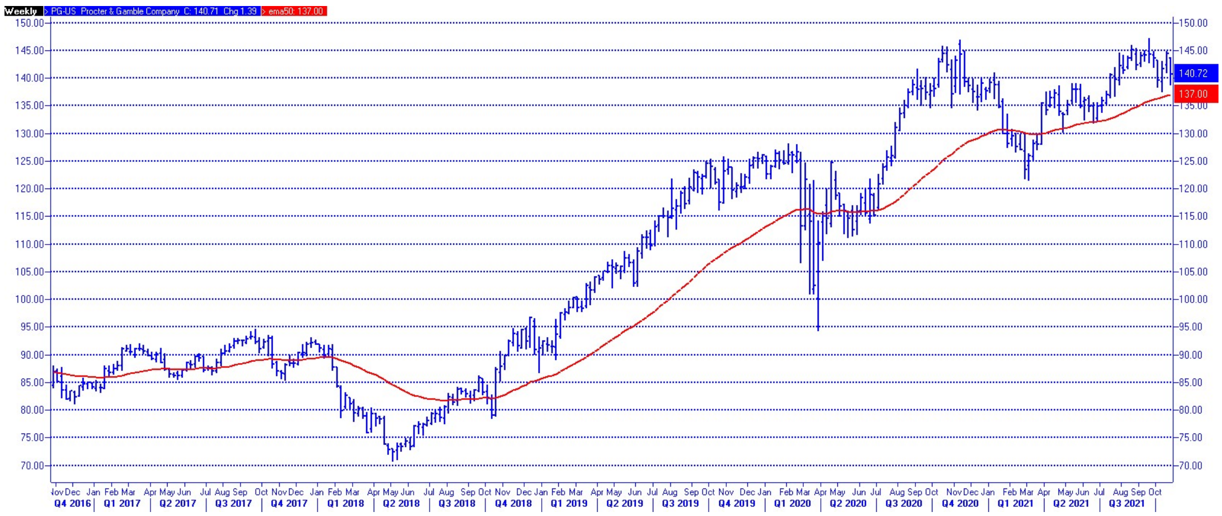
As an example of a price increase representing a decline….

Procter & Gamble (PG-NYSE-$140.75) Year to date



Source Steve Hilberry/NBF/Refinitive

Procter & Gamble 5 years



PG is up 2.1% year to date and up 62% from Oct/2016 (12.4% per year).

Source: David Wilson Chart of the Day Thurs. Oct 21, 2021 – used with permission

Relative to their earnings, P&G hasn't been this cheap since 2000. That doesn't mean P&G will rise in price this month. It can take time for investors to fall back in love with a stock. Patience and a rising dividend can help. ***One of these things is not like the others.***

Moving on to energy.

'Inconvenient Truths' – Sailingstone Capital Research/Pickering Energy Partners

https://sailingstonecapital.com/pdf/InconvenientTruths.pdf

Sailingstone White Papers

https://sailingstonecapital.com/research_whitepapers.html

'Net zero's surprise winners? Middle East oil producers' Financial Post You Tube

https://www.youtube.com/watch?v=SW06Ycyh2zs&t=101s

'Transcript: Bloomberg Odd Lots interview with Goldman's Jeff Currie on the Commodities Supercycle' Oct 19, 2021

This week's Bloomberg News interview with Goldman Sach's commodities analyst Jeff Currie discusses why we may be in a commodities 'Supercycle'. The gist is that we ain't seen nothin' yet. The Podcast is by subscription here:

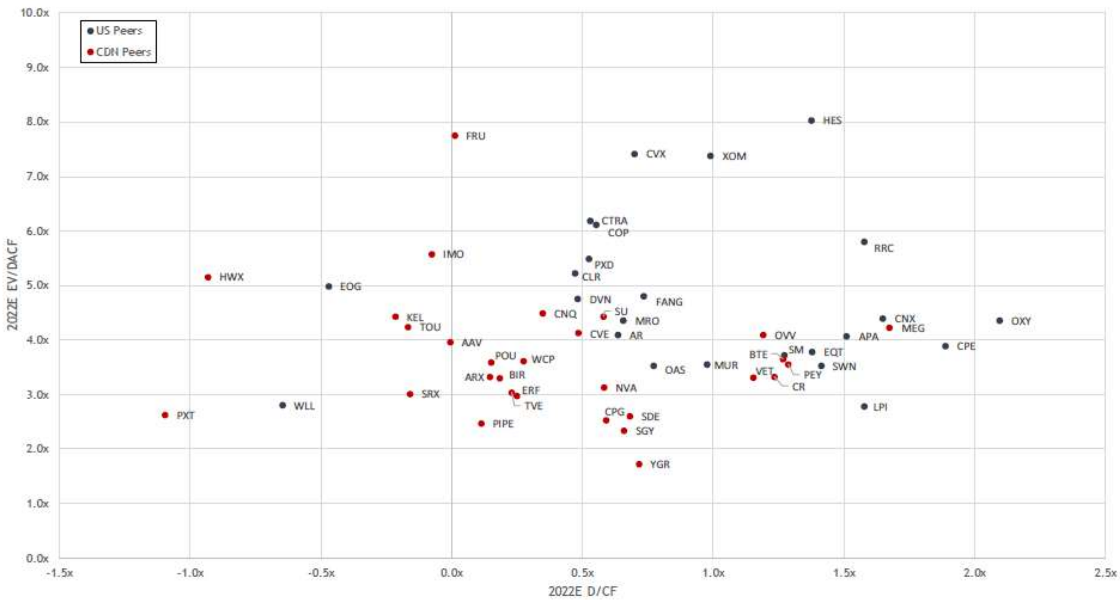
https://www.bloomberg.com/news/articles/2021-10-18/goldman-s-jeff-currie-it-s-a-commodities-supercycle-and-we-still-haven-t-hit-max-pain?srnd=oddlots-podcast

Bloomberg made a transcript available for public consumption at DropBox here.

https://www.dropbox.com/s/yzjfk83gynmq9m2/HFIR%202021%20Transcript%20Goldman%E2%80%99s%20Jeff%20Currie%20on%20the%20Commodities%20Supercycle%20-%20Bloomberg.pdf

If you'd like to see a PDF of the transcript let us know.

Distributions of Canadian energy producer valuations (red dots) vs. US peers (black)



Takeaway. Canadian energy is cheaper than US energy.

'Accelerating battery demand is here to stay' – Rystad Energy Oct 21, 2021

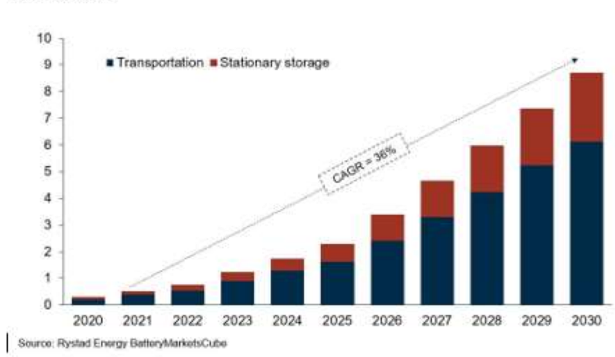


Figure 1: Battery demand forecast by sector
Terawatt-hours

Source: Rystad Energy BatteryMarketsCube

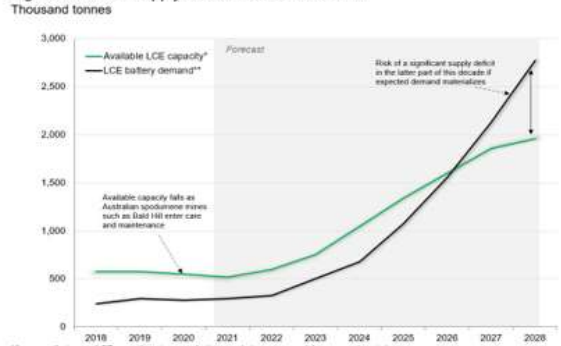


Figure 2: Lithium supply/demand balance forecast
Thousand tonnes

*Assumes that some LCE capacity enters non-battery markets every year (glass, ceramics etc.)
**Forecast LCE demand includes both electric vehicles and storage requirements
Source: Rystad Energy BatteryMaterialsCube

https://www.rystadenergy.com/newsevents/news/newsletters/OfsArchive/supply-chain-october-2021/

'Canadian Banks: Energy rally and the Big-6: it really is different this time' – NBF Sector Research Oct 11, 2021.

NBF's Gabriel Dechaine looks at the effect of the energy rally on the earnings and prices Canada's big banks.

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=0c9fa4a4-ebd3-40ee-b4fa-1412e3704b61&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

He believes the Energy Effect will be less than many expect but…

"At least you're not paying up for this optionality:

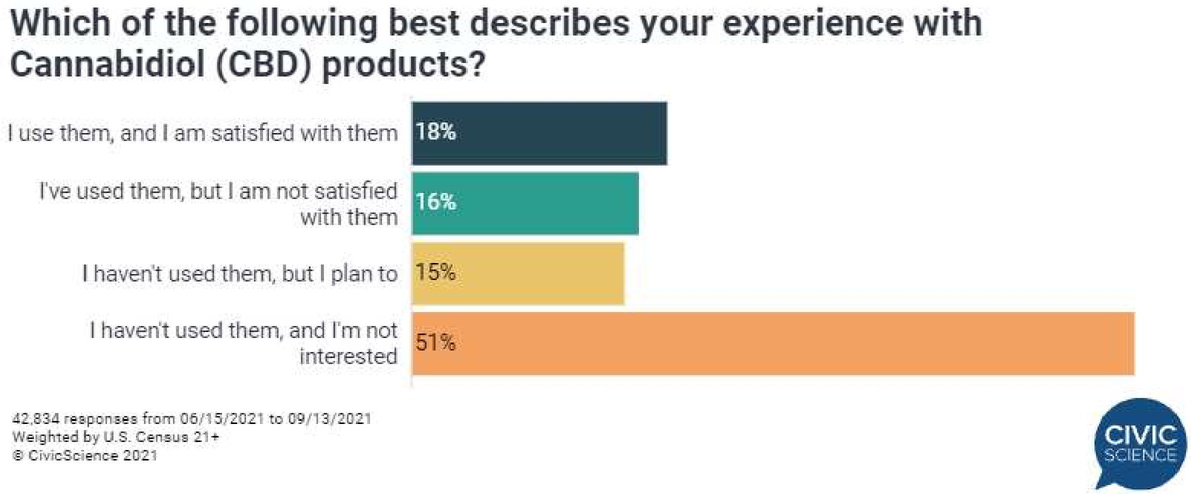
Although the upside to banks from an energy rally isn't the same as it used to be, we believe upside still exists. More importantly, investors are not currently paying a premium for that optionality. At a high level, Canadian bank stocks have experienced forward multiple compression of ~6% since mid-January, hardly an indicator of an over-hyped catalyst. At a more granular level, we look to CWB, which has nearly 40% of its loan book in Alberta. The stock has outperformed the Big-6 average by ~1,200 bps on a YTD basis, though it still trades at a nearly 10% forward P/ E discount. Finally, higher energy prices could provide a boost to Canadian GDP forecasts and provide a commensurate boost to bank valuations. We note the current sector P/E multiple of 10.8x (forward) is nearly 20% below its "natural" level relative to Canadian GDP growth forecasts." (Highlighting Steve – '*CWB'* = Canadian Western Bank. '*1,200 bps YTD'* = 12% year to date. 100 bps (basis points) = 1 %

STEVE'S TAKE: The last highlighted sentence means Canadian bank share prices are trading for $10.80 per $1 in future projected earnings. That relationship or P/E ratio is, on average, roughly 20% below historical ratios of $13.50 per $1, should projected growth in Canadian GDP prove true. If GDP grows, so should bank earnings. If bank earnings grow 10% and no change in the 10.8:1 ratio occurs, share prices should rise by 10%. If the future price-to-earnings relationship reverts to historical norms, share prices will rise an additional 20%. I can't predict if/when this will happen. I'm very confident dividends are about to rise. Rising earnings and rising dividends don't usually translate to zero price gains. ***One of these things is not like the others.***

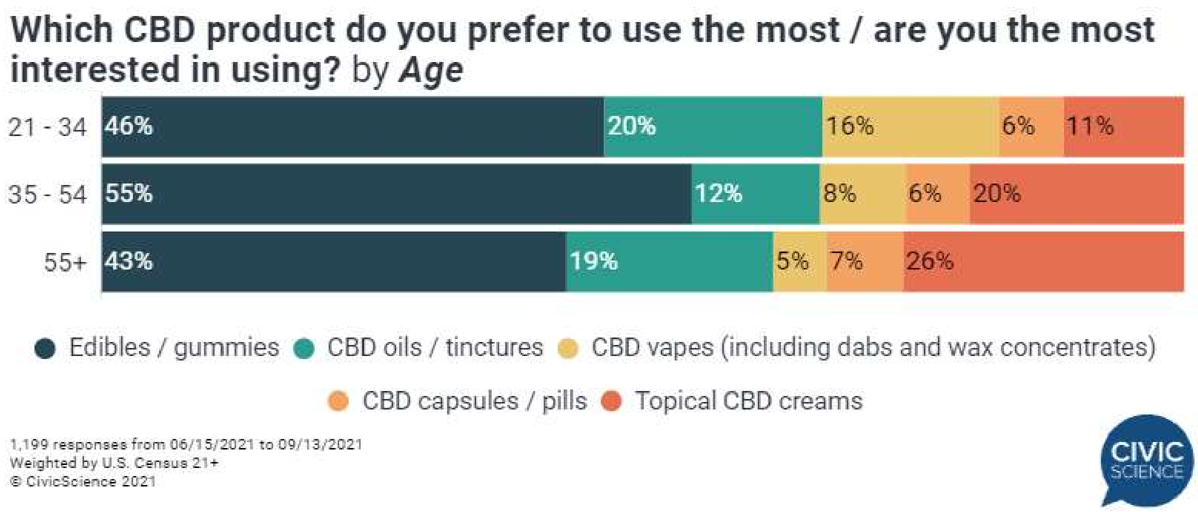
Q: "Are you High?" A: (chewing sound) "Uhmm…what was the question?"

'Higher Levels of Stress, Worry May Be Driving Increased Use of CBD Products' – Civic Science Sept 14, 2021

Half of the general population of Americans 21 and older have had some experience with various cannabidiol (CBD) products or intend to give them a try soon. As the pandemic continues to change how consumers feel and make decisions, new data from Civic Science illustrate key drivers of this increasingly prevalent trend.



"While edibles are every age group's favorite, Millennials and of-age Gen Zers show significantly more interest in CBD vaping products."



https://civicscience.com/higher-levels-of-stress-worry-may-be-driving-increased-use-of-cbd-products/

Oct 22, 2021

What's the Biggest Risk to Your Financial Portfolio? | How to Protect Your Investments in a Crash

Watch Anna's latest video here

https://www.youtube.com/watch?v=8N2BHufOKpg

It's supposed to be a wet weekend. Good time for some 'comfort food'. Mine will be pea soup. Steve & Anna Hilberry

Have A Great Weekend

FOR THE RECORD Oct 22, 2021

DOW INDUSTRIALS:	35,692
S&P 500:	4,543
S&P/TSX COMP:	21,183
WTI:	$83.49
LOONIE IN $USD:	$0.8014 $US

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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

NATIONAL BANK FINANCIAL WEALTH MANAGEMENT

HILBERRY GROUP