Hilberry Group
Wealth Management

July 7, 2023

This and that

We're providing a catchup up of various stories over the past two weeks. Continuing on last week's foray into energy, we'll start with the new Federal Carbon Tax put in place July 1, 2023. Happy Canada Day drivers!

Environmental, Social and Governance: Clean Fuel Regulations; Fueling the Future

NBF's ESG Desk update their analysis of Canada's Federal *Clean Fuel Regulations* (CFR) going into effect July 1, 2023. They lead off the report with…

Building upon the noted successes of the implementation of regionally regulated Low Carbon Fuels Standards (British Columbia and California), the Canadian Government unveiled its highly anticipated Clean Fuel Regulations (CFR), which will regulate the use of traditional liquid fuels (gasoline and diesel) in the transportation sector, while working in association with other industrial emitter programs.

This initiative is a key component in the Canadian Government's arsenal in the "greening the economy" to ultimately be on the pathway towards meeting our nationally determined contribution (NDC), which is currently reflective of reducing emissions by 40-45% by 2030 (off of a 2005 baseline) and charting the way to attain net-zero by 2050. The proposed initiative is set on the precedent of stimulating innovation and growth of low carbon fuels, essentially suppressing the carbon intensity profile of incumbent transportation fuels.

See the attached NBF report. Environmental, Social and Governance Clean Fuel Regulations; Fueling the Future

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British Columbians may question the reports "noted success" of BC's *Low Carbon Fuel Standards.* A major element for the then BC Liberal Government's selling the carbon tax to voters was 'revenue neutrality'. Increased carbon taxes on gasoline and diesel were to be offset by a LARGER reduction of taxes elsewhere, the goal being to change behaviour, not increase government taxes. Made a lot of sense. That is until governments got the revenues.

'Examining Revenue Neutrality in British Columbia's Carbon Tax' – Fraser Institute Feb 16, 2017

The tiresome critics of Big Ideas at the Fraser Institute looked at the purported revenue neutrality of BC's Carbon Tax back in 2017. 9 years into the tax and neutrality didn't exist. By 2017, The $1.2 billion per year brought in by the carbon tax was already exceeding 'offsetting measures' by roughly $300 million per year.

https://www.fraserinstitute.org/sites/default/files/examining-the-revenue-neutrality-of-bcs-carbon-tax.pdf

Does it matter?

Once a government revenue stream becomes embedded in spending expectations, reducing those revenues, is very difficult. Mission Creep takes over.

In 2018, the Fraser Institute again inconveniently looked at claims made by the think tank *Canadians for Clean Prosperity (CCP)* that Canadian middle-class and lower income households would receive more benefit than cost from a Federal carbon tax, IE that '*somebody else'* pays. This idea became an element in selling the Federal Clean Fuel Regulations now in force.

'Interpret new carbon tax study with caution' – Fraser Institute Sept 25, 2018

https://www.fraserinstitute.org/blogs/interpret-new-carbon-tax-study-with-caution

The Fraser Institute notes a lack of revenue neutrality means somebody pays more. That somebody is all of us. They use BC's Carbon Tax as a test case.

"Consider the case of B.C.'s carbon tax.

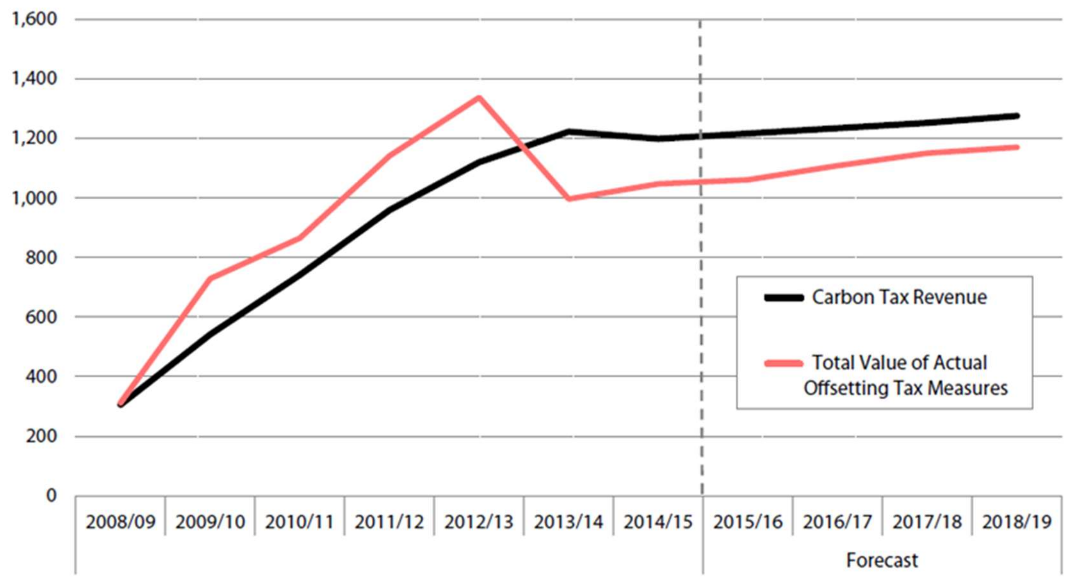
Back in 2008/09, when the province first introduced the carbon tax, the B.C. Liberal government promised revenue neutrality. And according to a recent study, initially the tax was revenue neutral. (In economic parlance, "revenue neutrality" means that when a government imposes a new tax, it lowers other taxes in proportion to the new tax, so that no new net revenue is generated for the government.)

To offset the new revenue, the government introduced new cuts to personal and business tax rates and a new tax credit for low-income earners.

However, a mere five years later, as the carbon-tax revenue increased, the government no longer provided new tax cuts that sufficiently offset the revenue generated from the carbon tax. So B.C.'s carbon tax was no longer revenue neutral in 2013/14, as the government began *to include pre-existing tax credits to specific groups such as the B.C. film industry when reporting the offsetting tax cuts in the budget.*

Now, 10 years after the carbon tax was introduced, revenue neutrality is no longer provincial policy in British Columbia. The current NDP government (supported by the Green Party) has discarded revenue neutrality by saying the new revenues will be used for spending initiatives. The 2017 provincial budget not only included such tax increases, it also eliminated from law the requirement for offsetting tax cuts. Simply put, B.C.'s revenue neutral carbon tax was a fleeting policy that didn't survive under a single government. Thus, assuming governments will rebate carbon tax revenues to households is wishful thinking based on how B.C.'s carbon tax revenues have been used. "

BC's Carbon Tax Revenue and Actual Offsetting Tax Measures with Pre-existing Credits Excluded ($ millions)



Did it the carbon tax work in BC? Are BC provincial GHG emissions lower?

From the BC Carbon Tax Wikipedia page:

https://en.wikipedia.org/wiki/British_Columbia_carbon_tax

"Ten-year review

A more recent assessment of the consumption of fossil fuel products as well as total GHG emissions has shown that that initial success has not been sustained. Based on data from Statistics Canada, gasoline consumption was 5,590,356 m3 in 2018. In 2007, the provincial gasoline consumption was 4,629,896 m3. That indicates that the consumption of gasoline has increased by approximately 20.7% since the carbon tax was introduced.[28] Similarly, the consumption of diesel fuel has increased from 1,796,661 m3 in 2007 to 1,963,507 m3 in 2018. That indicated an increase in diesel consumption of approximately 9.3% since the carbon tax was introduced.[29]

Based on the data, it is unsurprising that the total GHG emissions in British Columbia have also increased between 2007 and 2018. Based on the latest report from the BC government, the total GHG emissions in the 2007 base line year were 63,401 kTCO2e, which increased to 67,924 kTCO2e in 2018. That represents an increase in total GHG emissions of approximately 7.3% since the introduction of the carbon tax. The latest data also showed that the GHG emissions from the transportation sector had increased by approximately 23.6% from 2007 to 2018.[30] Based on the most recent results, it is unclear if the carbon tax as implemented in BC has had a direct effect on the consumption of fossil fuel products as was reported in the earlier studies cited here."

Does this mean carbon taxes can't work?

If one raises the cost of anything enough, eventually it becomes too expensive to be useful to consumers and purchasing behaviour shifts. Think tobacco and smoking. If we raise the cost of hydrocarbon fuels enough, certainly the nation will stop using hydrocarbon fuels. Be careful what you wish for. A carbon tax falls directly lightest on citizens who don't drive much. Think the elderly (who are passionate voters) and city folk who can afford to live close to their places of work. Yaletown is an easy walk to everything Vancouver has to offer. Maple Ridge, not so much. They will, eventually, pay more for everything, but that connection isn't visceral at a fuel station. Rural residents, those who drive for a living, suburban commuters, employees in trades servicing heavy industry, heavy equipment operators and all business, face the direct wallet cost of higher carbon taxes. This may explain the political divide.

The billions to be raised by the new carbon tax are 'targeted' for alternative energy projects. A cautionary tale south of the border.

New York State Built Elon Musk a $1 Billion Factory. 'It Was a Bad Deal.' Wall Street Journal July 6, 2023

https://www.wsj.com/articles/elon-musk-tesla-buffalo-new-york-solar-plant-1b634b9e

BUFFALO, N.Y.—New York spent nearly $1 billion over the past decade on Elon Musk's ambitious plan for what was supposed to be the largest solar-panel factory in the Western Hemisphere, one of the largest-ever public cash outlays of its kind.
"You almost have to pinch yourself, right?" New York's then-Gov. Andrew Cuomo said at a construction ceremony for the factory in 2015. "That this is too good to be true."

Eight years later, that looks like a pretty good assessment.

New York state paid to build a quarter-mile-long facility with 1.2 million square feet of industrial space, which it now owns and leases to Tesla for $1 a year. It bought$240 million worth of solar-panel manufacturing equipment. Musk had said that by 2020 the Buffalo plant each week would churn out enough solar-panel shingles to cover 1,000 roofs.

The Tesla solar-energy unit behind the plan, however, is averaging just 21 installations a week, according to energy analysts at Wood Mackenzie who reviewed utility data. The building houses some factory workers, but also hundreds of lower-paid desk-bound data analysts working on other Tesla business. (in other words…NY State provides a subsidized office space for Musk's other business interests – SH)

The suppliers that Cuomo predicted would flock to a modern manufacturing hub never showed up. The only new nearby business is a Tim Horton's coffee shop. Most of the solar-panel manufacturing equipment bought by the state has been sold at a discount or scrapped.

A state comptroller's audit found just 54 cents of economic benefit for every subsidy dollar spent on the factory, which rose on the site of an old steel mill. External auditors have written down nearly all of New York's investment.

The state has agreed to amend the terms of its subsidy 12 times over the years, including by reducing the number of jobs to be created in manufacturing and shifting deadlines to accommodate the company.

Although there aren't as many manufacturing jobs as the company and politicians had forecast, Tesla reported in February it has created 1,700 positions there, enough to meet its obligations to the state and avoid a $41 million annual penalty.

Musk and Tesla didn't respond to requests for comment, and Cuomo declined to be interviewed.

Tesla pays $1 per year until 2029. In 2029 the bill rises to $41 million. It will be interesting to watch the company's decision-making in 2028, a lifetime in politics.

But wait. There's more.

An aid and an advisor to Mr. Cuomo were convicted by a New York court of abusing their positions after aiding a local contractor to win the Tesla factory construction deals. The contractor paid them cash.

New York's Big Idea was to revitalize Buffalo's declining industrial base with new, green and clean, high-paying manufacturing jobs. All it required was an angel investor to kick start the process. The New York State direct cash cost subsidies came in just under $1 billion. When it's someone else's money, tomfoolery may result. Ottawa's subsidies to build battery plants in Ontario make the New York gambit look like peanuts.

Motor Mouth: BMW's math shows we need hydrogen cars

We've maintained that hydrogen fuel cells will be an important component to a low carbon driving future. BMW agrees and shows why.

https://driving.ca/column/motor-mouth/how-bmw-math-need-hydrogen-fuel-cell-cars

We hold a position in Toyota. Unlike Mr. Musk, Toyota's leadership has not pursued social media influencer fame. (Can you name the CEO? Koji Sato). Rather than playing with flamethrowers (https://www.youtube.com/watch?v=BKDybVqc-oQ) Toyota has quietly and competently developed multiple solutions to a transportation transition. They rejected the 'Batteries or nothing' approach that is currently the rage. That cost them in the short term. This week Toyota announced they may have solved the weight, range and charging time problem.

Toyota says solid-state battery breakthrough can halve cost and size - FT July 3rd

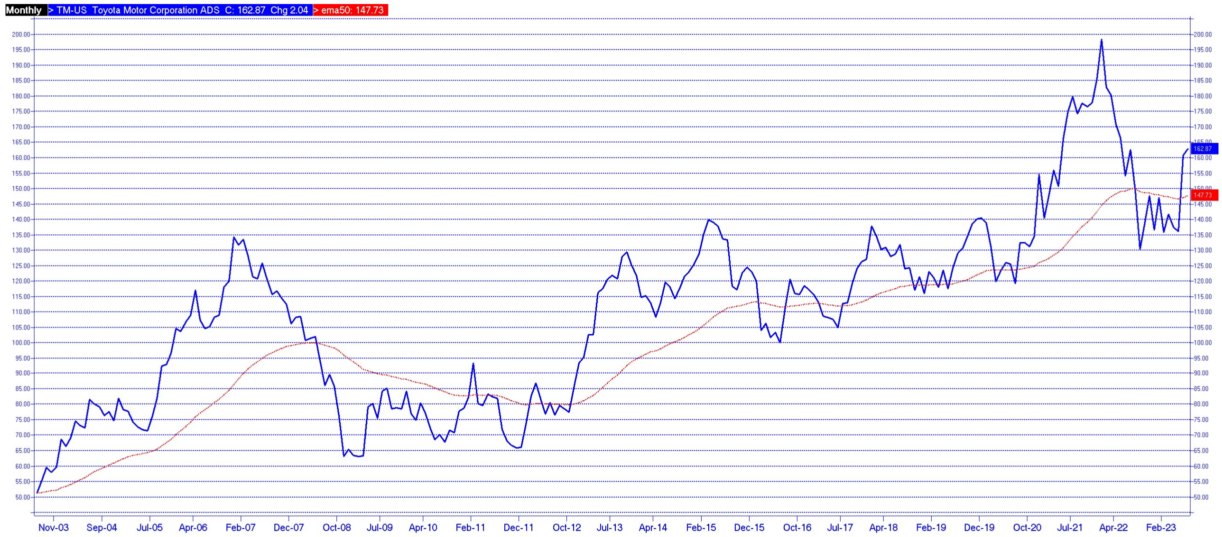
"…on Tuesday, Kaita said the company discovered ways to address the durability problems from about three years ago and now had enough confidence to mass-produce solid-state batteries in EVs by 2027 or 2028.

Toyota claimed it had made a "technological breakthrough" to resolve durability issues and "a solution for materials" that would allow an EV powered by a solid-state battery to have a range of 1,200km and charging time of 10 minutes or less…"

https://www.ft.com/content/87cb8e92-8e82-4755-8fc3-2943f8f63e1d

Toyota mmanagement notes all-battery EV's need to be charged, advising we address where the power comes from. That hasn't been popular either. After a recent flat spell, investors are becoming interested in Toyota again. It's been a solid, boring investment over time.

Toyota ADRs (TM-US-$162.87-$USD) monthly ranges – 20 years



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

Is the global dominance of the US dollar gradually eroding?

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=2e96bd44-dcc9-4f2c-9beb-0cb18ce57917&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

US Recession Risk Weekly Monitor – National Bank - July 4, 2023

https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=c33bf973-541b-4ed6-b325-c9fa215d2a0a&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

U.S.: Economic and financial indicators 3 months before recessions

As of July 3rd, 2023

		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%	-1.8%	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)**	11.3	17.5	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)	-10.0%	-9.9%	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)	-35.6%	-38.1%	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)	1.2%	1.1%	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)	-145	-157	yes	26	77	-76	98	-62	-127	-157	35	-18
Soft data	Consumer sentiment (Michigan)	64.4	59.2	yes	99.3	80.9	94.7	90.6	76.3	63.3	72.0	86.4	83.7
	SME optimism	89.4	89.0	no	102.7	96.1	96.4	99.4	97.4	93.3	NA	NA	96.9
	CEO confidence (quarterly data)	42.0	43.0	no	43.0	44.0	31.0	48.0	61.0	32.0	NA	NA	43.5
	ISM manufacturing	46.0	46.9	yes	47.9	52.8	42.3	49.5	53.5	48.0	63.5	54.6	51.2
	ISM services	50.3	51.9	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)	35%	34%	yes	6%	8%	26%	6%	2%	20%	12%	10%	9%
	Temp. help services jobs (% drawdown from past year max)	-3.2%	-3.4%	no	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%	no	-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)	-12%	-21%	no	-5%	-27%	-2%	-39%	-21%	-30%	-30%	-19%	-24%
	Real consumption (3-month, % ann)	0.7%	0.7%	yes	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)

More red implies increased recession risk. We've followed the trend of this report noting red turning to yellow. We're starting to see some green. The top line S&P500 drawdown (green) is not predicting a further recession. That happened in 2022, predicting what we've just experienced. The table supports our views that…

- We've already experienced a mild recession that is now ending.
- Inflation is unlikely to collapse.
- Bond yields are unlikely to plunge in a terrible Depression
- Stock prices are unlikely to 'crash'.
- Unemployment rates aren't going to surge, meaning wages will be steady to higher.
- Wage earners will keep making their mortgage payments implying…
- Housing prices are probably not going to collapse meaning…
- Banks aren't likely to suffer catastrophic losses.

Not much media-worthy panic to sell advertising.

We're not saying everything is rosy, easy-peasy. There's been a North American decline in Capital Expenditure (Capex - equipment, manufacturing, infrastructure, etc.) Slower capex implies slower future economic growth vs. a more typical rebound coming out of a deep recession. The lack of a spectacular recession led collapse implies an unspectacular rebound. Boring can be okay. Scott Grannis explains why the recession risk is low and how Capex affects future growth. Note that Mr. Grannis expects inflation to decline back to the US and Bank of Canada's 2% target. We're not so sure. We think a tad higher but that could be hair splitting.

M2 Update: No need to worry. – Calafia Beach Pundit – Scott Grannis June 28, 2023

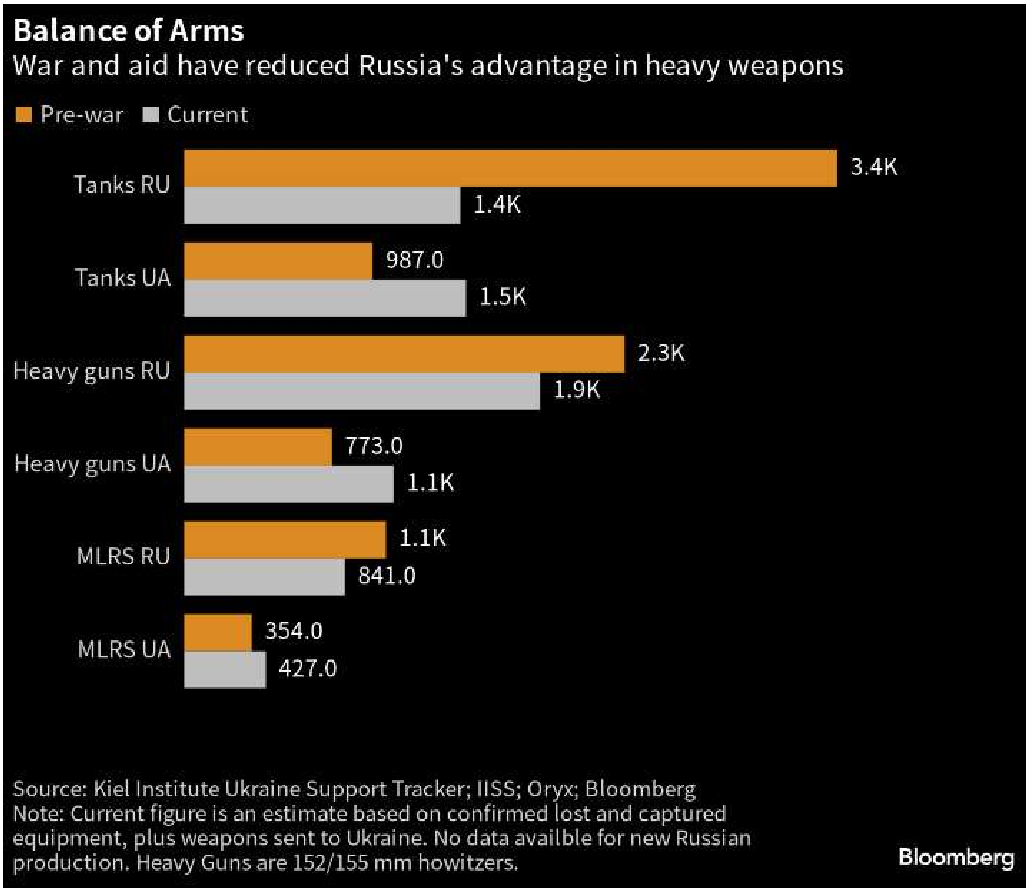
http://scottgrannis.blogspot.com/2023/06/m2-update-no-reason-to-worry.html

Aerospace and Defense updates:

The past twenty years saw low tensions between major military powers. G-7 40-year olds haven't known major power conflicts. Afghanistan, Iraq, Yemen, ongoing local conflicts in Africa, smaller-scale battles between Slavic nations and the Caucuses weren't enough to alter their lived experience. In 2010, Vladimir Putin sang *''I Got My Thrill on Blueberry Hill'* at a St Petersburg charity event with Sharon Stone, Kevin Costner, and other major US movie stars in attendance. https://www.youtube.com/watch?v=TbkGkr0iceI

There was simply too much money to be made for world leaders to bother trying to kill each other. Major war was a 1930's black and white thing. Europeans in particular, who should have known better, assumed their borders were safe. Germany slumbered. Barak Obama's 'Pivot East' redirected US Foreign policy resources towards China. Donald Trump then enacted a trade war with China.

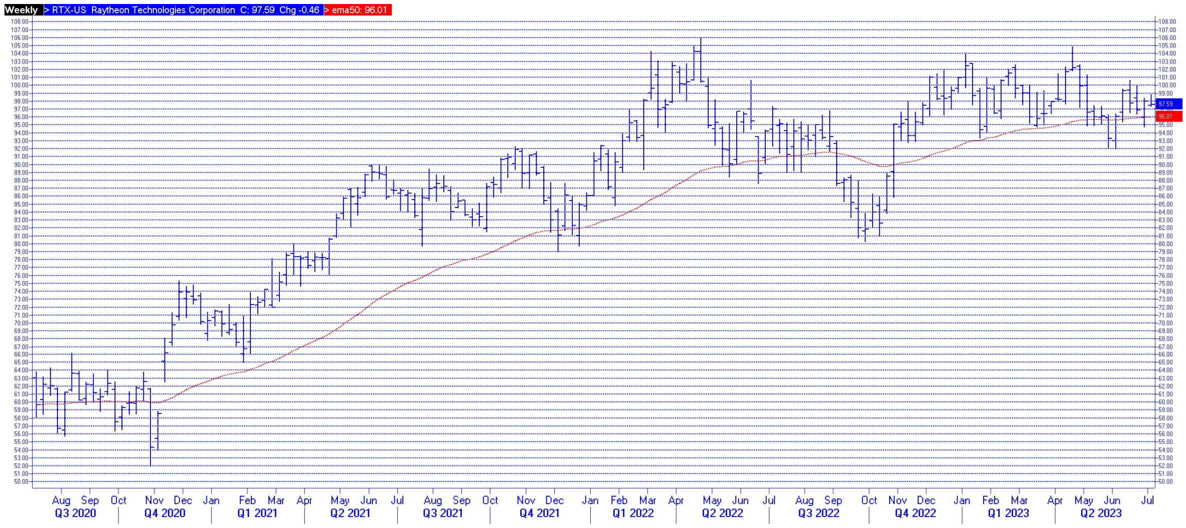
Ukraine happened... Suddenly we're reminded of the evil that humankind can do. It hasn't gone well for Russia.



Investors have bid up Aerospace and Defense contractors taking Raytheon with it. We acquired Raytheon Technologies via our purchase of United Technologies (UTX) during the Mar/2020 COVID-19 Pandemic panic. We bought based on discount, not a Big Idea. UTX was in the midst of a complex merger/consolidation with Raytheon, becoming Raytheon Technologies (RTX). It has worked well for our clients.

Raytheon Technologies (RTX-$97.62) – weekly ranges – 3 years.

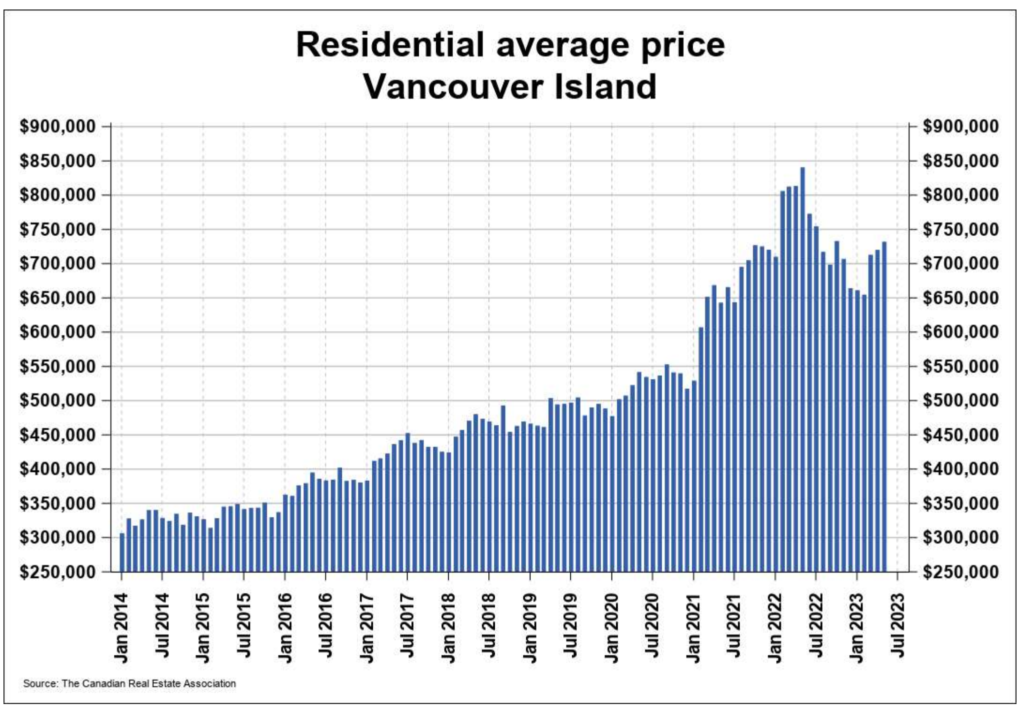
Sadly, we see more profits ahead for the sector.



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

On affordable housing

The cost of housing is a major political issue in BC. Rents are sky high. Building costs have soared, fueling inflation which drives up interest rates. In May 2023, the median cost for a single family home in Duncan was approximately $820,000, up roughly 2.7% on a year ago. The Vancouver Island Real Estate board says Island prices have moderated recently but have nearly doubled over the past 5 years.



Over the past 10 years, the US dollar price of lumber has climbed 71% to $528 US per 1,000 board feet. Prices spiked to over $1,600 in the COVID-19 Pandemic. Prices are sticky.

Source: Trading Economics

Housing advocates blame house-price increase on gread-flation, institutional investors and foreign buyers. It's always someone else's fault, to be solved with someone else's money. Premier David Eby echoed this sentiment in an interview on CBC Radio July 6

https://www.cbc.ca/listen/live-radio/1-91-the-early-edition/clip/15995722-premier-david-eby-cost-housing-british-columbia

Mr. Eby should know better. Prior to being appointed Premier in Nov/2022 he was the Provincial NDP's Housing Minister. In the above interview Mr. Eby notes a case of Lower Mainland government-sponsored low income housing development, three years into a fully permitted and subsidized project has yet to see a shovel in the ground. Legal challenges and local bureaucracies have tangled the project. Does this sound familiar?

Housing advocates want government to **Do Something** by stepping in to prevent *'speculators, institutional and foreign investors from driving up prices unfairly'* implying it's all the fault of Big Money and rich foreigners. Governments have obliged with tax solutions.

The city of Vancouver enacted a 3% 'empty homes' municipal tax on assessed value. The Provincial Government enacted a 2% 'vacancy and speculators' tax on the assessed value of unoccupied properties. Originally focused on Vancouver & Victoria, the Provincial version is now extended to much of Southern Vancouver Island. The Federal Government enacted a national 1% 'Unused Housing Tax' of on assessed value. The Federal, Provincial and Municipal versions of empty house taxes use different definitions meaning they are potentially all applicable at the same time.

With support from BC's Provincial leaders, the Federal Government also enacted a 'Foreign Buyers Ban'. For a period of two years starting January 1, 2023, non-Canadians are banned from purchasing homes in Canada under the definition of "residential property" indicated in the legislation and associated regulations that the federal government published on December 21, 2022.

Where does the 'empty house problem' notion come from?

An Acquaintance has a house in Duncan. They purchased a second residence, a condo in Victoria as an 'investment'. They made a down-payment and borrowed the rest. In reality, they purchased it to provide their son a place to live while he completed a 6-year master's degree program at UVIC. Kiddo moved in and invited two buddies to share the place. The three students paid 'rent' to Mom & Dad just enough to (mostly) cover Mom & Dad's monthly costs (they had to subsidize it from time to time). 6% on $650,000/$39,000 per year mortgage interest translates to $3,250 interest per month. The rent was set at roughly that amount. As much of the income paid by Kiddo was directly or indirectly sourced from Mom & Dad, Mom & Dad did not declare the income, upon which they would have otherwise had to pay tax. they didn't feel guilty about it. If the property was deemed 'rental' the property insurance was also much higher. Having Kiddo occupy the place, avoids the Provincial 2% 'vacant property' tax.

Kiddo graduated and moved out. The other two buddies got a third friend to move in. Now Mom and Dad own a property that is potentially not declaring rental income, meaning government data shows their place show as 'empty' and is now subject to the vacancy tax of 2% (2% on $650,000 condo = $13,000). It was and is not empty. They decided to sell it.

Let's assume the property was fully paid for. Let's assume rent is being paid under the table.. It could cheaper for the owner to pay the $13,000 2% vacancy tax than it is for them to declare and pay income tax on the $40,000 rental income (at 53% = $21,200 income tax). There could be other reasons they don't wish to either rent the place or declare the rent. In neither case is the broad availability of housing affected. But…government revenues are likely to go nowhere but up, either via the 2% property tax or by income tax being declared. To be clear I have no sympathy with those avoiding legitimate taxes.

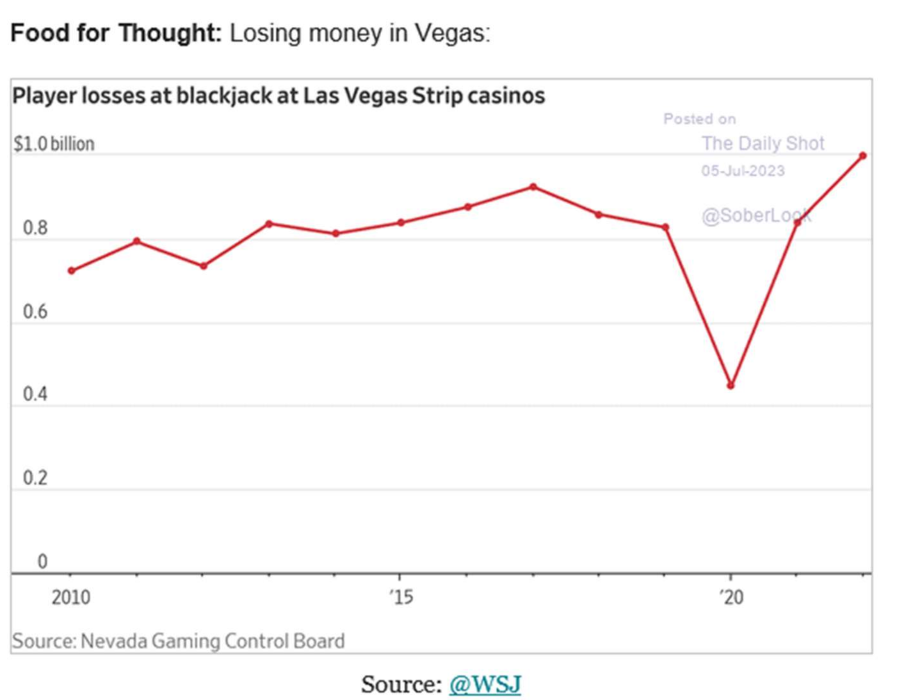
Vacancy Tax measures have not made housing more affordable. Why not?

BC experiences net migration. The arrivals must live somewhere. The vacancy tax notion avoids the inconvenient truth of supply. We have property developers and real estate agents as clients. One client family holds multi-acre raw land parcels at various locations on Vancouver Island. They've held the properties for decades with the intention developing into residential properties. When I ask their timeline to development, they note delays via NIMBY obstruction, Community Plan/local permitting resistance, bureaucratic delays, regulatory burdens, study fees, environmental fees, efficiency regulations, carbon-taxes and local taxes. Add in materials, wage and machinery operating cost inflation and the projects can cost more to build than they're worth. At very least they advised to make any kind of profit they must sell properties at much higher prices than they originally planned. With a high-cost barrier, buyers understandably want quality finishes, driving up prices further. In short, some of the cost acceleration is embedded from costs, and some is buyer discretionary. The result is higher priced new housing. Existing house prices follow. These builders and buyers are not bilking the public. Speculators and 'foreign' buyers aren't jacking prices in a conspiracy off the backs of the working men and women.

Our clients are builders. They love to build. They want to build. It's what they do. I asked them why they build-to-sell vs. build-to-rent? Given their ability to self-finance and build multi-family rental properties, surely the long-term, inflation-adjusting nature of rental income would be a desirable retirement income return on their time and money? They shake their heads. The last thing they want is renters who can refuse to pay, refuse to leave, then receive legal aid to fight eviction. They wish to avoid municipal and provincial rent controls, becoming a target for local housing advocates, and avoid legal fights with well-healed NIMBY's (see David Eby's comments above). It's been easier to simply do nothing, allowing inflation to drive up the value of the raw land. As Milton Friedman advised, "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." They are simply reacting to government policy outcomes.

Why we've never accepted the 'efficient market theory'

Confirming humans are not always rationale…and why there is always opportunity.



Have a Great Weekend

Steve & Anna Hilberry

NATIONAL BANK FINANCIAL
WEALTH MANAGEMENT

July 7, 2023

HILBERRY GROUP

July 7, 2023

FOR THE RECORD July 7, 2023

DOW INDUSTRIALS:	33,903
S&P 500:	4,424
S&P/TSX COMP:	19879
WTI:	$73.86
LOONIE IN $USD:	$0.7534 $US

Terms of use Confidentiality ABC's of security

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