Wealth Management
Dominion Securities

THIRD QUARTER REPORT – SEPTEMBER 30TH, 2021

25% of all money in the United States did not exist a year ago.

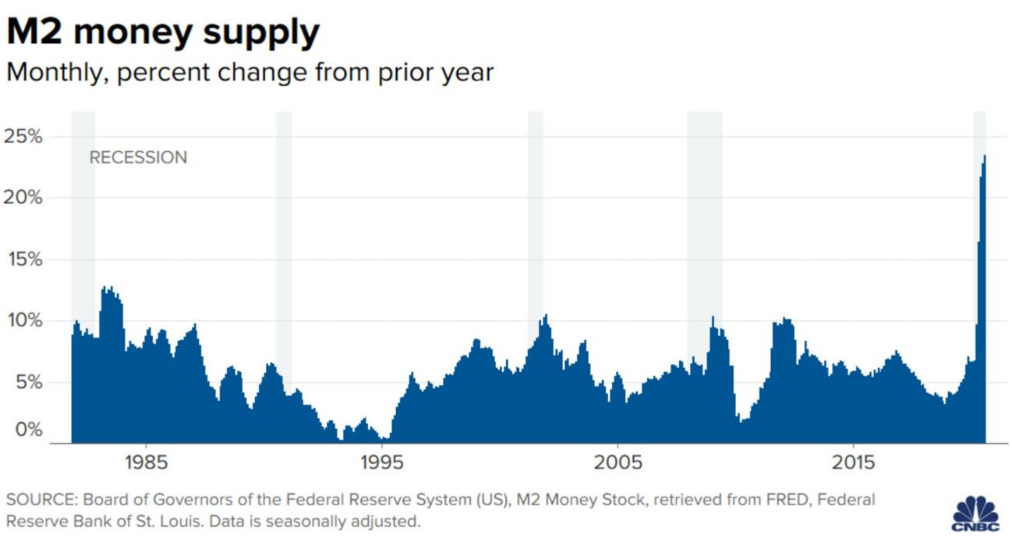
NO THANKS, WE DON'T WANT YOUR CASH

I have a good friend Monte. Monte loves his job. He gets more from his employer than his employer gets from him. He works from home, doesn't wear pants or do much work, takes extended lunches and coffee breaks, starts late, finishes early and takes a lot of vacations. Monte is replaceable with a part-time employee who works one day a month. Monte is not your ideal employee. He is my good friend and I would fire him.

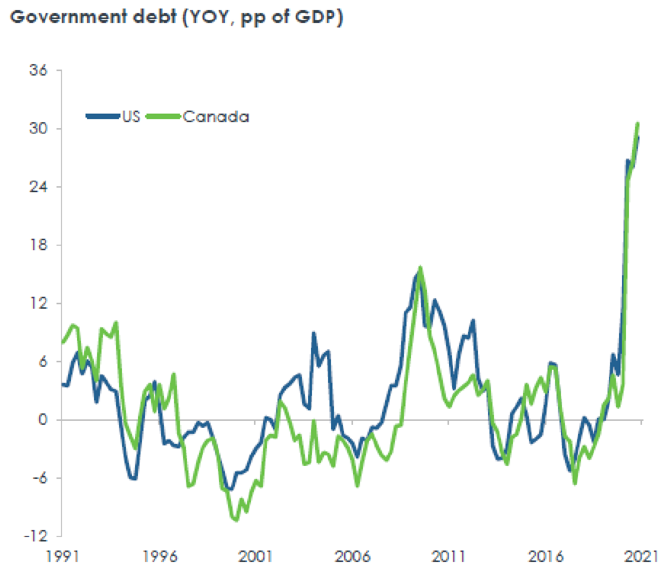
Right now we send our money to the bank to work for us and it's making Monte look good. Our cash is lazy. We are lucky if it's making us 0.2% in interest a year. Cash used to work hard, really hard. It was earning us 20% per year in the 80's. Working double shifts, weekends, taking no vacations… and doubling in value every four years. Today at 0.2%, it takes cash 360 years to double.

The problem is we have more cash than ever before and it's never been lazier.

Last year governments and central banks faced the impossible task of saving the economy and threw everything they had to keep it afloat. The yearly increase in the total amount of money in the United States hit an all-time record this February of 27.1%. The chart below shows the annual increase in US money supply since 1980. *Last year's increase was double any previous record over the past 50 years.*



On our side of the border, as referenced in my Q1 - 2021 newsletter: *'For every dollar that has been lost in Canada over the past year due to the pandemic, the Canadian government has given out $20.'* Below is the increase in Government Debt in both Canada and the US per person of Gross Domestic Product.



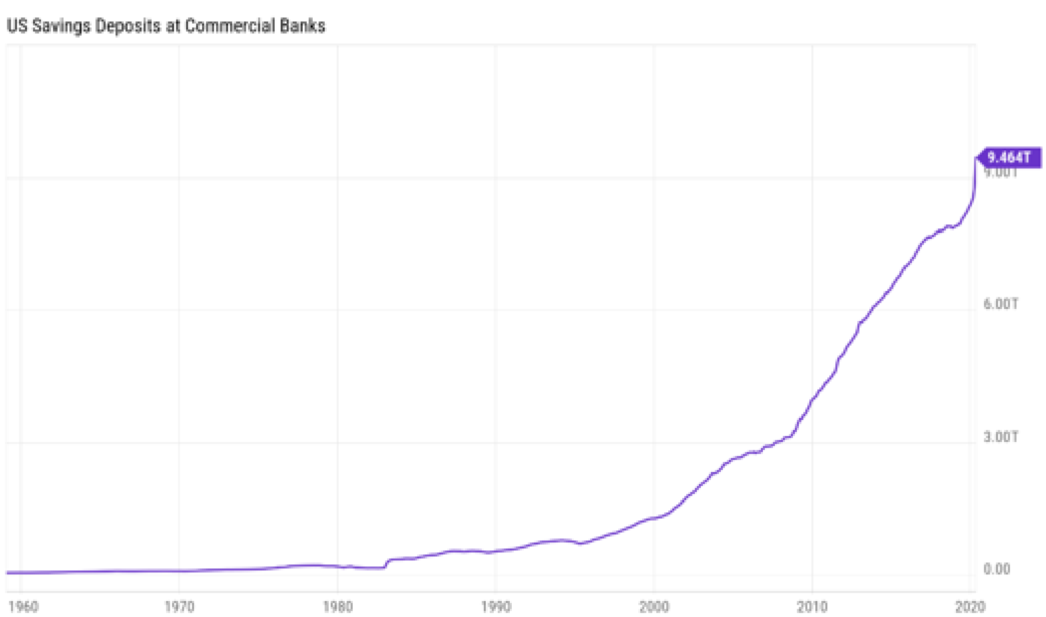
Bank for International Settlements, as at Q4 2020

The economy was saved, and just like after a night of drinking too much with friends, comes the hangover.

Where has all this new cash gone?

We have dramatically increased the amount of money, 25% of all money in circulation in the United States did not exist a year ago.

With all this new cash, most of it has gone directly into bank accounts. Cash at banks has been climbing steadily and are sitting at record levels. US banks are overflowing with cash and have so much they don't want anymore. They are asking clients to spend it or take it elsewhere.[1] Even Scrooge McDuck can't go swimming in his vault because there is so much cash in it, it is overflowing. Deposits at US Commercial Banks have grown to over $1 trillion. The average interest rate it is earning? 0.06%.



[1] https://www.wsj.com/articles/banks-to-companies-no-more-deposits-please-11623238200

We have never had so much cash.

The Hangover

With all this new cash created and the economy opening up, we are starting to spend some of it and it is causing everything around us to go up in price.

Inflation is running at the highest level in 30 years in the US[2] at 5.4%[3] and at the highest level in Canada in 18 years at 4.1%[4].

In the past 12 months the average house price in Canada has increased 20%, used car prices 24%, gas prices 33%, and the cost of building a new home 14%. And if you like bacon at breakfast, it's up 13%.

I was recently cleaning and found some Argentina pesos from a trip there three years ago. Before leaving, my goal was to become fluent in Spanish. I didn't meet my goal. When I got there, I could pronounce and understand two words: cambio - exchange, and agua - water. I tried my limited vocabulary on the plane, asking for agua…I got a Coke.

Since my trip, the central bank in Argentina has increased their money supply by 200%. For every peso in Argentina, 66 cents has been printed in the last three years.

What has happened in Argentina since my trip? Inflation is 50%, the Argentina peso has fallen 96%, and I still only know two words in Spanish.

The Implications of Low Interest Rates

After inflation, cash is worth 4-5% less every year. At this rate, cash will be worth 40% less over the next decade.

With record amounts of cash we need to do something with it. Otherwise we watch it slowly disappear with time and inflation. Cash goes to where it can earn the best return.

Investors had the same problem with cash after the financial crisis in 2009. Investors sold record amounts of stocks during the market crash. In addition, with all the uncertainty in the economy we started accumulating cash instead of spending it. With central banks dropping interest rates to zero, we had cash that was earning nothing and needed to put it back to work. Cash flowed back into the stock markets and during market sell-offs investors bought the dips, getting their cash back to work. The result? Over the next decade, the S&P500 returned 400% to investors.

The Risks with Low Rates

Low interest rates cause investors to take risks. Investing in Monte's new bacon business venture looks more appealing than losing money to inflation when the bank is offering 0.2%. However, if the bank offers me 20% per year, Monte can fund his own bacon business.

Low interest rates have helped cause many bubbles over the past 100 years. The Great Depression when the stock market lost 90%. The Internet Bubble in 2000 when the NASDAQ lost 80%. The 2006 US housing bubble when house prices fell nationwide by 35%.

As investors start taking risks and making money, more investors follow with expectations of high returns. Who wants to earn nothing at the bank when you can make easy money elsewhere? Eventually interest rates start rising which was the catalyst for funds to flow out of these investments and start the collapse of these speculative bubbles.

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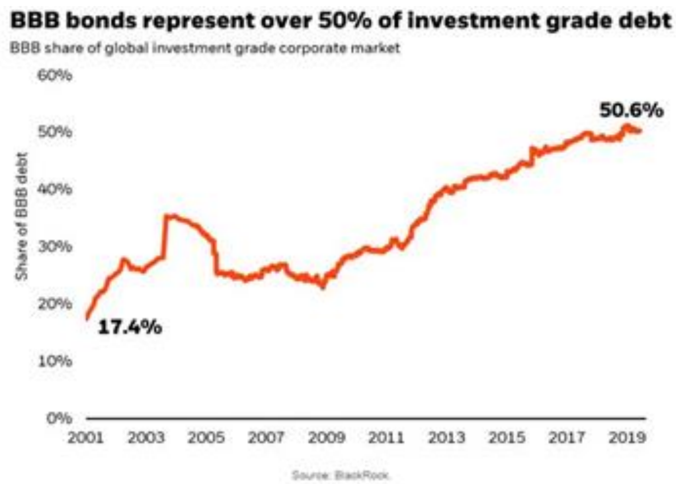
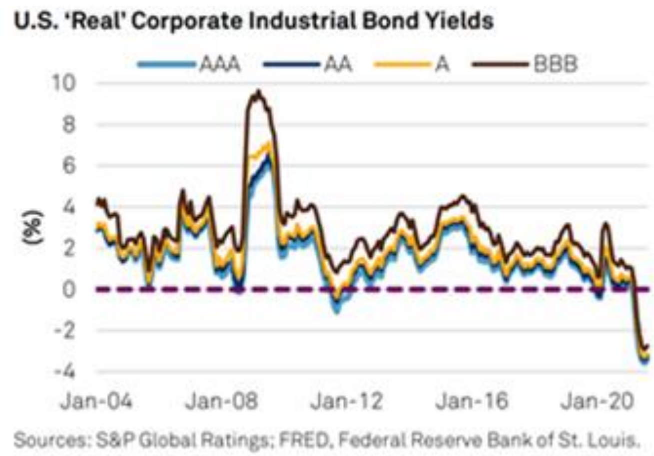
[2] https://www.cnbc.com/2021/10/01/key-inflation-gauge-watched-by-the-federal-reserve-hits-another-30-year-high.html
[3] https://www.nytimes.com/2021/09/14/business/consumer-price-index-august-2021.html
[4] https://www.reuters.com/world/americas/canadas-annual-inflation-rate-august-hits-41-highest-since-2003-2021-09-15/

In this low interest rate environment, investors are starting to take more risks. We are seeing a growing number of investors speculate in areas such as cryptocurrencies, and at the start of this year in companies such as Gamestop, which fell 80% from its highs.

Investors have also been hungry for yields with banks paying nothing. To get cash to work they have been buying more and lower grade bonds at record low rates. BBB bonds, which are the lowest quality investment grade bonds have grown to over 50% of the entire investment grade bond market, up from 17% at the start of 2000. Investors are also accepting the lowest yields on record for these bonds.





What is the best place for cash today?

We are closely watching the economy in both Canada and the US. There are no signs of weaknesses that point to an upcoming recession, especially with the massive amounts of stimulus. One of the most important predictors that has predicted every single economic recession, the yield curve, currently indicates no recession on the horizon.

With one trillion dollars in the US sitting in bank accounts earning 0.06%, $100,000 earns $60 in annual interest. Taking a stock that we own, Telus with a 4.5% dividend, earns $4500 annually on those same funds, or 75X more than what the bank pays. You would only need to own $1300 in Telus to earn the same amount of income on $100,000 at the bank.

We are finding incredible bargains in Canada right now. Stocks like Telus with almost a 4.5% dividend yield that has doubled their dividend in the past 10 years. Or Manulife with a 4.6% dividend yield that has grown their dividend by over 50% over the past decade and will benefit from higher interest rates.

The valuation gap between the Canadian and US markets is the biggest since the tech bubble in 2000, with the S&P/TSX trading at 17X forward earnings vs the S&P500 at 22.6X forward earnings[5].

The last time this occurred, Canadian stocks dramatically outperformed the US stock market by 57% over the next 10 years[6].

There are still great bargains in the US. Companies such as Merck, and JPMorgan Chase which have excellent growth prospects, an attractive yield and well positioned for earnings growth in the future.

The areas in the market where investors have been willing to accept smaller and smaller returns for greater risks has caused us to be cautious. We are focusing on high quality bonds that are still compensating us for the risks. Bonds that protect us from rising rates and inflation by keeping our interest rate exposure low, which include floating rate bonds, and finding opportunities outside of Canada and the US with more attractive yields.

[5] https://www.theglobeandmail.com/investing/markets/inside-the-market/article-stock-markets-are-trading-at-historically-high-levels-what-should/

[6] The S&P/TSX including dividends outperformed the S&P500 including dividends by 57% from January 1, 2000 – December 31, 2009

The most successful investors in the world have been successful by sticking to a consistent, repeatable, investment process. Warren Buffet, J.P. Morgan, Andrew Carnegie, have created some of the largest amounts of wealth in the world by not getting caught up speculating and following the crowd that is taking larger risks for smaller returns. We follow the same approach. You will not find weed stocks, cryptocurrency, or Gamestop in your portfolio. Rather we are protecting capital based on today's unique investment landscape, and investing to generate the best returns for clients over the next decade.

We are currently taking advantage of market dips. Cash needs to get back to work. With the banks overflowing with funds and turning it away, cash will continue to flow to where it will earn the best returns. We are very excited about our current positioning to grow and protect our clients' capital in this low interest rate and unique economic environment.

And if you want to continue having bacon at breakfast every morning, I recommend finding a new job for your cash on vacation at the bank.

-Kind regards,

Joshua Brown, CFA
Portfolio Manager

Wealth Management
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