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Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well informed of changes affecting local business decisions and our investment recommendations. We believe Knowledge Pays and we want our knowledge to help pay for you.

REVISITING CANADIAN HOUSING STATE OF THE MARKET IN 2019

We last commented on Canadian housing in April 2018 after the federal government announced a slew of new regulations limiting mortgage size relative to income. The housing market response to these regulations was clear.

- House sales fell to more normalized levels in most jurisdictions
- Prices of high-end homes fell and prices of low-end homes rose as buying power was reduced, pushing more buyers to compete for relatively cheaper properties
- Homebuyers and real estate investors shifted their sights from high cost cities like Vancouver and Toronto to low cost cities/regions like Kitchener-Waterloo, London, Kamloops and Chilliwack though BC faces an unprecedented amount of regulation.

This trend has continued as condos and other lower cost properties remain near peak prices while high-end properties are well below peak prices, particularly in high cost cities. Mortgage rates also rose about 1% over this period, further pressuring housing market fundamentals. Because of the market softness – e.g. March 2019 Toronto and Vancouver home sales fell to 10 and 33 year lows respectively – the federal government proposed new initiatives to help first time homebuyers buy homes.

Two housing initiatives proposed in the federal budget:

- An *increase to the home buyers plan amount to $35,000*, from $25,000 previously
- A *shared equity mortgage* whereby the Canada Mortgage and Housing Corp. (CMHC) provides buyers with up to 10% of the purchase price of a new home and up to 5% of the purchase price of a resale home. The insured mortgage plus shared equity is limited to $480,000. Details are not yet clear about how the shared equity arrangement works (e.g. does the CMHC participate in the price gains/losses?).

One thing is clear. These initiatives are not intended to reverse the broad Canadian housing market slump given the $480,000 limitation and these initiatives will likely increase competition at the low end of the housing market in the near-term and have limited impact on affordability in the long-term as market prices adjust to the rule.

There is no white knight to swoop in and save the Canadian housing market from its slow decline. We expect more of the same, including:

- Weak sales and steady-to-falling prices for high-end housing, with Vancouver and Toronto taking the brunt of that weakness and price decline
- Robust sales and rising prices for low-to-mid level housing
- Falling average prices in Toronto and Vancouver and steady/rising prices elsewhere

Mortgage rates have fallen by ~0.5% from their most recent peak, and could fall as much as 1% but this is likely not enough to boost housing market activity.

Current Rates & Data

Govt of Canada

90 day	1.67%
1 year	1.74%
2 year	1.65%
5 year	1.66%
10 year	1.80%
30 year	2.08%

U.S. Treasury

90 day	2.42%
1 year	2.43%
2 year	2.40%
5 year	2.39%
10 year	2.57%
30 year	2.98%

Canada Prime Rate

3.95%

U.S. Prime Rate

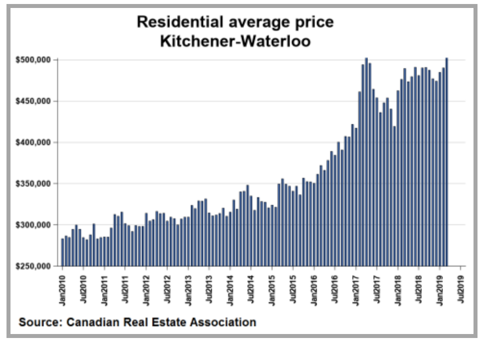
5.50%

Exchange Rates

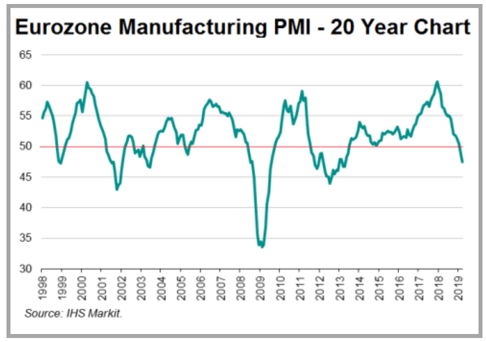
CAD/USD	0.747
USD/EUR	1.130
JPY/USD	112.0

ECONOMIC TIDBITS KW HOUSING DOING JUST FINE & EUROZONE MANUFACTURING AT A RECESSIONARY LEVEL

• While the headlines tend to focus on the weakness of the Canadian housing market, it is important to remember that location, location, location matters most. Take our local housing market, which is sitting at an all-time high as of March despite below average sales activity. KW's commutability and lower price point to Toronto make it one of the top destinations for those fleeing Toronto's high prices.



• The eurozone manufacturing purchasing managers' index (PMI) fell to 47.5 in March, well below the expansion/contraction demarcation line at 50. The last three times the eurozone PMI was at this level was during eurozone recessions – 2001, 2008 and 2011. While the eurozone manufacturing sector is in a recession, the eurozone service PMI indicates the eurozone service sector is still growing.



LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

Investors Are Shifting to Low Volatility Stocks So We Highlight Two Trading at Historical Discounts

- **North West Company (NWC)** and **Exxon Mobil (XOM)** fit this theme.
- **North West** is a multinational retailer with operations concentrated in northern and western Canada, Alaska and the Caribbean under the banners Northern, Giant Tiger, AC Value Center and Cost-U-Less. North West trades at ~9x trailing EV/EBITDA and a ~10% discount to larger Canadian grocery peers. We believe North West deserves to trade at a premium to its peers given the lack of competition in the remote areas North West serves and in turn the pricing power North West maintains. Many smaller grocery and pharmacy chains have been acquired over the years (e.g. Shoppers Drug Mart, Safeway Canada, Uniprix, Jean Coutu, Farm Boy) and North West may be in the larger grocers' crosshairs.
- **Exxon** is the largest publically traded energy company in the world. Exxon trades at a ~10% discount to its historical average valuation (based on earnings) despite improving oil price dynamics. We prefer Exxon over other large US oil companies due to its diversification and the fact that it can maintain high profitability in most environments (e.g. energy downturn in 2015 and 2016). We believe there is opportunity for Exxon to erase its 10% discount as well as experience upside related to oil prices.

  Key risk points: While these stocks generally exhibit lower than average volatility they are still susceptible to company-specific downside and periods in which they exhibit higher than average volatility.

JEANNINE'S TIP O' THE MONTH Tax Time is the Max Time – Check Your Contribution Limits

Tax time is a good time of year to review current year RRSP and TFSA contribution limits.

When your notice of assessment arrives, take the opportunity to provide us with your RRSP contribution limit for 2019.

Did you know that you can obtain your TFSA contribution limit online through 'My Account' on the Government of Canada website? Ensure you are fully utilizing your TFSAs and RRSP by double-checking your contribution limits.

Let us know how we can help.

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