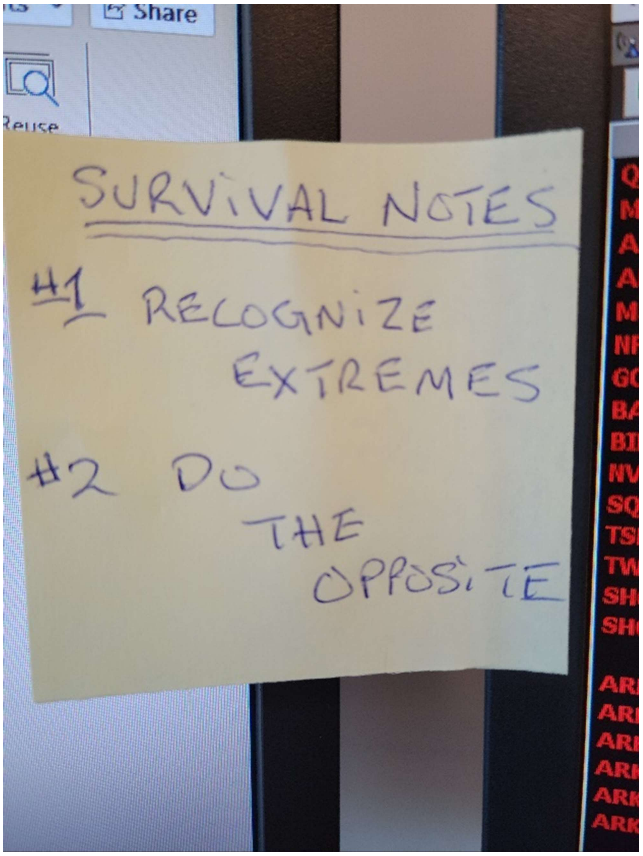
HILBERRY GROUP
WEALTH MANAGEMENT

October 14, 2022

Recognize Extremes - Do the Opposite Edition

Post-it note on my PC



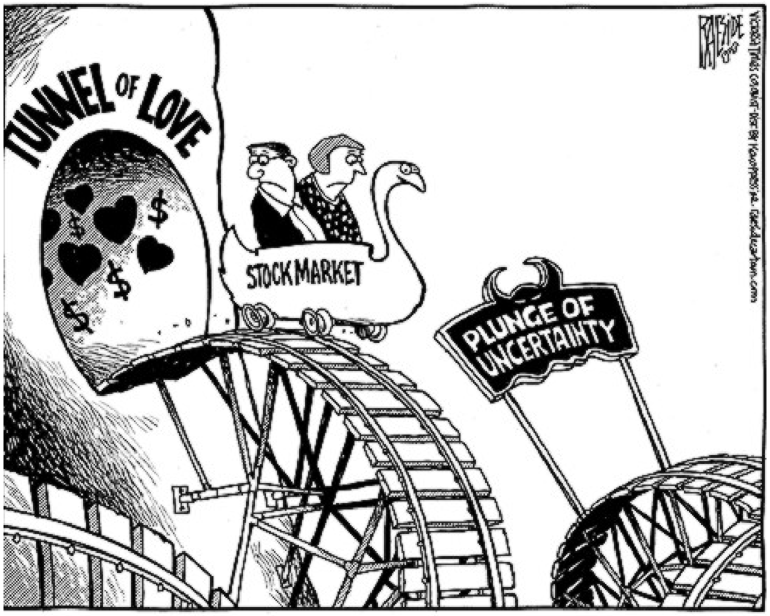
Toronto Star: Perry Cartoon Oct 20, 2014

A few headlines:

***'World set for first 'significant destruction' of wealth since 2008 financial crisis, says Allianz In real terms, households could lose a tenth of their wealth'* – Financial Post Oct 13, 2022**

***'Stocks could fall 'Another easy 20%' and the next drop will be 'Much More Painful Than the First' Jamie Dimon Says'* - Baron's Oct 11, 2022**

***'IMF Again Lowers Call on World GDP Growth, Citing Sea of Risks'* – Baron's Oct 11, 2022**



So…what about a US recession?

NBC US Recession Risk Monitor Oct 11, 2022

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=dde0f739-07db-4937-a108-b45657397d24&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

By Alexandra Ducharme and Matthieu Arseneau

The signal sent by the financial market improved compared to a week ago*. The price of oil climbed 9% from a week prior, limiting the total pullback from its peak to 26%. Meanwhile, BBB spreads narrowed 12.1 bps and the S&P 500 gained a few points, but the signal of both indicators as defined by the colors of the dashboard remained unchanged. The price of copper, meanwhile, was essentially unchanged. At the same time, the yield curve flattened 1.4 bps, the U.S. dollar continued to hover around an historically high level and the real policy rate climbed by a tick. In short, equities, corporate bond market, commodities and the U.S. dollar are still at risk-off levels, while the still accommodative real rates suggest a pro-growth environment. As for the slope of the yield curve, it has flattened from last week but remains above the median reading observed a quarter ahead of a recession.*

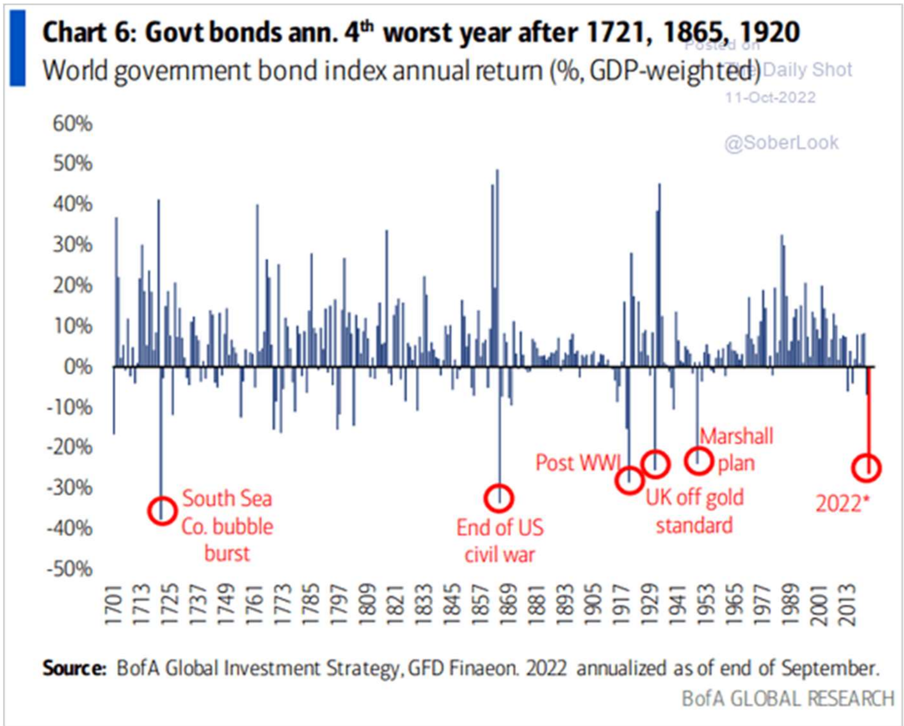
On the soft data side*, SME optimism published this morning slightly picked up, but not enough to crawl above its worst deterioration a quarter ahead of a recession. ISM manufacturing PMI came in lower than its prior reading and slipped below the median reading observed 3 months before a recession. ISM services PMI, meanwhile, was 2 ticks lower than its prior reading but was still above the historical range ahead of a recession. There were no other updates at the time of publication. CEO confidence for Q3 was much lower than its prior reading, but its signal as defined by the colours of the dashboard remained unchanged. The signal sent by consumer confidence was also unchanged as it stood at its worst deterioration a quarter ahead of a recession. We will get an update of this indicator on Friday.*

For hard data, *the latest employment numbers showed an increase in temporary help services jobs and in hours worked. Average UI claims, meanwhile, were essentially unchanged. There were no other updates as of yesterday. The growth of real consumption improved a tick but remained below the median reading a quarter before a recession. Building permits remained above the median drawdown observed a quarter before a recession.*

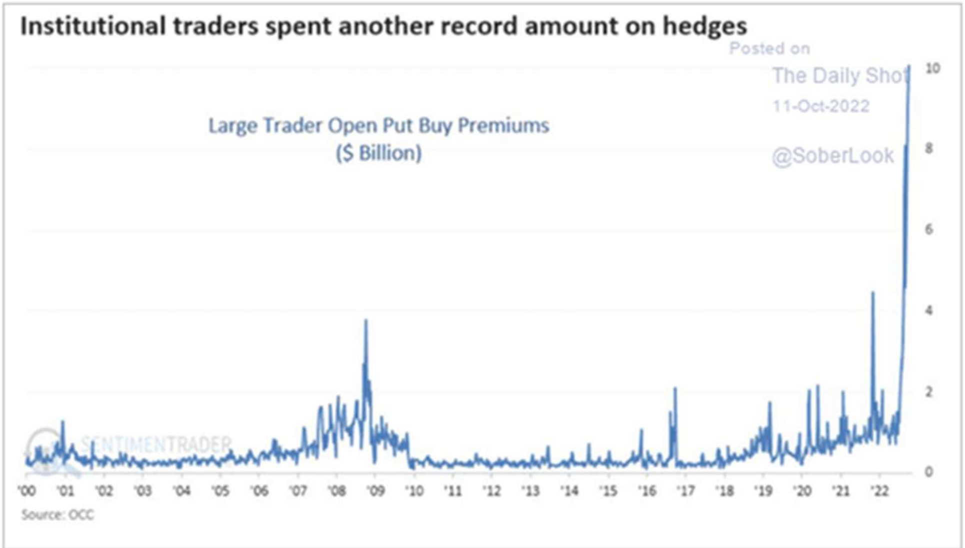
'Solid Growth, Persistent Inflation' - First Trust

Brian Wesbury updates First Trust's views on the US Economy. They see a recession in late 2023.

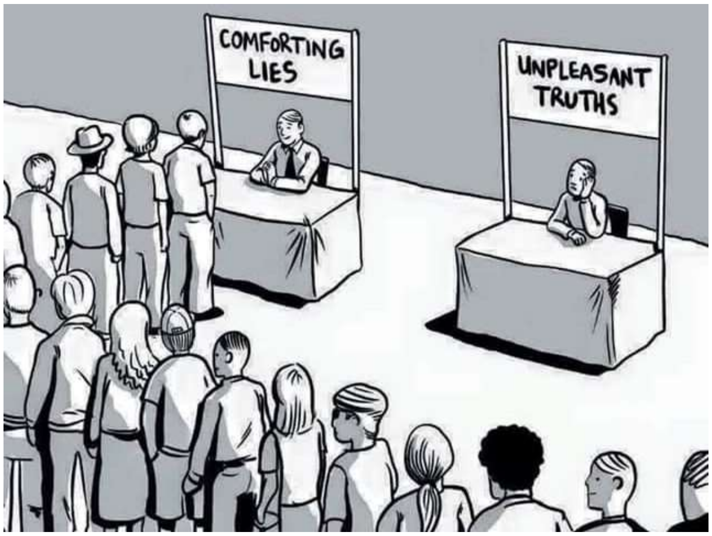
https://www.ftportfolios.com/Commentary/EconomicResearch/2022/10/10/reports-solid-growth,-persistent-inflation



The Sentiment on stocks is extremely bearish.



'Inflation Visualized' - Scott Grannis



Borrowing costs are a big factor for most Canadians, driving credit card, car payments and mortgage costs. Canadians must understand how Govt fiscal policy (spending) and Central Bank monetary policy (interest rates) affect us. Lenders require their money back at a positive return after taxes and inflation. Increasing both drives up the required interest rate to protect capital. Politicians of all stripes often don't know (or don't want to know) the unpleasant truths of fiscal policy and inflation. Government benefits and entitlements must be paid for from positive earnings from wages and corporate profits. Increasing taxes doesn't increase the earnings. It's the other way around! Canada is a broadly middle-class country. That's a good thing.

But…there simply aren't enough 'Rich' Canadians or large corporations to pay everyone else's bills. Many of the largest corporations Canadians see every day are not domiciled here. The earnings of Toyota, Tesla, General Motors, Home Depot, Best Buy, Walmart, Apple Inc, Google, Campbell's Soup, Amazon, etc. are beyond the clutches of Revenue Canada. Elected officials running on a social benefit platform are not motivated to tell their electorate the truth. This trend has accelerated on both sides of the aisle.

The following article explains why inflation and thus interest rates are up. It is required reading for our younger patrons who have never known a rising inflation/interest rate environment, and a required reminder for those of us who have.

http://scottgrannis.blogspot.com/2022/10/inflation-visualized.html

Why Is the Fed Always Late to the Party? – Barry Ritholz

https://ritholtz.com/2022/10/why-is-the-fed-always-late-to-the-party/

'Was that the bottom?' - Michael Batnick

https://theirrelevantinvestor.com/2022/10/04/was-that-the-bottom-3/

'Sun Setting on Wind/Solar Portfolio' NBF update Oct 5, 2022

Suncor (SU-TSX-$43.15) announced they are selling their entire Wind and Solar powered portfolio to **Canadian Utilities (CU-TSX-$33.94)** for ¾'s of a billion. Suncor says the proceeds will be used to concentrate on their conventional hydro-carbon fuels and hydrogen. Suncor has a history of astute long-term tactical moves. Do they know something?

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=9abaefe7-9840-41ed-a02a-9b2911e8311f&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

DISCLAIMER: I hold Suncor personally, in family accounts and for client accounts over which I have trading authority. We have traded in the security within the past 60 days

High Energy Cost Hurts Wind & Solar – GoRozen

Our Q4 2021 commentary was entitled "The Distortions of Cheap Energy." In our lead essay, we explained how extremely low energy prices throughout the 2010s distorted the cost of several energy transition technologies, notably wind, solar and lithium-ion batteries. Between 2010 and 2020, the cost of each of these technologies fell by more than 70%. Most investors believe the reduction was driven by a variation of Moore's Law known as the "learning curve." According to this model, the industry would get ever more cost efficient the more units were installed.

After having studied the wind and solar industries for years, we had a radically different view.

Wind and solar are extremely energy intensive forms of power. The ubiquitous (albeit now modest) 1.5 MW GE wind turbine contains 40 tonnes of steel and 600 tonnes of concrete in the foundation alone. The tower adds another 150 tonnes of steel while the generator requires 9 tonnes of copper. All these materials require huge amounts of energy to mine, process and refine. Between 2010 and 2020, the cost of every form of energy – whether it be oil, natural gas, coal or uranium – fell by 90% from *peak to trough. It stands to reason that much of the reduction in the cost of renewables can be attributed to lower energy prices. Furthermore, renewables are very capital intensive. Over the past decade, we have experienced the lowest cost of capital in human history. Again, it is likely this too contributed to falling renewable energy cost. As simple as these insights were, no one else seemed to be talking about them. Instead, the industry and Wall Street analysts were convinced that renewable energy costs would continue to move ever lower – oftentimes contradicting the very laws of physics.*

For the full report see the link.

https://blog.gorozen.com/blog/high-energy-cost-hurts-wind-and-solar

'Monthly Equity Monitor' Stefane Marion – NBF Economics

Highlights

- *The Fed's decisively hawkish tone certainly complicates matters for global equity markets, which were already facing heightened financial stress and a challenging earnings outlook due to the slowing economy. With no relief in sight on interest rates, stock indices around the world have hit new cyclical lows, with most regions back in bear market territory at the end of Q3.*
- *Thanks to a spectacular recovery propelled by an extremely accommodating monetary and fiscal policy, we are 11 months into the mature phase of the business cycle. The slope of the yield curve (the difference between the 10-year Treasury yield and the 3-month Treasury bill) generally flattens during the mature phase as monetary policy becomes increasingly tight and economic conditions turn less favorable for risky assets. An even more negative signal for the economy and the stock market is the inversion of the yield curve (YC). Though the YC remains positive for now, but the risks of an inversion are rising as the Federal Reserve intends to raise its policy rate higher.*
- *If history is any guide, an inverted yield curve in the mature phase of the cycle does not bode well for U.S. stocks. Energy and materials are the sectors that normally fare best at the start of an inversion, with Gold posting significant positive gains. As the S&P/TSX is more concentrated in these sectors, Canadian equities tend to do better than U.S. stocks in this environment.*
- *Our asset allocation is modified this month to reflect a potential inversion of the yield curve. Our fixed income exposure is increased by 3% at the expense of cash. The recent dramatic tightening of U.S. financial conditions has been accompanied by a drop of money supply growth to a level that historically has not been considered inflationary.*
- *Our S&P/TSX sector allocation is modified this month as we consider the risks of tighter monetary policy and economic lethargy. We move information technology and utilities from underweight to market weight and consumer staples from market weight to overweight. To make room for these sectors, we are reducing our exposure to industrials and consumer discretionary given economic headwinds (from market weight to underweight).*

Hyperlink to the full report:

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=3d76bf14-91f1-466c-8473-c8a476436c07&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Back to the future?

As Yogi Berra reminds us, ‘Making predictions is hard, particularly about the future’ Predictions of Canada’s energy mix in 2035 or 45 or 50 have featured heavily in Canadian political platforms. It’s not the first time.

Germany's projected power sources. 1974

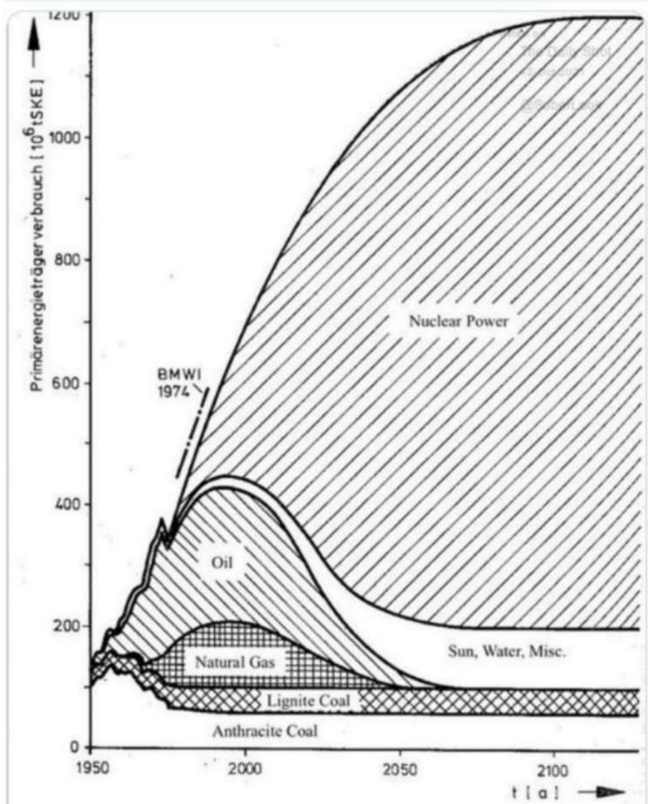
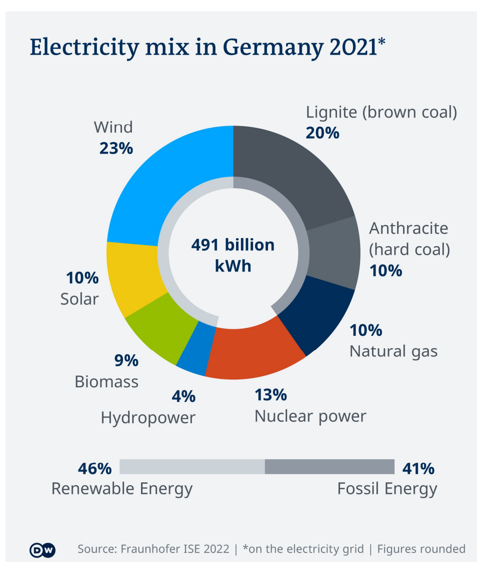


Figure 1: First model of primary energy consumption, based on the economic growth scenario provided by the Economics Ministry’s (BMWi) Energy Program in 1974 (million tons SKE).

https://www.linkedin.com/posts/timothy-stout-5b6951172_energy-europe-nuclearpower-activity-6981255714203709440-TuM8

German electrical power source mix in 2021



‘Germany's energy U-turn: Coal instead of gas’ DW.Com Aug 4, 2022

The following article details Germany’s plans for coal vs. realities. I advise a careful read through.

https://www.dw.com/en/germanys-energy-u-turn-coal-instead-of-gas/a-62709160

Two pieces from Peter Zeihan

The Costs of Germany's Support for Ukraine – Peter Zeihan

https://www.youtube.com/watch?v=Ioo37-e3Yl8

‘China and Semi-Conductors’ – Peter Zeihan

‘The Biden Administration has announced further limits on Chinese firms’ ability to access foreign (read: US dominated) semiconductor technology. Many of my followers ask why I don’t consider China a more capable potential threat to the global order than I do; the ability for Beijing to be cut off from global technology with what amounts to the stroke of a pen is one of them.’

https://zeihan.com/china-and-semiconductors/

Reuters Quote of the day - Oct 2014

"Those who expect the Chinese economy to be the largest in the world by 2035 will almost certainly be disappointed"

Michael Pettis - Professor of finance at Peking University in Beijing

Source: Reuters Daily Briefing – Oct 14, 2014 Linda

Q: When are Canadian bank stocks cheap?

A: When priced at book value (P/B:1)

Selected Canadian Financial Institutions Value Screens

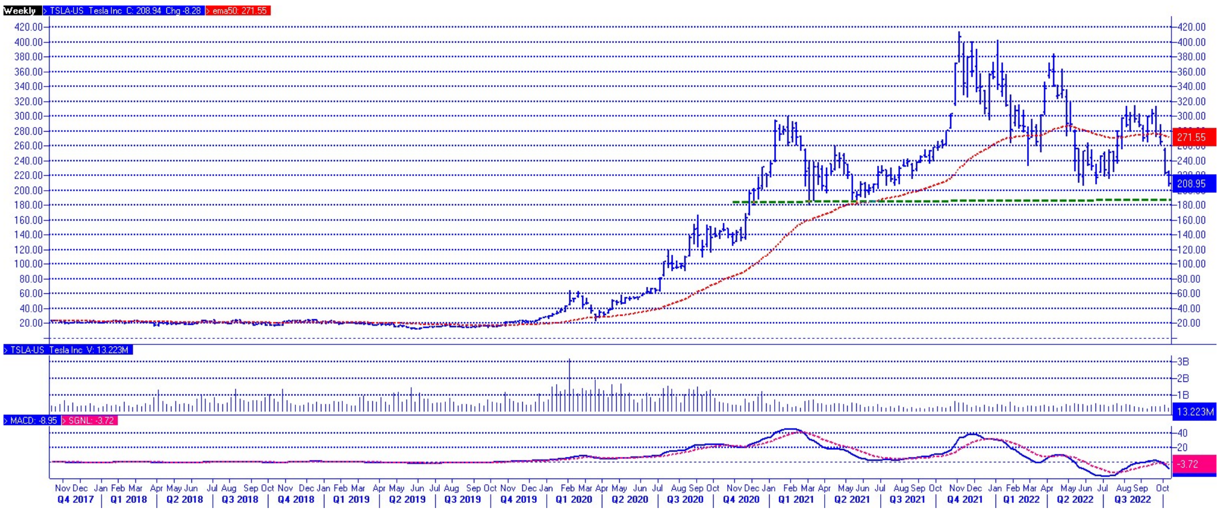
DESCRIPTION	SYMB.	LAST	P/B (FY-1)	DIV YIELD	P/E	EARNS YIELD	TOTAL RETURN*
BANK OF NOVA SCOTIA	BNS-T	$65.67	1.17	6.27%	7.82	12.8%	19.06%
CIBC	CM-T	$58.06	1.15	5.72%	8.32	12.0%	17.74%
MANULIFE	MFC-T	$21.76	0.81	6.07%	4.65	21.5%	27.57%
SUN LIFE FINANCIAL	SLF-T	$54.97	1.30	5.02%	8.35	12.0%	17.00%
LAURENTIAN BANK	LB-T	$29.45	0.51	6.11%	22.65	4.4%	10.53%
CDN WESTERN BANK	CWB-T	$22.34	0.64	5.55%	6.05	16.5%	22.08%

***TOTAL RETURN assumes earnings yield is reflected in price gains + cash dividend yield over time.**

We like **Scotia, CIBC, Sunlife and Manulife.** We note the huge discounts in Laurentian and Cdn Western Bank. They could prove huge wins, Their smaller size and relative lack of customer diversification makes them a harder choice

DISCLAIMER: I hold Scotia, CIBC, Sunlife and Manulife, personally, for family members and for client accounts over which I have trading authority. We have traded in all four with in the past 60 days.

Tesla (TSLA $208.75) Continues to fall…



The green line on the chart connects Tesla's stock price breakout past the Aug/2020 highs with the March/2021 and June/2021 lows around where the price is today. These low points may represent a psychological 'red line' below which investors panic…or not.

The dotted red line plots the 50-week moving average price, now $272. At $208, Tesla's share price is 22% below this average, meaning the average investor has a 22% loss. While most great companies share prices will be in this position at some point, for investors holding low/no dividend paying stocks, the price return is all they're getting. If the previous price range was very high vs. earnings (ahem!) the subsequent 'correction' can be painful.

Regard's Tesla's P/E, after declining 50% the stock price is 75 X trailing actual earnings and 50 X projected earnings (note: projected). The S&P500 average P/E (includes Tesla and similar stories) is currently 18.6. Tesla trades at a 2.6 X premium to the broader market. Tesla is a car company. Selected auto sector P/E's: Toyota 7.8, Mercedes 4.6, GM 4.8, Ford 5.8, Honda 6.8, Nissan 10.6. We continue to doubt the premium investors have been and are still paying with seeming religious fervor for Tesla's shares will result in profits.

Someone has to lose money to keep the market honest. When fans of concept stocks lose their enthusiasm, the crash in hubris costs more than money. Experience tells us their self-worth suffers. The response in this order is fear, followed by anger, then despondency, then disgust. *"The market is rigged. I got screwed. They're all thieves. Where were the regulators"?* etc. They vow never to do it again…until the next big thing comes along.

'Reaping the Whirlwind: A September 2022 Inflation Update!' Dr. Aswath Damodaran - Stern School of Business, NYU. Blog entry Sept 26, 2022

Dr. Damodaran writes detailed, technical yet readable explanations of financial valuations.

His ***Musings on Market's*** blog makes monthly commentaries on things financial. His work is well worth reading. Be prepared to sit down and concentrate. You may earn a headache or two along the way. If you need an explainer let us know.

Long term readers may recall our pointing to Dr. Damodaran's work on Tesla back in 2014. He updated his original work regularly with his latest valuation blog post Nov 9, 2021 ***'Tesla's Trillion Dollar Moment'***. We passed it along to our clients in November.

https://aswathdamodaran.blogspot.com/2021/11/teslas-trillion-dollar-moment-valuation.html

His Nov 9/2021 post valued Tesla at $571 per share ($190.30 adjusted for the Aug/2022 3:1 stock split). Nov 4/2021, Tesla hit an all-time split-adjusted high of $414.50. Market cap at the time exceeded $1 Trillion. Elon Musk was featured by Bloomberg Nov 1, 2021 as the richest man in the world with a net worth "3 X that of Warren Buffet". At the time we reminded our clients to recognize extremes. We advised continuing to avoid Tesla, along with the merry band of FAANG stocks. At this writing Tesla's market cap is $680 billion for a $360 billion loss. That's a lot of paper money that isn't there.

Dr. Damodaran's Nov/2021 valuation had Tesla's stock as 2.2X over-valued, meaning the stock needed to fall 50% to reach 'fair value'. His mea culpa qualified that he had been wrong on Tesla since his first 2014 work. Wrong as in the share price continued to rise despite being expensive. He noted that Tesla's explosive earnings growth was actually less than he'd provided for in his models, yet the stock went up farther. There's no telling what investors will pay.

His Nov/2021 work eventually proved prescient as investors appear to have given up the game. Tesla's share price has subsequently plummeted 49.5%. As Tesla was, and perhaps still is, the most fervently believed-in story, there may be more disappointment for Tesla shareholders to come. It's been such a dominant story, one wonders what the broader emotional spillover will be.

This story confirms that value matters – eventually. Patience – both for what you invest in and stay away from – is required. Some of the worst losses we're seen investors take are the ***Fear Of Missing Out*** (FOMO) ones where a normally conservative investor tires of their brother-in-law's golf game bragging, throws in the towel and buys a speculative name.

Dr Damodaran updates his broad market Equity Risk Premium model value for the S&P500.

https://aswathdamodaran.blogspot.com/2022/09/inflation-interest-rates-and-stock.html

While the entire multi-page post with 21 charts and tables (!!) is required reading and will be on the test, I'll spare the class with this summary. With many caveats, Dr. Damodaran observes that US stocks are now slightly below fair value. He projects much of the inflation risk is priced into interest rates. The S&P500 has largely priced this in too. His main caveats surround the damage to investor risk appetite. Fear must abate. It does so by selling.

I believe most of the downside risk for the market as a whole is behind us.

Speaking of cars…

New York 1929 –1928 Buick Roadster for sale $100. 1928 MSRP was $1,765 = $30,765 in 2022 dollars. Hemmings recent collector car price range (in top condition) $30 to $45K.

Takeaways: 1) Cars are not a good investment. 2) Paper boys dressed better than we do!

Hilberry Portfolio: Whadaya' done for me lately?

US Dollar Index (DXY-$113.34) 1992-2022 – Recognize Extremes

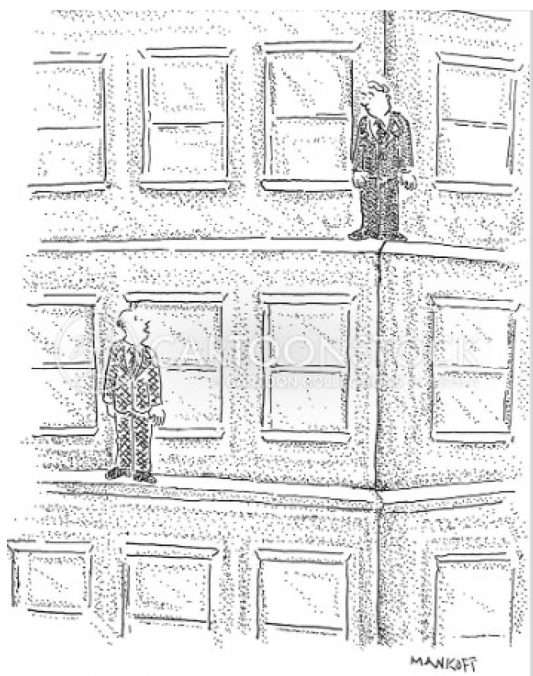
We regularly field calls from clients responding to market commentary. *"CNN predicts the market will crash". "Zero Hedge says it's going to get worse" "Jeremy Grantham predicts recession"* (see the opening section). Setting aside pundit accuracy, these predictions are often through a US lens… Currencies matter. Canadian investors returns often vary widely from US-centric results. Our returns often vary further.

We don't invest in 'the market' we own individual dividend paying stocks for mostly Canadian dollar-based clients For example:

Jan 4, 2022 to Wed Oct 12 close the S&P500 showed a **-28%** decline while the USD gained **8%** vs the Loonie as investors fled to safety. The FOREX factor reduced the loss to **-19.3%** in Canadian funds**.** Our preferred US stock market benchmark is the Dow Industrials. With it's lack of nosebleed valued NASDAQ/FANG and Tesla-types, plus receiving dividends, the Dow Total Return index is 'only' down **-19.7%** in USD. Adding back the FOREX factor reduces this Dow's loss for Canadian investors to **-11.7%.** This result confirms our repeated warning that Canadian investors be aware of currencies on their returns. We now think the Loonie is cheap. It's a great time for US investors to buy Canadian assets.

Our US dollar dividend portfolio avoided most of the tech wreck (we own Intel and it's been no fun) emphasizing conventional energy and industrials. Jan 4, 2022 to Oct 12, 2022 the Hilberry US dollar dividend portfolio shows a **-12.8%** in US dollars net of all costs. The Canadianized return of our US dollar result is **-4.9%.**

Our North American dividend portfolio typically allocates +/- 50% to US and CDN dollar stocks. Jan 4, 2022 to Oct 12, 2022, our CDN/US blended portfolio shows **-5.7%** loss in Canadian dollars (excludes Thursday's 3% price jumps). No fun but a lot less painful than **-28%** thanks. Losing less leaves us emotionally less stressed and hopefully clearer headed. We are more likely to see the current values as the beginning of future gains vs. the start of even worse losses.



"Oh, fine, thanks. And yourself?"

Our semi-annual review is back!

Oct 25th in Duncan, Oct 27th in Comox.

See our Upcoming Events page for details

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD Oct 14, 2022

DOW INDUSTRIALS:	29655
S&P 500:	3,592
S&P/TSX COMP:	18404
WTI:	$85.66
LOONIE IN $USD:	0.7197US

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