Will September earn its bad reputation again?

We're seeing stories about the terrors of September. Pouting Pundits note the S&P500 has on average declined more than gained in September. This is true. They note an 'Inverted Yield Curve' leads to a recession. This could be true…eventually.

S&P500 annual average rates of return as of July 31, 2022:

- The average return for the month of September: -0.70%.
- 1 Year: -4.87%
- July/2019 3 year: 13.36% (spans COVID-19 panic and recession)
- July/2017 5 year: 12.83%
- July/2012 10 year: 13.80%
- July 2007 15 year: 9.41% (spans 2008 Great Recession and 2020 COVID-19)
- July 2002 20- year: 10.01%
- July 1992 30 year: 10.03%
- Since inception in 1957 to Dec/2021: 11.88%

Time heals all wounds. One has been able to earn 10%+ from the S&P500 over time.

I was licensed in 1989. An investor who invested $10,000 USD into the S&P500 in July/1989 would show value of $238,470 at the July 2022 close. Those who ignored the financial media did just fine. Those who took negative headlines as a BUY signal improved their results. With the long-term in mind what about an inverted yield curve?

Inverted Yield Curves have been leading indicators of recessions.

Faithful Weekend Readers are groaning in their coffee cups. *"Not Inverted Yield curves again!"* In the late spring and early summer 2019 we went on, and on about inverted yield curves. For a quick primer, I'll assign Investopedia's notes.

'The Impact of an Inverted Yield Curve' Investopedia Jun 30, 2022

https://www.investopedia.com/articles/basics/06/invertedyieldcurve.asp

I'll caution much of yield curve analysis centers on the past 40-years. Since 1981, falling inflation meant falling interest rates and borrowing costs. Why inflation has fallen is a topic for another day. Declining borrowing costs has been mostly positive for the present value of assets vs. the future. The longer the ownership duration, the better (think real estate). At one point EURO area central bankers held interest rates below zero forcing German bond holders had to pay the Government to guarantee their money. Hardly a vote of confidence in the economy. Maybe they sensed Russia's rumblings?

Declining lending rates have allowed Governments to borrow with abandon to pursue all kinds of whacky ideas at little consequence from voters. It got so bad *Modern Monetary Theory* (MMT) was trotted out again by left-leaning politicians. Right wingers weren't much better squandering money on border walls and other gems. To update US Senator Everett Dirksen's 1969 quip, *'A trillion here, a trillion there; pretty soon you're talking real money.'*

If the broad trend of interest rates begins to rise, depending on the slope, we could see a long and potentially painful period as bond yields race Central Banks short-term rates to equilibrium from past excesses. Long and short rates have been rising recently. We've been warning about interest rates rising for the past 4 years.

Rising rates isn't necessarily all bad though. Economic expansions typically see rising rates as borrowers see opportunities above borrowing costs. If a business can expand profits 10% borrowing at 3%, they can still do so at 4%. As the economy expands, all rates lift. At the whim of central banks, the 90-day T-bill rate usually lags the trend, then accelerates as monetary authorities realize they've left their foot on the accelerator too long. In the early stages (innings 1-3) long rates head up, T-Bill rates muddle. In the middle stages of the expansion (innings 4-7), all rates go up together. As the cycle matures the rate differences narrow (inning 8). Eventually Central Bankers get tough and crank the 90-day rate above the longer-term rates to cool inflation (9th inning). The game ends, the lights go out and we all go home.

Why does the economy slow down after a rate inversion? Put your banker hat on. Would you rather make a 25-year mortgage bet lending to Jim and Jolene Jones at 5% or would you rather lend to the US Federal Reserve for 90-days at 5.5% with zero repayment risk? No surprises, credit dries up. The economy eventually contracts. The stock market sniffs out a pending slow down and slumps roughly 6 to 12 months before the onset of the recession.

Recall the data confirming a recession will be posted months later. By then the cycle will probably already have turned again.

'Don't Fight the Fed' means don't ignore an inverted yield curve unless you're willing to be patient (see the opening info)

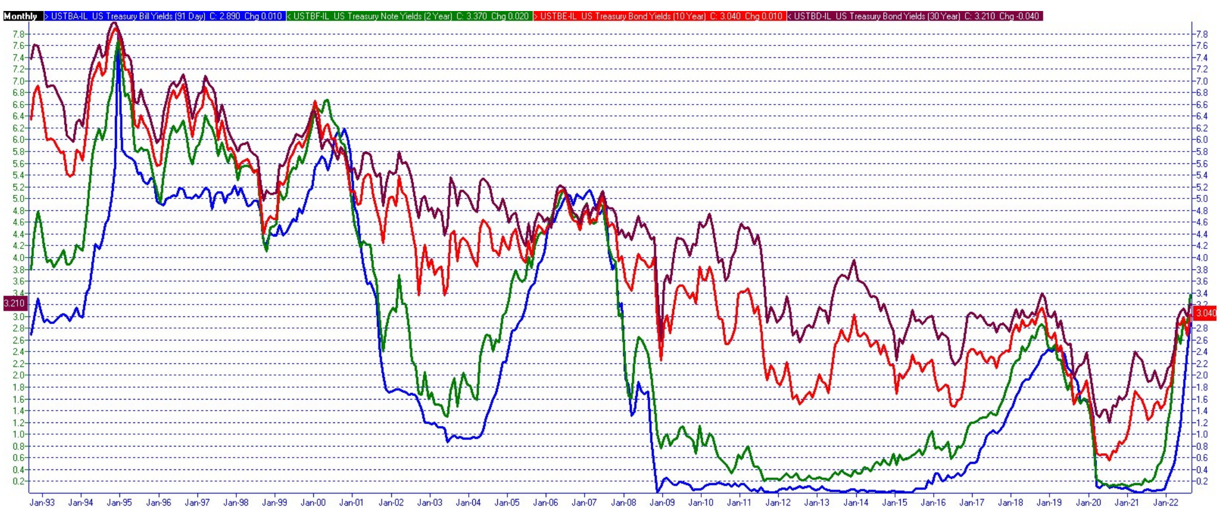
Remember all those 'lower for longer' calls back in 2018-19? Pundits (David Rosenberg, Robert Schiller, Jeremy Grantham et al) were saying the very low rates predicted a Depression…in 2018. Buy long bonds. Mr. Grantham's early 2022 predictions this had the S&P500 'crashing' more than 50%. Grantham was at it again this week saying we're in a 'Super Bubble' (see the Google Trends section below). We predicted the 2020-21 extreme low rates wouldn't last. Recession was likely. Depression not so much. I believe we're in the late middle stages of this economic expansion cycle. Call in the late in the 6th or middle of the 7th inning. Plenty of time to hit homers before the lights go out.

Are we there yet?

We follow the 2-year vs 10-year rate structure. We find it important for bond selections (currently CDN 2 yr is inverted above 10 yr.). When it comes to stocks, experience says the 90-day T-bill rate vs. 10-year rate has been a better timing indicator (if one wants to try to time at all – review the opening section). The following charts compare the rates on US Federal Govt issued debt. It's a busy chart.

US Fed Govt Debt - yield structure 30 years. 1992-2022

90-day (blue) 2-year (green), 10-year (red) and 30-year (burgundy).



The upward spikes in the blue line above red have preceded recessions. The nuance is that longer term rates have consistently moved from above to below the blue lines before rates plunged in a recession. The delay between a confirmed yield inversion (for a month or more) and subsequent recession has typically been 12 to 18 months - not weeks or days. Also note the long-term down slope trend may be basing out. Is this down trend about to be broken to the upside? To be useful in 2022, we need to zoom in.

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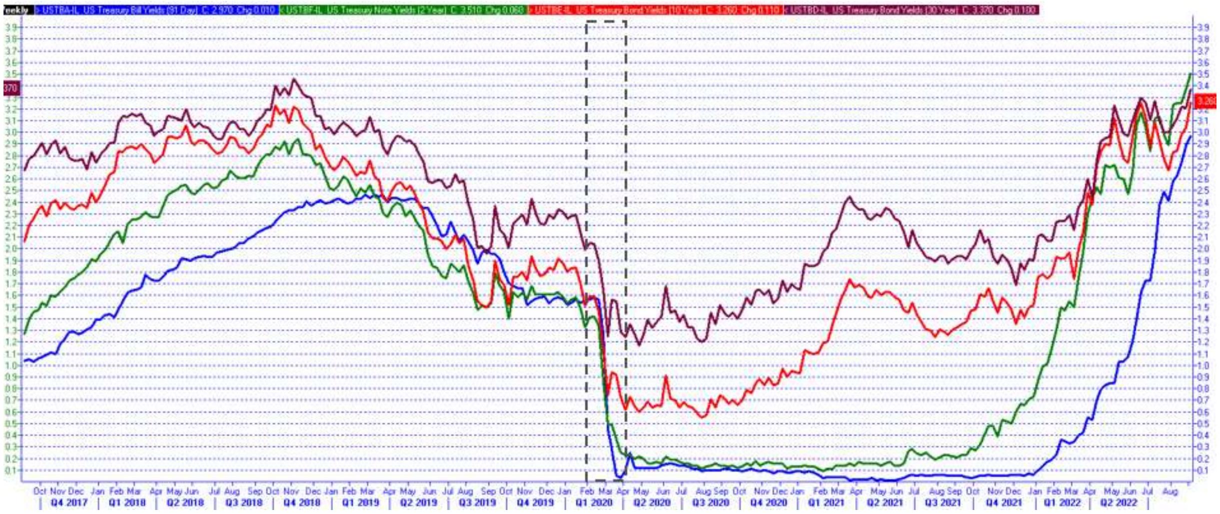
US Fed Govt Debt - yield structure 5 years. 2017-2022



Note how the structure began to change in late 2018 (right hand 1/3rd of the chart). The 90-day yields (blue) had been moving up. They 'inverted' above 10 yr. (red) in Q2/2019 (middle of the chart). Prior to the cross over, the 2, 10 and 30-yr yields began to fall, crossing from above to below the 90-day rate as bond investors saw a slowdown coming. We noted the event at the time. *"Inverted yield curve, blah, blah, blah."* We trimmed stock holdings 35%. We did NOT sell everything. The 2020 Recession (dotted box) was likely given the 2019 rate structure. It arrived, amplified and accelerated by COVID-19 lockdowns. Lasting two 2 months in the USA, it was the shortest on record since 1854 and saw the sharpest decline/rebound in employment on record.

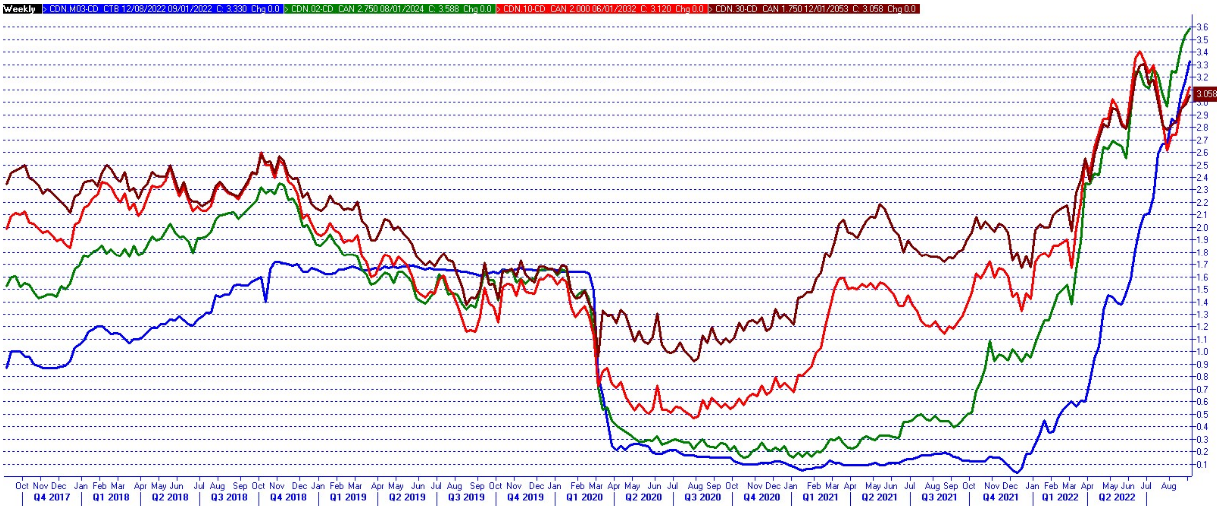
Since the bottom in Q1/2020 (chart middle) one can see the rising economic tide out of the COVID-19 lockdowns lifting all boats with the 90-day rate (blue) lagging then catching up. At this writing, despite some noise with the 2 year above the 10 we still seeing an upward trend in all four rates. I expect we'll see the 10 (red) and 30 (burgundy) move higher again confirming the demand for credit is strong and the economy isn't dead yet. This trend is not pricing in a falling demand for credit. It is not pricing in a recession. It will eventually.

The economy is not dead yet. https://www.youtube.com/watch?v=jYcPBE5PXhs

What about Canada?

The credit demand picture is even stronger in Canada. It looks like the longer-term rates are set to mover higher, we suspect bypassing the short-term rates. The 10-year yield recent range was 3.409% to 2.61%. At this writing 3.125% vs 90-Day T-bills at 3.33%. Technically an inversion…for now. The confirmation of our view would be 10-year rates above 3.40% and moving higher. If the 10-year breaks below 2.61% on a confirmed downtrend, that would be a recession call. We're not seeing that yet. If we do, we change our stance.

Canadian Fed Govt debt yield structure 5 years. 2017-2022



Standout differences between the Canada vs US debt 5-year charts.

1) Canadian 90-day to 2-yr rates are clearly above 10 to 30 yr rates. (inverted). While I focus on the US term structure, an inverted yield environment could be tough for Canada. We might see a made-in-Canada recession, perhaps beginning in the property markets. My bet though is we'll see the 10-30 year maturities climb higher surpassing the short-term rates. From a financing cost perspective, let's clarify the CDN rates are all under 3.6%. The bond market in Canada is hardly pricing in a Weimar Republic style currency collapse.

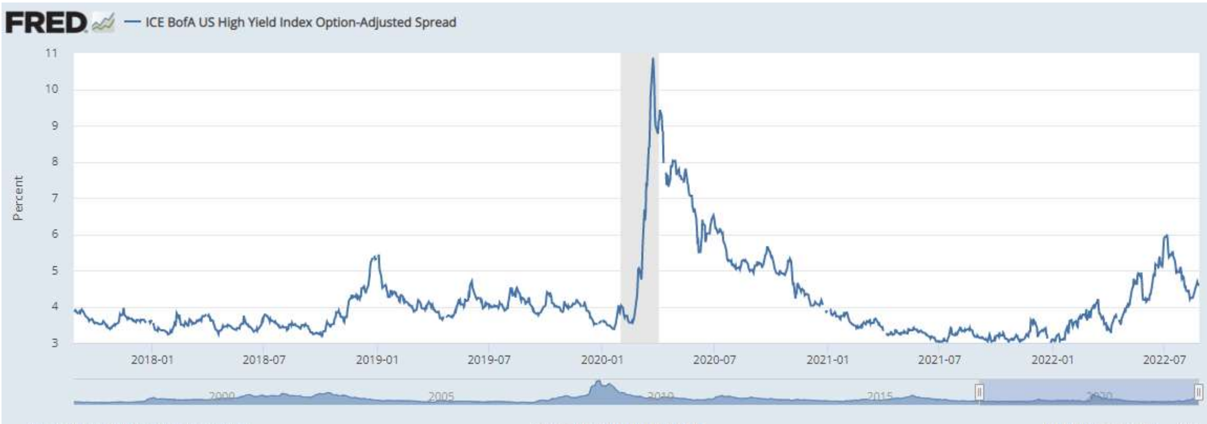
2) Current Canadian rates are well above their 2018 peaks. Canadian 30-year rates are roughly 20% above 2018 levels. US rates have barely returned to the 2018 ranges. Note Canadian rates were lower than the US rates in 2018 and are still lower today. Does this mean international money views Canada as safer than the US thus willing to accept a lower yield, or does it reflect lower Big Money relative lack of interest in Canadian borrowing demand due project development frustrations? A lot of big money skipped town last decade. Does the sudden jump in Canadian rates mean bond investors don't like what they see in government debt trends, or does it mean the international money is finally coming back? We think it's vinegar and honey.

Vinegar: Canada's posture on its energy patch chased off investors. individual Canadians went hog wild for real estate stretching their borrowing and our Federal Government continues to spend like there's no tomorrow. **Honey:** On the plus side, the international money (despite a lack of enthusiasm from Ottawa) seems to see value here in Canada. Calgary real estate is back with prices up last month vs. a national average decline.

https://housepriceindex.ca/2022/08/july2022/

Commodity demand has been strong. We still sell lots of hard stuff. After a drop in May/June, longer term bond yields in the US and Canada appear to be rising, confirming an improving economy. For those pundits who seeing a depression behind every tree, we're not seeing junk bond yields ballooning out. The next chart compares junk bond yields to

Investment grade bonds. Yes the spread is up from the extreme lows of last year when cheap govt money flowed into everyone's pockets – remember the Meme Stock frenzy?



Source: https://fred.stlouisfed.org/series/BAMLH0A0HYM2

Considering the strangeness of the COVID-19 recession, rebound, reversal, rebound again, I believe we're seeing continued COVID-19 ripples flowing through the economy (see last week's note on Canadian Tire). I'm broadly seeing an expanding credit environment.

Staying with housing….

'Canadian Housing Outlook: Testing the Foundation' - TD Research Aug 29, 2022

This week Canadian Financial media shouted ***'Canadian House Prices to drop 25%'***

https://financialpost.com/real-estate/canada-home-prices-fall-25-percent-td-bank

As the media is wont to do, the headline is click-bated. TD predicts house prices might fall 25% from the COVID highs. They note such decline would partially retrace the COVID house price spike over 46%. They see this is a recalibration to sanity not a sign of serious structural long-term issues. We agree. The report also addresses how property prices are calculated, the potential effect on GDP, the difference for house owner/occupants (okay), and house investors (bad), consumers cash position (good) and why TD is confident over the longer term (hooray). We've been cautioning on Canadian property prices for some time, noting the effect rising rates might have. Some of the chickens have come home to roost. I don't predict 1981 style terrible property results in Duncan. Here's the link to the TD report.

https://economics.td.com/ca-testing-the-foundation

The Ukraine began a military offensive in the Dnieper River area this week.

Political analyst Peter Zeihan explains why this could be significant for the Ukraine conflict.

https://www.youtube.com/watch?v=Tb3U9Ydiw64

Mr. Zeihan references the International Study of War (ISW) website. I've booked marked it.

https://www.understandingwar.org/

While researching military hardware we came across Skylark Drones produced by Israeli defense manufacturer **Elbit Systems (ESLT-NASDAQ)**.

https://elbitsystems.com/products/uas/skylark-i-lex/

A favorite of fund manager David Fingold, Elbit has been a money maker for investors.

DISLAIMER: We have no position in Elbit Systems. With a low dividend and 39X trailing P/E it doesn't fit our conservative dividend screens. Might be worth following.

The science isn't black and white, writes Alice Palmer.

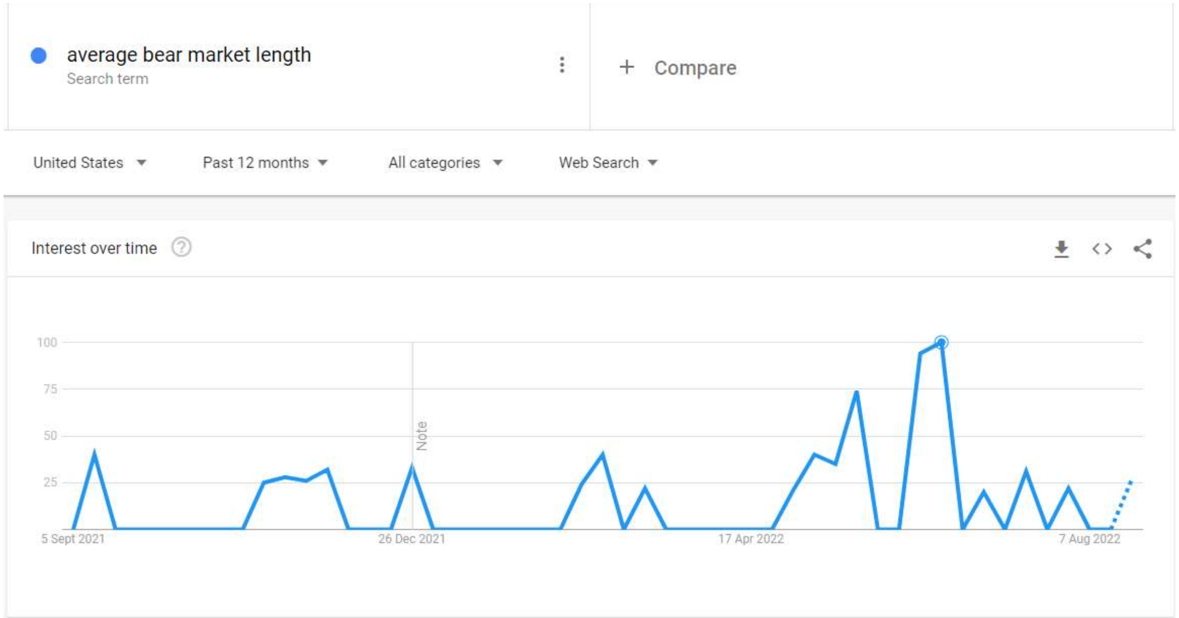
This spring, British Columbia (BC) launched its [Mass Timber Action Plan](), partly on the premise that building with wood has a lower carbon footprint than construction alternatives such concrete and steel. Meanwhile, environmental groups continue their threat of protests against old growth logging across BC, in part based on claims about logging's carbon footprint.

Puzzled by this apparent contradiction in climate claims, I took a deeper look at the science underlying the carbon impacts of forestry and wood use, beginning with the "big picture" of global carbon emissions.

https://www.resourceworks.com/old-growth-products-and-emissions

The public is fearful. Google searches *‘average bear market’*.

The spike with the circle at the top is June 19-25. The S&P500 year-to-date trough was June 17th at -24.5%. Google searches for bear market length peaked the next week. Anxiety was high.



S&P500 12 months.

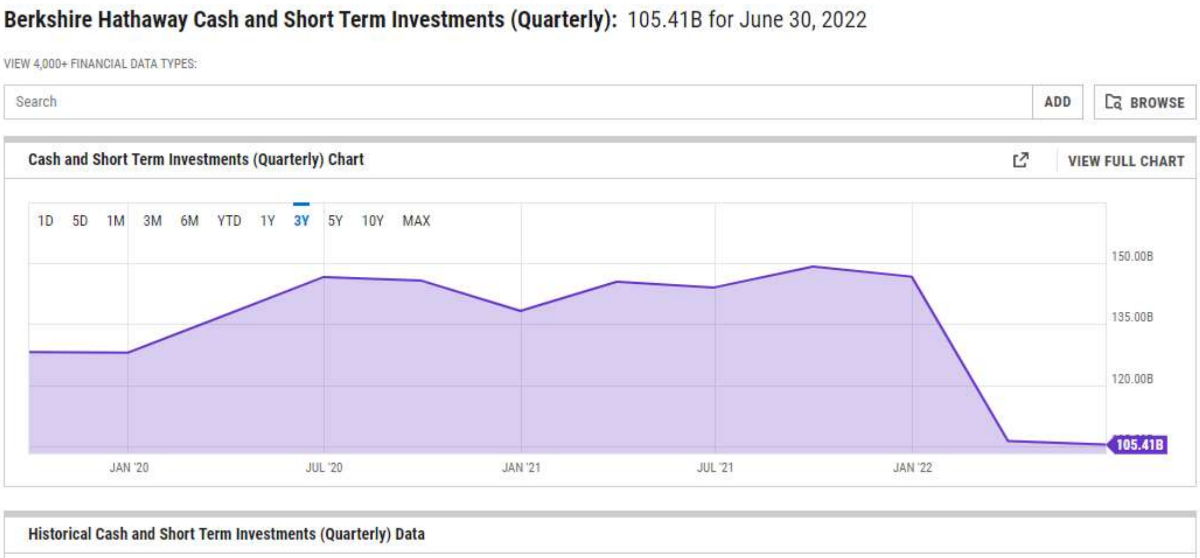
When the S&P goes down, bear market worries go up. Oh, right.

“Be fearful when others are greedy and greedy when others are fearful”.

- **Warren Buffett**

Warren's Not Fearful

Mr. Buffett is walking the walk. Berkshire's cash position has declined by about 1/3rd in 2022. Berkshire has been spending cash this year buying stocks.



Source: https://ycharts.com/companies/BRK.A/cash_on_hand

Berkshire added to conventional energy stocks in the 2nd quarter upping Chevron and Occidental Petroleum, trimming Chinese EV manufacture BYD (a very small trim). He also added to Activision and Apple.

***'Warren Buffett's portfolio: Here are the stocks Berkshire Hathaway is buying or selling'* – BankRate.Com Aug 15, 2022**

https://www.bankrate.com/investing/warren-buffett-stocks-berkshire-hathaway-portfolio-13f-filing/

On that optimistic note…

Have a Great Labor Day Weekend

Steve & Anna Hilberry

FOR THE RECORD Sept 2, 2022

DOW INDUSTRIALS:	31,735
S&P 500:	3975
S&P/TSX COMP:	19360
WTI:	$88.48
LOONIE IN $USD:	$0.7619 $US

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