CANACCORD Genuity
Wealth Management

LEPOIDEVIN GROUP

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LePoidevin Letter

Markets shrug off Brexit
U.S. economy has room to continue growing beyond the typical 7-year cycle.
B.C. imposes additional 15% tax on foreign real estate buyers in Vancouver.

Table 1: U.S. Interest Rates and Unemployment [1]

Stock Market	Month	Year	3-month rate	1-year rate	2-year rate	3-year rate	5-year rate	10-year rate	US Unemployment Rate
Top	March	1990	8.30%	8.40%	8.70%	8.70%	8.70%	8.60%	5.30%
Top	May	2000	6.40%	6.30%	6.80%	6.80%	6.80%	6.80%	4.00%
Top	July	2007	5.00%	4.80%	4.60%	4.50%	4.50%	4.60%	4.00%
Bottom	March	2009	0.50%	0.70%	0.90%	1.40%	2.00%	2.60%	9.30%
Current	July	2016	0.30%	0.60%	0.70%	0.80%	1.10%	1.60%	4.90%

Though British polls predicted a close race in the recent referendum to determine whether the UK would exit the European Union (EU), stock markets assumed that it would ultimately remain part of the EU. However, in the June referendum, 52% of voters elected to leave, and markets responded to the shock with a sharp sell-off as fears of a British recession swept the trading desks.

Within two trading days of the vote, the Dow Jones Industrial Average fell nearly 900 points only to surpass its pre-Brexit high seven trading days later.

The UK's vote to leave the EU clearly caused a growth scare as well as fear that other countries may follow with similar referendums. Why then did the markets shrug off the referendum results.

Stock prices are essentially driven by money flows. Though global events (like Brexit) may create stock market sell-offs, declining interest rates have provided minimal yield to investors fleeing to the safety of cash or bonds. As indicated in table 1, current interest rates are the

[1] US Department of the Treasury. Interest Rate Statistics. Retrieved from: https://www.treasury.gov/resource-center/data-chart-center/interest-rates. Retrieved on August 3, 2016.

lowest in US history. In fact, rates today are even lower than the emergency rates that existed at the stock market bottom of March 2009.

Not only are US and Canadian interest rates low, but rates offered for some foreign-denominated bonds (i.e. Europe, Japan, Switzerland) are negative, meaning investors actually pay to hold these bonds. As such, the money flowing out of the stock market tends not to stick to the sidelines for long and has been returning to stocks. Conversely, in March 1990 when capital began leaving stocks for cash and bonds, yields were significantly more enticing (over 8%). This trend is evident at each of the market tops (1990, 2000 or 2007), when higher yields enticed the sidelined money to stick and, as a result, the stock market trended lower.

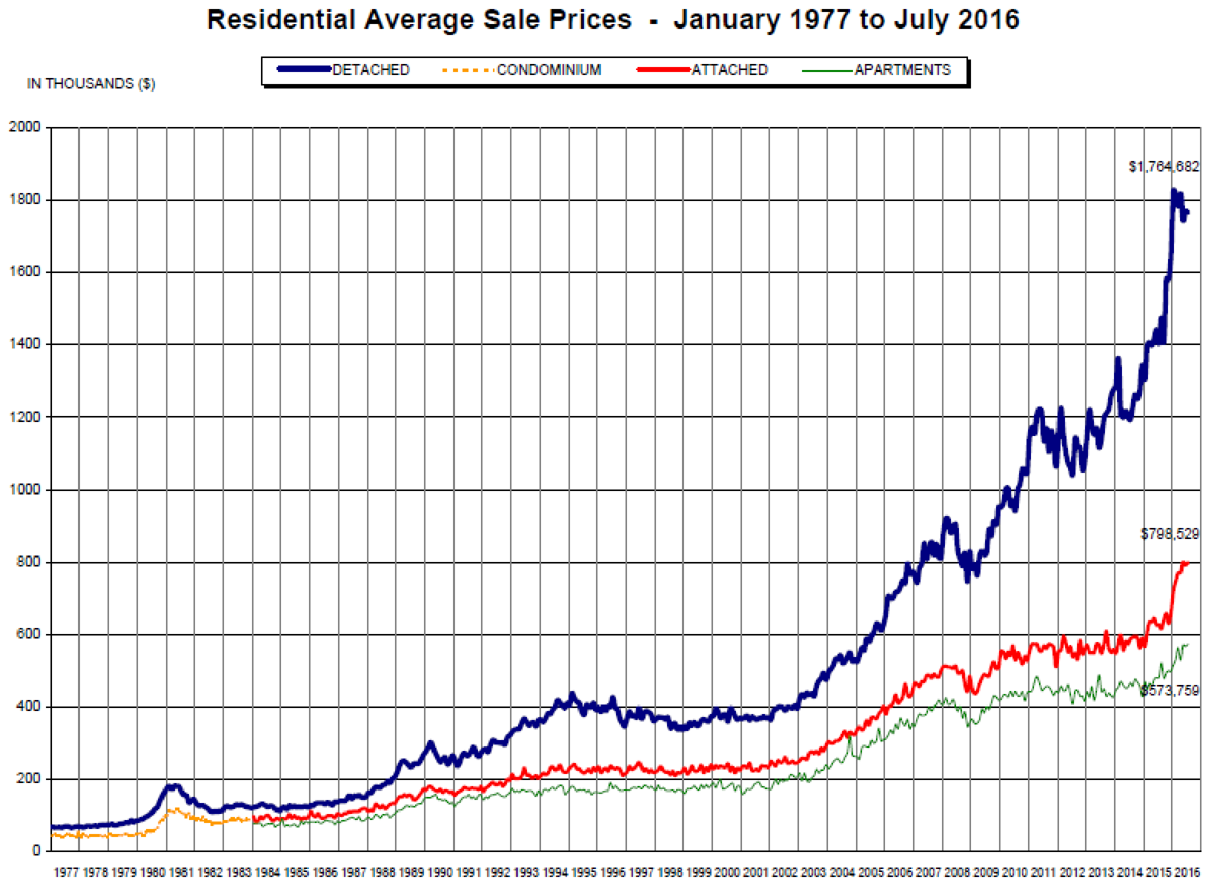
In March 2009, despite a sharp recession I stated it was a “good time to go back into the market” because “stocks indicate that they are in line with the lowest valuations of the bear market bottoms.” Keep in mind that investors feared the next depression as unemployment topped 9 percent. Going back into stocks in 2009 proved to be pretty good advice.

Today, stocks appear to be about fair value relative to earnings or dividends. While the outright bargains of 2009 are not as prevalent, there are still many appealing opportunities, especially given that interest rates today are lower than they were at the depths of the 2009 recession. Today’s 4.9% unemployment rate is typically associated with a rising interest rate environment, though the Brexit result likely kicked “the can down the road” on a US interest rate increase to late 2016 or even 2017.

Today’s interest rates are nowhere near the rates associated with market tops, which typically follow 18-30 months of rate increases. It is worth pointing out that rates at market tops have been trading lower with each peak (8.37%, 6.4%, 5.0%), so the next market peak could be in the 3%-3.5% range. With the Feds moving very slowly, that may be a few years away. Capital will find a home. The “cleanest dirty shirt in the laundry” may just continue to be US stocks.

In a recent Business News Network (BNN) interview, I mentioned that the final move in financial bubbles is usually the biggest[2]. Consider the technology stock bubble which ended in 2000: when the NASDAQ stock index of technology shares peaked at 5000, trading at a price to earnings ratio of 100 (long-term average is 16), the index had gained 25% in the last 4 months. Gold peaked at $850 in 1981, gaining over $200 in the final two weeks. In June 2008, oil peaked at $143, up from below $100 just two months prior.

[2] BNN video via The Globe and Mail. Retrieved from: http://www.theglobeandmail.com/video/video-why-vancouver-housing-might-be-at-the-top/article30851651/#video0id30851651. Retrieved on August 3, 2016.



[3]

Bubbles sometimes fall under their own weight, while other times there is a catalyst. Detached houses in greater Vancouver have experienced a similar parabolic move in the past year, which may well have peaked in April. Real estate speculators have argued that foreign capital, especially from China, would continue to flood into Vancouver property. In the meantime, China has doubled its efforts to stem outflows and the flow of capital from China may have already started to slow materially.

On July 25th, 2016, the BC government announced several measures to cool the real estate market in Vancouver. The most noteworthy of these measures (effective August 2nd) is an additional 15% land transfer tax applied to residential property purchased by any foreign national or foreign-controlled company (in addition to the existing land transfer tax).

While BC government statistics showed foreign purchases accounting for just under 10% of transactions, discussions with realtors suggest that they dominate the high-end market. Consider that a $5 million house will now pay close to $900,000 in land transfer tax!

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[3] Real Estate Board of Greater Vancouver's Website. Retrieved on August 3, 2016.

Certainly, there will be some reduction in demand, and it will be interesting to watch home prices over the coming months. A significant cooling in housing activity would have negative implications for the Canadian dollar and Canadian bank shares as well.

Real estate has been the single biggest driver of growth in the Canadian economy. The resource industry is weak, manufacturing continues to be weak; if housing cools Canada will be 0 for 3.

Ontario has announced that it is considering a similar tax . . . stay tuned.

Sincerely,

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