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BNN MARKET CALL

***e*Research Corporation** is pleased to provide two excerpts from Tuesday's BNN Market Call Newsletters.

It features the Market Outlook from two leading investment analysts with their respective commentaries (see below).

MARKET OUTLOOK

Stephen Takacsy, Chief Investment Officer at Lester Asset Management
Focus: Canadian Equities

World stock markets, particularly in the U.S.A., have been trading at rich valuations despite tepid growth and increasing financial risks, such as rising interest rates. A sure sign of a near-top were the massive inflows piling into ETFs from investors— who mindlessly buy stocks irrespective of valuations or prospects — and various speculative manias such as bitcoin/cryptocurrencies, blockchain, and marijuana-related stocks trading at nonsensical levels. We are now witnessing a dramatic rise in volatility as foretold in our January 22 letter and expect this to continue. For this reason, we were holding a larger-than-usual amount of cash. In addition, we now have the threat of trade wars, which we warned about shortly after Trump was elected.

Nevertheless, we continue to find attractive opportunities in the less liquid and under-followed Canadian small and mid-cap segment, where ETF fund flows have not driven valuations to unreasonable levels (some companies have been trading at historically low valuations despite good results). We also remain focused on companies that are expanding in the USA. We continue to hold more cash than usual so that we can take advantage of opportunities to acquire good companies more cheaply. Some large caps we follow are starting to look attractive.

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MARKET OUTLOOK

John Zechner, Chairman and Founder of J. Zechner Associates
Focus: North American Large Caps

We believe that economic and profit growth will peak for this cycle in 2018. Leading economic indicators from the industrialized (OECD) countries have already started to roll over. Record global debt levels and rising interest rates will lead to retrenchment in consumer, business, and government spending that will limit expansion. Profit margins are expected to peak this year as rising input costs (wages, basic materials) offset further cost restructuring. While the U.S. tax cuts will lead to double-digit profit gains this year, those are one-time in nature. Moreover, most of the excess profits have thus far been directed to share buybacks rather than direct investment in growth, making this more of a "stock market event" than an "economic event."

Stocks have been in a nine-year bull market, with the bulk of the upside generated by higher earnings multiples due to record-low interest rates. With the U.S. economy running at full capacity, inflationary and wage pressures are starting to grow, which will necessitate a period of rising interest rates, thereby turning a major tailwind for stocks into a headwind. We have also not been impressed by the technical quality of the recovery in stocks off the February 8 lows. The advance has been exceptionally narrow, driven largely by the FANG, financial, and large industrial stocks. New lows have exceeded new highs, "down volume" has been much higher than "up volume", and the new flow into ETFs has been negative and offset only by record levels of share buybacks.

The Bottom Line is that we are very late in this economic cycle and the usual cyclical pressures are starting to build. The increased volatility in stocks this year is a clear sign that the unabated bullishness of investors over the past few years is being challenged at a time when valuation levels are still excessive and the backdrop of generational lows in interest rates is ending. We remain cautious on the outlook and are carrying higher-than-normal levels of cash in all of our accounts.

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Market Call Newsletter

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