HILBERRY GROUP
WEALTH MANAGEMENT

July 15, 2022

Living in the Past

The Financial media is big business, just ask Michael Bloomberg. The media's only job has always been to sell advertising - not advice. Social media companies don't bother pretending to operate as a 4th Estate. Media companies understand their consumers. They are good at it. They pile onto a story until viewer interest is exhausted then move on to the next one. Ponder the editorial staff's daily headline decision-making. The headlines they select are an instant poll. When they decide to present bearish narratives, they are telling you what their viewers are thinking. What you see in the media is groupthink unfolding minute by minute. It is NOT wisdom but is useful. When you see a steady drum beat of gloom, this tells you the crowd is nervous, expecting bad times. Lately we see much talk of recession. Is one coming or here now? A quick check of the prices for your favorite companies will probably confirm 'Yup. Prices are down along with sentiment'. Be contrarian. That's where the wisdom comes in…yours. I've yet to see market tops and bottoms called by the media.

We've seen the typical Bad News Bears out in the media again, talking financial doom. These folks always have the same song to sing. It's who they are. What they're saying isn't important. The fact the media is presenting them is the point.

We think a recession is coming. One always is. We could see some fading back from last year's COVID rebound but we don't think a deep recession is here now and we don't think a worse one is right around the corner. We think investors, or more accurately the financial media has over-reacted. Panic sells. The easiest way to sell panic (advertisements) is to predict recent negative trends will continue or reoccur and get worse. It takes no creativity. Just predict the past. Reliable attention grabbers.

'Living in the Past' – Jethro Tull

https://www.youtube.com/watch?v=2YymGJKhGgY

Lately a favorite living-in-the-past, perma-Bear talking point is floating rate mortgage reset risk. The Bank of Canada made a supersized over night lending rate hike on Wednesday of 1 full percentage from 1.5% to 2.5%. The bears began to dance.

Text of Bank of Canada's rate decision meeting after 100bp hike

Reuters10:28 AM Eastern Daylight Time Jul 13, 2022

TORONTO, July 13 (Reuters) - The Bank of Canada today increased its target for the overnight rate to 2½%, with the Bank Rate at 2¾% and the deposit rate at 2½%. The Bank is also continuing its policy of quantitative tightening (QT).

Inflation in Canada is higher and more persistent than the Bank expected in its April Monetary Policy Report (MPR),and will likely remain around 8% in the next few months. While global factors such as the war in Ukraine and ongoing supply disruptions have been the biggest drivers, domestic price pressures from excess demand are becoming more prominent.

More than half of the components that make up the CPI are now rising by more than 5%. With this broadening of price pressures, the Bank’s core measures of inflation have moved up to between 3.9% and 5.4%.

Also, surveys indicate more consumers and businesses are expecting inflation to be higher for longer, raising the risk that elevated inflation becomes entrenched in price- and wage-setting. If that occurs, the economic cost of restoring price stability will be higher.

Global inflation is higher, reflecting the impact of the Russian invasion of Ukraine, ongoing supply constraints, and strong demand. Many central banks are tightening monetary policy to combat inflation, and the resulting tighter financial conditions are moderating economic growth. In the United States, high inflation and rising interest rates are contributing to a slowdown in domestic demand. China’s economy is being held back by waves of restrictive measures to contain COVID-19 outbreaks. Oil prices remain high and volatile. The Bank now expects global economic growth to slow to about 3½% this year and 2% in 2023 before strengthening to 3% in 2024.

Further excess demand has built up in the Canadian economy. Labour markets are tight with a record low unemployment rate, widespread labour shortages, and increasing wage pressures. With strong demand, businesses are passing on higher input and labour costs by raising prices. Consumption is robust, led by a rebound in spending on hard-to-distance services. Business investment is solid, and exports are being boosted by elevated commodity prices. The Bank estimates that GDP grew by about 4% in the second quarter.

Growth is expected to slow to about 2% in the third quarter as consumption growth moderates and housing market activity pulls back following unsustainable strength during the pandemic.

The Bank expects Canada's economy to grow by 3½% in 2022, 1¾% in 2023, and 2½% in 2024. Economic activity will slow as global growth moderates and tighter monetary policy works its way through the economy. This, combined with the resolution of supply disruptions, will bring demand and supply back into balance and alleviate inflationary pressures. Global energy prices are also projected to decline.

The July outlook has inflation starting to come back down later this year, easing to about 3% by the end of next year and returning to the 2% target by the end of 2024.

With the economy clearly in excess demand, inflation high and broadening, and more businesses and consumers expecting high inflation to persist for longer, the Governing Council decided to front-load the path to higher interest rates by raising the policy rate by 100 basis points today. The Governing Council continues to judge that interest rates will need to rise further, and the pace of increases will be guided by the Bank's ongoing assessment of the economy and inflation. Quantitative tightening continues and is complementing increases in the policy interest rate.

The Governing Council is resolute in its commitment to price stability and will continue to take action as required to achieve the 2% inflation target.

Bank of Montreal (BMO-TSX) hit a 52-week high of $154.47 in March/2022. The banks all sold off on Wednesday. More investors wanted to sell BMO than buy it pushing the price down to $122.23 – approaching the 52-week low of $121.56 June 30th (the 2nd quarter-end 'window dressing' by institutions). A boring company's share price is down 21% from the extreme high. For each seller there is a buyer.

The Dancing Bear's say house buyers have concentrated their mortgage loans into floating rate types They say as rates rise a lot higher surely those rising rates will 'crush' those borrowers. They predict banks will see catastrophic losses leading to a credit collapse worse than the US 2007 Credit Crunch or the Savings & Loan Crises.

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

This notion gives no credit to individual borrowers or their lenders capacity to self-regulate their own risks. Only the bears have the exclusive inside story. Exclusive sells.

We agree that some excessive borrowing will be exposed.

***"Only when the tide goes out do you discover who's been swimming naked." –* Warren Buffet**

We don't think floating rate mortgage exposure will prove devastating to the Canadian economy or to the Canadian banks.

Canada's banking mortgage qualification regulations, financial institution capital requirements and regulatory oversite regime (stress tests, etc.), combined with the lack of mortgage interest deductibility means Canadians generally show a lower percentage of disposable income dedicated to mortgage debt payments (less leverage to real estate) than US borrowers. If we're going to point to the past, our banking system survived those challenges. Investors who showed up (or held on) during those previous times did very, very well. Lest the Canadian Fed's take too much credit for a lower Canadian debt leverage, Canada's higher tax regime also leaves less disposable income for Canadians to get into trouble with.

Regan Switucka with National Bank's Vancouver Island mortgage lending division provided this quick update of the impact of Wednesday's 1% rate hike on local mortgage decisions.

The Bank of Canada increased PRIME even higher than most anticipated with a Full 1 % increase, from 3.7% to 4.7%

Impacts.

- *Qualifying rate – increase with the variable qualifying rate. Most variable mortgages with a discount of Prime - .5 or Prime - .7. will now have to qualify between 6% - 6.2%* (emphasis mine)
- *Payment increase.*
  - *For example Prime - .6% (rate jumped from 3.1% - 4.1%)*
  - *Payment per 100k @ 3.1% = 427.02*
  - *Payment per 100k @ 4.1% - 483.20*
  - *Increase of 56.18 per month per 100k*
- *HELOC rates are now over 5% in most cases.*
- *Next Bank of Canada meeting is Sept 7.*

A $400K mortgage cost goes up by $225 per month. Not nothing but not kicked-to-the-curb either. Who receives that extra $225? The Banks! My take is the super-heated property markets are about to cool. We may see some initial price declines as the excess is scrubbed from seller's expectations.

Not enough hard data for you? Okay - here we go:

In pre-Covid 2019, Canadian household consumer debt service ratio (% of all debt payments vs. household income) was 15.02%. As of June 30, 2022 the debt service ratio was 13.48% = a decline of 10.25%. Household income rose 16.2%. Note that Govt transfers rose 19.8% (gee I wonder why there's a bit of inflation?). If we back out the Govt transfers, household income went up 12.6%. Total actual interest paid declined 8.4%. While some of the decline resulted from lower mortgage interest payments, most of the decline was the result of lower non-mortgage debt interest (consumer debt). To clarify: The actual amounts paid for interest payments made by consumers went down. The amount of interest paid on mortgage debt declined 3.35%. Consumers have been understandably cautious. Ask the mirror. Are you feeling upbeat and aggressive on the economy? Are you ready to blow it all and splash out? Do you feel economically frisky? Probably not, because you're an adult with experiences that keep you honest.

For the Canadian consumer debt service ratios go here:

https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110006501

This tells me A) Canadians are NOT 'piling on debt' and B) Canadians are feeling cautious. It's a bad news/good news situation. The bad news is consumer caution means the economy will probably not be as explosive as many had predicted coming out from COVID, explaining the recent slide in stock prices, repricing growth expectations. The good news is the longer-term future, being less leveraged to the COVID past, means we're probably not facing a deep dive in the economy either. As we noted last week, we think investors (who are consumers too) are being conservative. Suddenly, after going bonkers in late 2021 they are unwilling to splash out.

Pondering Canada's largest customer, US borrowers have a historically low debt service to income ratio. Brian Wesbury walks us through the US numbers. We think his conclusions apply in Canada.

***Mortgage Reset Alarmism Is Off the Mark* – Brian Wesbury –July 11, 2022**

https://www.ftportfolios.com/Commentary/EconomicResearch/2022/7/11/mortgage-reset-alarmism-is-off-the-mark

Telecom Services

Assessing the Fallout from the Outrage Stimulated by Rogers' Outage

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=412560db-a04a-499e-b8fc-889c694c44e1&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Rogers Communications Inc.

CRTC Wants Answers by July 22 for Why Outage Occurred & Preventative Measures Being Taken

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=3c9c8ab7-783c-42aa-ae5b-688651d52cb5&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

NOTE: ISED – Ministry of **I**nnovation, **S**cience & **E**conomic **D**evelopment.

Rogers/Shaw Merger Updates

'Telecom Services: No Resolution During Mediation As We Wait To See If A Negotiated Settlement Can Occur' NBF July 6, 2022

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=fce6d35c-2ef2-429a-99d6-dd8ef460fc65&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

We hold Shaw Communications **(SJR.B-TSX-$35.00).** Our cost for clients is in the mid to low $20's per share. The merger deal is at$40.50 in cash. Investor frustration with Govt intervention has the stock 15% below an all-cash offer. Will the Fed's quash the deal? Your tax dollars at work.

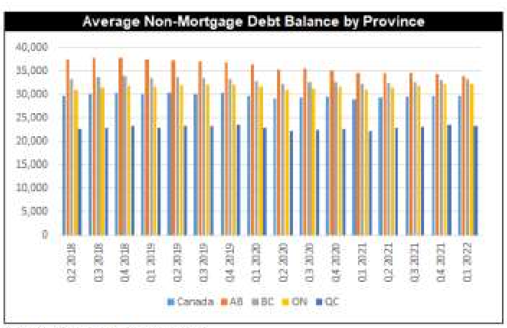
We hold banks and life insurance companies. They're down in price lately. Investors are fretting about loan losses due to rising mortgage interest costs.

'Canadian Financial Services Weekly' – Sector update Gabriel Dechaine

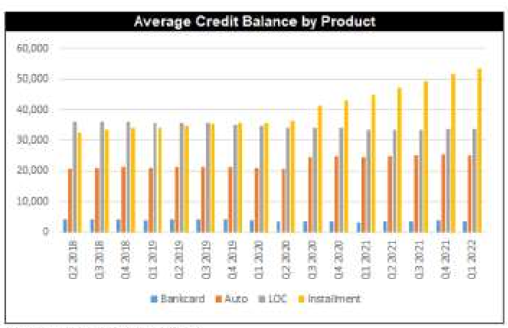
https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=77edd4fc-0c6f-4fcd-bcdf-fe6c6fd50486&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

The following chart from page seven of the report is worth a closer look.

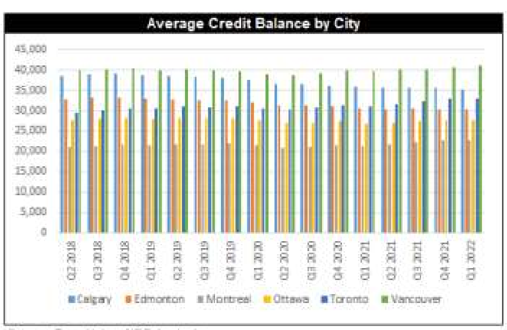
TransUnion Credit Data



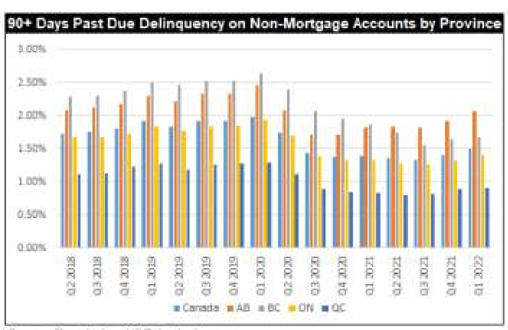
Source: TransUnion, NBF Analysis



Source: TransUnion, NBF Analysis



Source: TransUnion, NBF Analysis



Source: TransUnion, NBF Analysis

The top left-hand graph plots Canadian national outstanding mortgage balances 2018 onwards. Trend is down. Top right-hand is bank account cash balances. Trend is up. Mortgages 90+ days past due is lower than in 2018. Contrary to the Bad News Bears, the Canadian consumer is okay. Gee Whiz. Who'd a thought. Canadians are careful. This doesn't mean it's all roses out there, but neither is it a bed of thorns. We are confident Canadian business will thrive.

Turning to the energy markets…MIND THE GAP

Over the past 5 years, we have advised holding/adding to conventional oil and gas companies. We've believed there was, and remains, a significant gap in the popular understanding and govt policy goals between energy use and the impacts of those aspirations and policies on the reality of how/where energy is produced, who uses it and how, what changes in consumption might be accomplished, how long it could take, how much it could cost and the geopolitical implications of it all. Given the significant declines in market prices of conventional energy producers, from 2017 onwards we believed owning those assets were likely to lead to significant gains for client portfolios. We REALLY thought so in the fall of 2020. It was a contrarian view. It was correct.

Conventional energy prices have exploded upwards carrying oil & gas share prices with them. The recent stock market slide has confirmed our view. Over the past 12 months and year-to-date, holding conventional energy assets has meant the difference between mild stomach upset vs. life altering losses.

What now? Should we be sellers? We don't think so. Neither does Warren Buffet who recently added to his holdings of oil and gas producer Occidental Petroleum.

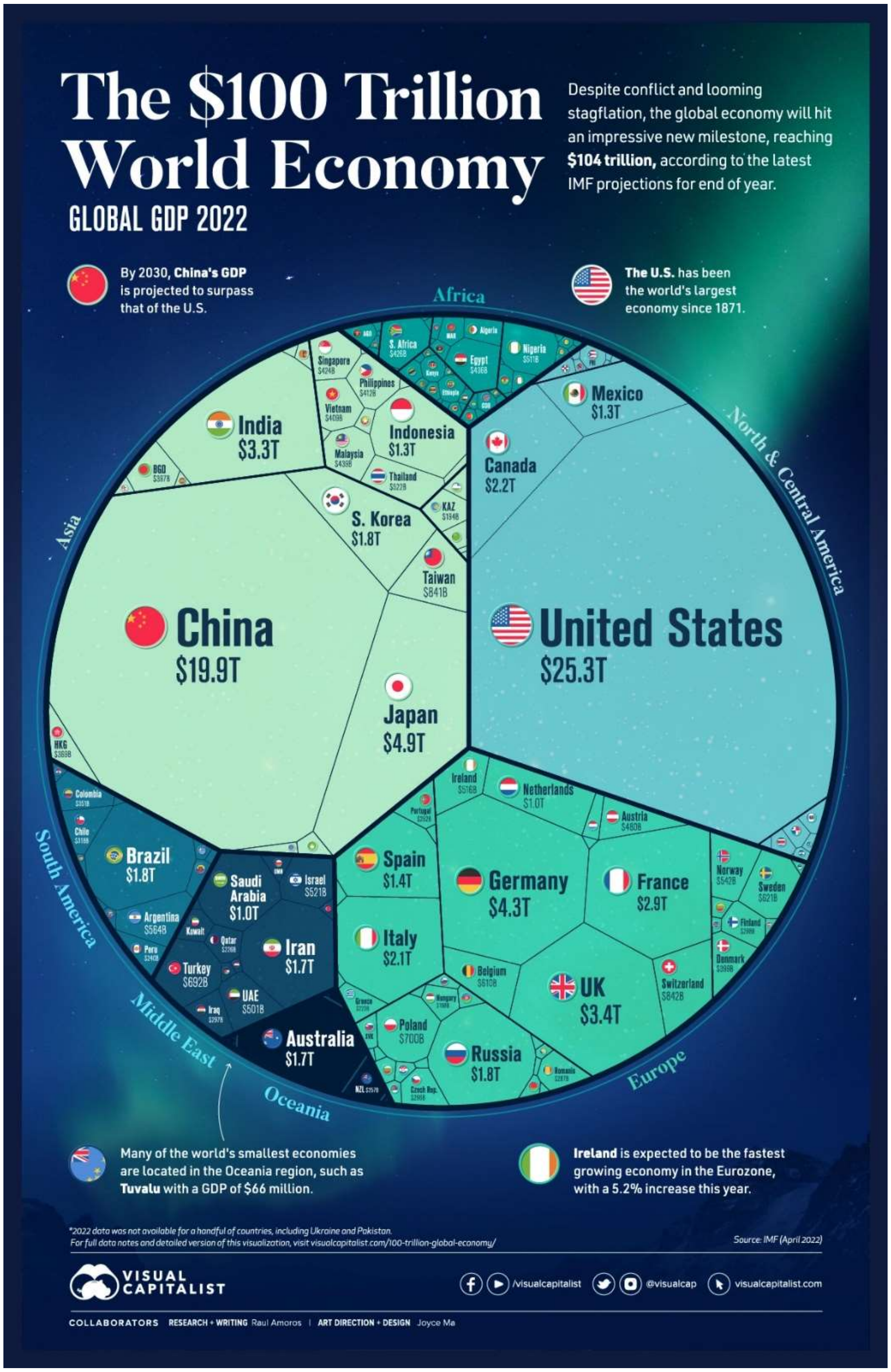
The following YouTube video is required viewing for those following energy markets, conventional or alternative. The video is from a US perspective but applies to Canada. I urge our clients to spend the 1 hour to view the entire video.

The Transition To Clean Energy Takes a Long Time

https://www.youtube.com/watch?v=TMI9GoKmFJo

As the video focuses on the global economy, who are we talking about? Who's Who? The next chart courtesy of Visual Capitalist maps the world's GDP. Look at the larger blocks. Note the importance of Asia. I've tried to imagine those SE Asian nation's priorities. Then I attempt to envision their likely policy goals discussed in the previous YouTube video.

I conclude it is too early to dump oil and gas stocks.



https://www.visualcapitalist.com/100-trillion-global-economy/

Also Compare Canada's $2.2 trillion economy to Russia's $1.8 trillion. Now imagine Canada attempted to invade…anyone. How long could we sustain a protracted War?

Conclusions: A) Mr. Putin may be in trouble and B) Canada may wish to revisit it's national defense policies. C) The world needs much of what Canada is good at. We could make hay.

Another gem from Mr. Buffett - ***"The stock market is a device that transfers wealth from the impatient, to the patient."***

Is it time to take that calculated risk? With the right protection, there's no need to hold back!

Watch Anna's latest video here - https://www.youtube.com/watch?v=KD1SnsoGlCQ

On that optimistic note…

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD July 15, 2022

DOW INDUSTRIALS:	31,212
S&P 500:	3,853
S&P/TSX COMP:	18378
WTI:	$98.04
LOONIE IN $USD:	$0.7672 $US

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