

December 1, 2017

Ben's Year-End Comments/Observations/Crystal Ball!

"While I believe we're in for a long period of relatively low rates, it doesn't mean they (rates) won't pop up cyclically every five to seven years and cause us some cyclical bear markets along the way"

Jeff Vinik
Former Manager Fidelity Magellan Fund
Oct 30, 2017

"History shows that a loss approaching 20%, the standard definition of a bear market, has been almost as likely when the economy is expanding as it has been during a recession... Big market drop outside of recessions are harder to get a grip on, but fall into two categories"

1) Why Are U.S. Stock Markets Exploding to the Upside in 2017?

- Fantastic corporate profits have been a key factor in propelling stocks higher, especially in the tech sector. Earnings surprises have largely been to the upside, not to the downside.

- Another key factor has been the prospect (or carrot) that Trump's Republican party will be able to pass significant tax reform legislation. Lower tax's are calculated to juice the profitability of both small and large businesses.

2) Tech Stocks: Superior Businesses and Superior Profit Growth Equals Superior Investments (Microsoft/Google/Facebook/Apple/Amazon)

- Unlike Tesla, an insatiable cash draining business, the above "Tech Stars" have huge competitive advantages (economic moats) which has allowed them to earn excessive amounts of free cash flow with high returns on capital.
- Throw in positive earnings (growth) surprises and these "Tech Stars" have been filled with rocket fuel!

3) GE Is Not Going Bankrupt – (Was \$29.00 now \$18.00 – could be \$13.00)

- GE over the past few years has been a poor allocator of capital, having overpaid and/or bought at the top of the commodity cycle.
- GE exited many of its financial service businesses without being able to adequately replace those earnings.
- A major GE business, power turbines is undergoing a major industry slump. Only time will tell if it's a temporary "cyclical" downturn, as opposed to a permanent "secular decline".
- Instead of earnings close to \$2.00 per share, GE recently shocked the market with a forecast closer to \$1.00.

Add it all up, and GE is potentially a \$13.00 – \$15.00 stock at the bottom of the next bear market.

4) Technical Indicators: Dow Transport Index Still Positive

- Historically, it's been a negative sign if the Dow Transport Index – planes, trains and trucks – the vehicles used to transport all the "stuff" being

produced by the companies in the Dow, S&P 500, NASDAQ and Russell 2000 Indexes, is not also making new highs. Thankfully, the Dow Transport Index is cooperating.

5) What Catalyst Could Derail the Powerful U.S. Stock Rally?

- Bitcoin explodes or Trump implodes!
- The failure of the U.S. Senate to pass Republican tax reforms; or
- Exuberant, expensive frothy markets sometimes just go into reverse.

When the stock market pendulum swings too far to one side – “reversion-to-the-mean” brings the markets back down to earth.

6) 2018 – History Is On The Side of the Toronto-TSX Index (Late In the Cycle)

- Commodities, Commodities & Commodities will be the key to Toronto outperforming in 2018.
- One should not be surprised to see the TSX Index power ahead in 2018 on the back of Trees, Rocks, Oil and Water. Traditionally, the commodity laden Canadian economy outperforms late in the business cycle.

On a final note, in 2018 “reversion to the mean” will translate into much greater stock market volatility. The days of calm bath water can’t last forever!

Ben Horwood

Fund Manager

Value Contrarian Equity Fund

December 1, 2017

Next purchase date Value Contrarian Equity Fund: January 25, 2018

(call today: 514-398-0808)

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Your comments are always welcome via e-mail benh@valuecontrarian.com, phone (514) 398-0808 or LinkedIn.

Please note: The timing of Ben's market comments will only be sent when something of value should be shared.