BIG BETS & BIG CHANGES

Last week was notable for, potentially, big tax changes ahead and ongoing big financial bets – both of which have the ability to impact financial prices in the months ahead.

Inflation vs Bonds

First, remember with bonds that are already issued, if interest rates rise before the bond matures, the price of the bond will decline for a period before the maturity date. Obviously, the longer the time period before the maturity, the greater the potential declines in price when interest rates go up. <u>The general rule of thumb is a 1% rise in interest rates equals a 10% drop in the price of a ten-year bond</u>. As noted, if one holds until maturity the bond price will rise to the maturity price and erase the paper losses. The two big risks are losses, if one must sell in the meantime, and purchasing power. Example: right now a 10-year US Treasury bond pays 1.46%, and latest reports showed inflation in the U.S. rising to 5%, its fastest pace since 2008. If that rate would remain for the next 10 years, a holder of a 10-year bond is "losing" 3.5% (5% -1.46%) in purchasing power every year – not a great investment!!

Yet, despite signs of inflation everywhere, institutional money managers and overseas investors are flooding into US Treasury bonds. Last quarter, US pension funds shifted $90 billion from stocks to bonds and recent government issues have been hugely oversubscribed by over 60%. The inflow of demand has helped push bond yields lower (higher prices = lower yields) and if the rise in inflation proves temporary, as the US Administration and The Federal Reserve Board maintain, it will look like a winning move.

Minimum Corporate Taxes EVERYWHERE?

Overseas, the G7 nations reached an agreement on a global minimum tax following years of discussions. <u>The key thrust would prevent companies from shifting profits to low tax jurisdictions and ensure the biggest multinationals pay more tax in the countries in which they operate.</u> Some ***VERY*** big obstacles lie ahead, such as Ireland, whose low tax rate encourages foreign investment, and China and India, two of the world's largest economies and not part of the G7. However, if this effort picks up more global agreement (G20 is next) it may be hard not to acquiesce.

The other big news of the week: The US Senate announced a bipartisan infrastructure package with NO tax increases, corporate or personal. While still to be approved, this will have a stock-market-friendly outcome: infrastructure spending, no corporate or income tax increases.

Two other news items caught my eye. In another sign of post-pandemic economic turnaround, Boeing, which was sitting with 100 unsold Max 737 jets after Covid induced order cancellations, now has only 10. Existing and new airlines have jumped in with purchases to meet rapidly increasing demand. One notable buyer of 13 aircraft was new Canadian discount carrier, Flair.

Electric Vehicle (EV) company valuations: On November 23rd last year, I commented on the billions of dollars in stock market value of EV companies, many that had yet to put a car in the road. I opined this was going to end badly for many companies and their investors. Last week, Lordstown Motors joined the pile of fallen EV hopes, as the company announced insufficient funds to start commercial operation. Shares fell 30% and are now 65% lower in just over 3 months.

Last, but not least – equity markets? Overall, they were modestly higher with a broad mix of select US sectors and European indices leading the pack. Our TSX was in the lower third with a weekly gain of 0.55%. Real Estate shares were the stand-out winners, both here and south of the border.