Why pessimists always get it wrong

Tuesday, investors returned from the first ever 'Juneteenth' US holiday – marking the day in 1865 when Union Army general Gordon Granger proclaiming freedom for enslaved people in Texas. They seemed in a celebratory mood as stocks jumped 2.45% on the day.

The recent slide in stocks had financial media perma-bears Jeremy Grantham, David Rosenberg et al crowing *'I predicted the 'crash' of 2022'*. Yes, they did as they will likely remind media viewers for years to come. I wonder if they'll remind viewers, they predicted 10 of the past two market crashes. We don't believe the market is your portfolio. We find value in not simply owning the market. We also believe the old Wall Street chestnut *'Bear markets return stocks to their rightful owners'*. Investors continually overestimate the short-term impacts of progress and underestimate the longer-term ones. The recent mania for social media/e-commerce stocks proved this in spades. We see the recent declines in our boring dividend payers as opportunities.

Why do we think so?

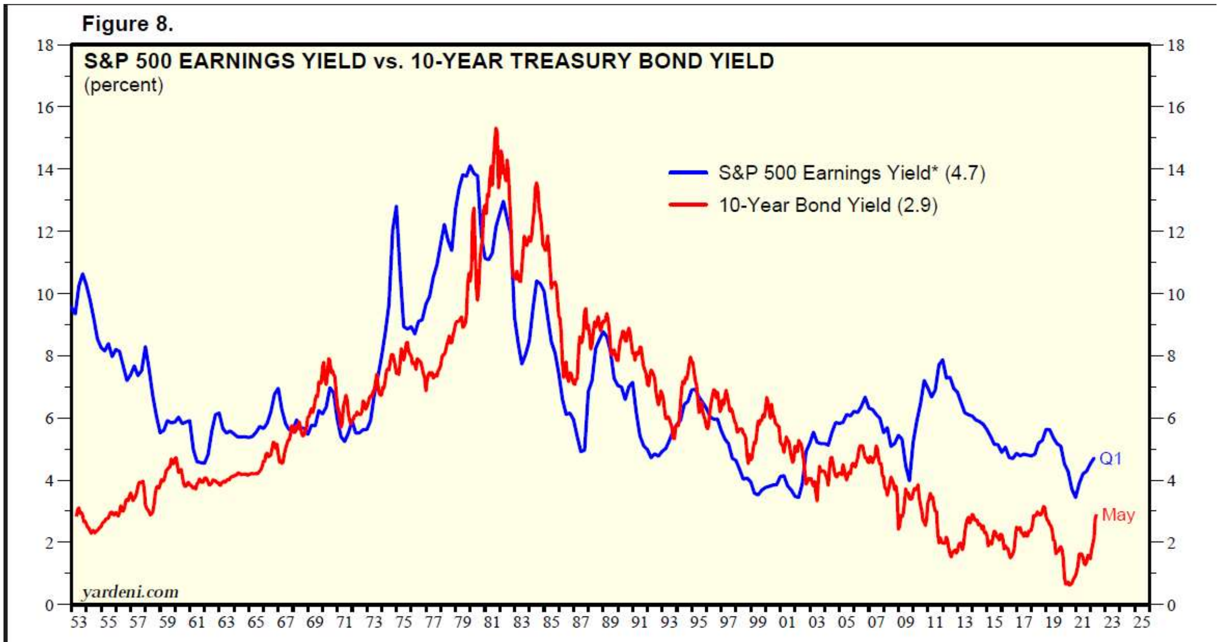
Aren't stocks expensive. Doesn't the S&P 500 need to contract a lot to get back to reasonable prices? The next chart is via Ed Yardeni.

Original here: https://www.yardeni.com/pub/sp500trailpe.pdf

The chart compares S&P Earnings Yield (earnings expressed as % of price paid-blue –inverse of P/E now around 5%) vs US Fed Govt 10 year Treasury Bond yields (red around 3%). There is a correlation. Pundits have fretted higher bond yields would 'crush' the S&P 500. No doubt a 1981 bond yield at 14% would drive up the S&P earnings yield by driving down the stock prices…a lot. Are we going there? No one I follow thinks so. How much yield anxiety is already in S&P500 prices? What yields are already price in?

The S&P Earnings yield is now higher than in 1999/2001 and is about the same as it was in 1987 and 1991, both recession periods. The S&P500 is priced for recession. Bond yields are well below those previous periods.

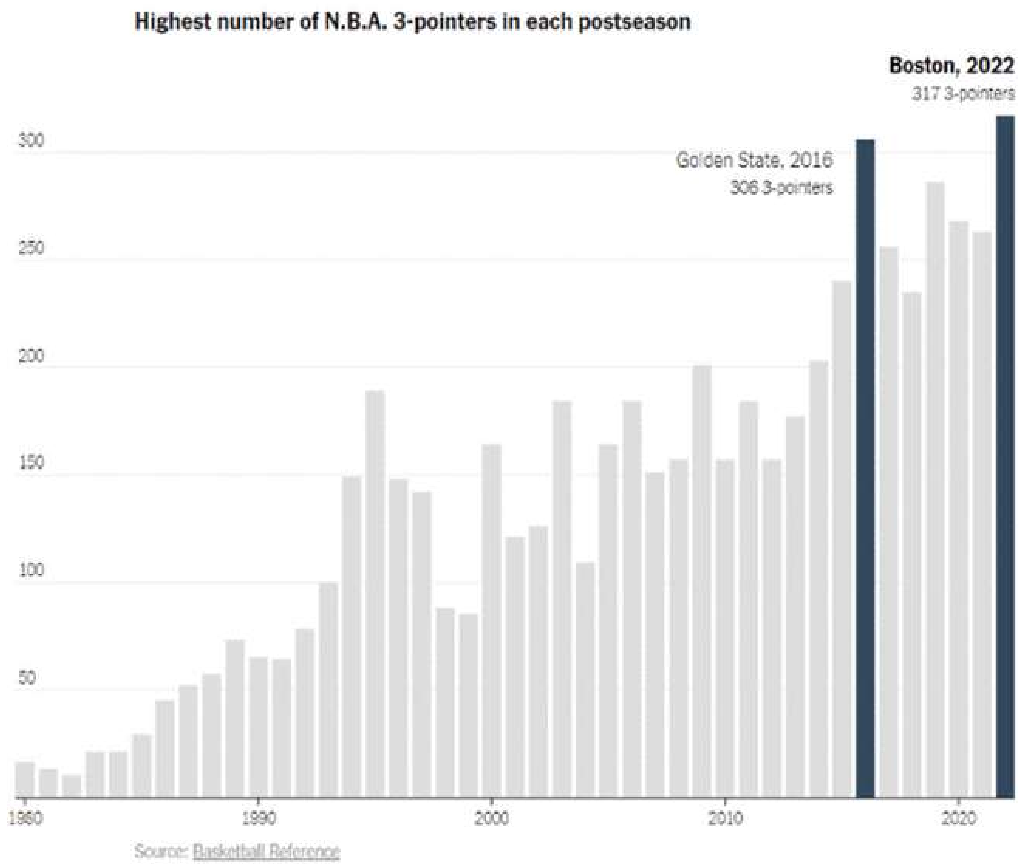
This chart says S&P 500 is not expensive, has already priced in a recession and does not need to decline a lot. That doesn't mean it won't. When you're close to the ground there isn't much more room to fall.



* Using quarterly average of daily data for S&P 500 price index, and 4-quarter trailing reported earnings through Q3-1988, then operating earnings.
Source: Standard & Poor's and Federal Reserve Board.

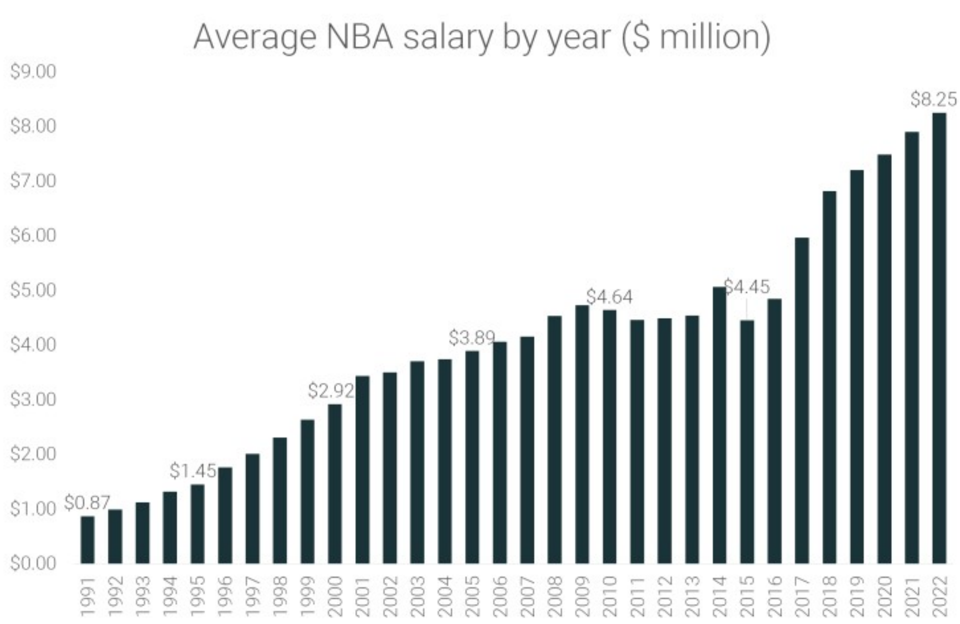
While I could drone on about productivity and profits, perhaps an easy argument why pessimists are eventually wrong is NBA basketball. A successful shot made beyond 23 feet 9´ from the hoop earns 3 points not 2. The span is marked as the '3 point line' (arc on the floor). In practice a 3-point shot will be made from at least 25' away. Its hard to do. Games are often won by 3-point specialists.

The next chart plots the total number of 3-point shots made in each post season since 1960 (charts source WSJ Daily Shot). The trend is up. How does this happen? Practice, training and finding talent that has been enabled via incentives. This progress in 'productivity' explains another chestnut *"I've never met a rich pessimist".* Think about that incentive thing when you consider rewards and taxes (more on this below)



NBA Players salaries have also been on an upward trend.

https://runrepeat.com/salary-analysis-in-the-nba-1991-2019



June 24, 2022

NATIONAL BANK FINANCIAL
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Gee, I wonder if there's a connection between rising basketball productivity and player compensation? This takes us to gross compensation and net reward here in British Columbia. I compare 2022 to 2012 for a top marginal taxpayer.

In 2012:

- Top combined marginal tax rate on amounts exceeding $132,406: 43.70%
- $100,000 at the top BC rate in 2012 resulted in $56,300 after income tax.
- Applying the 12% BC Sales Tax = $50,267 net purchasing power (50.2% net).

In 2022

- Top combined marginal tax rate on amounts exceeding $227,091: 53.5%.
- $100,000 at the top BC rate now results in $46,500 after income tax.
- Applying the 12% BC Sales Tax = $41,517 net purchasing power (41.51% net).
- The after-tax purchasing power at the top marginal rate has declined by 17.4% since 2012, in 2022 dollars

But wait! There's more.

The Bank of Canada says national 2012-2022 CPI compounded inflation by 22.59%.

Deflating the above 2022 net purchasing power by 22.59% results in 2022 net after-tax and inflation equivalent purchasing power of $33,866 in 2012 dollars vs $50,267 in 2012. The combined hit is -32.6% to purchasing power in 2012 dollars over the past 10 years.

This means these taxpayers must see their value for services rendered increase by 33% just to stay even. As they demand more compensation either from their business customers or their employers, everyone else's costs go up. Voila! Inflation. We hear politicians claiming, *'The rich must pay their fair share'*. What does *'fair share'* mean? What incentive message is that tax policy sending? Experience says higher taxes don't encourage risk-takers to take risk in BC. They'll take it, but they'll do that somewhere else.

Staying with optimism…

Six Things That Might Go Right

https://blog.validea.com/six-things-that-might-go-right/

And some shorter-term caution (maybe)

Charlie Bilello's 10-chart Wednesday

https://compoundadvisors.com/2022/10-chart-wednesday-6-22-22

Moving on to Canadian bureaucracy and your tax dollars at work…

Rogers, Shaw make deal to sell Freedom Mobile to Quebecor for $2.85B in hopes of getting merger approval

https://financialpost.com/telecom/rogers-shaw-make-deal-to-sell-freedom-mobile-to-quebecor-for-2-85b-in-hopes-of-getting-merger-approval

Competition Bureau doubles down on objections to Rogers' deal for Shaw

https://financialpost.com/news/canada/competition-bureau-doubles-down-on-objections-to-rogers-deal-for-shaw/wcm/847f1c6c-78af-4719-8d3b-b4ff74cdfa6c

NBF Research analyst Adam Shine updates the firm's opinion on this deal.

Telecom Services: Awaiting Competition Bureau Reaction to Proposed Sale of Freedom to Quebecor

Extract from the report:

The Competition Bureau continues to argue that "the proposed divestiture of Freedom Mobile is not an effective remedy". It believes that any sale "fails to eliminate the substantial lessening and prevention of competition the proposed transaction [Rogers buying Shaw] will cause". The main arguments seem to be that the sale of Freedom "will not replace the significant and growing competition Shaw Mobile was delivering and would continue to deliver in Alberta and British Columbia, and it would make Freedom Mobile a substantially weaker competitor than it would have been but for the proposed transaction".

We disagree with these statements which we believe incorrectly assume that the buyer of Freedom can't at least match Shaw's wireless efforts and competitiveness. Anyone looking at Quebecor's strategy in Quebec and its achievement of a provincial wireless market share of 22.5% would be hard-pressed not to acknowledge its success and be compelled to reassess the statements above. To do otherwise would be to simply deny the reality of results over the past few years.

Shaw Mobile subscribers are really Shaw Internet subscribers with a cheap wireless add-on. If their ARPU isn't in the range of zero to $10, then any related $25-$45 plans are discounted by the same amount that associated Internet plans are increased We estimate that Shaw Mobile might have revenues approaching $100M which translates to about $18.52. That's a figure more than half below ARPU levels at Quebecor and Freedom and not sustainable if a company ever truly wishes to make profit and FCF. Nobody has a full sense of what exactly Shaw's related strategy was here, but it could simply have been evolving experimentation and interplay between wireline and wireless pricing amid a clearly-articulated effort to try to reduce churn among Internet subscribers in the face of market share gains by TELUS out west. (highlighting mine).

Recall the Competition Commission's main objection to this deal appears to be based on the Canadian cost of monthly mobile subscriptions vs. similar offerings in Europe and the US. This logic seems to bypass the realities of Canada's highly regulated markets (CRTC, language laws, foreign ownership regulations, etc.) and Canada's small population spread out over thousands of miles.

See the full report in the attachments section.

Despite what we see as messing with a good thing, the economy in Canada continues to do just fine. We see the recent market declines as a chance to build future dividend at a higher rate than was available when markets were hot last fall.

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD June 24, 2022

DOW INDUSTRIALS:	31,500
S&P 500:	3,911
S&P/TSX COMP:	19,062
WTI:	$107.66
LOONIE IN $USD:	$0.7754 $US

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