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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.

LATE 2018 MARKET SELLOFF ASSESSING THE DAMAGE AND FINDING DIRECTION

2018 was the worst year for US stocks since 2008, and December 2018 was the worst December for US stocks since 1931. Over 90% of global assets experienced negative returns in 2018, the highest percentage in modern history. One might jump to the conclusion that the economy is struggling and outlook is dire but this is not the case.

State of the Global Economy

Global economic activity, as measured by the JP Morgan Global Composite PMI, has slowed to the average level of the post-2008 period but remains well above the lows reached in the 2008, 2011 and 2016 slowdowns. This should indicate that global GDP growth comes in at 3%-3.5% in 2019 notwithstanding an unexpected shock.

Access to credit for mid-to-large businesses, as measured by the Senior Loan Officer Opinion Survey on Bank Lending Practices, sits at a five year high as of Q4 2018. Access to credit for US small businesses and households remains at normal, non-recessionary levels. According to similar surveys, access to credit for Canadian, European and Japanese firms remains at normal, non-recessionary levels. Declining access to credit always precipitates a recession. Access to credit remains robust.

The Economy is Strong So Why the Market Turmoil?

Investors are worried that trade wars will continues to push economic growth lower to the verge of or into recession. To that we argue that Trump's M.O. has always been to support the economy and personally pushing the economy into recession is likely not at the top of his to-do list. He walked away from lengthy NAFTA negotiations with only a minor victory and he will likely settle for a minor victory with China as well.

Political finagling has largely caused the slowdown in the global GDP growth rate. US-led trade wars in North America and China have hurt business optimism and delayed spending on people and capital goods. Brexit negotiations are creating temporary uncertainty throughout Europe as businesses await the new equilibrium before making major capital investments. Historically, the political infighting in Western countries tends to resolve itself while the economy continues to chug along.

Looking Ahead

The newly signed and soon to be ratified NAFTA, US-China negotiations are finally progressing, and Brexit will likely be finalized without significant economic damage. In early January, the People's Bank of China announced the largest cut in bank capital requirements since March 2016 and China Railway Corp announced it would boost 2019 railway investment by 40%. We think the worst is priced in and investors are underestimating the possibility of above average economic growth in late 2019.

Current Rates & Data

Govt of Canada

90 day	1.60%
1 year	1.84%
2 year	1.87%
5 year	1.87%
10 year	1.93%
30 year	2.13%

U.S. Treasury

90 day	2.42%
1 year	2.50%
2 year	2.56%
5 year	2.50%
10 year	2.57%
30 year	2.68%

Canada Prime Rate

3.95%

U.S. Prime Rate

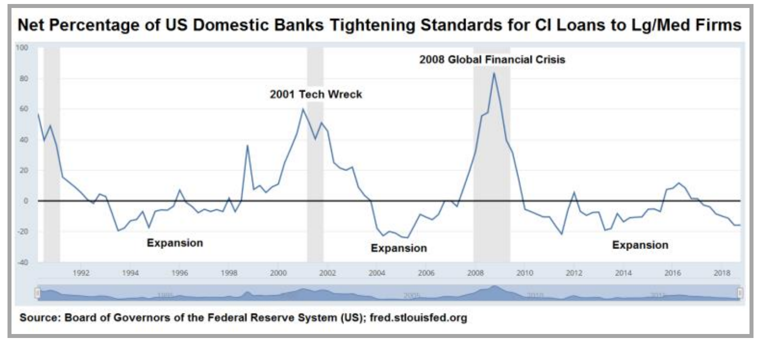
5.50%

Exchange Rates

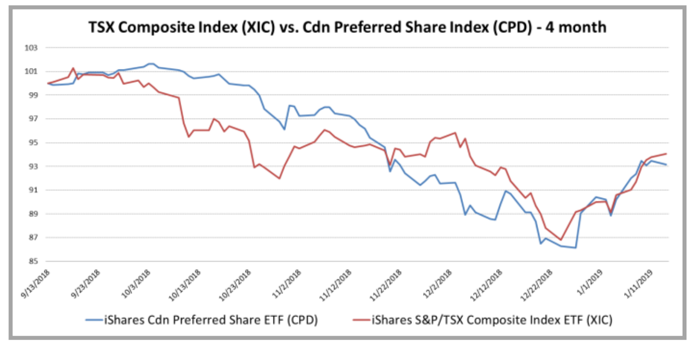
CAD/USD	0.754
USD/EUR	1.147
JPY/USD	108.2

ECONOMIC TIDBITS US BANK LENDING STRONG DESPITE INVESTOR FEARS & CDN PREFERRED MARKET SLUMPS

- Above we discussed economic data that indicate the global economy is still growing at a healthy rate. Most importantly is the US Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices. The chart to the right shows that lending standards for medium and large US businesses is in line with the fastest growing points of previous expansionary periods: 1993-1998 and 2004-2008.



- The Canadian preferred share market has experienced unusual downside relative to changes in government bond yields as well as extreme volatility over the past four months. It is rare for the Canadian preferred share market to underperform the Canadian equity market during a market decline but when it does, it often presents a significant, but often fleeting, opportunity.



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

Canadian Retail Stocks Battered Due to Ailing Energy Sector and Global Flight to Safety

- **Sleep Country Canada (ZZZ)** and **Canadian Tire Corp (CTC.A)** are two ideas related to this theme.
- **Sleep Country** is Canada's leading mattress retailer with an estimated 35% national market share. Sleep Country has a stranglehold on the high-end mattress market and through its Bloom and Endy mattress brands has a commanding share of the mattress-in-a-box market. Sleep Country trades at ~7x trailing EV/EBITDA versus US mattress peers at ~10x. Sleep Country has historically traded at a premium to US peers. Negatively affecting Sleep Country's trailing earnings has been the below average household formation over the past year due to tighter mortgage rules. There is a reasonable chance that the federal Liberal party will ease mortgage rules going into the 2019 federal election which, combined with lower mortgage rates, could provide a boost to Canadian mattress sales.
- **Canadian Tire** is a leading retailer of automotive goods and services, sporting goods and housewares. Canadian Tire trades at ~8x trailing EV/EBITDA, a significant discount to its US peers at ~12x. Canadian Tire historically trades at ~11x EV/EBITDA. Canadian Tire's loyal customer base and same-store-sales growth of over 2% in a difficult economic environment in Canada likely warrants an average to above average valuation for Canadian Tire shares.

  Key risk points: Both securities are highly cyclical, and would likely come under pressure in a weak economic environment. Government policy can create uncertainty in consumer spending as well.

JEANNINE'S TIP O' THE MONTH TFSA Limit Increases for 2019

The TFSA contribution limit for 2019 is $6,000, up from $5,500 in 2018.

This brings the total cumulative contribution room available to $63,500 this year. This amount is available to anyone who has never contributed and been eligible to contribute to a TFSA since 2009.

Make your tax free savings account contribution today!

This newsletter has been brought to you by Steele Wealth Management

Brian Steele, CA, CPA, CFA | Jeannine Campbell | Laura Prust, CIM, CPCA
Kelly Edmonds | Matthew Bell, CFA

Phone: (519) 883-6030 Toll-Free: 1 (877) 642-6408

Email: steelewealthmanagement@raymondjames.ca

Address: Unit 1, 595 Parkside Drive | Waterloo, Ontario | N2L 0C7

Website: www.steelewealthmanagement.com

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