FOSTER & ASSOCIATES

Market Commentary

A market retreat led by the FANG stocks was no surprise. What may have startled investors is the length, breadth and depth of the correction. Instead of being mostly a North American event, the decline has spread to parts of Europe and Asia. Given Canada's crippled energy sector, the bruising from the NAFTA negotiations (ongoing?), the GM plant closing, exiting pools of capital and the Trump tariffs, the best reason to be optimistic is the probability that the outlook is unlikely to worsen.

There is mounting evidence that parts of the Canadian economy could be entering a deflationary period. Deflation is a serious condition, far more serious than inflation. Inflation is generally controlled by raising interest rates. Unless caught very early, deflation has no such convenient remedy. When in full bloom, deflation is characterized by a shortage of credit, fewer jobs, a scarcity of money and a parade of personal and corporate financial failures. Calgary is experiencing most of these points of pain. The maritime economies look flat.

Besides falling stock prices, what other evidence is there of a deflationary trend? First, there are worrisome levels of personal and corporate debt and interest rates remain relatively low, encouraging excessive borrowing. In spite of reasonably robust economies throughout the G8, many commodity prices remain near their lows, partly in response to strength in the U.S. dollar.

Making matters worse, Canada-wide there is a lack of savings. Large chunks of investment money have been leaving Canada for regimes offering less regulation and lower taxes. Canada's seniors, who now out-number the millennials, are spending their savings, while the lifestyles of many millenniums and "Igens" preclude their taking up the slack. To their credit, these new generations manifest limited interest in "Keeping up with the Joneses." There is much to admire about a minimalist existence: online living, renting rather than owning, eating out rather than cooking, no mortgage, a gym membership rather than a private club, a music app rather than a stereo system, an Uber account rather than a car. Regrettably, this restrained, low-carbon level of economic activity does not do much for the nation's GDP.

In the unlikely event a deflationary spiral takes hold, it will come when a rising number of debt failures becomes an avalanche. For example, a trend of mortgage failures causes house prices to fall. Excessive provincial, municipal and corporate debt limit the ability of the economy to provide liquidity when it is most needed. The U.S. experienced a deflationary spiral in 2007-08 when the failure of the mortgage-backed securities nearly sank the U.S economy. Personal debt levels in Canada are precariously high.

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During the coming months, especially if we have a Santa Claus rally, investors might consider increasing the cash and dividend-paying segments of their portfolios.

When it comes to growth equities, the economies with the most potential appear to be India, China and Australia. In Canada there are many bargains on our markets, especially among the resource stocks, but investing among the fallen angels will require some careful analysis, patience and maybe a little luck. Patience is most important. When the upward cycle in resource stocks occurs, the rise in prices will invariably exceed expectations.

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