HILBERRY GROUP
WEALTH MANAGEMENT

Sept 16, 2022

Lean into the wind.

The Bears Are Back In Town.

To mangle Thin Lizzy's 1976 Hit…

*"Guess who just got back today? Them wild-eyed boys that had been away.
Haven't changed, had much to say. But man, I still think them cats are crazy"*

https://www.youtube.com/watch?v=hQo1HIcSVtg

Markets sold off 4% Wednesday as investors digested higher-than-hoped US inflation data. Consensus now sees the US Federal Reserve raising the 2.50% discount rate by 75 basis points (¾'s of 1%) at the Sept 21-22 policy meeting to 3.25%, the highest since 2008. The market assumes the Fed sticks to a 2% inflation target and gets tighter. Maybe a lot tighter. The S&P500 Hump Day Flop to 3985 took us back below the 50-day moving average of 4047. We've seen chart analysts call the flop a negative trend signal of further price declines to come. Prices falling equals more prices falling (until they stop falling). Following last week's note on September's bad news bear reputation…

September/2022 major equity market score card:

- S&P500 Aug 31, 2022 close ($USD): 3955.00
  - Last 3986: +0.28%
- SP/TSX Composite Aug 31, 2022 close $CDN: 19330.81
  - Last 19737: +1.02%

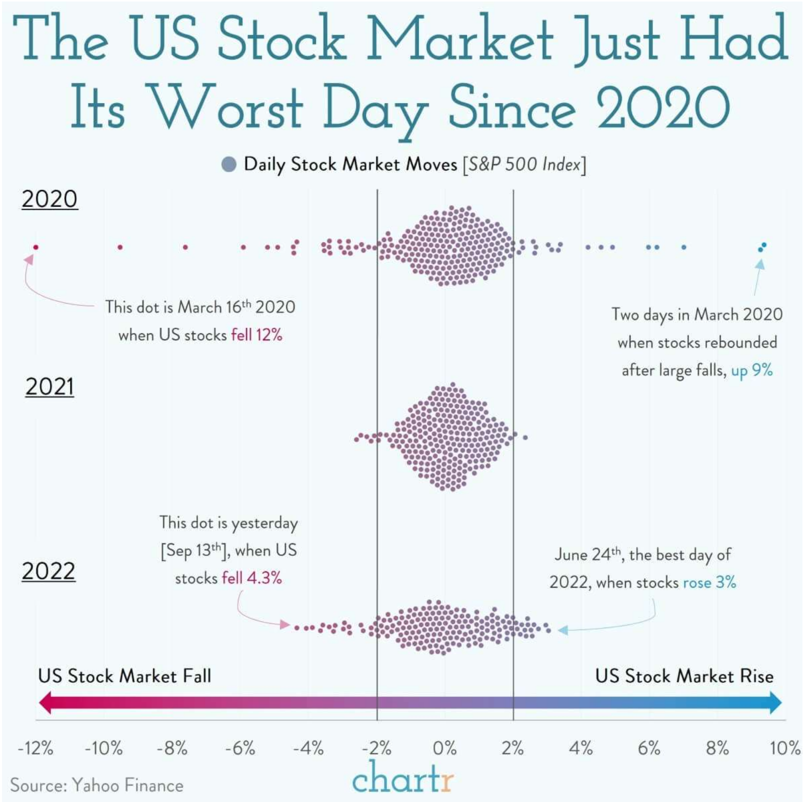
The media is reflecting the mood...

'Inflation's Terrible, Horrible, No Good, Very Bad Day' – Bloomberg Sept 14, 2022.

'From the data to the market reaction to how the Fed must now view the problem, the inflation picture is awful — for everyone.'

https://www.bloomberg.com/opinion/articles/2022-09-14/terrible-inflation-data-and-a-big-market-selloff-make-bad-news-for-everyone?sref=866aH6XX

'Spooked' – Chartr.Com Sept 14, 2022



https://read.chartr.co/newsletters/2022/9/14/spooked

More glum notes inflation and interest rates.

'It Starts With Inflation' – Ray Dalio Sept 13, 2022

https://www.linkedin.com/pulse/starts-inflation-ray-dalio/

Mr. Dalio predicts inflation will moderate from 8% but remain sticky at 4-5% over the next few years. He predicts US Fed Govt Bond Yields will move up to "…*between 4.5 and 6 percent in both long and short rates*." [As he doesn't clarify a bond series. I'll use the US Fed 2-year as a proxy for *'short-term'* (today 3.78%) and the 30-year for *'long-term'* (today 3.47%). We prefer the the 90-day (3.24%) vs the 10-year (3.41%) as an 'inversion' indicator]. He predicts rates ranging 20 to 70% higher. The 30 -year has tripled from the extreme lows of early 2020 and is now back to the 2015-2017 range. The 20-year high for the 2-year was 5.27% in 2006. We haven't seen the 2-year to 30-year yield curve consistently above 6% since the late 1990's.

Following this logic, Mr. Dalio predicts a tough time for the stock market. As he acknowledges, his inflation call is key to this narrative. **IF** we see a sticky 6% inflation rate and 6%+ bond yields, I can't argue with the conclusion of further tough times for the stock market.

Summary: Inflation, interest rates and stock prices will all continue to do what they've been doing. Recall the recent peak to trough -24.5% slide for the S&P500. Predicting the past? I hold Mr. Dalio in higher regard than Jeremy Grantham we featured in last week's notes.

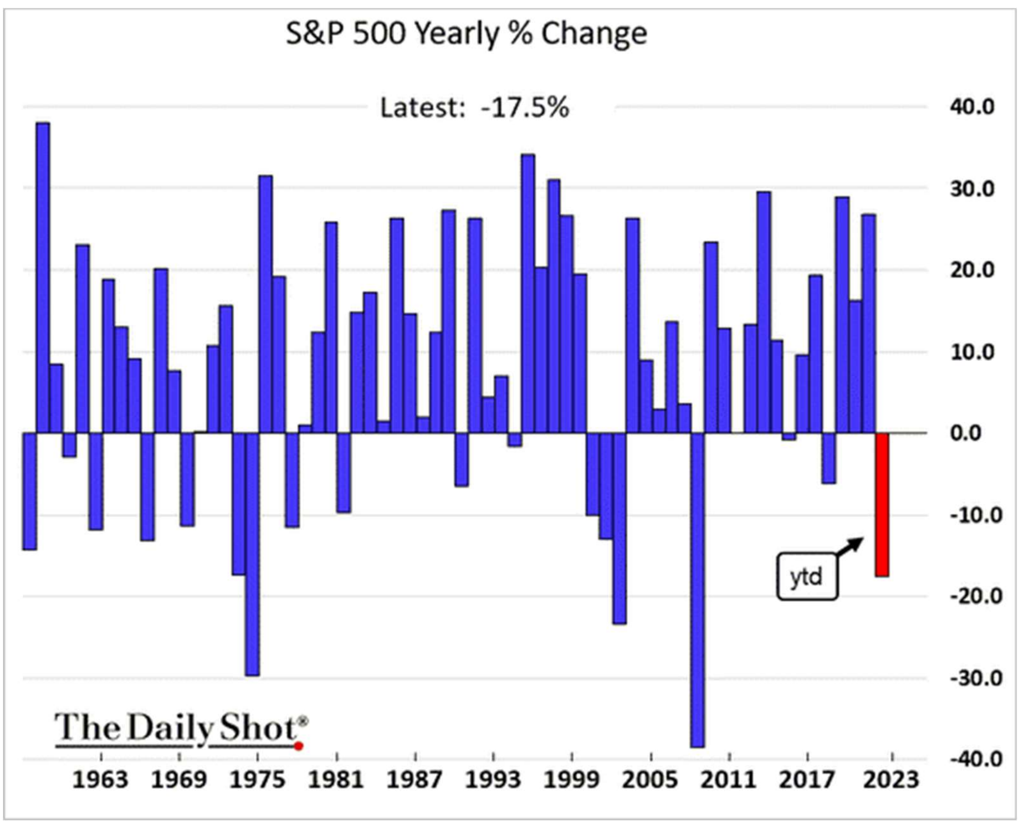
While Ray Dalio has insights, I've found Scott Grannis more useful. He has a different take on inflation (already receding) and interest rates (they don't have to go a lot higher).

'Inflation Pressures are in fact cooling' – Scott Grannis

http://scottgrannis.blogspot.com/2022/09/inflation-pressures-are-in-fact-cooling.html

Mr. Grannis' comments are technical and worth wading through. If you want an explainer let us know! We love to hear from our clients. Some context for the above glum views…

Equities: Here is the S&P 500 year-to-date decline compared to annual performance since the 1960s.



The S&P500 2022 year-to-date price decline is approaching previous extremes. Recall the S&P fell 24.5% into June placing that decline into the few and the furious. That doesn't mean stocks can't go lower. Using history as a guide, we're unlikely at the beginning of whatever decline we're in.

Yet more fear signals.

The US dollar is seen as a 'safe haven'. The US Dollar is up against major trading partners.

US Dollar Index (DXY-109.66) 2017-2022 – weekly

…and is approaching the July 2001 peak of 120.99 . Since Jan/1975 the all-time high was 164.79 in Feb/1985.

US Dollar Index (DXY-109.66) 1975-2022 – monthly

Excluding the 1985 spike, the $USD is approaching previous extremes. Doesn't mean it can't go higher. NOTE: Oil prices typically show inverse correlation to the dollar. USD up/oil down. This time oil prices are up despite the rise in the greenback. We think this shows strength in oil prices. If the USD retreats oil prices could surge. On Oil..

The Incredible Shrinking Oil Majors - Part III – GoRozen Sept 16, 2022

GoRozen's latest posting on large oil producers is required reading for those following energy, conventional or alternative. As Europe has discovered, that is all of us.

https://blog.gorozen.com/blog/the-incredible-shrinking-supermajors-part-iii

Portfolio managers are 'super bearish' with cash holdings highest since 9/11, Bank of America says – Morningstar

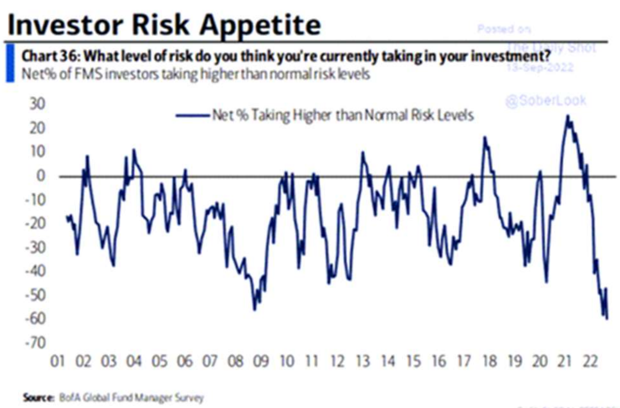
"Global fund managers have been piling into the dollar and out of stocks lately, and by one measure have become the most bearish since Sept. 11, 2001.

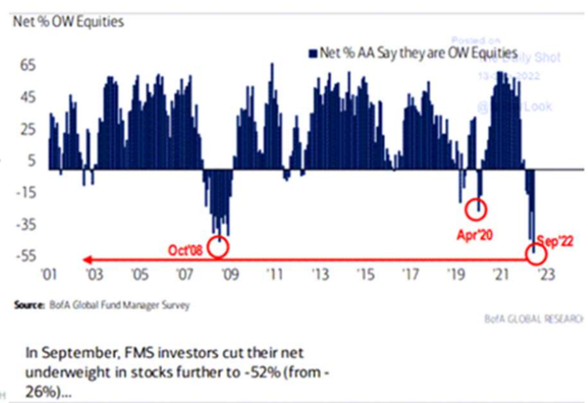
That's according to a Bank of America's September survey of global fund managers, whose unrelenting gloom is perhaps justified by a disappointing report on August inflation that is sparking a brutal day on Wall Street -- along with a looming energy crisis in Europe. Average cash balances for global managers hit 6.1%, according to the latest survey, the highest level since the deadly terrorist attacks on U.S. soil 21 years ago."

The survey, aptly titled "Les Misérables," showed global growth expectations nearing all-time lows, with a net 72% expecting economic weakness next year, though a net 79% expect inflation to fall in the next 12 months.

And while optimism appeared to return for markets at the start of September, with some Wall Street bulls maintaining recession can be avoided, global fund managers didn't appear to be having any of it. The share of those viewing a recession as likely rose further in September to 68%, the highest since May 2020." Highlighting emphasis mine.

https://www.morningstar.com/news/marketwatch/20220913246/portfolio-managers-are-super-bearish-with-cash-holdings-highest-since-911-bank-of-america-says





May/2020 was two months after the Feb-March/2020 COVID -19 panic that saw the S&P500 crash -36%. The first 6 months of 2022 saw stocks fall-24.5% and are still flopping about. Remember all the nuttiness of late 2021? How much of the recent slide is simple correction of excess? Investor sentiment is at bearish extremes. This doesn't mean stocks can't fall further. Like euphoria, panic continues until it stops. History says stock prices usually don't decline dramatically after prices have declined dramatically. Note: usually & dramatically. In my world dramatically means -20%+. During those times investors who were willing buyers from panicked sellers, paid lower than average prices and received higher than average dividend yields. Over time they had higher than average returns and were happier than average. Eventually. None of this is guaranteed.

Time to Invest?

Pretty glum sounding isn't it? A client recently made a deposit equaling 40% of their previous holdings. It is a significant junk of money to them. They seek large cap growing dividnd payers to compound for future income and growth. Their current employment income is in the top tax bracket. They don't need income for a decade or more, don't require access to the current value. Their debt levels are low and hold property assets, both personal and investment. Profiting by owning stocks through good times and bad, they are familiar with price volatility. With all the bum news flow, they questioned the timing of their deposite. Are they too early? I replied in writing. Here is a summary. To protect their privacy I've redacted the dollar values and will call him John and his wife Jane.

Jane's holding company deposited $XXXX yesterday. The account is now live and ready to deploy. Your risk objective focuses on large cap, dividend paying stocks. The plan is to build dividend income that may be flowed through the corporation to Jane at her choosing. The resulting dividend income is currently taxed at a preferential (lower) rate vs. 'other' or interest income. History says dividends tend to maintain purchasing power after inflaton.

You asked: Timing, now or wait?

We must clarify you are buyers. Time is on your side. Not so for sellers. Please review the attached profile detailing historical total annual average returns for investors seeking a similar potential 100% allocation to equities.

Source: National Bank Financial – Wealth Management model portfolio asset allocation from 1950 to 2016.

Investors who are only willing to hold stocks for 12 months (right hand column) saw avearge returns of 9.9%. ***"Great!"*** *But….they made as much +39.8% or lost as much as -22.1%. Price ranges over less than 12-months exceeded those ranges.* ***"Uh..no thanks!"*** *Investors must be prepared to wait. We advise 3 years+ minimum time horizons.*

“Gee great Steve! We may have to wait. What about waiting before we take risk?”

In the short-term this question becomes a guessing game of other investor’s risk appetite. Like watching a school of fish in one of those undersea videos, the short-term direction changes seem randome as the school reacts to one or two fish on the outer edges reacting to some preceived threat. But they are all headed for one destination. Where the food is! Understanding their appetite tells where they’re going. How they get there is un-important.

Understanding investor risk appetite and what compels them over time is important to investment success. Stock prices are slaves to growing earnings because growing earnings equal growing dividend income. As long as we assume the economy will continue to grow, earnings and dividends will grow. History says stock prices follow…eventually.

When I entered the industry, the Dow Industrials Average was around 2,000. Today it’s around 31,000+. During my 33 year career ANYTIME you showed up with money, you made money…eventually. Perhaps that’s all we need to know.

But are there better times than others to invest?

Lets clarify this debate often centers on one Buy or Sell decision, made once. Silly isn’t it? An investor who ‘overpays’ then buys again on dips will smooth out their returns. But let’s stick with ‘once and once only’.

History says…

Buying (once) during periods of above average optimism and greed leads to below average returns. The more extreme the optimism, the sooner and lower-for-longer the returns…eventually.

Buying during periods of below average optimism IE when pessimism and fear is high, has provided above average returns. The more extreme the pessimism, the sooner and higher-for-longer the returns…eventually

Which mood to you detect today?

*Bank of America’s above **Global Fund Manager Survey** interviews institutional investment fund management professionals around the world each month. One question looks at each fund manager’s appetite for risk. The aggregate opinion is often a contrary indicator of what is likely to happen next. Makes sense. If the Big Money is nervous, whose left to sell?*

The current risk appetite is as low as it’s been since just AFTER the Sept/11, 2001 terrorist attacks and is lower than just AFTER the depths of the COVID-19 panic in March/2020. History says buying during such periods has been rewarding…eventually. That’s the market as a whole.

*We don’t buy ‘the market’. Our equity portfolios hold individual stocks for dividend income. Many of the stocks we follow already look appealing. Here’s an example **Manulife Financial (MFC-TSX-$22.86).***

Manulife's 12-month high was $28.09. At $28 the $1.32 dividend per share generated a respectable dividend yield of 4.7%. Last trade is around $22.85 for a decline of -18.6% from the high. The 12-month low was $21.28 in June. At today's price the $1.32 dividend equates to a 5.7% cash yield. Manulife made $3.25 per share last year and appears likely to earn $3.20 per share next year (no growth). The next chart compares earnings (blue bars) to consensus projected earnings (grey bars) since 2017.

Concensus estimates and actual results have been close. The company rarely brings big surprises. Boring is good. If I pay $22.86 per share today and the company generates $3.20 per share over the next 12 months, the internal earnings is 14%. That's next year…on a flat year-over-previous-year comparison …with no future earnings growth assumptions. 10 years ago Manulife made $1.12 per share. Earnings have gained 2.8 fold. Over the same period the per share dividend has climbed from 52 cents to $1.32 = 2.5 X. The stock price has done little since 2014. What happended?

In 2014, investors were willing to pay $15 per dollar of earnings (P/E 15.1). Today they're paying $7 (P/E of 7.15). Earnings have grown yet the price hasn't changed, Today's price relative to earnings is 50% cheaper than in 2014. The average P/E for the S&P/TSX Composite Index is 14.2 X earnings. The S&P500 average PE is 20.18. Both have been higher. Manulife is priced 50% below the average for Canadian large cap stocks and 65% below the S&P500 average. It is also priced below it's own long term ratios. If Manulife grows their earnings, dividends should follow. Adding a 14% internal return to the current cash dividend income of 5.7% brings us to 19.7% total return. Seems attractive to me.

When to buy that future?

The lower the starting price for the future, the better. If earnings grow, the future price is unlikely to remain lower than today for long. It's just too tempting for existing shareholders not to sell and hold on to the rising dividend. Potential buyers can't ignore the rising revenues. It's too tempting not to buy.

And yet…when the stock was at $28 there was little talk of wanting to sell (someone did to make that $28 trade). Now that the stock has declined to $22, the media says no one wants to buy (someone is). Which price would we rather pay $28 or $22? So simple yet so hard.

"But….what if I buy and the price goes down some more?"

Will you have sell it? If not, the answer should be "Who Cares? I'll just sit and collect my 5.7% cash income this year and probably see growing dividends into the future. I can afford to wait. If I can't, I shouldn't own stocks." ***I think the timing of your recent deposit is excellent!***

DISCLOSURE: I hold Manulife personally, for family members and for client accounts over which I have trading authority. We have traded in the stock within the past 60 days.

'Recognize Extremes' – Steve Hilberry ad nauseum

"Be fearful when others are greedy, and greedy when others are fearful"

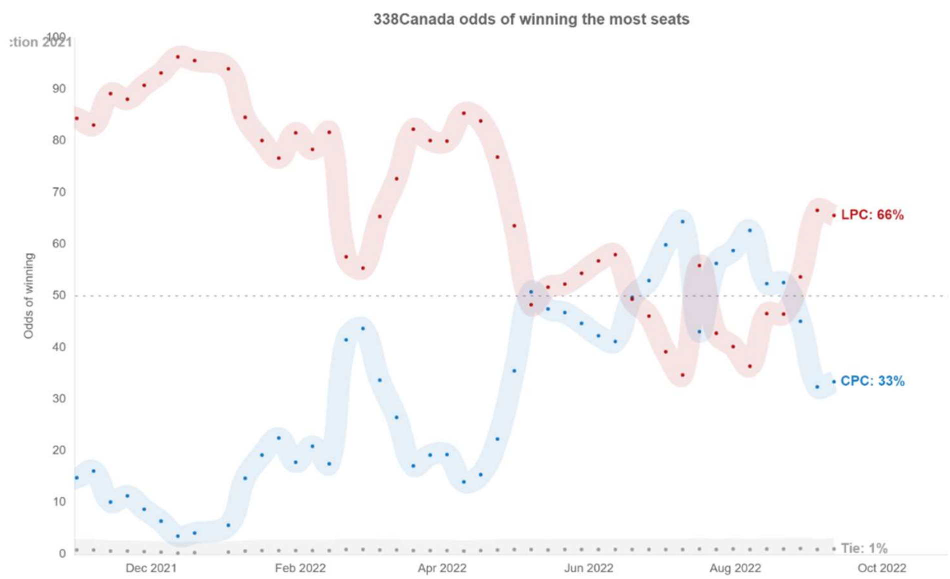
- Warren Buffet - Berkshire Hathaway Chairmans Letter 1986.

https://www.berkshirehathaway.com/letters/1986.html

The Conservatives just elected Pierre Poilievre as leader.

Canadians were not amused. Odds of winning the most seats.

https://338canada.com/



The Conservatives have work to do, but… the Liberals have won 3 consecutive elections, the last two being minorities. Following two minority governments, odds do not favor the party in power winning another term. Canada hasn't seen a party win 4 consecutive terms since

Pierre Trudeau's Liberals in 1980. It's been 42 years since Canadians re-elected a Prime Minister 4 times, the last being the father of the current one.

A recession is likely by 2024-2025. Will the Liberals wait to take their chances in a recession allowing the Conservatives to mend their reputation, or will they move first? I bet first. The NDP will be 'outraged' (again). Who says Canadian politics are boring?

Steve will be away from the branch Sept 19 returning Oct 11th. No Weekend Reading till October 14th. Class dismissed!

Have a Great Weekend

Steve & Anna Hilberry

FOR THE RECORD Sept 16, 2022

DOW INDUSTRIALS:	30,628
S&P 500:	3,851
S&P/TSX COMP:	19,318
WTI:	$85.53
LOONIE IN $USD:	$0.7516

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