HILBERRY GROUP
WEALTH MANAGEMENT

February 9, 2024

Oh (why) Canada

Starting with the big picture

U.S. Recession Risk - Weekly Monitor – National Bank Feb 5, 2024

Signals are still showing mostly yellow / caution. A bit of green showing. 'Reds' have been fading.

U.S.: Economic and financial indicators 3 months before recessions
As of February 2nd, 2024

		Last reading	Prior reading*	Published last week?	Value 3 months before U.S. Recessions: 2020	2007-09	2001	1990-91	1981-82	1980	1973-75	1970	Median
Financial/commodity	S&P 500 (% drawdown from past year max)	0.0%	-0.1%	yes	-1.3%	-0.4%	-13.6%	-7.7%	-5.6%	-7.8%	-13.3%	-14.6%	-7.7%
	BBB spread (increase from past year min, bps)**	7.7	4.9	yes	2.0	46.2	133.8	6.0	0.0	41.0	43.0	23.0	32.0
	Copper price (% drawdown from past year max)	-8.8%	-9.2%	yes	-10.6%	-2.2%	-9.5%	-12.0%	-16.2%	-1.2%	0.0%	-1.6%	-5.9%
	Oil price (% drawdown from past year max)	-22.8%	-16.7%	yes	-16.0%	-4.0%	-31.0%	-21.0%	-4.0%	0.0%	0.0%	0.0%	-4.0%
	U.S. Dollar (% increase from past year min)	3.0%	2.9%	yes	3.1%	0.0%	5.3%	8.3%	12.5%	4.5%	1.4%	NA	4.5%
	Yield curve (10-year minus 3-month, bps)	-135	-122	yes	26	77	-76	98	-62	-127	-157	35	-18
Soft data	Consumer sentiment (Michigan)	79.0	69.7	yes	99.3	80.9	94.7	90.6	76.3	63.3	72.0	86.4	83.7
	SME optimism	91.9	90.6	no	102.7	96.1	96.4	99.4	97.4	93.3	NA	NA	96.9
	CEO confidence (quarterly data)	46.0	48.0	no	43.0	44.0	31.0	48.0	61.0	32.0	NA	NA	43.5
	ISM manufacturing	49.1	47.1	yes	47.9	52.8	42.3	49.5	53.5	48.0	63.5	54.6	51.2
	ISM services	50.5	52.7	no	55.7	53.5	52	NA	NA	NA	NA	NA	53.5
Hard data	UI Claims 4-week ave. (% increase from past year min)	4%	2%	yes	6%	8%	26%	6%	2%	20%	12%	10%	9%
	Temp. help services jobs (% drawdown from past year max)	-7.1%	-6.6%	yes	0.0%	-3.2%	-4.3%	NA	NA	NA	NA	NA	-3.2%
	Average hours worked (% drawdown from past year max)	-0.9%	-0.9%	yes	-0.9%	-0.3%	-0.6%	-0.9%	-0.3%	-0.6%	-0.5%	-0.8%	-0.6%
	Building permits (% drawdown from past year max)	-3%	-5%	no	-5%	-27%	-2%	-39%	-21%	-30%	-30%	-19%	-24%
	Real consumption (3-month, % ann)	4.0%	3.3%	no	1.3%	2.4%	2.3%	1.8%	-0.1%	0.7%	4.1%	6.4%	2.1%

*Previous Friday for financial data, previous month for hard and soft data (quarter for CEO confidence)
** As of Thursdays
NBF Economics and Strategy (data via Refinitiv, Bloomberg)

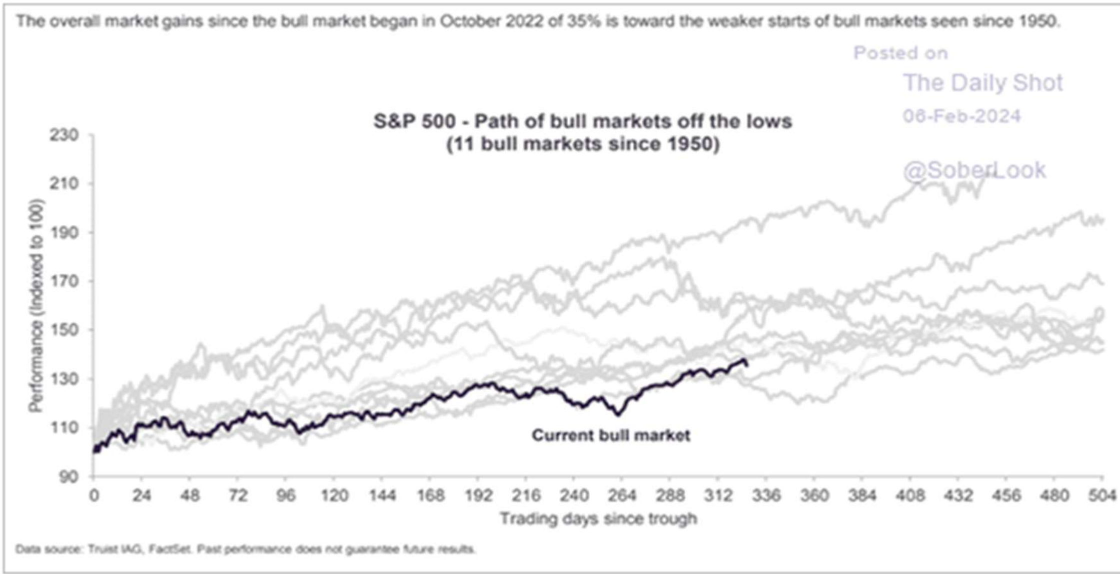
See the link for the full report

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=a02b1dfc-47cf-4b4b-ab7a-eef508a18812&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

US stocks climbed out of October/23 hole. How do the gains compare?

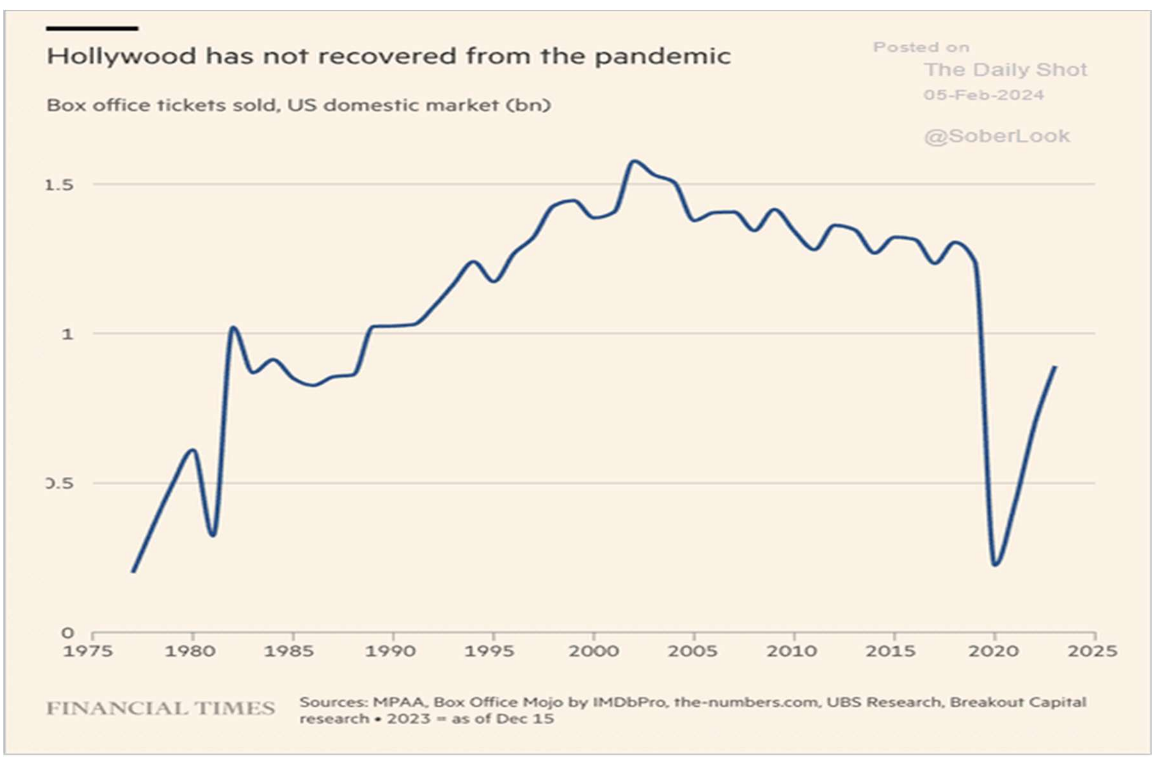
Price gains have been below average. Investors remain cautious. There's room to run.

Equities: In a historical context, the current bull market has shown relatively modest strength.



Source: Truist Advisory Services

When buying stocks, we screen for companies with proven track records of paying rising dividends rising from profits, priced for failure or doubt. Movie makers fit the criteria.



Walt Disney Co (DIS-NYSE-$107.83) – weekly – 5 years

Source: Refinitiv, NBF, Steve Hilberry

The Feb-March/2020COVID-19 panic saw Disney shares crash from $150 to $80. Disney suspended their dividend in Jan/2020. Investors then decided we were on permanent Staycation and chased Disney's shares from $80 to over $200 in Spring 2021. Then pandemic lock-downs eased, consumers emerged from their basements into the Summer sun. Investors drove Disney back to $80 again last fall. Past Disney chair (and largest private shareholder) Bob Iger came back to the helm, promising to reinstate the dividend. With the company's history of dividend growth, we looked past the lack of one and bought in Oct/2023 around $80 per share. Things have perked up since with the stock hitting $110 this week. Unless the company is facing terminal decline, we see buying this year's assets at 2014 prices <u>before inflation</u> as a bargain.

Walt Disney Co (DIS-NYSE-$107.83) – monthly – 20 years

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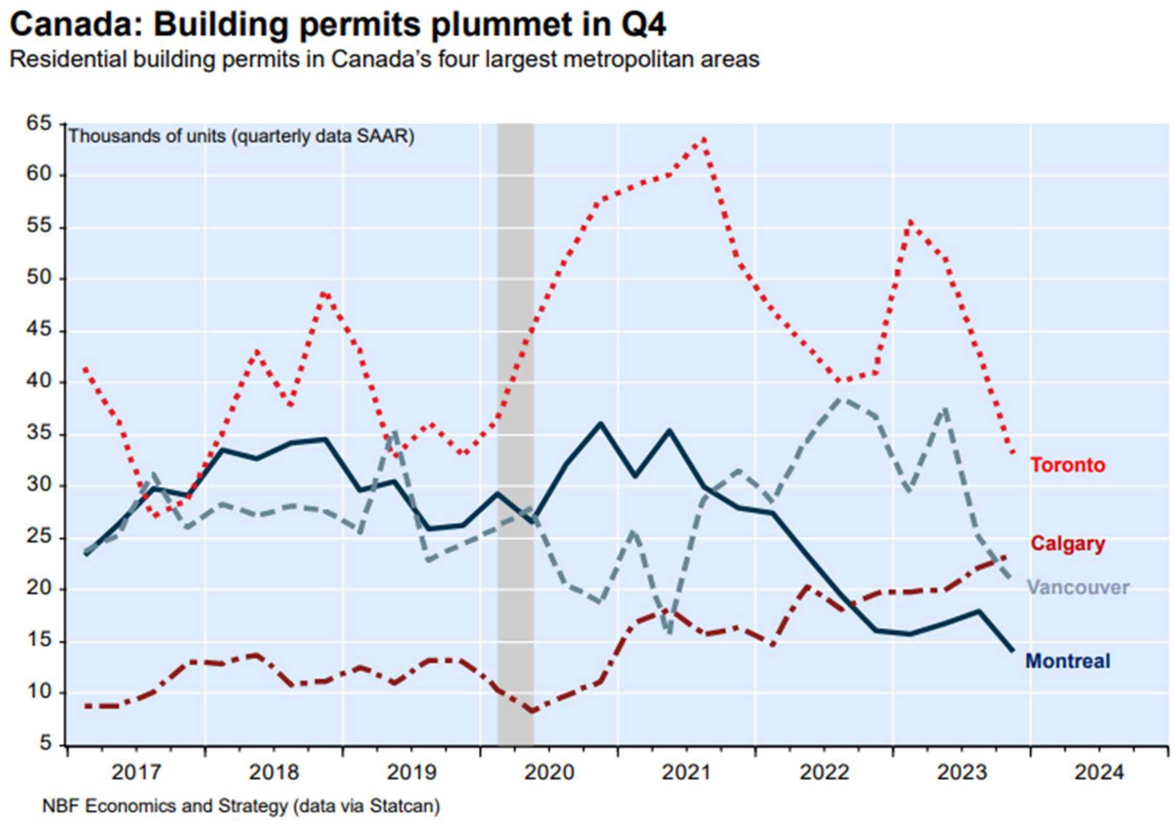
Source: Refinitiv, NBF, Steve Hilberry

DISCLOSURE: I hold Disney shares personally and for family members over which I have trading authority. We have traded in the security over the past 60 days.

On Canadian Housing:

After hockey, housing is Canada's favorite sport. Politicians have been staking ground for a potential election (more on that below) on 'housing affordability'. Federal and Provincial officials have talked up increasing supply while side-stepping past polices that have restricted the same (see last week's notes on residential construction obstacles). Municipal leaders have gone quiet on zoning, knowing the power of NIMBY voters. So…how is that supply thing going? Are the various past and present policies increasing supply? A leading indicator of future housing supply is building permits (again - see last week's note on the Victoria area experience). Uhm…not so much.

Hot Charts - Canada: Building permits plummet in Q4 – NBF Feb 6, 2024



https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=75915745-1ed3-448a-be22-21493b6979ba&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

Lending rates affect affordability. We've been expecting declining lending rates. Scott Grannis updates

'It's a moderate-growth, disinflationary world' – Scott Grannis Feb 5, 2024

https://scottgrannis.blogspot.com/2024/02/its-moderate-growth-disinflationary.html

Oh (why) Canada?

Last week we said we like Canada's chances as a place to invest. Lacking that lovin' feeling, an avid client reader replied by email, *"Please explain your enthusiasm".*

Our edited reply follows:

Why Canada…

"Why invest in Canada" is a question clients have been asking. We've had Federal and Provincial ruling parties that have been…ahem…less than business friendly, risqué with government finances piling on regulations and taxes. From pipelines to property development, railways to power dams, energy infrastructure to export terminals it has been a challenge to get projects done at all, let alone on-time and anywhere near on-budget. Political leaders have appeared dismissive of Canada's business opportunities. A famous example being one elected leader doubting the 'business case' for LNG exports to Europe while the USA dramatically expanded the same. A 4th grader with a globe (or Alexa access), would discover the surface shipping distance from Halifax to Amsterdam is 2,858 nautical miles. Houston to Amsterdam is 5,173 nautical miles. The 81% longer distance explains why WW2 European-bound supplies departed from Halifax. There is a business case for Canadian LNG that was discouraged.

Holding back/discouraging Canadian business investment constrains supply. Canada's growing population means rising demand. Less supply/rising demand = inflation. Increasing taxation on the rising cost of goods increases inflation. Sending 'inflation relief' money to voters, hands non-productivity-generated cash entitlement to buyers increasing inflation. Rising inflation begets rising interest rates. Rising rates will, eventually and painfully, reduce demand. Only a bureaucrat could see that as a win. Yes, it's been discouraging.

Why are we bullish on Canada?

Canada's growing demand is a problem of many European countries would love to have. As we've been predicting since 2021, Canadian pocketbooks are starting to feel this demand/supply inflation, yet our political leaders appear to have missed the memo. This week Bank of Canada Chairman Tiff Macklem stated "High interest rates aren't to blame for housing crisis"

https://www.cbc.ca/news/onbusiness/tiff-macklem-boc-interest-rates-housing-crisis-1.7101890#

Mr. Macklem is technically correct and we certainly can't blame the Bank of Canada for attempting to rein in inflation. The 'housing crises' results from an increased number of purchasers competing for a constrained supply of housing, driving up prices to wonderous levels. The lack of housing supply, created by all the factors we noted last Friday, is a core problem. Increasing supply is a long-tailed solution. Increasing building permits today wouldn't alter supply for a couple of years. What is missing from Macklem's comments is "How were consumers able to pay those extreme prices?"

The answer is "financing rates being below inflation from 2019 until 2023". A middle-class consumer borrowing for 5 years below inflation implies that middle-class borrower is a zero-risk to the lender. Our plucky borrower was such a good risk, lenders were willing to accept a loan yield below inflation. Or at least that's what the lending rates implied. This ability to borrow below inflation was a 'force multiplier' on prospective home-buyer's borrowing power. We noted this as a property price risk for *our readers. To be clear we did not believe the borrowers were that safe and we didn't believe the lenders believed so either.*

So why/how were rates below inflation?

Central Banker's reacted to COVID contagion-risk by keeping the foot on the monetary gas pedal too deep on the floorboard for too long. Central bank Quantitative Easing programs, altered the organic process of lenders pricing in inflation risk. Governments also went on a fiscal spending spree, flooding their pet projects with stimulus. Bingo.

We believed the dam would break; we didn't know when. We predicted lenders would eventually demand higher rates. Lending rates have rebounded to a natural level. The bubblicious housing prices of 2018-2022 are beginning to decline to a natural level vs. incomes. We've noted this <u>relative decline</u> doesn't have to translate into a collapse in housing prices, although it could.

Lucky for the Canadian banking system, most buyers, despite the above excesses, acted within their own best interests or were prevented by banking lending ratio regulations from going really crazy. We see the fears over Canadian bank risk exposure to property price declines as over-done. We have been buying the banks.

We predicted consumers (voters) would also get restless. That pocketbook thing seems to be on voters' minds. High-minded global goals are fine ... if it doesn't hit Joe and Joeline Public's wallets. History says increasing Mrs. Mcgillicuddy's monthly power bill by $35 is a fast train to electoral retirement. Politicians are revisiting global goals.

We think Canadians are about to vote for a different government. To be very clear, we are not hoping for this nor are advocating any political party or leader. History says Canadians tend to 'throw the bums out' after three terms, particularly if the latter two terms were minority ones. The current captain seems to have exhausted public good will, so we'll probably have a new one. This has investment implications.

How might an election come and when?

We've been predicting an election call this summer, well before the mandated October/2025 call. Where do we get this idea? Recall the job of party leader is to gain seats in Parliament. The current government maintains power with NDP support. We've predicted political strategy for the NDP demands pulling their supply and confidence agreement while the Liberals are down in the polls. If you were the leader of the NDP, knowing the Liberals ate some of your lunch last go around attracting left-leaning voters, you want those seats back.

Eyeballing the low polling of the Liberals, driven by inflation, rising interest rates causing economic pain, would you allow them to escape into a lower interest rate environment with probably improving economics by 2025? More likely you'd call a vote of no confidence, force an election in 2024 that polls tell you Canadians want. You know the next government won't be led by the NDP, so it's that seat count thing (and your leadership) that counts. It's likely fiscal reality (that's a thing, right?) will constrain the Liberals from handing out yet more goodies the NDP can take credit for. The Conservatives will probably bring in cut-backs. The leader of the NDP, could force an election, probably winning seats.

If the Conservatives win and bring in restraint you can earn street cred by blaming the Conservatives for these budget cuts, claiming high ground you won't have to defend fiscally. If the

Liberals win another minority, the NDP is likely win seats meaning the NDP leader could renegotiate a new support and supply agreement. Yes, its all very cynical. That's how politics works.

NOTE: After this email exchange on Monday, we saw this headline Wednesday Feb 7.

'Singh threatens end of pact with Liberals, but says it will be government's fault' Canadian Press Feb 7, 2024

https://www.cp24.com/news/singh-threatens-end-of-pact-with-liberals-but-says-it-will-be-government-s-fault-1.6760145

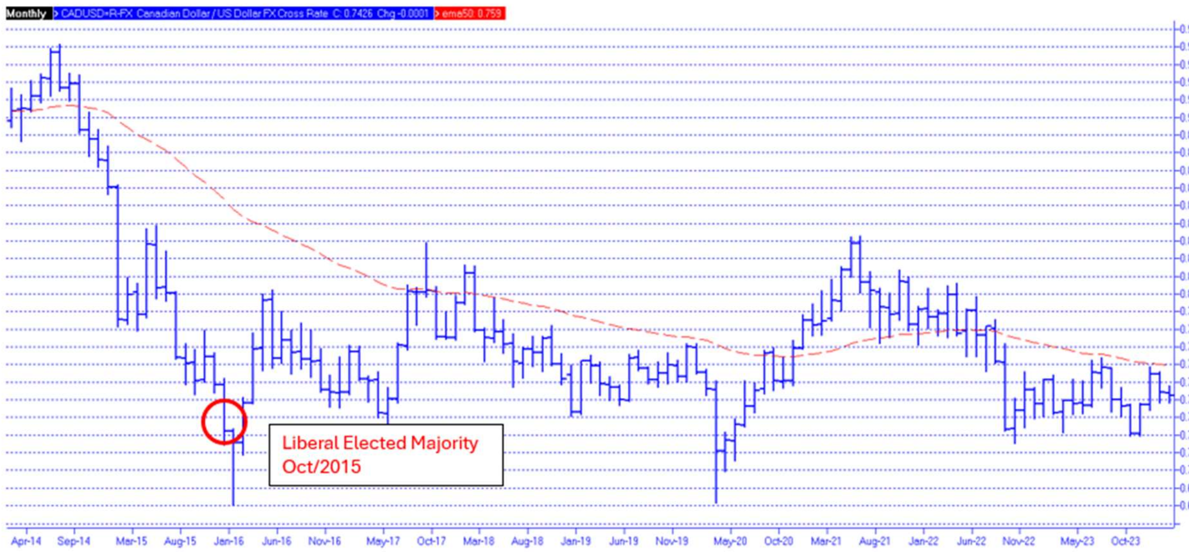
The knives are getting sharpened. Our note continued...

"The next election appears to be the Conservatives to lose. If elected, given their platform, we'd expect to see Conservatives roll back of some of the above policies. Investors may cheer. Again, we're not advocating any of this, just attempting to predict economic outcomes."

What does this mean for investors?

We believe Canada is likely to exit the current economic malaise sooner than investors are pricing for. Given the discounted prices with fat dividends it's an easier bet to make. The downside risk appears minimal (see the Loonie chart below). If we must wait, we will get paid to do so. A chart of the Loonie says it's a good time to Buy Canada.

$1 Canadian in US funds ($0.7426)– 2014-2024



Source: Refinitiv, NBF, Steve Hilberry

What about the US Presidential Elections in Nov/2024?

Yes. It's True. It looks like a rematch of Biden vs. Trump in Nov/2024 US Presidential Election. Polls have them even. We don't have a prediction to the outcome. Both candidates have issues for Canada.

Mr. Biden has displayed a historical Democratic party fondness for protectionism. Exhibit 1: The structure of the ''Inflation Reduction Act' combines largess with protectionism. Exhibit 2: The

Softwood Lumber tariffs are back on yet-again. How would Mr. Biden view a Canadian Conservative government moving in another direction on many of his favored policies?

Mr. Trump is…unpredictable. As President he might (maybe) be less hostile to a Canadian Conservative federal government than a Liberal one. Will he be more favorable to business? Or would it be 'America First' in spades? Would he target Canada with trade sanctions?

CONCLUSION: *The above may explain why prices for many of the Canadian equities we follow are at a discount. The Loonie is bouncing off decade lows. Not even Canadians like Canadian stocks! We think the discount is excessive. We don't think it can get a lot worse, could get better, and see value in Canada. We're optimistic about the country's future. To clarify we're not saying dump US / Buy Canada. We're tilting towards Canada in our North American equity allocations, round numbers 55% Canadian equities, 45% US equities.*

We're taking a break from the weekly commentary for the next three weeks. We will return to the fray on Friday March 8

Have a Great Weekend

Steve & Anna Hilberry

<u>FOR THE RECORD February 9, 2024</u>

DOW INDUSTRIALS:	38,685
S&P 500:	5,025
S&P/TSX COMP:	21,016
WTI:	$76.79
LOONIE IN $USD:	$0.7431 $US

Sent by

Montreal Office
National Bank Financial
Wealth Management
1155 Metcalfe 5th Floor
Montreal, Quebec, H3B 4S9
Phone: 514-879-2222

Toronto Office
National Bank Financial
Wealth Management
130 King Street West Suite 3200
Toronto, ON, M5X 1J9
Phone: 416-869-3707

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