HILBERRY GROUP
WEALTH MANAGEMENT

April 14, 2023

Econ 101: Supply Vs Demand

If you want 'affordable' houses, build more of them and increase jobs.

Left-leaning politicians have jumped on the house price band-wagon lately, shouting ***'Fat cats own all the condos and won't rent them to us'*.**

In a confused bid to increase availability (supply), these folks support an 'empty housing tax' on vacant buildings. There are four breathtaking leaps of logic here.

1) Adding a cost to anything will somehow drive down it's price.
2) Punishing owners of empty condos/houses (who paid for the property with their own money) who, for whatever reason, choose not to occupy or rent, will encourage building more of the same.
3) Government telling homeowners what they cannot do with their homes will encourage building more houses at a lower price.
4) Increased taxes is the solution to everything.

This same bandwagon complains ***'All the money is going into houses for the rich'*.** Well…if you drive up the cost of new houses via taxes and regulations, guess who cannot afford to buy one?

We have clients who are property developers. They advise that after going through a multi-year permitting process fraught with NIMBY risks that can render the original raw land purchase moot, increased environmental regulations, municipal sceptic, land use fees, municiple 'green belt' advocacy, school levies, Provincial water, fire suppression, zoning battles have added over $50,000 to the cost of building a single-family dwelling. Costs of building in our area are approaching $400 per square foot.

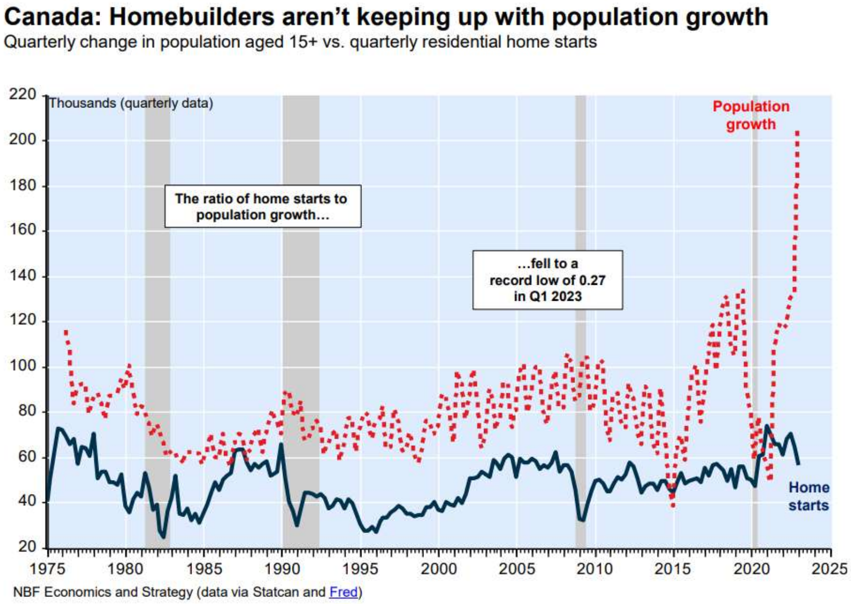
A modest (by today's standards) 2,500 sq foot single-family, 3 bedroom, two baths, finished basement house costs $1,000,000 to put up the building alone. Add a $300,000 lot, plus, plus, plus, plus and you'd better have $1.5 million to spend or forget about it. Assuming a 10% down-payment this leaves $1.35 million to be mortgaged. A 25-year mortgage at 5% interest requires a $7,891 monthly mortgage payment = $94,703 per year. To qualify for financing, the monthly payment must be a maximum of 35% of pre-tax income. This borrower requires a pre-tax income family of $270,000 (placing them into BC's top marginal tax brackets of 53%). To be a '1%'er' Assuming a dual income family sharing $200K+$70K = $270K. Taxes are going to consume $75,500, leaving $194,500 after-tax. The lower wage earning is effectively paying all their income to tax. Subtract the $94,703 and roughly $100,000 remains. The average pre-tax family income in BC is $92,795.

https://advisorsavvy.com/average-annual-income/

Staring at this hard cold math, again our merry band-waggoneers want the Government to step in and build subsidized houses. IE to compete against the very builders they complain about via artificially reduced-price housing. That policy will of course drive even more builders away. Those that remain must become 'slum landlords' as putting ANY outlay into the building is a lost cause.

Finally, yet again, the waggoneers demand restricting access to Canadian housing by 'foreign buyers' (a suspiciously racist tilt). The thinking is, if one restricts the number of buyers, it will leave the remainder (presumably Canadian-only) facing less competition, driving down the prices. Need we remind that the many of the homeowners who want to sell are older Canadians downsizing into retirement? Did anyone ask how they feel about their selling prices falling? Will (theoretically) reducing the pool of buyers, induce the construction of more houses at lower costs? Canada is growing via immigration (a very good thing in our eyes) and is not building enough houses (a bad thing). Supply vs. Demand

NBF explains.



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The above tells us that, Yes house prices got ahead of themselves in 2020-21. Given immigration, No house prices are not likely to crash. We repeat our belief house prices will do nothing for a while.

Meanwhile the drumbeats of doom have been telling us we're facing a terrible downturn. Recessions are not fun. They are a period of natural selection 'stress testing' and washing out excesses.. Amazon, Microsoft, Facebook, Twitter have realized they were getting ahead of themselves and been laying off workers. Through no fault of their own, recessions can see workers lose their jobs or face cut backs. The brutal truth is recessions are simply part of the economic cycle.

Things can't be THAT bad…

Source: ChartR **https://www.chartr.co/newsletters/2023-04-10**

US Grand Strategy: NATO, Alliances, & Ukraine - how alliances underpin American influence – Perun YouTube

Got an itch for a weekly geopolitical commentary? I have book-marked Perun's YouTube Channel. He tends to focus on the geopolitical economics of warfare. Think the cost of tanks and ships. WARNING: Perun's YouTube reviews are all 1 hour long. Boooooring.

Yet defense economics and political corruption explains Russia's abysmal performance in Ukraine. As noted in last week's Reading' to Perun's commentary, add Antony Beevor's *'Russia: Revolution and Civil War 1917-1921'*.

A short-hand version of Mr. Beevor's book is here (we think you should force your self to read it).

YouTube: Antony Beevor Breaks Down the Russian Revolution of 1917

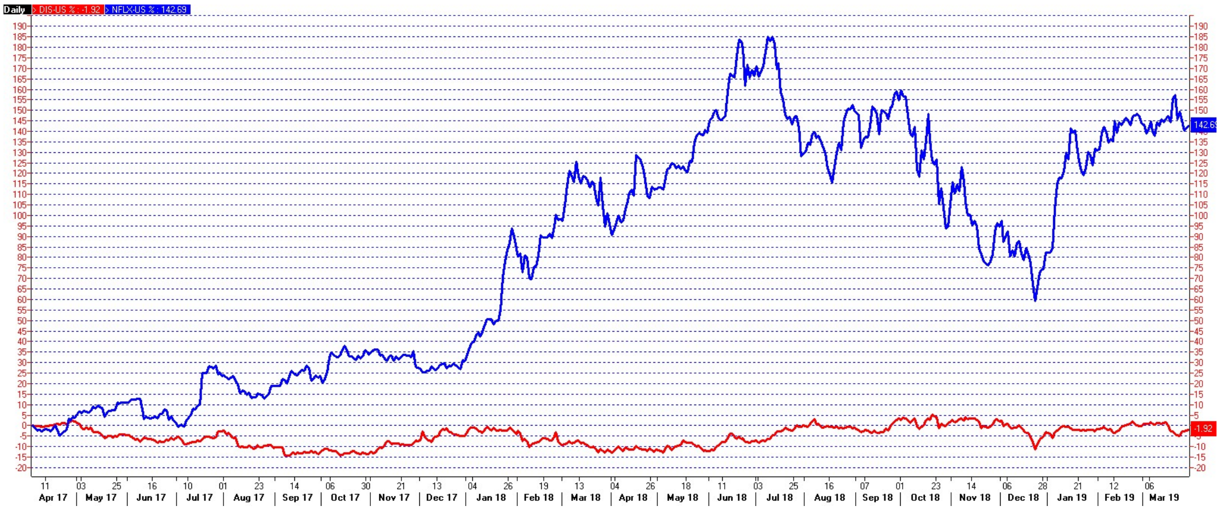
https://www.youtube.com/watch?v=p52KiKFkLRM

Ukraine appears to be a sad repeat of previous Russian failures. Putin proudly advises 'Russian's know how to suffer'. He seems ready to prove the point. History says, eventually Russian's tire of the leaders who brought that suffering. It doesn't end well.

What about Disney?

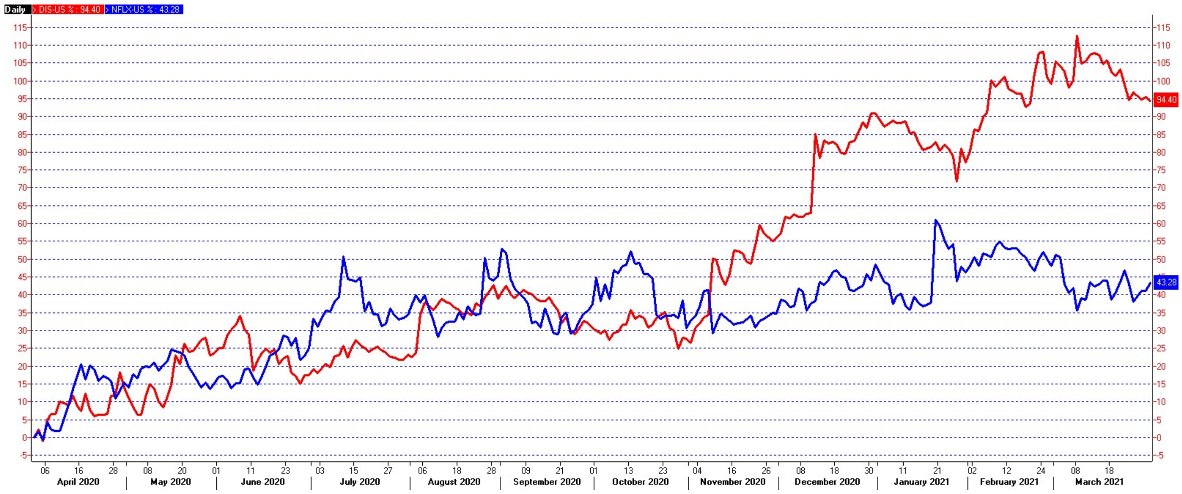
Pre-COVID, the financial media narrative on movie entertainment was *'NetFlix will kill Disney'* From March/2017 to March/2019 Neflix soared 146%, while Disney declined -1.9%.

Netflix (NFLX-Blue +146%) vs Disney (DIS-red -1.9%) Mar/2017-Mar/2019 - % change



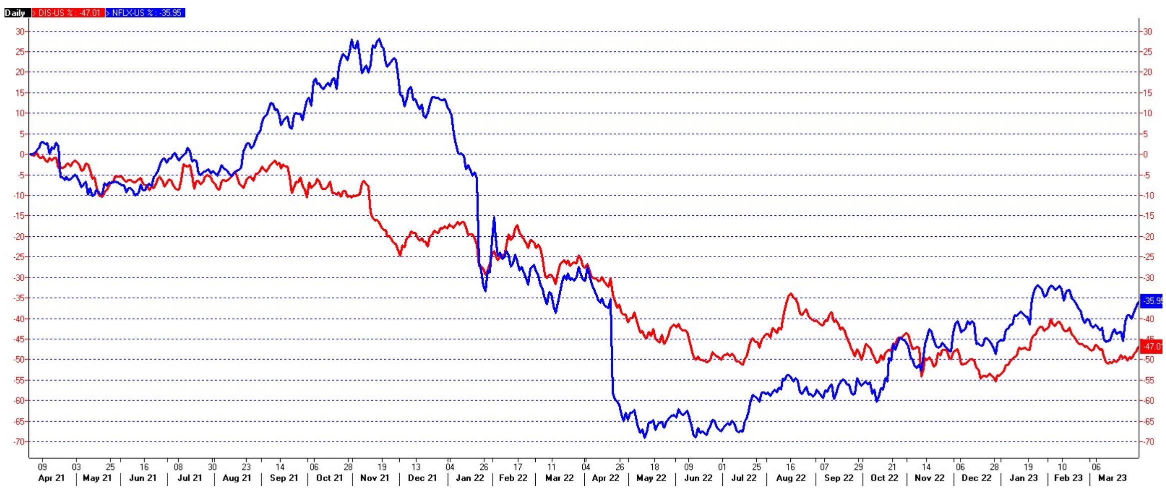
The impact of COVID-19 became clearer in March/2020. March/2020 to May/2021 Disney rose 110% while Netflix climbed an additional 55%.

Netflix (NFLX-Blue +43%) vs Disney (DIS-red-+94%) March/2020-March/2021 - % change

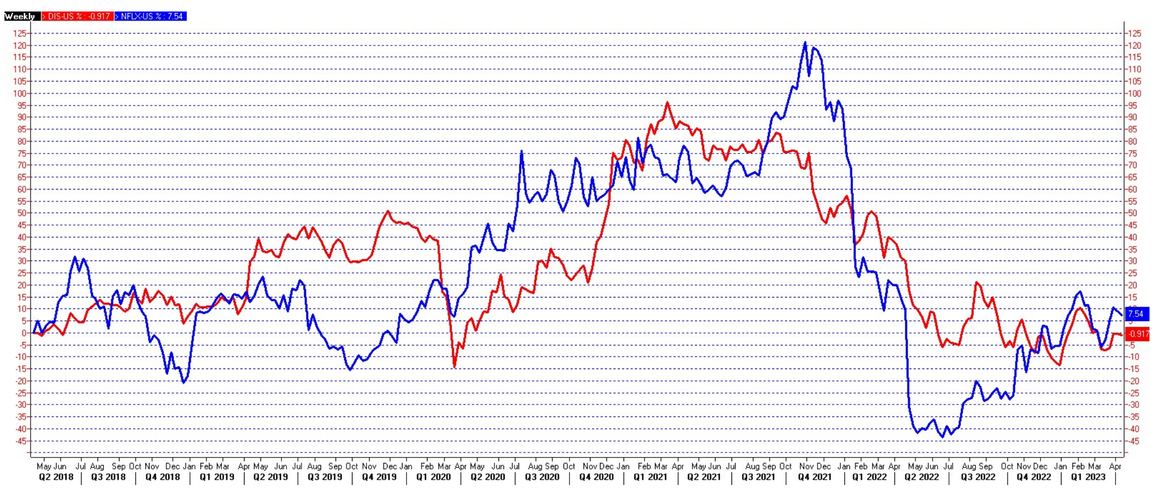


And then…COVID's impact on entertainment proved temporary. Investor's panicked and dumped both names. Since March/2021 Netflix and Disney have declined sharply.

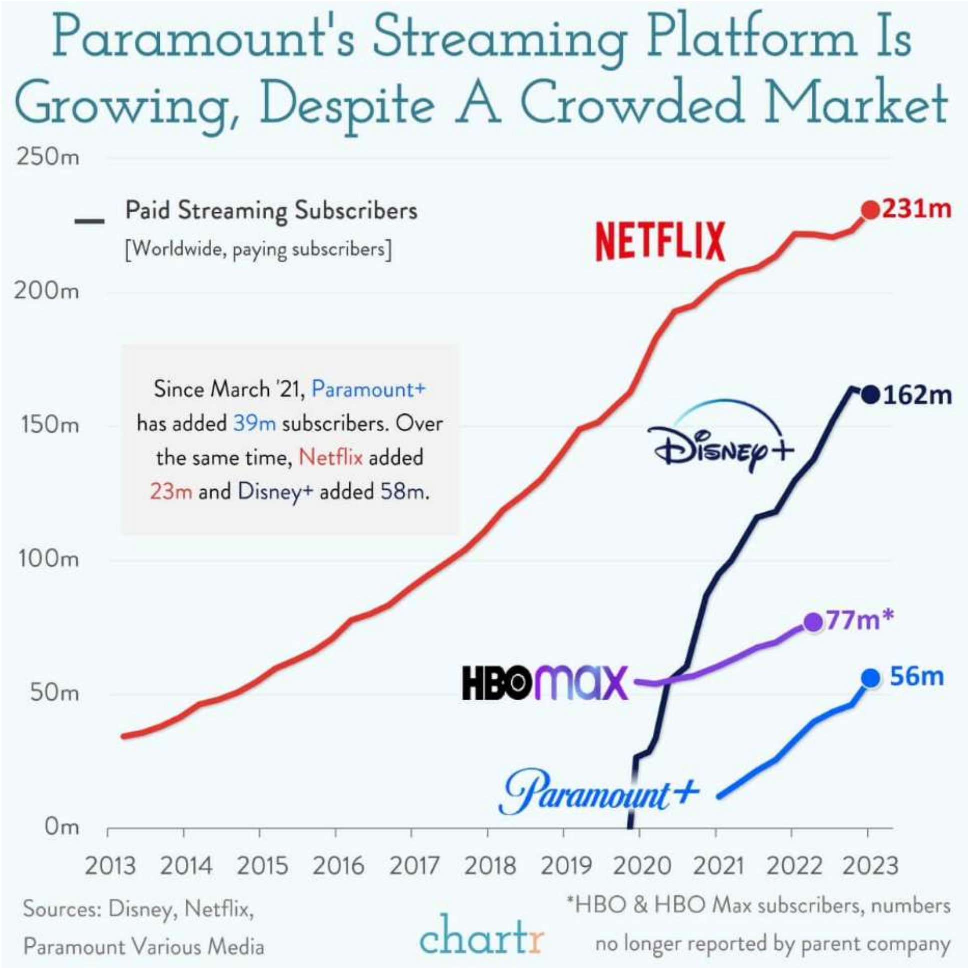
Netflix (NFLX-Blue -36%) vs Disney (DIS-red -47%) March/2021-March/2023 - % change



Netflix (NFLX-Blue +7.6%) vs Disney (DIS-red -0.8%) March/2018-March/2023 - % change



Meanwhile is the streaming business dead?



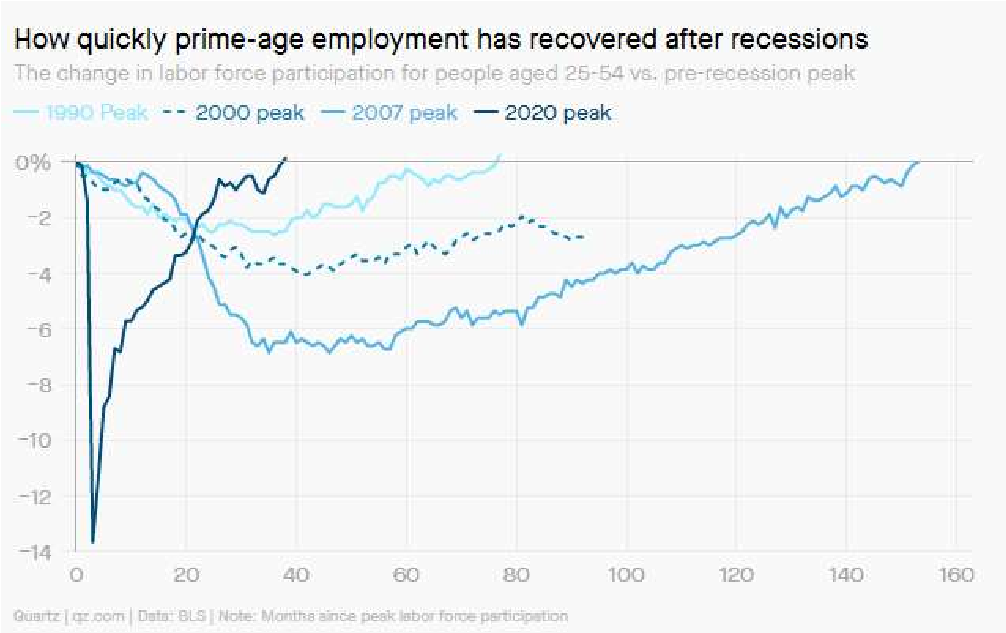
Source: ChartR Apr 12, 2024

Since starting their streaming site in 2020, Disney has seen the largest raw subscriber growth by a wide margin. Anyone with kids (or grandkids) will know this.

What do we think?

With no dividends, Disney and Netflix don't fit our Dividend Growth model today. That might change. Disney was a solid dividend payer for years. 2010 to 2019 the dividend doubled. Responding to the early 2020 COVID-19 collapse in theme park revenue, the Board of Directors cut the 1.5% dividend to zero in June/2020. No dividend has been paid since. Recently reinstated CEO Bob Igor (Disney's largest individual shareholder) wants a dividend. The reinstated dividend is likely to be lower that in the past and is projected to begin paying in 2024. The above ChartR graph shows strong streaming growth. Add in the return of traffic to Disney Theme Parks (no matter what Ron DeSantis says). NetFlix is unlikely to pay a dividend in the near future. We like Disney's prospects. Patient investors might have a look.

‘You lived through the fastest economic recovery in three decades’ – Quartz Apr 1, 2023



I’ve grumbled about a ‘Big-Government-get’s Bigger’ response to the COVID-19 Pandemic I’ve complained about Central Bank ‘helicopter money’ monetary response, to the resulting induced recession. The combination of Government restrictions and extremely loose monetary policy ended with a surge in inflation. Right-wingers and conspiracy theorists saw it was a Deep State power grab. I’ll believe those actions, while in hindsight excessive, weren’t somehow morally wrong. What were governments supposed to do? Let millions die and even more of us lose our life savings?

My concern is once Governments get their hands on voter mandates, and the tax money to fund it, they are reluctant to let go. *‘Well, we solved that problem, now let’s go solve some even bigger ones’*. It’s a Bull Market in government self belief. Tax revenue is limited, paying for those Big Ideas is expensive, deficits and debt grow exponentially.

We’re seeing this in Canadian politics. Solving the XYZ-existential crises by tax and spend. In Today’s politicians will be long retired when the bill is presented.

With those caveats and complaints in mind, things are actually going quite well for wage-earners. They have labor pricing power for a change. Heading off the political credit-taking, as we’ve long explained, demographics explain this trend. Baby Boomers aging out followed by the Millennials entering their family building years. Retiring Boomers take their peak skills, experience, and earnings power with them. Those stepping in can demand higher wages. Employers have no choice but to pay up. While good for immediate earnings, wage growth historically leads to inflation. I’m not predicting an early 1980’s double-digit inflation. We might even see inflation sag back into the 2% range (see Scott Grannis post below) but…I doubt we’ll see multi-year periods of sub-2% inflation again in my lifetime.

Quarts explains job and wage growth:

https://qz.com/you-lived-through-the-fastest-economic-recovery-in-thre-1850313273

Scott Explains why inflation will abate.

‘Inflation is yesterday’s news’ – Scott Grannis April 12, 2023

http://scottgrannis.blogspot.com/2023/04/inflation-is-yesterdays-news.html

Summing up

We continue to believe…

- **Inflation has peaked.**
  - Invest long-term, borrow short-term.
  - Now is NOT the time to lock in your mortgage rate.
  - Floating is probably a better deal now.
- **Stock markets have been pricing in a recession since the 2nd quarter of 2022**.
  - S&P500 peak to trough -27%. Don’t forget the 2021 runup.
  - That washing-out-excess thing.
- **A recession is on now.**
  - We think it will be relatively mild.
- **Stocks have over-priced the recession we’re getting** (dropped too much).
  - We think the worst that happens for stocks from here is ‘not much’.
- **Our dividend portfolio rolling 12-0month returns are flat.**
  - We’ve used the past to work the dividend income higher.
  - Recessions can be gifts.
- **We might be early or wrong on near-term price direction.**
  - We don’t buy The Market. Dividends pay us to wait.
  - Dividends + patience + not doing stupid = surprising returns.
- **We like the Loonie, and we like Canada’s prospects.**
  - That which has gone against Canada could now be in our favor.

Have a Great Weekend

Steve & Anna Hilberry

April 14, 2023

FOR THE RECORD April 14, 2023

DOW INDUSTRIALS:	33,846
S&P 500:	4,132
S&P/TSX COMP:	20554
WTI:	$82.43
LOONIE IN $USD:	$0.7480 $US

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