Hilberry Group
Wealth Management

Sept 22, 2023

‘For whatever ye sow, so shall ye also reap’

Western Governments of varying stripes have pursued regulatory and fiscal policies resulting in inflation. Will their political careers reap what they’ve sown?

According to 1970’s economist Milton Friedman…*“Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.”* We agree, with some modifications.

Mr. Friedman’s comments were made in the context of the 1970’s Stagflation. There are similarities and important differences with today. In the 1960’s, with the Democrats controlling both houses of Congress, US President Lyndon B Johnson (LBJ) passed his *‘Great Society’* legislation. https://en.wikipedia.org/wiki/Great_Society . LBJ engineered significant tax cuts for those in the highest tax brackets from 91% (yes 91%) to ‘only’ 71%. Ah the good old days of Big Government. They really knew how to tax and spend!

The following decade saw rampant inflation. From a 1960s base under 2% a combination of 1970’s loose monetary and fiscal policy, artificially constrained energy supplies (Arab Oil embargo) and Cost Of Living Allowance (COLA) clauses in union contracts against a background of declining GDP growth saw inflation peak at 14.5% in 1980. Sounding familiar?

This time around we have similar inflationary fiscal policies, (everyone gets an achievement award and a cheque), but we have rising taxes and again constrained energy supply, this time via Government mandate. In past readings we’ve predicted recent government policies (COVID response, regulations, taxes) would be inflationary. To be clear we are not saying all those responses were bad ones. It’s the unintended consequences thing. It takes awhile for headline inflation to show up in the wallet. I filled up the diesel farm truck at the Glenora Store this weekend. 100 liters later I paid $218. You now have my attention! Politicians often use the time gap between policy and result attempting to avoid connecting the dots.

We’ve predicted political fall-out from inflationary policies. According to US poll aggregator 538.com Joe Biden is now floundering in the popularity polls. We’re not saying that’s a good thing. We don’t look forward to another Trump administration.

https://projects.fivethirtyeight.com/polls/

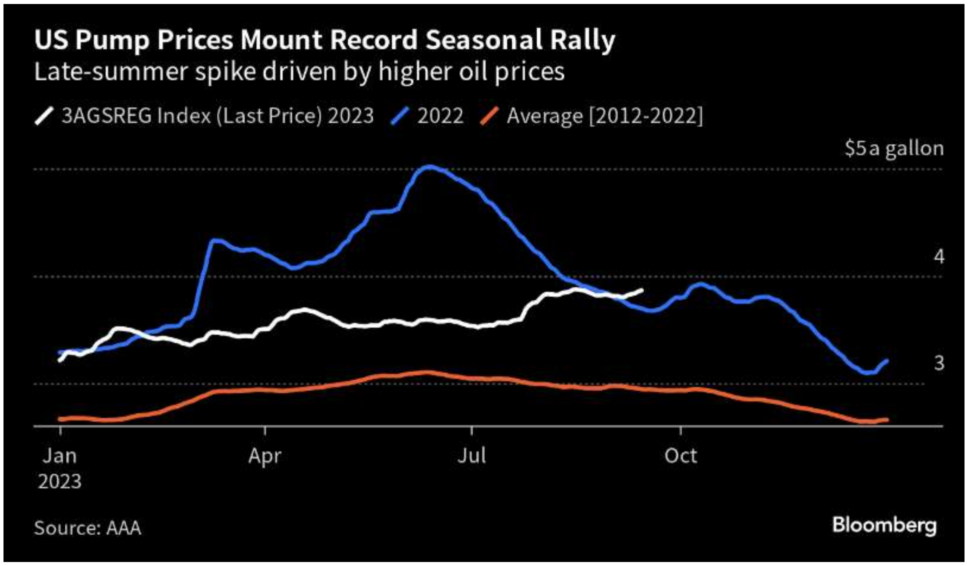
The Canadian Federal Liberals aren’t doing any better.

https://angusreid.org/trudeau-poilievre-best-prime-minister-liberals-conservatives-approval/

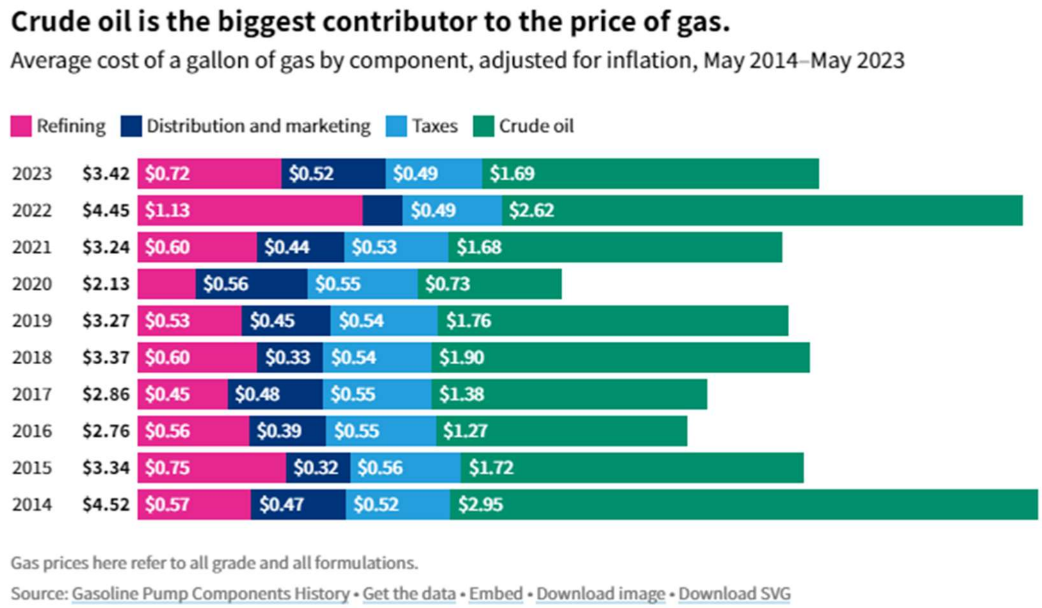
What is the near-term direction of the energy component of inflation?

From National Bank’s Daily Energy and FOREX note Sept 18, 2023

Right in line with the step up in crude prices has been the push higher in US gasoline prices – working against the US administration’s target on inflation. The average US gasoline price is now just over ***$3.86/gallon*** *which, as highlighted below, is above the seasonal average. The price of gasoline on average is up nearly 8% over the last 8 weeks – which is seasonally uncommon. Gasoline prices alone accounted for just over half of the increase in the US CPI. A continued push higher will eventually weigh not only on consumption but the potential for the bad “R” word to again start rearing its ugly head. Recall the US SPR release was originally done to help keep a lid on gasoline prices as it was a major hot button heading into the US midterm elections. What is the plan this time around?*

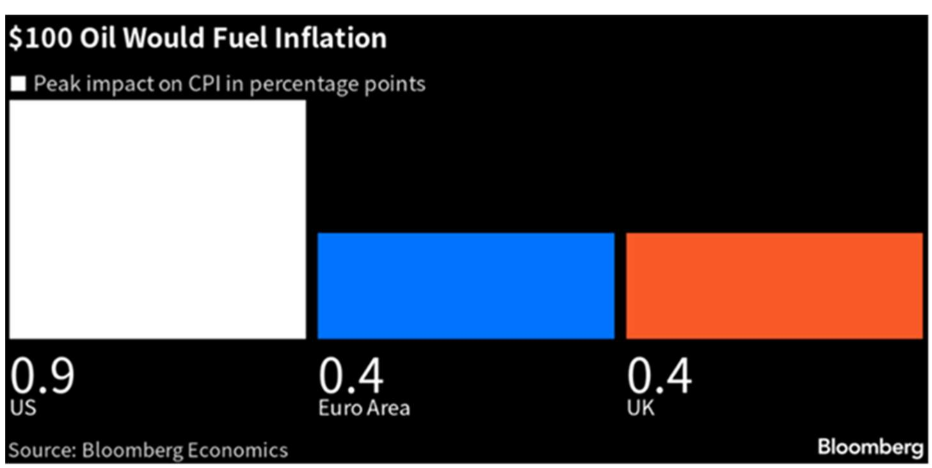


‘What causes high gas prices?’ USA Facts.Org Sept 1, 2023



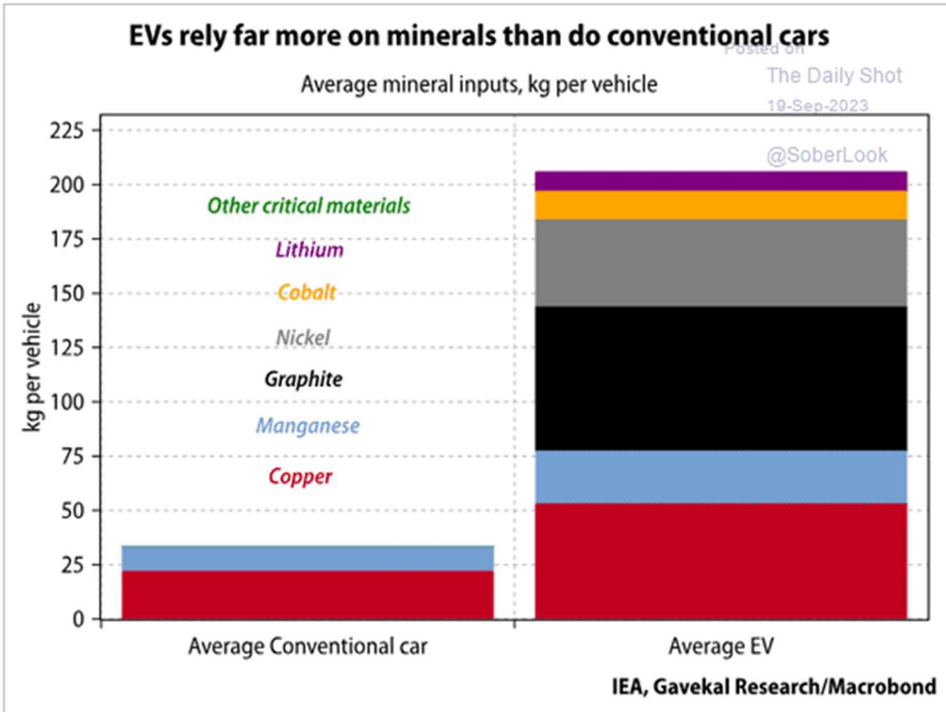
https://usafacts.org/articles/what-causes-high-gas-prices/

Contrary to right-wing media types, in the United States, direct US State and Federal taxes on fuel have not been a significant factor in US gasoline pricing at the pump. As any cross-border shopper knows, this is not the case in Canada. The indirect affect of Federal and State taxes and regulations on US domestic producers, slow-walking pipeline approvals (supply) that connect Canadian producers to US consumers (ahem…bypassing US producers), broader regulatory plans to phase out fossil fuels (supply), talk of ‘Wind Fall Taxes’ on oil producers (costs - where was that discussion when the industry was going broke in 2016) and the general anti-‘Big Oil’ industry tone (regulations), have unsurprisingly convinced US domestic hydrocarbon energy producers to rein in spending. The response in Canada has been even more severe. International hydrocarbon money has fled Canada in the billions. The historical response of US and Canadian producers to WTI nearing $100 has been ‘*Drill Baby Drill*’. Not happening. Demand up, supply down. It’s pretty simple. WTI prices up. WTI up = inflation up. Voters are not amused.



As we attempt an energy transition, we'll need a lot of rare earth metals explaining the rare-earth metals rush.

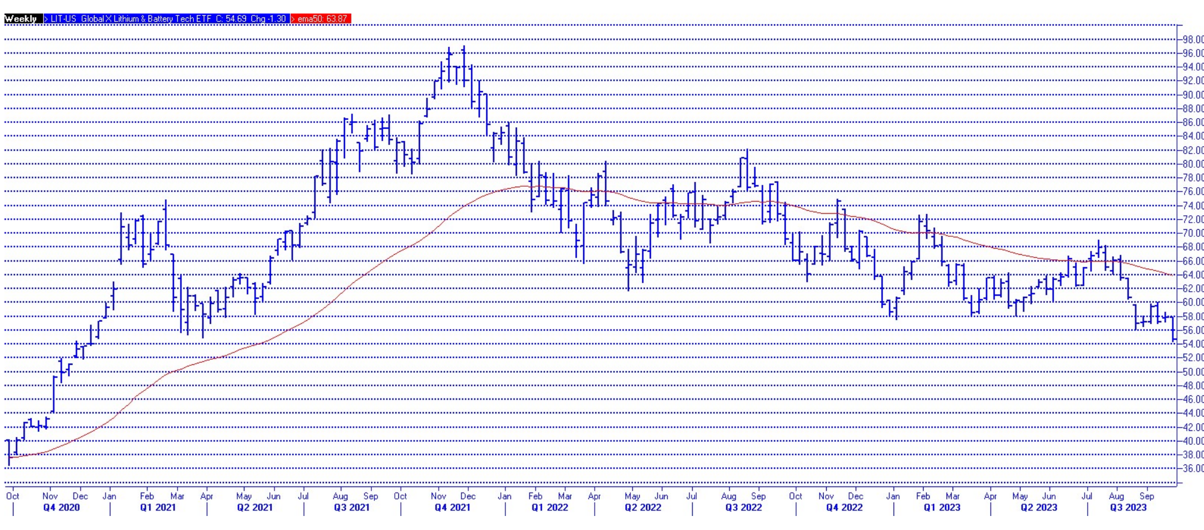
Food for Thought: Here is reliance on key minerals in vehicle production:



Source WSJ Daily shot

What do investors betting their <u>own</u> money think?

Global X Lithium and Battery Tech ETF (LIT-$USD-$54.71) – weekly – 5 years



Source: Refinitiv, NBF, Hilberry.

LIT hit a new 52-week low of $54.37 this week, breaking our downside alarm of $55. What about over the longer term?

Global X Lithium and Battery Tech ETF (LIT-$USD-$54.71) – monthly – 20 years

Source: Refinitiv, NBF, Hilberry.

The IPO was in July, 2010. The opening trade was $31.50. Ten years later, in June 2020, with Donald Trump the White House, the stock market price closed at $31.65. Bummer dude. Joe Biden was elected US President in Nov/2020. As went his political fortunes, so went the stock price. In Nov/2022 LIT's priced surged to $52.22. It traded over $94 in Dec/2021, peaking within weeks of the broader FANG/Social Media/ESG surge. Like the weather, the political will has decidedly cooled lately.

DISCLAIMER: I hold no position in the Global X Lithium and Battery Tech ETF. We have not traded in the security within the last 60 days.

Sunak's Green U-Turn Angers Tories, Casts Doubt on Net Zero (2)

- UK premier weighs delaying ban on petrol, diesel cars to 2035
- Plans speech on green agenda this week, before Tory conference

Source: Bloomberg

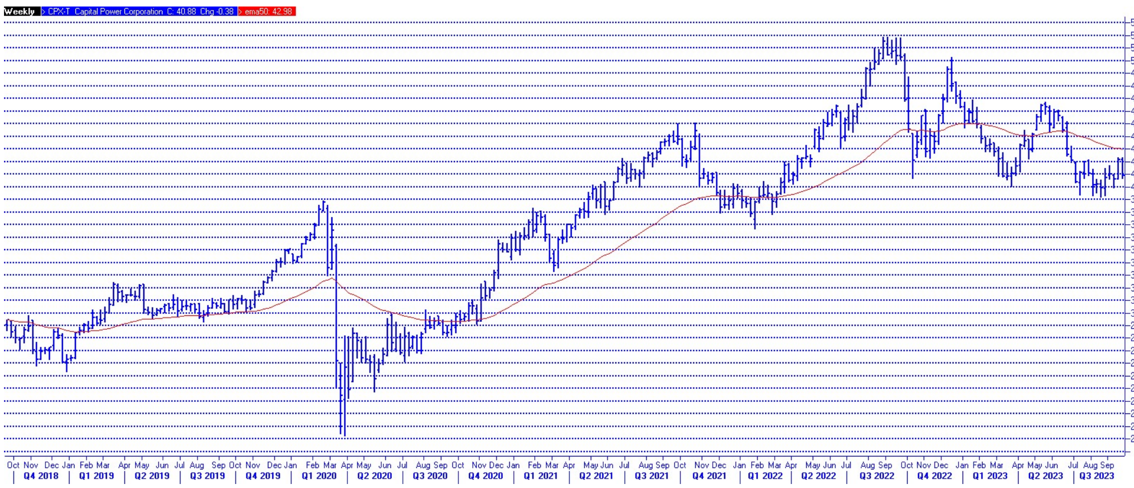
China climate envoy says phasing out fossil fuels 'unrealistic'

Source: Reuters

This MIGHT be an entry point for fans of Lithium. Only adventuresome types need apply. We remain on the side lines. That could change.

There are less risky energy transition profits to be had right here in Canada. Just maybe not how you think.

Capital Power (CPX-TSX-$40.87) – weekly ranges – 5 years



Source: Refinitiv, NBF, Hilberry.

Edmonton-based electrical power producer **Capital Power** is a core holding in our Canadian Dividend Growth portfolio. The current dividend is $2.46. In 2018 the dividend was $1.67. Income is up 47% over 5 years. 9.5% per year income growth is well above inflation. At the recent $41 price per share, the $2.46 dividend is priced to pay 6.0%. Beats bank GIC rates. Capital Power, being a Canadian-domiciled publicly traded company pays a dividend eligible for the Canadian Dividend Tax Credit (CDTC). A British Columbia taxpayer whose only taxable income was from CDTC eligible dividends, can earn up to $91,310 in 2023 and pay 1.63% tax on CDTC dividends*.

*Reference TaxTips.Ca: https://www.taxtips.ca/taxrates/bc.htm

Sept/2018 Capital Power's share price averaged $28.10. Compared to the 2018 $1.67 dividend, the stock was priced to pay 5.95% dividend yield. Same as today. Unsurprisingly, as income has grown, so has the stock price. This week Capital Power's shares also approached 52-week lows. After the sell-off, the stock price is still up 44% over the past 5 years. It has been a solid performer. We see today's price as a chance to buy. NBF commented this week.

NBF's Sept 21 notes:

Revisiting Capital Power (CPX-TSX-$40.87)*. Alberta spot power prices have averaged >$160/MWh in Q3 ($154 YTD), which is more than double our long-term power price assumption of $75. Recall, every +$10 increase to our long-term power price assumption represents ~20% valuation upside. As an incumbent, CPX is well positioned to benefit from reduced competition related to Alberta's moratorium on building new renewables, and Ottawa trying to block new natural gas-fired generation facilities via its draft clean electricity regulations. This slowdown in new supply coming online comes at a time of power demand growth in Alberta, rising carbon taxes, and labour cost inflation - combining to support upward pressure on spot Alberta power prices.*

- *Despite being off coal in 2024, and having a clear path towards net zero by 2045 (not just a pledge), the stock trades at just 5x AFFO (20% FCF yield). Looking ahead to this time next year when the company is officially off coal, and assuming its $2.3 bln Genesee carbon capture project is sanctioned by then as well, a re-rate to just 8x AFFO would translate into a $65 stock price, representing 50% upside before considering the torque from higher merchant* *power prices - i.e., $100/MWh long-term Alberta pricing instead of our current $75 would be another 50% upside;*

- *On the organic growth front, the company has secured $655mm of new projects in Ontario YTD, adding ~350 MW of high quality, contracted gas-fired and battery storage capacity. Overall, CPX has a growth pipeline of 4,700 MW of gas, wind, solar and storage, which is on top of the $2.3 bln ($0.5-$0.6 bln net) Genesee CCS opportunity, underpinning the company's sector leading 6% annual dividend growth rate;*

- *Bottom line, despite the ~100% total return that CPX has generated for investors over the past 5 years, we still very much see the potential for the stock to double again over the next 5 years, and perhaps sooner if all the stars align.*

An electrical power producer with a long history of using coal, based in Edmonton the capital of Canada's much maligned Alberta can be a great Green Investment. The recent price declines make CPX an easier risk to take on.

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

Staying in Alberta… we predict this next one will quietly go nowhere.

'*Alberta to explore leaving CPP as report lays claim to $334B, more than half of fund'* CBC, Sept 21, 2023

https://www.cbc.ca/news/canada/calgary/alberta-premier-danielle-smith-nate-horner-1.6973981

'Peek Inside America's Largest Privately Owned Company' Javier Blas at Bloomberg: Sept 19, 2023

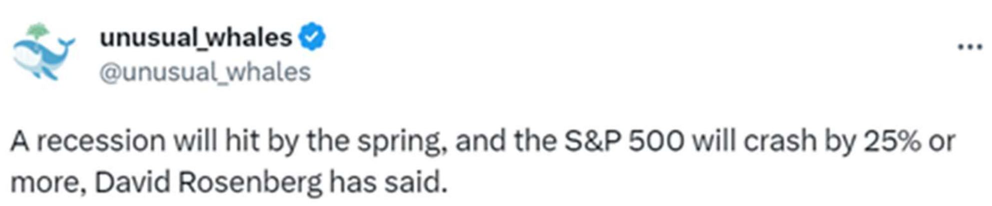
https://www.bloomberg.com/opinion/articles/2023-09-19/peek-inside-cargill-s-cash-machine-as-america-s-largest-privately-owned-company

Moving on to Geopolitics

'Don't be surprised by China's collapse' - Peter Zeihan

https://zeihan.com/dont-be-surprised-by-chinas-collapse/

Markets have been going down more than up lately. Que the media bears. Mr. David Rosenberg is back to predicting yet another crash. Eventually he'll be right.



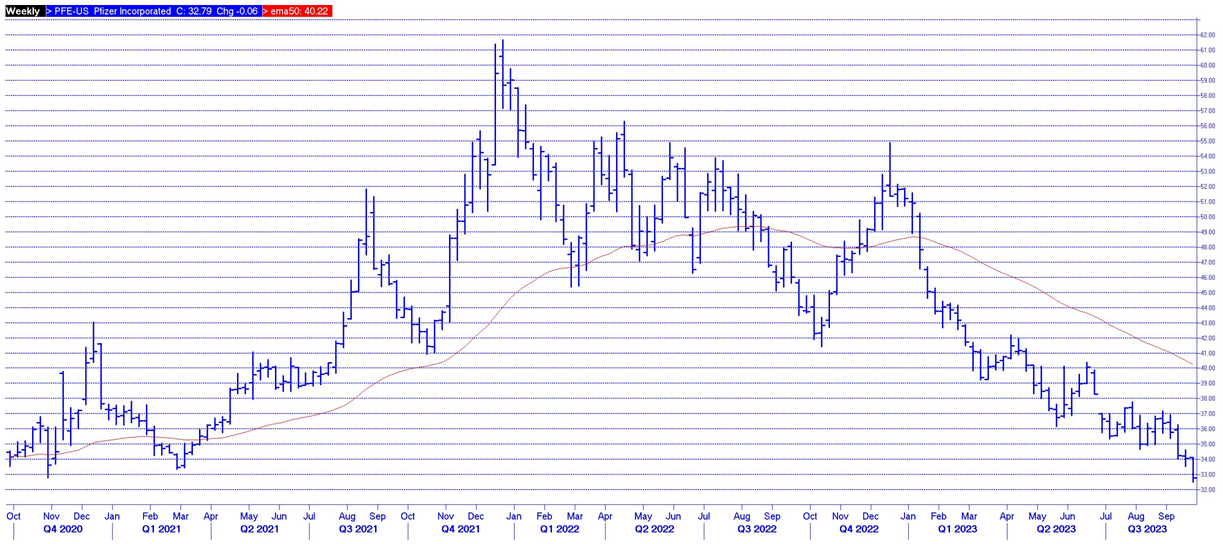
Source Twitter

We'll add that the S&P 500 typically prices in a recession at least 6 months before the event. Mr. Rosenberg's Spring/2024 Recession call implies the S&P500 should have already sold off and selling off further into the end of October/2023. We're not seeing that yet.

What do <u>we</u> think about 'the markets'?

We don't spend much time on trying to figure out what major markets are going to do next. We've been able to make money for our clients anyway. Yes, markets matter but, again maybe not how you think. When broad markets are roaring higher, we're nervous. When markets flop, we're gleeful. As Warren Buffet has advised, "*You are better off buying a wonderful company at a fair price than a fair company at a wonderful price".* When everyone is selling, you're more likely to find wonderful companies at fair prices. A recent example is Pfizer Corp. The stock price also hit a new annual low this week.

Pfizer Corp (PFE-NYSE-$32.78) – weekly ranges – 3 years



The price is back to Oct/2020 levels. At today's prices the dividend yield exceeds 5%. Price to earnings is 9.9X = 10.1% earnings yield. The stock price has been boring. Perfect. The price might slip further into the typical October tax-loss selling season. We have our eye on Pfizer.

DISCLAIMER: I hold Pfizer Corp common shares personally, for family accounts and for client accounts over which I have trading authority. We have traded in the security within the last 60 days

But what about that market thing?

We will be putting on our semi-annual Fall review in the last week in October. NBF's Chief Economist Stefane Marion will be presenting to our clients in Victoria, Oct 30th. Come get your fill of economics. At recent client events in Calgary and Vancouver, Mr. Marion gave a gloomy outlook for the Canadian and global economy. The question is how much of that gloom is already priced in? We're not convinced the economy is about to get a lot worse before it gets a lot better. At least not yet.

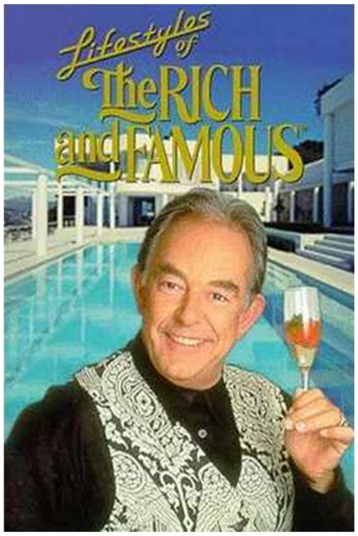
We see the S&P500's Jan-Oct/2022 -27% peak-to-trough slide as the market's call on the subsequent series of rolling recessions we've been in. The whole-lot-of-nothing return over the past 24 months is frustrating but not devastating. In the meanwhile, corporate earnings and dividends are up (see Capital Power above). We're seeing higher dividends on same-tolower prices. For current stock prices to make sense either interest rates continue an upward march for the next few years, or dividends are about to be slashed across the board. We don't think either is likely. More likely, stock prices will go up…eventually. We don't know when. The potential bogey is energy costs. Rising energy costs act like an interest rate hike or tax increase, taking money out of consumer's pockets. $100 WTI may adjust our optimism.

'Hundreds of flying taxis to be made in Ohio, home of the Wright brothers and astronaut legends'

My guess is a ride will cost more than a Yellow Cab. Ah to be rich and in a hurry.

https://apnews.com/article/joby-taxis-ohio-aircraft-manufacturing-wright-brothers-12d38aaff14ebfbbf16cd2533d931ca9

Back to the 1980's ***'Lifestyles of the Rich and Famous'*** with Robin Leach. "Champagne wishes and caviar dreams" indeed. https://www.youtube.com/watch?v=0MxoOG2Spw4



Have a Great Weekend

Steve & Anna Hilberry

[Anna Hilberry's YouTube Page]

[NBF – Hilberry Group website]

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FOR THE RECORD Sept 22, 2023

DOW INDUSTRIALS:	34,097
S&P 500:	4,346
S&P/TSX COMP:	19811
WTI:	$90.10
LOONIE IN $USD:	$0.7419 $US

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