The Empire Club Presents

ANNUAL INVESTMENT OUTLOOK 2019:
MAKING MONEY IN THE GLOBAL MARKETS IN 2019

Welcome Address, by Mr. Kent Emerson, Associate Vice President at the Municipal Property Assessment Corporation and President of the Empire Club of Canada

January 10, 2019

Good afternoon, ladies and gentlemen. From the Arcadian Court in downtown Toronto, welcome, to the Empire Club of Canada. For those of you just joining us through either our webcast or our podcast, welcome, to the meeting. Today, we present the "Annual Investment Outlook: Making Money in the Global Markets in 2019." One of the traditions of the Empire Club is that the Empire Club makes very long speeches, except at the Outlook Dinner, because we have such great, intense guests here today that we want to listen to them.

HEAD TABLE

Distinguished Guest Speakers:

Mr. Gianni Kovacevic, Executive Chairman, CopperBank Resources Corp.; Author of My Electrician Drives a Porsche?

Mr. Pierre Ouimet, Chief Investment Strategist, UBS Bank (Canada)

Mr. David Rosenberg, Chief Economist, Gluskin Sheff + Associates Inc.

Guests:

Mr. Nick Barisheff, President and Chief Executive Officer, BMG Group Inc.

Ms. Georgina Blanas, Executive Director, Private Capital Markets Association of Canada; Director, Empire Club of Canada

Mr. David Brown, Partner, WeirFoulds LLP

Mr. Richard Carleton, Chief Executive Officer, Canadian Securities Exchange; Director, Empire Club of Canada

Ms. Vivien Clubb, Head of Marketing and Communication, IBK Capital Corp.

Mr. Philip Grosch, President, Treble Victor Group

Mr. Joe Hinzer, President, Watts, Griffis and McOuat Limited

Ms. Jacoline Loewen, Director of Business Development, UBS Bank (Canada)

Mr. Glenn Mullan, President, Prospectors & Developers Association of Canada (PDAC)

Dr. K. Sethu Raman, Chairman, Holmer Gold Mines Inc.

Mr. Ian Russell, President and Chief Executive Officer, Investment Industry Association of Canada (IIAC)

Mr. Chris Taylor, President and Chief Executive Officer, Great Bear Resources Ltd.

Mr. William White, Chairman, IBK Capital Corp.; Director, Empire Club of Canada

Mr. Al Wiens, Partner, Wildeboer Dellelce LLP

We live in a very interesting time, an erratic U.S. political environment that has fostered a more protectionist attitude amongst trading partners around the world, and an environment where interest rates are rising and where GDP growth is increasingly dependent, at least in part, upon consumers having affordable access to borrowing.

Today's event could not be more timely. The more uncertain the future is, the more it is of benefit to be prepared for. As Warren Buffet has said, "It is only when the tide goes out that you discover who has been swimming naked." Because here at the Empire Club, we only want you to skinny dip if it is your own choice and not, obviously, in any matters of your investments. We have brought the great speakers here to prepare you for the tides ahead.

We are lucky to have Pierre, David and Gianni, who are brave enough to bring their crystal balls for all of you.

I am going to quote David's speech from last year. No, I am not. Happy New Year! Let us get started.

First I am going to introduce our first speaker, who is the Strategist for UBS Bank Canada's Wealth Management and Global Asset Management Group on Canadian Equities Strategies and Asset Allocation.

As Chair of the Canadian Asset Mix Committee, he has responsibility for top-down macro inputs to UBS's investment management process.

Previously, he was Head of UBS Bank's Canadian Equities and was responsible for research and portfolio construction activity in the Canadian market. In this role, he was the lead portfolio manager for large-cap portfolios.

Pierre holds a BAA from the University of Montreal and an MBA with a specialty in finance from McGill University.

Please, welcome to the stage, the Executive Director and Senior Investment Strategist for Canadian Equities at USB Bank (Canada), Pierre Ouimet.

Mr. Pierre Ouimet

Good afternoon, everyone. Thank you, Mr. President.

Board members, distinguished guests, and ladies and gentlemen, clearly, a pleasure for me to be here today to address an organization that has been around since 1903, and, obviously, has had quite an impact on the community down through those years. It is definitely a pleasure not only for myself, but for UBS, as well, to be here. Without further ado, jumping into it. Let me just get the mechanics of this going in the right direction. Where are we headed to into 2019? Obviously, we are coming off a half-decent year, as far as global economic growth. You could not tell by the markets, obviously. Earnings were up, and the markets were down. That is not typical, but it does happen from time to time. Major revision downwards in terms of valuations. Hopefully, the worst of that is behind us.

I think it is, in general. We think the global economy will slow this year. We have it down to 3.6%. Some have it a little bit lower than that, 3.5%, 3.4%. The main culprits, of course, will be the U.S., which is slowing. That was to be expected with the roll of tax reform in the U.S., but also

China. China is slowing appreciably.

The official numbers will probably still come in around 6%, 6.2%, but unofficially, the Chinese economy is slowing a lot more than that.

If you look at rail freight volumes, you look at airline passengers, you look at car sales, you look at container traffic in the ports, the hard data is actually slowing, maybe not appreciably more, but it is slowing more than official data which, in effect, is probably a good thing, particularly, in this day and age with trade negotiations going on with the U.S., so it could force them to the table and to be more realistic in terms of their expectations.

Central banks have been part of the problem as well, particularly, towards the end of 2018, in terms of what they have been doing, particularly in the U.S., but also in terms of peeling down their balance sheets. The Federal Reserve in the U.S. has been quite active with respect to that.

As you can see by this chart, since 2017, the banks have been shrinking their balance sheet, essentially draining liquidity out of the system. We think that will taper off somewhat in 2019, flatten out towards the second half of the year and maybe even the Federal Reserve is talking, to a certain extent, maybe of stopping some of the quantitative tightening that we have been witnessing through the last few years.

There is an upcoming policy shift, particularly, now that the U.S. economy is slowing. I think you will see in the first quarter, in particular, an appreciable slowing in the U.S. economy. The Federal Reserve is already hinting at maybe some form of a pause; although, they are still officially talking about rate increases next year. But there are certain members of the FOMC now that are hinting that possibly they might pause at the next upcoming FOMC.

We are probably looking—the market is still expecting probably two rate hikes this year. We had factored in three rate hikes. We are starting to peel back on that expectation.

I think the market now is looking at one rate hike and maybe a lengthy pause at some point in time, which should be quite positive for the markets, in general. That is one thing the markets were worried about towards the end of 2018, which is the risk of a policy error.

As far as Europe is concerned, sovereign funding is actually kind of flattening out, so we do not see many pressures there as far as the sovereign funding situation is concerned in Europe. European rates. The other thing also is that monetary policy in Europe is likely to shift as well. They moved away from quantitative easing. Right now they are maintaining their balance sheets. We think their rates, in Europe, will start rising sometime towards the end of 2019. If that is coupled with a pause in the U.S., then we can start to see a shrinking, a narrowing of the spreads between European interest rates and U.S. interest rates, which has been kind of the fixation of the markets over the last three or four years as well. The widening spreads between U.S. and the rest of the world have been basically what has been driving the trade on the U.S. dollar. We think that will, in 2019, slow to a certain extent. Whether it leads to a decline in the U.S. dollar is debatable, but, clearly, the movement on currency markets will be less dramatic going forward than they have been in the past, and the one-way trade on the U.S. dollar is going to start to abate as well. The curve inversion, which everyone is worrying about, got down to as low as 20 or 25 basis points. This is the difference between the three-month and the ten-year bond rate. Right now, it is around close to 30 basis points. Most of that actually happened because of a significant rally in the long end of the market because of the significant short position on long bonds.

We do not expect a recession in 2019. The probability of a recession is still relatively low, as you can see by this chart. This is combining a whole bunch of indicators, the PMI indices and other forms of indicators. The probability of a recession is still relatively low. The concern of the market about a recession is somewhat overblown, and we think that what we are seeing right now, a return of the markets to a more sanguine type of expectation will be the norm for the next year. Further signs that the cycle is still intact: You look at investment spending, in general, and it is still relatively low where it has been in the past. Also, you look at temporary employment. That tends to peak way ahead of a recession as well, and it is still rising. The risks of overheating have actually abated to a large extent. In the middle of last year, we were worried about overheating in the U.S. and the potential for higher inflation and, of course, a more aggressive Fed in the U.S.

That has abated significantly. As we go through 2019, we will also see a reaction on the Fed from that perspective, which means that inflation is slowing. On the global basis, inflation is slowing. The U.S. is likely to slow to somewhere below 2%, maybe 1.6%, 1.7%. The Eurozone is going to slow; China as well, which could be a double-edged sword. China inflation with a slowing economy means that nominal growth in China will be slowing. The rest of the world could accelerate somewhat, but, generally speaking, the major economy is the major economic blocks.

We will see a little bit lower inflation which, in essence, is not bad. We will return to maybe a type of environment that we have known over the last three or four years as opposed to last year, something that is more akin to progressive slow growth with inflation being under control, with monetary policy continuing to be supportive.

U.S. inflation remains under control, as you can see by this chart. This is the core PCE. It has actually decelerated lately. Central banks will react to that. The Fed is expected to raise rates, but, as we see, as we expect, the Fed will probably be a little bit slow in raising rates as we go forward.

As far as the Bank of Canada is concerned, there was talk towards the third quarter, the latter part of the third quarter in Canada, that the Bank of Canada could move aggressively to raise rates, which is kind of a conundrum for us. It was tough to explain in many respects, because their outlook on economy really had not changed, but they have become a lot more aggressive in terms of their telegraphing future rate increases. That has abated significantly. Right now, we do not think the Bank of Canada is likely to raise rates at least until the spring. Quite honestly, in looking at the monetary policy report that came out yesterday, in all likelihood, they will not raise rates until the fall at the earliest. They are expecting a weak fourth quarter and even weaker first quarter in 2019. The Bank of Canada is probably going to stay in neutral for the foreseeable future and the bulk of 2019.

This is a worrisome trend in the U.S., but it is combined with other factors as well that, in essence, make it, to a certain extent, something that had to happen. In the U.S., of course, the tax reform has led to amplification of the deficit. Tax reform, in essence, was a blessing, and it will help also in terms of the trade deficit in the U.S., because it is going to re-establish a level playing field as far as corporate taxes with the U.S. relative to the rest of the world, which eventually should attract capital, should attract investment into the U.S., and, over the longer term, it also will promote job creation production in the U.S. It should address the trade deficit over the longer term. It is almost a passage obligé, as we say in French. They had to go in that direction. Unfortunately, it has had quite an impact in terms of the current fiscal deficit. This is worrisome. We have, in the U.S., these twin deficits, the trade deficit, of course, and the fiscal deficit, which we think should be weighing on the U.S. dollar considerably, even if rate spreads are still very positive in the U.S. relative to the rest of the world.

That should abate as we go through 2019. I was alluding to the very substantial short position of long bonds, which reversed and obviously had quite an impact, obviously, on interest rates and did kind of shift the yield curve as well and created some of the angst that we saw on the market towards the end of the year. We went on U.S. equities from a slightly overvalued situation to probably somewhere under normal value right now, so there was an appreciably downtake in terms of valuations.

That was basically the angst and the fear episode that we lived through until the fourth quarter. High yield spreads have widened as well. This is an area of concern for the markets. A lot of that, also, has to do with what has happened in the energy area with the drop-off in energy prices. We have seen, particularly in the energy area, the yield spreads widen considerably. That has had quite an impact, also, in high yield in general, somewhat similar to what we had in 2016. You might remember when there was a growth scare. Oil prices declined to below $30 a barrel.

The current episode that we went through is somewhat similar to that, and it has had a high impact on high yield spreads. When you look at default rates, they are still relatively low, and the expectation is that they will remain relatively low for the forecast period. We are expecting lower earnings next year. In the U.S., the rate of growth we are looking at is 4%. The consensus is at 6.7%, so we are not looking for earnings to go down.

When we look at valuations on the S&P or the Canadian market or other markets, most of those markets are discounting a drop in earnings in 2019, which we think is totally unreasonable. We think the earnings could be up by 4%.

The economy in the U.S. is going to probably grow around 2% with inflation at 2%, which means that nominal growth should be around 4%. That is a good proxy for revenues. At least revenues would be up by something like 4%.

That should drive probably earnings higher than 4% which is our expectation. We are being relatively conservative. Even at that basis, the S&P is trading at around 15 times earnings. The Canadian market is a little bit cheaper, around 14 times earnings.

Of course, the variability in Canadian earnings is a lot higher, but there is a large component in the Canadian market that does not trade over earnings. It trades over cash flow, particularly the energy area. It is somewhat misleading to look at P/Es in Canada from that perspective.

You look at the world, the MSCI World Index, and 12-month forward P/Es—below historical averages.

So there is value in global equities as well.

Emerging markets are even cheaper than the developed market equities as well. Also relative to bonds: If you look at the earnings yield on the S&P, it is north of 6%.

On the Canadian markets, it is around 7%. Bond yields are anywhere between 50 basis points in Germany and 2.7% in the U.S.

On a relative value basis, equities are still quite attractive. This is the thing we look at, the misery index.

Right now with the current multiples and the P/E—first the misery index is a combination of the unemployment rate plus the inflation rate. Assuming the unemployment rate really does not go much lower, let us say it stays where it is right now in the U.S., at current multiples. The misery index is merging something in the neighbourhood of 6%–6.5% inflation going forward, which is just totally unrealistic. It is another way of looking at valuations.

Typically, this level of misery index that we have right now in the U.S. should drive multiples in the area of 19–20 times. We are not saying that the market is going to go at those levels of valuation, but clearly where we are right now is severely discounting, and it is overreacting to some of the negative news we had over the short term. This is the major issue as far as trade is concerned. I can spend a whole half hour talking about that.

Right now, the Chinese and the Americans are negotiating. Our expectation is that there will be a deal by March 1st. There is a Chinese National Congress of the Communist Party on March 5th. They want a deal to be signed by then. It will be not comprehensive, but it will cover enough issues. They will be enough to satisfy both sides in this debate, particularly on the U.S., so the U.S. administration will be able to claim some margin of victory. There will be some backing off on the tariffs. There will be some backing off, also, in terms of U.S. access into the Chinese market as well. As far as intellectual property and things of that nature go, there will, unfortunately, be ongoing issues. I think those will be longer in terms of getting resolved, but I think we will see a lot of progress over the next few months as far as the China-U.S. trade negotiations go which are going on right now. Of course, with the slowing in the Chinese economy, there is pressure right now in Chinese authorities to come up with some kind of negotiated settlement.

I will skip a few charts because I am sure I am taking too much time here. Emerging markets are attractive.

They are, however, tied to the U.S. dollar. The drop in emerging markets is largely attributable to the trend in the U.S. dollar. I think that should be behind us. As the U.S. dollar stabilizes on a trade-weighted basis or maybe slightly depreciates, there could be an opportunity in emerging markets where it is extremely, extremely undervalued right now.

We think oil prices will stabilize. I will not talk more about it, because one of our speakers, obviously, will address that issue, but we see them as trending slightly higher from where we are right now. As far as gold is concerned—because we are a European bank, we always talk about gold—we think that gold has turned the corner. Actually, if you look at a long-term chart of gold, if we break out over around $1,350, $1,360, gold could rally substantially above those levels right now.

What we are seeing now in terms of uncertainty and angst is, obviously, helping gold. Inflation typically should help gold. Obviously, that will not be a tailwind, but we think that gold should have definitely a place in the portfolio as a hedge against risk, and it does behave differently than conventional assets as well. Looking at the longer term, I threw this chart in. It is in the presentation, if you want it.

We think we have just come out of a secular bear market, which finished in 2013, where the market we are in right now is the first leg of the upcoming secular bull market. That secular bull market will be composed of a whole bunch of different themes. We formulate sometimes, on our recommendations with clients around some of these themes. The main themes are population growth, aging and urbanization. Around those themes are a whole bunch of other themes, including technology, health and other issues.

The advent of 5G is going to be a big event. You think of 5G in terms of capability, and it is about 100 times more capable than 4G. It is going to open up all sorts of opportunities as far as technology, automation, robotics and things of that nature go. From time to time, we go into some cyclical pullbacks, and these themes will be the themes that you have to look at going over the longer term as we move into this secular bear market. It also embraces a whole notion of sustainability. As well, environmental, sustainability and governance become key elements in that strategy over the longer term as well. I will stop it there, and hopefully I have not gone too much over my time. Thank you very much for your attention.

KE: Thanks, Pierre. Our next guest at Gluskin Sheff + Associates will provide a top-down perspective to the firm's investment process and Asset Mix Committee.

He has received both Bachelor of Arts and Master of Arts degrees in economics from the University of Toronto. Prior to joining Gluskin Sheff, he was Chief North American Economist at the Bank of America Merrill Lynch in New York for seven years, during which he was consistently ranked in the Institutional Investor All-Star analyst rankings. Prior thereto, he was Chief Economist and Strategist for Merrill Lynch Canada based out of Toronto. He was the only economist recognized for his accurate economic projections in Fortune Magazine's "Best and Worst of Wall Street 2011", and was ranked "Most Accurate Forecaster" for 2011 by MSNBC. Some people call him the permabear. I just had occasion to ask him whether he thought that was accurate. He said, "Well, I missed the first rally, but I caught half of the second rally, so therefore, I do not think it is accurate." I guess we will just have to watch, today, to see whether you lead everyone into the cave or out of the cave, today.

We will learn something from that. He is also the author of "Breakfast with Dave," a daily distillation of his economic and financial market insights. Please, put your hands together for Gluskin Sheff + Associates Inc.'s Chief Economist and Strategist, David Rosenberg.

Mr. David Rosenberg

To set the record straight, bear, yes, perma, no. Actually, I do want to commend Pierre during his presentation, because you did not mention Donald J. Trump once. I think that for the past two years, that is all we talked about.

I am going to one-up you on that. I am going to just mention Donald J. Trump just once, if that is okay. He was interviewed recently, and he was asked what the 'J' stands for in 'Donald J. Trump'. He said, "Genius."

Nothing I say going forward is going to be very funny. This is going to be—I do not want to call it by a label because I do not believe in labels, 'bull' or 'bear'—in the next 15 minutes, an exercise in just giving you a reality check. I actually firmly believe you can invest around the Chinese zodiac. If you remember last year—who was here last year?—the title of the presentation was "The Year of the Dog," and the little quip was, "Will the dog bark, or will the dog bite?" I was talking about Jay Powell. Jay Powell barked, and then he bit, and now he is whimpering.

This year is actually the year of the pig. The quip is that there is no lipstick that can be applied this year. I like to start off the year by going through my former mentors.

Bob Farrell is at the top of the list. Show of hands: Who knows who Bob Farrell is? This table, you cannot do that. Just a few hands. Bob Farrell was the Chief Technical Strategist for Merrill Lynch for 50 years. He was quoted in Barron's all the time. This is going to sound a little preachy, but if you get anything out of what I say today, what I would recommend you do is just Google Bob Farrell's "Ten Market Rules to Remember." Just do that. You can do it now; I am not going to be offended, or you can do it when you get back to the office. I will tell you, no matter who manages your money, if you manage your money yourself, if you do not know about Bob Farrell's "Ten Market Rules to Remember," which is the ten commandments for investing, there is really not a snowball's chance in hell you could have been as effective as you would have been if you knew about his "Ten Market Rules." In fact, the greatest pride I have when I walk up and down the halls over at Gluskin Sheff is when I see the young analysts have Bob Farrell's "Ten Market Rules" pasted on their blue book terminals.

In any event, I do not have the time to go over the "Ten Market Rules." I have always adhered by them. Our firm does. I want to go to that inflection point, and it may well be the case that we are in some long-term secular bull market, but we are here every year, so we are going to take it year by year, not five or ten years, if that is okay.

Bob Farrell, at that inflection point during the tech req in his venerable "Theme and Profile Investing" publication said, and I always bring this out when we are at an inflection point in the market and business cycle. What does he say? He says, "In the early stages of a new secular paradigm, most are conditioned to hear only the short-term noise they have been conditioned to respond to by the prior existing secular condition. In a shift of secular or long-term significance, the markets will be adapting to a new set of rules, while most market participants will be still playing by the old rules." People say to me, "What do I do?" In the past year and today, I am saying do not play by the old rules.

You have got to play by the new rules. Things are changing, and changing for valid reasons. The other mentor that I had in my life was a fellow named Don Coxe. Show of hands. That is significant. Don was and continues to be—although he is retired—a mentor. When I was a young pup, and I started in this business in the mid-1980s, he said, "You're the economist, and you're the strategist, so you're a little bit schizophrenic. The economist has to call the economy, but the strategist has to always decide how much of the good news or bad news is priced in the financial assets." He says, "The one thing you always want to pay attention to is the front-cover effect." This means that when some piece of news makes it to the front page of the newspaper, it is fully priced and then some. You want to fade that story. You always want to be focused on what the Page B-16 story that is on the way to Page A-1. When it makes it to Page A-1, time to sell. Actually, the first thing Don gave me was a copy of the BusinessWeek—the famous BusinessWeek—front cover, in 1979. Do you know what I am talking about?

What was it called? "The Death of Equities," to only go on a real secular bull market for 20 years. That was a great contrarian. What happened, in October 2017, literally months before what I consider the first fundamental peak in the stock market in the S&P 500, which was January the 26th of last year? The Economist magazine runs with the bull market in everything. That was, for me, an aha moment, that basically everything was priced in. We know it was the bull market in everything. Last year, everything rallied except for cash. Everything rallied—even asset classes that were inversely correlated, and I talked about it last year. Actually, the one call I made last year that I remember is I said—and I had this chart of everything from bitcoin to bonds to emerging markets to high yield: "This is a one-in-century event, and enjoy it, because it is not going to last." It did not. The chart on the left, as you can see, was 2017. Every stock market was up, globally.

That was the year of the rooster. I told you, you can invest around the Chinese zodiac. In the year of the rooster, everybody was crowing. Then, we had the year of the dog, and tell me that was not a year of a dog. Practically every market was down and downsized. Even though the S&P 500 was the last one to join the club, the problems in emerging markets in China were starting at the beginning of the year.

I was listening to Pierre, and it was making me think that we have to focus on valuations; we have to focus on fundamentals. But I have always found it useful to take a very eclectic approach towards the stock market, because it is a stew. There are several things that we have to pay attention to. It is not just valuations. It is not just fundamentals.

It is fund flows; it is sentiment; it is market positioning.

I started in this business on October 18th, 1987. Do you remember that date? The 23% collapse? That is where the permabear comes from, when you started on October 18th, 1987.

What if I told you that earnings year over year, that in the fourth quarter of 1987 was up 50%? What if I told you the unemployment rate had come down to cycle lows? GDP growth was not 2% or 3% or 4%; it was 6%, because the real key, as Larry Kudlow, whom we will talk about later, famously says, "Earnings are the mother's milk of the market." Fine, but liquidity is the oxygen tent for the market.

And so we have to pay attention to liquidity and something else. People think this is voodoo, but we have to pay attention to the technical picture as well. I am not a technical strategist, but I know how to read charts. Mark Twain was right when he said that there are lies, damn lies and statistics. Economists—you know this—make up 73.38468% of all the facts they spew out right on the spot, just to let you know that. Charts do not lie, simple as that.

Look at the chart on the left, 2017, and look at the chart for last year. Tell me, which is the old paradigm, and which is the new paradigm? Look at the chart, the double peak. The first peak was January 26th. Historians will say that was the fundamental peak; although, the price peak was September the 20th, on lower volume and weaker breadth.

Look at the chart. Double peak—a failed retest of the old high, littered with intense volatility. Then, we can take this back, 2000, 2007. There is last year, again. I could take it back, 1960, 1980. I have only got 15 minutes, and I could take this back to 1900, but you see what I am saying.

I was not only saying that one should not play by the old rules, but I was also saying that maybe for people in my position with the crystal ball, maybe this is one of those times when I have to say I am going to play the role of the student, and I will let Mr. Market play the role of the teacher because the markets are giving us a tremendous amount of information. Sit back; do not hyperventilate; just sit back and assess what is going on here. Double peaks, sprinkled with volatility of what we saw, historically, has always and everywhere been the hallmark of a transition from a long bull market, which we have had, to a bear market, which is just starting. I talked about how the root cause is about liquidity.

What is the root cause of liquidity are the central banks, and the most important central bank in the world is still—it is not the ECB (European Central Bank), despite Super Mario Draghi, who is on his way out anyways; it is not the PBOC (People's Bank of China); it is not the Bank of Japan; it is surely not Steven Poloz. It is the Fed. What is interesting is that as I was standing here last year in January, my good friend, Greg Ip at the Wall Street Journal penned this article where he talked about what the ultimate economic consequences will be: "Eventually, the boost from reduced tax and regulations will peter out," which it has had; that is yesterday's story. He continues: "The most important determinant is monetary policy." Full stop. That is the liquidity story. That is the most important story right now. It is more important, actually than what is happening on the trade side, which I do not see being completely resolved, because the situation with the U.S. and China is much broader, geopolitical, than just soybeans and automobiles. Around the same time, the Wall Street Journal came up with an editorial and said, "Keep in mind that we have never lived through a monetary policy reversal like the one that is coming." I thought, "Okay, have they been there?" Because I agreed with them at the time. Look at what is happening.

There are lags between this chart and everything else in the world. This is one-month paper—old paradigm, new paradigm. The era of cheap money ended with Jay Powell, that dog. You are taking a look here. We have had a monumental increase in short-term interest rates. I agree that it is over, but it is too late. As Pierre had mentioned, we are now re-running that experiment of QE. If QE worked so well on the upside in the bull market providing all that liquidity, quantitative tightening has to be doing the opposite because, you cannot have it both ways. The St. Louis Fed has something called—if you go on their website—the "shadow fed funds rate," which tacks on not just the normal funds rate that we have all looked at our entire professional lives, but tacks on the balance sheet impact. What I have done here is done a three-year change in terms of what the balance sheet has done, which is now shrinking. When you measure this, the Fed has, de facto, already raised rates 300 basis points this cycle. That is almost invariably generated a recession. You could see the exception in the mid-1990s. Why? Because, in 1995, Netscape went public and ushered in a whole structural shift in the global aggregate supply curve that gave us an extra five years of growth. I, frankly, do not think the cycle of iPhones and weed is going to do quite the same thing, but, historically, a 300-basis-points increase by the Fed has generated either a significant slowdown or an outright contraction, but there were lags. I will say this. I think Steven Poloz made a mistake raising rates three times this year. I was saying before the December 19th FOMC meeting—because at that point, there was only 30% chance in the markets on December 19th they were going to raise rates. I was there thinking, and I wrote about it in my daily that I thought they should take a pass. Maybe because Trump tweeted that morning, "Powell felt I am painted into a corner," but we are living through history.

We have never, ever seen the Fed, even with Volcker, raise rates into that maelstrom—the stock market is down 20%; the cyclical is down even more; oil is down 40%; steel is down 20%: copper is down 30%. They have never raised rates—and he raised rates. History will show that the September and December rate hikes by the Fed were a mistake.

Actually, I think both central banks, the Fed and the Bank of Canada—this is a case where your assumptions drive your conclusions. They somehow believe that the neutral overnight rate or policy rate is say 2.5%, 2.75%. I think it is actually much closer to 1.5%–2%. History will show, in my opinion, that the central banks, yet again, over-tightened.

That is going to generate a completely different economic landscape this year that the markets have only recently started to price in. That is not a straight line. We had a nice, little bounce in the stock market in January, which is perfectly appropriate in the context of the worst performance since December 1931. It is not a depression. The market got way oversold.

Do not be mistaken about what the economic landscape is going to look like because there are lags between what the central banks do and time at point a and then at the peak impact it has in the economy on STUV. There are lags involved. Let us take a look at the cycle. Look where we are. We are 115 months into this economic cycle. A normal cycle back to the Civil War was 40 months, but look: 30% of the population does not live on the farm anymore.

Take it back to say the post-World War II experience on average, or the norm, and we still call it 'the norm' because it is normal. What is a 'normal expansion'? A normal expansion is 60 months since 1948. This is already rivaling the Internet expansion of the 1990s. It is getting long in the tooth. One of my favourite late-cycle indicators is the output gap, which is this economic nerdy term for the amount of spare capacity there is in the economy and the product market and the labour market combined together.

Without getting overly technical, when you are above zero, you are in excess demand; below zero, you are in excess supply. This is what the Fed and the Bank of Canada have been responding to. This is really just—if I overlaid this and then inverted it with the unemployment rate, it would be basically the same chart.

I think by this time next year, that chart will be back to below zero, and we will be talking about deflation again, but this is where we had been and that is what the central banks have responded to.

Looking at a whole bunch of different aggregates, including the output gap, we run this model in house. We look at a range of different macro-market capacity variables, and we look at how the contours are behaving in relation to previous cycles. I brought this last year, if you remember.

I think last year it was basically over 80% of the way through the cycle, and I was saying last year that we were at the 7th inning stretch—start investing with late cycle in mind. I gave you folks a whole bunch of different strategies. We are now more than 90% through the cycle, based on our work, which means, in baseball parlance, that we are top of the ninth with one out. One of my favourite, of course, is the yield curve.

People will ask me all the time that if I were alone on a desert island—and a lot of people wish I were—what my top metric would be. It would be the yield curve, always maligned. Economists always find a way to explain why we should not pay attention to it. Out of the 12 district banks, the one that does put out the best research is the San Fran Fed. Last year, they came to the conclusion in a report that the power of the term spread—which is central bank lingo for the yield curve—to predict economic slowdowns appears intact. Indeed, I agree with that.

This is, again, about a situation where there are lies, damn lies and statistics. Pierre had his yield curve, and I have my yield curve. This yield curve actually leads all the other yield curves. The two-year, five-year yield curve have gone negative. This is when the bond market is telling the Fed, "Uncle, you have gone too far." When you get a situation where mid-term rates go below frontend rates, take a look at the chart, and you will see there has always been a precursor for an economic recession, except back in the late 1990s around the Asian crisis, but 80% of the time, this has worked.

Not just that, but let us take a look at history. Let us put our historian hat on. The Fed has already tightened policy aggressively. I showed you that with the balance sheet: 300 basis points. There are segments of the yield curve that are inverted. That is a yellow flag. Look at all the historical examples of the Fed raising interest rates, the interest rate cycle.

Every interest rate cycle—there have been 13 of them, and ten landed the economy in recession, and three landed the economy in a soft landing. The soft landing is slower growth. A recession is actually a haircut in GDP. I would say, yet again, will we get a soft landing? In the mid-1960s, mid-1980s, mid-1990s, the Fed got it just right. They did not over-tighten in those cycles, and, at the same time, we were early cycle. We were not in year ten. There was a longer runway for growth. I think this is going to be a lot more complicated.

You know how I said that the San Fran Fed puts out the best research? But the only Fed district bank that actually produces recession of probabilities is the New York Fed.

Their odds have gone up to a ten-year high. You will see it is at 16%. What is there to worry about? This chart never goes to 100%. In fact, by the time it goes to 40%, it is already too late.

Anyway, the important thing in this business is direction. Whether or not you agree with my premise about a recession starting this year, the risks are rising. If you are managing money, it is all about probabilistic determination. It is about weighing the probabilities. Those odds are going up. Actually, my conviction level is actually not even 80%; it is more like 100% because of this particular chart, which is Cuddles Kudlow. Larry Kudlow actually said in December of 2007, "There ain't no recession." That is the month that it started. What did he say last Friday? "There is no recession in sight." I told my two guys that work for me, "I think I have to include that chart for the presentation I am going to give today."

Then, take a look at the Fed chairmen from the past. These are the most brilliant people in the world. Jay Powell, in September, said: "There is no reason to think that the probability of a recession in the next year or two is at all elevated." I do not want to be rude and call him 'dude', but I will say, "Hey, Jay, you do know that your own New

York Fed shows the recession odds are at a ten-year high, so what are you talking about?" Then, we have got Bernanke in January of 2008: "The Federal Reserve is not currently forecasting a recession." Can you believe that? By January of 2008, it already started the month before. Okay, good.

Then, you have got Alan Greenspan: "We are observing an inventory readjustment process," in January of 2001.

He did not see it for what it was, which was actually not an inventory cycle; it was a detonation of the technology capital stock. I am not into really throwing stones at glass houses. I have made my own share of bad calls, but these people have an awesome responsibility, and you can see how it is that they often make critical mistakes. Bottom line is that, historically, on the eve of a recession, even the Fed staff does not see the recession starting, which is absolutely remarkable—the best economists in the world.

Very recently, the other Rosie, Eric Rosengren, who is head of the Boston Fed, said that the record of policymakers' ability to engineer a growth recession that nicely lands the economy at full employment without morphing into a full-blown recession is not comforting. I think I tip my hat that he actually comes out with the raw honesty. I think a soft landing is a low-odds event. Let us say that I am right: Ten years into the cycle, and I realize that no cycle dies of old age; they get killed by the Fed, and I think the same is going to happen this time. I think we are just reliving history. It is not the first time that we have had a recession, or a bear market, and we know how to live through them.

Here is what it looks like. Before the recession happens, the market price is at end. The S&P is down 10% before the recession begins because the market is a forward-looking indicator. The market price is at end; the market is down 10%. What are we down right now? We are down 10%.

We bounced off those September 24th lows, down 10% price at end, but then, in the recession itself, we are down 20%, and the whole bull market is down 30%. It is not the end of the world. You just have to take an umbrella out and know when to open it up. During the recession, by the way, historically, bond yields go down an average of 160 basis points for the ten-year treasury note. I guess if you do the math, you are thinking, "Wow, he is calling for zero."

No, that is not what I am saying. I am just saying that is an average, but normally, bond yields go down.

For those that like to have a visual, this is what it looks like. The stock market on the left peaks before the recession, which I think happened January, September. It goes down, bottoms before the recession ends, and you can see that ten-year treasury note yields also go down in that period, but keep on going down past the recession because we still have an output gap and inflation is still coming down.

What I am saying is this. You see how things move through the recession—the median returns. The TSX, S&P are down more than 20%. This is a different timeframe. This is three months before the recession, and six months before the recession, and three months before it ends.

This is the key right here. Stay away from index investing. Stay away from passive investing. That cycle is over. Commodity prices go down. That is a death note for the Canadian dollar, which is a great sell right now: 132.

It is basically all about the stuff on the right. Where do you hide? You hide in high-quality dividend stocks, and you hide in high-quality bonds, government and investment grade. Actually, you do not have to run all on the cash.

There are places to hide in a recession that generate some alpha, even as the economy is in setback mode. In other words, as the USA Today says—and you can see I buy the paper more than just for the sports section—"Time to prepare for the end of the bull market." In other words, for 2019, boring is going to be sexy. Sex up the portfolio by de-risking. It is not too late.

Thanks very much, and Happy New Year, everybody.

KE: Thanks for that. Given you have made some comments about Governor Poloz, we do have him secured to speak to us in December of 2019, so if we do this event next year, he will be speaking just a few weeks prior to you, and you can make some more comments at that time. Our final guest has enlightened audiences around the world with his unique brand of storytelling. Drawing from over 20,000 hours of research, he is frequently interviewed by the media and is known for the colourful way he decodes complicated modern themes. His research book My Electrician Drives a Porsche? was introduced to audiences by way of a one-of-a-kind journey across America in an all-electric Tesla. He is a graduate of electrical studies from the British Columbia Institute of Technology, and he is a sought-after expert in the analysis of the global energy matrix and in the study of how technology will impact commodities and emerging markets. Fluent in English, German, Italian and Croatian, he makes his home in Vancouver. Please, welcome investor, author, strategist, Gianni Kovacevic.

Mr. Gianni Kovacevic

An economist, I am not, but my brother and I were reading encyclopedias and National Geographic while everyone else was playing video games. I am a hobby historian and I, too, am a big fan of Donald Coxe.

The title of my talk, today, comes from a 2008 piece from his basic points. In my view and what I would like to demonstrate today is that the global energy matrix is at a hinge of history. The most important date in the history of energy is January 10th, 1901. It was the discovery of the world's first true oil gusher in Spindletop, Texas, discovered by a Croatian immigrant, Antun Lucic, who changed his name to Anthony Lucas. First, we have to go back in time.

In 1879, in October, Thomas Edison would invent the electric light bulb. His patron was John Pierpont Morgan.

It took a couple of years, but he finally electrified the home of J.P. Morgan, and he invited 400 of the most influential people in New York, and Thomas Edison said, "Welcome, to the electric age." They left. His father, of the House of Morgan, said, "Son, how can you embarrass yourself in front of all these important people? This is a science trick.

This is for fairs. How embarrassing." Of course, as we got to the late 1890s, it was important. I can think what John D. Rockefeller thought on that day. I do not think because kerosene, which is what we were doing with oil—we would refine it; throw the gasoline away. And it was the illuminant and the lubricant of the economy, but they did care, because all of a sudden, it did supplant oil as the illuminant.

We did not use it for motorization because we were still in the animal age. We were still using trains and ships, the steamship. Then, this guy discovers the world's first oil gusher. What will we do? Of course, we know it was the internal combustion engine.

Something else happened 12 days later, after January 10th. This was on January 22nd, 1901. Queen Victoria passes away. Ruled the empire for 63 years.

She gave birth to nine children, and they called her the "Grandmother of Europe." They married through all the royal circles. She would die in the arms of her grandson, the German Kaiser, Wilhelm II.

They were cousins—Czar Nicholas, King George and Kaiser Wilhelm. By 1910, it was the strongest industrial power in Europe.

Sixty-six million people lived in the reunified Germany, in 1871, through Otto von Bismarck. They had 33 million people in England.

Did you know that they generated and consumed more electricity than Italy, France and England combined, but they did not colonize the world? They did not have those naval fleets. That was done with other people.

There was an assassination in Sarajevo in 1914. I will suggest to you that this was the match that lit the fuel, but it was a war of the haves versus the have-nots—Germany, Austria-Hungary and the Ottoman Empire.

A hundred years goes by, cycle after cycle, and we did not organize this, David, but The Economist on March 6th, 1999, told us we were drowning in oil. Oil was trading at about $11 a barrel, but they were using the old rule book, just like you said. They followed the statistics of the OECD, which was a club of a few countries in the west and Japan, but they forgot about them, the emerging markets and, of course, China. In September, 1980, commodity stocks were 35% of the S&P. On that day in 1999, there were 5%, but they forgot about these people, the greatest efflorescence of human progress in the history of mankind. They went from $1.5 trillion of output today to $13 trillion. Look at the impact: 31 times.

I was in Beijing in November, and I can assure you they have spending power. They have an economic footprint like you and I do. Now, there is a battle between number one and two, the second largest economy in the world.

In time, they will have 1.37 billion people. They will surpass America, and it is not that there is—it is just flexing the muscle of the populations. If these people are looking at the old rule book, I am here to suggest to you, and I am going to demonstrate through evidence, through my global travels and my curiosity, but supported by evidence, that you do, indeed, have to look at a new rule book, especially if I tell you that we are at a hinge of history in the way global energy is procured and delivered to society. Iron Mike Tyson said, "Everyone has a plan until they are punched in the face." The experts of oil tell us—and I mean the big oil economists and the IEA and people like that—that the growth in oil will still grow. The question now is about when we will have decline. Is it 2040, 2035? If you start looking at a hyper-adoption, when you layer in innovation, technology, fuel switching, you have a delta of 400 million barrels a day—oil. Someone is going to be wrong. I do not know what happens in the next 5, 10, 20 years, but what I will suggest to you is that there comes a time sooner than 2030 that it is no longer a growth business, but the demand of it. It will be about the CAGR growth rate and demand.

This country embellishes those places that export oil—of course, Saudi Arabia, the most important, but that is not the focus here. I am an investor. You need to think of the countries that are present here, and they are, in fact, some of the economic superpowers of the world. They speak of Japan, China, growing India, Germany, Italy, Israel, Croatia, Switzerland.

The point I am trying to illustrate is that these people have to choose option A, which is the way they have done it for 120 years, or, if you have not travelled, if you get your passport and put a few stamps in it, you will realize that there is change. It is happening in real time. There are many incentives for that. This is London. Sadiq Khan is the mayor. He has put many initiatives with respect to pollution. This is the primary reason. The collateral benefit is going to support us in climate change, but you see it. It is not just a China problem or an emerging-markets problem; this is pervasive throughout society. How do I explain this to people? I have had a hard time because not everyone is a petroleum engineer. Not everyone has driven an electric car across America, and not everyone appreciates the science of energy, because it is not their industry. Imagine our world without the magnificence of electricity because almost everything you buy comes with an electrical cord stuck at the back of it.

[VIDEO.]

The magic of electricity. Energy without the use of fossil fuels is electrification. That demands copper. Most people do not know in the energy trade that, of final energy usage today, 19%, is electricity. That number is going to climb in the next 30 or 40 years to about 50%. You do not need to get out a pencil and paper to figure out the input; the great enabler of this electrification is metals and mining.

That will be led by copper, and it will be augmented by things like aluminum and lithium and cobalt and vanadium.

As a country, our GDP is $1.8 trillion, and about 10% of that is reliant on energy, oil and gas and electricity. We are, in some capacity, positioned to offset these changes.

When you look at these things, and, as you drive by them, I want you to look at the average electric car, electric bus, because when this final energy becomes electrified or increasingly so, and even if I am wrong, by a power of magnitude, in the end, everything does become electrified.

Offshore wind takes ten times more copper for each one megawatt. Go do a little research report and find out how many gigawatts of offshore wind they are building around the world. We have electric buses, electric cars, electric everything. Let us look at the two commodities. If I take a cubic kilometre of shale formation, we have technology, which has enabled us to, with less effort, get more hydrocarbons out. I am going to give you the state of the nation in my last three minutes of what is going on in the world of copper mining. CAGR growth rates since 1900 has been 3%. I do not lose any sleep at night over the fact that the CAGR growth rate of copper is going to be maybe better than that, maybe 5%. We have underinvested in copper mining on a global scale. I have been telling people that oil and copper will decouple—price, of course. But also, when we look at it, what is the CAGR growth rate of these things?

Here is a 20-year chart of copper and oil. Ninety percent of the time, copper follows oil. That is decoupled.

You can see it there. On that same day in 2000, before the China super cycle—and you can see the dips—but now from an engineering perspective, that ton of low-grade copper ore in the future, has to be worth $40. That tells us, as engineers, the copper price will surpass its all-time high, and it ends up somewhere in that orange box. Otherwise, you are not getting anymore copper. It is not the will.

You have got lots of that in Lima and Santiago. It is the money. The money—it is not economic. We have not had a horizontal fracking renaissance in copper mining.

Ask anyone. I tell people, my friends in the oil and gas business, that the world's oil supply comes from 4,700,000 individual wells. I tell them, "Did you know that 50% of primary copper comes from 25 mines?" That is it. If you think we relied on Middle East oil—20% of our oil supply comes from those countries. From two, Peru and Chile, comes 45% of primary copper. Wait until they start talking about that on page one of the newspapers. I just happen to know the people that produce copper, and if I get together with seven or eight CEOs, they control it. Cobre Panamá will be commissioned this year.

We do not have one major copper mine that will be commissioned until 2022 under investment. This is something that we, as Canadians, understand. I am sure many people here participated in the 2006/2007 cycle and maybe the one to 2011, but copper has never left the long-term cyclical bull market, which is going to last another ten years, maybe 20 years. Get the technicians to look at that. In 2010, for the

15 largest producers, the grade was 1.2%. Now, it is lower than 0.7% and falling. Once again, if you take a cubic kilometre of that rock, for more effort, your pay is far lower. The future of copper mining only gets worse. The grade has fallen in half, as I have already alluded to, and we had the benefit of the hangover. After Pinochet reinstated the market economy, we had truly the golden era of exploration. Now, because the copper price went higher, we had the benefit of putting that into production. Now, comes the hangover. The future: The next 50 projects are predominantly below 0.5% copper. There are many jurisdictions that have 100 years of oil reserves, and they are wondering now.

It is not like a Mad Max movie where the last barrel of oil sells for $1 million. The question is whether we will donate that barrel of oil and make an enhanced product: plastic, petrochemicals and what have you. We have 20 years of reserves going into a foreign five-year CAGR growth rate in copper. It is not a reserve at this price. People think the price is going to go higher with the same cycle. We, my friends, spent $100 billion looking for more copper in the China super cycle. See the blue bars. Note to my energy friends: We did not find a lot—low grade, high elevation, no water, countries that do not understand copper mining, no work culture. You have got to fly the crew in and out. Just because the copper price goes higher, it does not necessarily mean that is going to change. I am a contrarian. Like the famous Ben Graham, I buy from pessimists, and I aim to sell to optimists.

That is what I do, and that is what CopperBank does. We have acquired and we are acquiring high-value copper exploration projects in jurisdictions where our children can go work, and we are paying 2¢, 3¢, 4¢ on the dollar of the money that has already been spent. We look to sell those to optimists—what I believe is one of the great investments, starting this year in this hinge of history, throughout the 2020s.

To enlighten your children to appreciate the magnificence of electrification, you are welcome to buy 10 or 20 copies of my book for next Christmas. Thank you everyone, and I wish you a very prosperous 2019.

Note of Appreciation, by Mr. Richard Carleton, Chief Executive Officer, Canadian Securities Exchange; Director, Empire Club of Canada

Yes, apparently a very quick thank you, Kent. It is, indeed, one of my favourite lunches of the entire year, to see the passion, the intelligence and the clash of ideas that are represented by the market. Frankly, that is the healthiest thing that we see all year—really smart people with different ideas about how things are going to play out.

Because I am a nice guy, I will not remind Mr. Rosenberg about his Japan call last year. In any event, we are deeply indebted to Pierre, David and Gianni for their views.

I hope you have learned something today that you can take back to the office and put to work, even if in Gianni's case, it may be 10 or 15 years before anything actually happens, but you did read it here on page 16, before it does get to the front page of the news. Thank you very much, everybody. We are so grateful that you are supporting the Empire Club. On behalf of the Empire Club board of directors, we are so grateful that you joined us here, today. Thank you, again.

Concluding Remarks, by Kent Emerson

Thanks, Richard. Thanks, again, to our sponsors.

One quick announcement. We have a number of great events in January, including with Kyle Dubas and Bobby Webster, General Managers of the Toronto Maple Leafs and of the Raptors respectively. They will be talking about big data. We just found out yesterday, that Elliotte Friedman from Sportsnet is going to moderate it, so it is going to be a great event. There are not too many tables left—maybe five or six. Get your tables now. Thank you very much for coming, today.

Meeting adjourned.