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*“bull markets can ignore bad news”*

# “By The Way”

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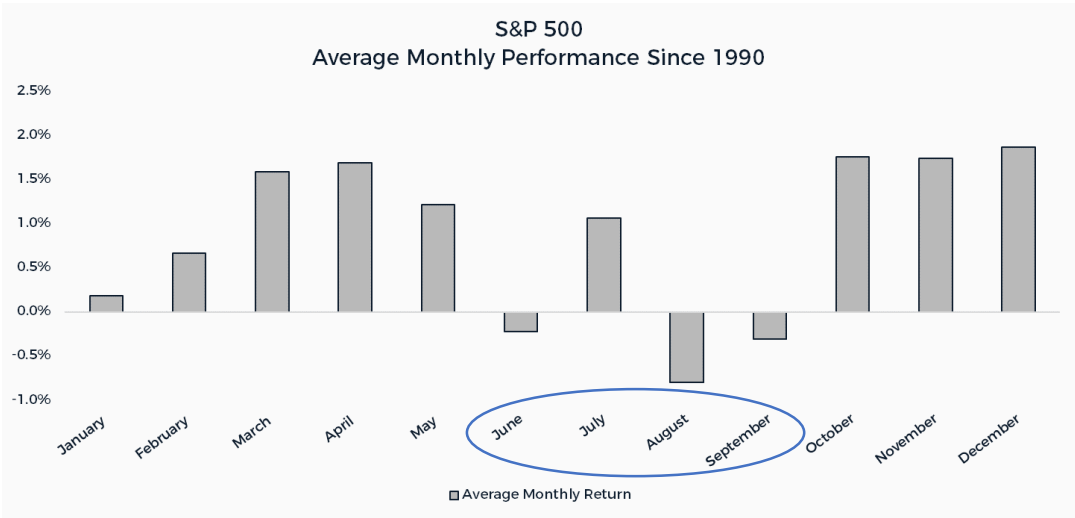
If we have learned any lesson since the 2009 market bottom, it would be to never doubt the power of a bull market to ignore negative news, and to continue its march higher. Investors, including ourselves, have been rightly concerned over those years about various very real geopolitical events that appeared certain to take markets lower. A very abbreviated list would include: Russia invading Crimea; gridlock in Washington; the “taper tantrum” when the Fed talked of decreasing the amount of quantitative easing; and the early 2016 fear about softness in the Chinese economy. While there were certainly periods of market weakness, “buy the dip” proved to be the most successful investment strategy. But have we become too sanguine about negative macro events, and should we be more worried about what could go wrong? While there is no reason at the moment to suggest adverse results, we are facing a myriad of situations that, I believe, the markets have not priced in should the outcomes be inopportune.

Most frightening of course is the situation in North Korea. I have no idea how it will be resolved, and at this point tensions are still escalating, but the consequences are too dire to imagine, and more far reaching than just financial markets.

While we might wish to hear less about the madness that passes for governing in Washington, the ramifications of what happens there are critically important to the future of the economy and markets. The unpredictable behavior and the lack of focus from the man in the White House increases our cause for concern. I laughed when one blogger referred to Trump as “Donald Seinfeld”, since he is a “show about nothing”. But the President isn’t alone, the stubbornness of the opposing factions in Congress also makes assessing possible outcomes difficult. As we have discussed in past letters, the raising of the debt ceiling and a new budget must be dealt with this month or the U.S. Government could be shut down for lack of funds. It is important these two issues get resolved soon, so that other important matters like tax reform can be addressed. A glimmer of hope is the suggestion that a new debt ceiling and short term budget resolution could be passed in Congress by attaching them to the bill that provides money to aid the victims of hurricane Harvey, since that is a virtual certainty to pass. Speaking of Harvey and its effect, Morgan Stanley had a great quote (assuming the irony was not lost on them); “Natural disasters are never good for the economy, but they can cause a temporary increase in GDP.” That’s because the homes and businesses lost are not subtracted from GDP, but the rebuilding does provide a boost. And finally, closer to home, the NAFTA renegotiations could have potential implications for Canadian corporations and markets.

Central Banks continue to have an impact on markets. The rate at which the Fed raises rates and unwinds its huge balance sheet assets is one element to be watched. In addition, the future makeup of the Fed board could be a key factor as several members will be retiring, and Janet Yellen’s term as Chairman ends in January. Policy may become vastly different, depending on who become the new members of the board. Gary Cohn, ex of Goldman Sachs, is rumored to possibly replace Yellen, and he is seen as being very business and market friendly. The European Central Bank is considering backing off on its stimulation, while Japan remains fully committed. That’s where we stand today, but it all could change tomorrow. China is interesting as its central bank has been using stimulative policies to keep the economy growing, but the country’s 19th National Congress will take place October 18th and all bets are off as to what new policies may come out of those meetings. Whatever happens, the strength or weakness in the Chinese economy, the world’s second largest, will have global implications.

My last letter emphasized the strong S&P 500 market internals, but many of them have dissipated over the last month. The traditional seasonal weakness (see chart below) and the summer doldrums have removed much of the positive momentum we saw in the late spring, but have not changed our longer term outlook. (Dow theory was never a short-term indicator anyway.) We are watching nervously as these macro events unfold, being aware of the risks involved. But as mentioned at the start of this letter, bull markets can ignore bad news, and we remain in a bull market.



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