Fall/Winter Letter 2018

Walter Scott Investment Conference

November 15, 2018

When I think of fall, two things come to mind; the beginning of football season and time to go back to school. As a lifelong Lion's fan, in September at least, there is still hope. And I may no longer be starting a new school year, but I am still eager to learn and share my insights with friends, colleagues and clients. This past October I was very pleased to be one of 130 investment managers from around the world invited to attend the 2018 Walter Scott Investment Conference, held in Edinburgh Scotland. In this letter I would like to share a few of the insights gleaned from the event.

The event was titled, "**Towards New Horizons"** and the overarching theme was **Innovation and Disruption** occurring in all aspects of life. In my business or in any business, one should never rest of their laurels, which is why it pays to keep an open mind and always be learning. Speakers included CEO's, Authorities on various topics, Authors, Athletes and Professors from The London School of Economics, Oxford and MIT. Below are a few highlights from just three of the 22 lectures I attended.

Professor Paul Marsh – London School of Economics

- 1900 to 2018 or over the past 118 years stocks beat cash, bonds and inflation in every country of the world
- $1 invested in **US stocks in 1900 is worth $1,654 today**; a return of 6.5% after inflation
- $1 invested in **US bonds in 1900 is worth $10.35 today**; a return of 2% after inflation
- $1 invested in 1900 in **US T Bills (GIC's) is worth $2.60 today**; a return of 0.8% after inflation
- Since 1900 we have experienced 9 Bull markets and 18 Bear markets (down 20% or more).
- Bull market last 9 years on average and the current bull is almost 10 years old
- Bear markets last on average 1.4 years before turning positive
- Based on the *"Gordon"* dividend discount model, many stocks are now undervalued.
- No one can know if the market is at the top, or bottom so do not try to time the market. The current market is already down over 10% from its highs; we could be two month into a bear market and won't even know it.

  (at the end of this letter I provide some commentary on the volatility we are experiencing, what is affecting markets, especially since October)

Bjorn Lomborg – Professor of Copenhagen Business School and President of the Copenhagen Consensus Centre

Dr. Lomborg was named one of Time Magazine's 100 most influential people in the world. His books include, *How to Spend $75 Billion to Make the World a Better Place* and *The Nobel Laureates Guide to the Smartest Targets for the World 2016 – 2013.* The title of his lecture was "How to Fix the World Smartly".

- Over the past 100 years, life expectancy has gone from 30 to over 80 years of age.
- Global poverty has gone from 90% to just 10% today.
- Global warming is occurring but we not getting the entire story and current initiatives to address the situation are almost certain to be ineffective.
- According to the Intergovernmental Panel on Climate Change (IPCC), since 1930 there is no evidence of any increase in flooding, costs due to floods are down and incidence of hurricanes are all actually down. Yet the climate change alarmist's would lead you to believe otherwise
- If every country was 100% Paris Accord compliant it would reduce CO2 by 56 gigatons and **cut temperatures by just 0.023 degrees; (not even 1% of the 2 degree target) by 2100.**

- Addressing climate change is the largest project humanity has ever undertaken – comparable to two world wars, the Apollo program, the cold war, abolition of slavery, the Manhattan project, the building of the railways, the rollout of electrification and sanitation combined!
- The cost of Paris vs the benefit of Paris is far larger (by a large margin) than any other global treaty in history. As a comparison, the costliest treaty in history was the *Treaty of Versailles in 1919*. In today's dollars it was a one-time $0.5 Trillion expense, and it failed for the same reasons Paris will fail: **unfair and unreasonable** (as recently evidenced with one death and 400 injured during violent French riots over fuel taxes).
- The cost of the Paris Accord is $1 Trillion to $2 Trillion cost per year in perpetuity, or $164 Trillion by the year 2100, when it would be assessed either a success or failure.

Life on earth is actually improving and there are growing pains and real issues to address. Despite the debate let's assume Global warming is real and *mostly* man made, the current promises of the Paris Accord will do little to tackle the problem, while costing a fortune.

This dilemma begs the question, what is the truth and what is the solution?

Climate change has become too political and an opportune tax grab and we are missing the real threat and opportunity to truly address the problem. If the costs of what we are currently doing to address climate change are so high with no impact, what will work?

The Copenhagen Institute identified 169 well-meaning targets that governments currently spend money on. There is only so much money to go around and we need to spend wisely and strategically to get the greatest social impact vs political impact which seem to get the most attention. The social, economic and environmental benefits…

For every $1 dollar spent:

- To reduce world trade restrictions and supply chain management = $2,011 in return
- Universal access to contraception (very controversial) = $120 in return
- Aspirin heart attack therapy = $63 in return
- Cut salt intake = $39 in return
- Reduce child malnutrition = $45 in return
- Increase skilled worker immigration = $15 in return
- Reforest to reduce CO2 = $7 in return
- Meet the 2 degree Paris accord climate reduction target = **less than $1 in return**

The number one environmental hazard that kills 4 million people per year and gets no attention is indoor air pollution. For every dollar spent providing better stoves to cook on = $10 in return.

Lomborg argues that the solution to climate change isn't to panic and double down on the flawed approach of the Paris Treaty. Punishing society with high energy taxes will not work as evidenced by the French riots.

What's needed are incentives, education and awareness to encourage vast increases in thought and R&D spending on green energy alternatives that are cheaper, cleaner and more convenient than the fossil fuel sources currently used today. In the 1800's the world switched from Whale oil to fossil fuels to heat and light our homes. It wasn't by taxing whales, it was the discovery of "black gold" that made John D Rockefeller the richest man on the planet. There is a better solution to the oil we use today. Someone could (and should) get very rich from discovering and investing in the next energy source for the future. We just don't know what it is, yet.

In the meantime by spending our money intelligently we can expect both a better human and environmental outcome. Based on current knowledge, spending just $75 billion smartly would make the world a place with less poverty, less global conflict, saving the environment and creating a better life today and for future generations.

Professor Lynda Gratton – London Business School

Professor Gratton is the author of the best-selling book ***"The 100-Year Life"*** *and was invited to join the "Council for Designing the 100-year life Society", chaired by Japan's Prime Minister, Shinzo Abe*

- Life expectancy in Canada is currently 82.3 years of age
- Anyone born in 1998 (or later) have a life expectancy of 100 years
- Every ten years life expectancy increases by 2 years
- The more active one is in retirement, the longer and more healthy they can expect to live
- People are living longer and having fewer babies
- This current technological revolution will be more profound than the Industrial revolution
- Technology will affect every job on the planet and workers must constantly upgrade their skills

"With a 100-year living time horizon we need to change our thinking to long-term thinking; we must begin to think about building more Cathedrals and less shopping malls"

Society today is based on a three-stage life model:

1. Education ends in early twenties.
2. Work/Career till age 65
3. Retirement for 20 years

Three stage life model replaced by the future multi stage life model:

1. Education for life
2. Exploration between careers
3. Transition/career/education as a continuum
4. Career/self-employment/education is a way of life
5. Consulting while retired as long as mentally and physically able

"Invest like a sequoia tree, constant steady compounding". Implications to investments and finances of a 100-year life:

- Future generations will be less reliant on government and corporate pensions to sustain them.
- Outliving money is a real risk; financial literacy, competence and guidance will become more important than ever.
- Much longer investment retirement time horizon of 35 and 40 year will require more equity exposure and more sophisticated planning.
- Longer working life and higher real estate values will require much longer mortgage amortizations.

Values that will be more important than ever of a 100-year life

1. Continually build on your reputation, skills, networks and experience.
2. A healthy balanced lifestyle.
3. Nurturing personal relationships.

Postscript; current market conditions

This "brief" summary has gone too long already and this letter attempts to summarize just three of the twenty two lectures I attended. There is so much more to discuss and I look forward to sharing next time we talk.

Though this letter covered primarily future long-term trends, I would be remiss to not comment on the current state of the economy and the markets. I have had some very insightful conversations and read timely reports from several Canadian bank analysts and pension funds managers regarding the current state of affairs and what we can expect in the future as well. There are too many issues to do justice in this note but October and November certainly reminded us that markets can volatile. Canadian and U.S. markets were down almost 10% in the month of October alone. Despite the good economy, our Canadian TSX is down 8%, while the U.S. S&P 500 is down 0.5% year to date.

The current bull market is in record territory and a slowdown/recession sooner or later is inevitable. In summary the strong economy may continue but I am watching early warning signs of a potential recession:

- Rising interest rates due to the strong economy beginning to weigh on the economy.
- Higher interest rates are a headwind for both stocks and real estate
- Tariffs are impacting the global economy
- Over the past month the price of oil plunged 25% from over $70/bbl to $53/bbl which can be attributed (in part) to a global economic slow down
- Canadian oil plunged 66% in price traded as low as $12 per barrel! The widest spread to global oil ever, reflecting the lack of pipeline capacity and a lack of confidence in Canadian assets.
- Market darlings Apple is down 26% and Aphria (which we don't recommend) is down 25% over the past month.
- Over one Trillion dollars has been erased from FAANG stocks Facebook, Apple, Amazon, Netflix and Google.

A market selloff is a form of ***creative destruction*** and value is being restored.

- After the much needed sell off, over half of the market is down 20% or more and many stocks are no longer expensive
- Given the developments above, the US federal Reserve and Bank of Canada are less apt to aggressively raise interest rates, they may even pause expected hikes.
- The market selloff created high dividend yields which makes dividend equity very attractive and **increases an investors cash income, not in spite of but because of the volatility.**
- A resolution of global trade conflicts and or a pause in interest rate increases could send the potential recession and bear market back into hibernation, for now at least.

Thank you for the trust and confidence placed in us. We continue to work hard and travel the world if necessary to seek out the best solutions for your hard earned investment savings.

Sincerely,
CIBC Wood Gundy

Darren Luck, CIM®
First Vice President, Investment Advisor
The Luck Financial Group