A Tale of Two Divides

Political divides in both Canada and the US are threatening our prosperity.

A divide is something different from a mere disagreement, or a change in policy, such as RRSP contribution limits or tax treatment of dividends and capital gains. A divide is deeper, broader and has longer-lasting implications. Quebec's attempts at separation were a divide strongly affecting nearly everyone who lived there. Quebecers worried about their pensions, passports and what currency they may have to accept. Brexit is a divide which may soon be settled but will have divisive effects on the population for decades. The granddaddy of divides was of course the growing tensions leading up to the U.S civil war, echoes of which are still reverberating in areas of the South.

The core of the U.S divide is *Inequality*. What used to be a robust middle class has shrunk to become a debt-ridden class on the edge of poverty. Basic wages, especially factory wages, have not kept pace with decades of rising productivity. Housing prices have grown out of reach. Some blame globalization, robotics and having to compete with low wages in emerging markets. More important, there is a lack of social programs to redress the growing division of wealth between wage earners and those with stock options.

On the other hand, shareholders and corporates executives have obviously prospered from globalization and robotics, as have the graduate school professionals who have a global market to pay them well for their services. They too have some debt, though most likely for the education unaffordable to the wage earner.

The result is a severe political division, the angry, resentful side having successfully elected Donald Trump as President. Belatedly, the Democrats seem to have awakened to the fact they have ignored the plight of the wage earner. After all, the Democrats used to be the party of wage earners. To address *Inequality* and in order to win the presidential election in 2020, there is ample evidence the party will espouse programs which heretofore have been deemed socialist, if not communist. Included for consideration are such programs as national healthcare, pharma care, free tuition post-secondary education, subsidized daycare, a guaranteed annual income -- possibly to be paid for by wealth taxes, increased-capital gain taxes, a steeper graduated income tax, even a national sales tax and budget deficits, and more deficits.

Supporting the likelihood of at least some of these "radical" measures being enacted is the fact that President Trump's popularity has shrunk and, as *The Economist* recently pointed out, "socialism" is no longer a dirty word, especially among millennials.

For investors, the implementation of even some of these measures means reduced corporate profits, inflationary pressures and a weaker U.S. dollar. Many of the social programs being suggested are long overdue, but the effect on financial markets will be significant. And what will Wall Street's and silicon Valley's response be?

In many respects, Canada is ahead of the U.S. in social programs. Canada has a different division to resolve. Geographically, it is West versus East. From a policy perspective, it is the resource industries versus environmental idealism.

Canada's economy depends on trade, and the bulk of the trade is resources. The resources used to be predominantly wheat, metals and forest products. Once OPEC took control of the price of oil, Canada's energy industry gradually became the dominant export. As Canada' energy business expanded, a need for access to foreign markets became paramount. Environmental concerns conflicted with pipeline projects. Thus far the attempts to find a compromise of interests have not been successful. Western resentment toward the Eastern establishment has risen to levels not seen since Trudeau senior imposed the National Energy Policy. Regrettably, the additions of a national carbon tax and the infamous Bill C-69 have further solidified Western resentment.

The core of the U.S divide is Inequality.

To the investor, environmental idealism is an added cost, not an economic benefit. Ontario premier Dalton McGinty discovered that some years ago.

Whatever the outcome of the October federal election, it is unlikely to solve the conflict. In fact, Western anger and resentment could increase along with protests by environmentalists. Resource capital and resource talent are leaving the country. The question becomes, what might investors do to protect their capital? Eventually, the absence of resource investment and political unrest over Canada's resource sectors will weaken the Canadian dollar.

To counter a weakening currency, standard investment strategy is to invest in companies with substantial reserves in such commodities as copper, gold, silver, zinc, natural gas, lithium as well as agricultural exports. Oil is not a reliable inflation hedge; select foreign currency investments are. It is also best to avoid Canadian companies with significant amounts of debt, especially foreign debt. A weakening currency is not good for bank profits. The object is to protect purchasing power.

Politics has always been a part of investing. Most of the time, it creates stability, or at least tries to. But when political conflicts metastasize into divides and dominate the economy, investors are investing in uncertainty, and that's called gambling.

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