

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.

FIXED INCOME LOW YIELD AND LIMITED UPSIDE SO WHY OWN IT? AND WHEN?

When to own fixed income? In recession of course!

In January, we highlighted how markets had priced in a poor economic outlook despite data showing widespread strength. We were not recommending adding to fixed income at that time. Fast-forward to today, markets are back to all-time highs, the US yield curve has inverted and some economic data is pointing to recession. The case for fixed income has grown.

But aren't recessions impossible to predict?

There is a first time and a last time for everything, but the months leading up to recessions have been consistent. You are never going to predict the exact month a recession begins, but in the post-war era, the US equity market was either already in a bear market OR facing a near-term recession every time the US Federal Reserve cut interest rates while the US yield curve was inverted. If a meteorologist issues a tornado warning, it is probably best to stay indoors, even if a tornado is not certain.

Isn't this market timing and isn't market timing something you should not do?

We do not recommend changing your asset allocation or specific positions based on a short-term event. We do recommend adjusting your asset allocation and specific positions based on decades of stock market history but we always recommend that investors should always stay diversified (i.e. don't sell everything and hold cash).

Why own fixed income? To protect your portfolio when the odds are against it!

Economic downturns typically push central banks to cut interest rates, which boosts the market price of government bonds and most high-grade corporate bonds. So in a recession, high-grade fixed income securities tend to rise when equities tend to fall. For example, from June 2007 to December 2008, the iShares 20+ Year Treasury Bond ETF (TLT), the archetype of investor defence, rose 48% while the S&P 500 fell 37%. An investor equally invested in TLT and the S&P 500 would have experienced positive returns over this turbulent period. While we do not predict TLT to necessarily behave exactly the same way in future nor do we think TLT is best for all clients, TLT's performance between June 2007 and December 2008 is the utmost example of how allocating to fixed income can defend one's portfolio against losses.

So where do we stand now and should you own some fixed income?

The global economy is down but not necessarily out. The manufacturing sector is struggling due to elevated trade tensions but the service sector is growing and the labour market is strong. An inverted US yield curve can remain inverted for a long time. Owning some fixed income now makes sense. Increasing your fixed income allocation when more timely recession indicators arrive also makes sense.

Current Rates & Data

Govt of Canada

90 day	1.64%
1 year	1.73%
2 year	1.64%
5 year	1.56%
10 year	1.59%
30 year	1.74%

U.S. Treasury

90 day	2.23%
1 year	1.97%
2 year	1.85%
5 year	1.84%
10 year	2.05%
30 year	2.55%

Canada Prime Rate

3.95%

U.S. Prime Rate

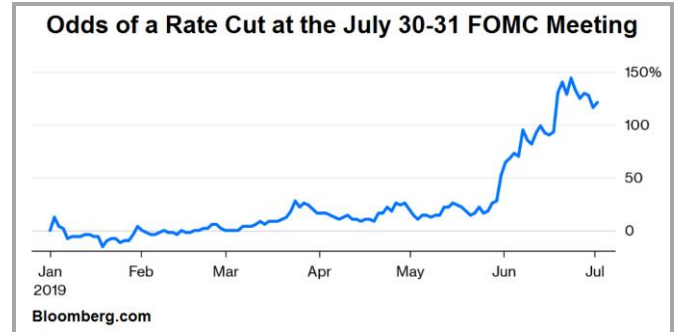
5.50%

Exchange Rates

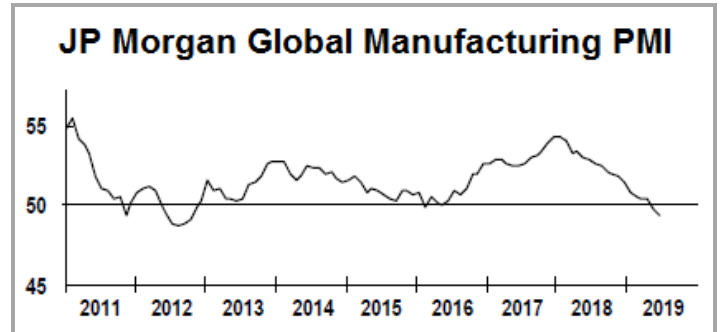
CAD/USD	0.763
USD/EUR	1.126
JPY/USD	108.4

ECONOMIC TIDBITS 100% ODDS OF US INTEREST RATE CUT IN JULY & GLOBAL MANUFACTURING HITS 7 YR LOW

- Based on US Treasury bond prices, expectations are that the US Federal Reserve is guaranteed to cut the key US interest rate by 0.25% at its July 30-31 meeting. This puts the Federal Reserve in a tight spot as not cutting the interest rate could shock bond and equity markets while cutting the interest rate without sound rationale could stoke an asset bubble like the one following the 1998 rate cut.



- The JP Morgan Global Manufacturing PMI fell to 49.4 in June, hitting the lowest level since late 2012 and marking the second month of manufacturing sector contraction. Global vehicle sales peaked in 2017 and auto companies have been rightsizing. In June, Ford announced plans to cut 12,000 jobs across Europe. The US trade war has also had a negative impact on global manufacturing activity.



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

Forest Products Companies Face Weak Demand and Pricing but Curtailment Usually Pays Off

- Canfor Corp (CFP)** and **Interfor Corp (IFP)** fit this theme.
- Forest product prices are unsustainably low and Canadian forest products companies are operating at a loss. Canfor is down over 70% and Interfor is down over 50% from the June 2018 highs.
- Driving forest product pricing is US housing market activity, Asian economic activity and regulation.
- US housing starts peaked in early 2018. US home improvements and repairs peaked in late 2018 and is forecasted to decline in 2019 according to Harvard's Joint Center for Housing Studies. Chinese economic activity has been lower than expected in 2019. US tariffs on Canadian lumber, initiated in November 2017 and an uncertain outlook for the signed but not ratified Canada-US-Mexico Agreement (CUSMA) has depressed demand for Canadian lumber and hurt margins for Canadian forest product companies.
- Many Canadian forest products companies, including Canfor and Interfor, have announced production curtailments. Curtailments involve stopping or limiting production at a company's least efficient lumber mills. These curtailments have boosted forest product pricing and profit margins in the past and marked the start of a turnaround in forest product stocks.

Key risk points: Both companies are susceptible to higher US lumber tariffs or other trade restrictions. Canfor is a highly levered company that will experience more volatility over time. Demand for forest products are highly cyclical so further downside is possible if the economic picture fades.

JEANNINE'S TIP O' THE MONTH Safeguarding Client Information is Something We Take Very Seriously

Recent studies identified Canada as the third highest victim of cyber incidents in 2018. At Raymond James, we believe that putting clients' needs first – including their need for security – is the best way to ensure their success and, in turn, the success of the firm. Our guiding principles have led Raymond James Financial, Inc. to over 122 quarters of continuous profitability. The integrity, strength and stability at the foundation of our firm offer the most important protection for your accounts and we back our efforts with a pledge you can believe in.

This newsletter has been brought to you by Steele Wealth Management

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