HINESIGHT

Hines Investment Management
Toll Free: 1 844 887-4995
hinesinvestments@cibc.ca
www.hinesinvestments.ca

A CAPITAL CUNDRUM

Gerald Hines, Senior Portfolio Manager, First Vice-President, Hines Investments, CIBC Private Wealth Management

Sheldon Hines, Portfolio Manager, Hines Investments, CIBC Private Wealth Management

We tend to look at policy, not politics. However, with the current fiscal environment and political atmosphere, we find it prudent to briefly mention capital gains and dividend taxes.

In Canada, the Liberal throne speech has been supported by the NDP. The NDP wish to increase the capital gains inclusion rate to 75% as stated in their platform. When the Liberals came to power in 2016, this idea was previously reported as a potential, but ultimately sidelined. The difference today is they need support for their agenda and they need to show they are doing something about the deficit caused by COVID.

In the US, Democratic nominee Joe Biden, who currently holds a double-digit lead in the polls with a month to go, has pledged to increase the capital gains and dividend inclusion rate to 100% for high income earners.

With the political appetite on both sides of the border for increasing capital gains/dividend inclusion rate, this should not be overlooked.

We encourage all high-income earners to review their current capital gains situation and consult their tax advisor to determine the best course of action.

HIGHLIGHTS IN HINESIGHT:

- SPECIAL FEATURE: Looking For Inflation In All The Wrong Places. By Louise Yamada of LYA
- Preparing for further volatility
- There Is Gold In Them There Hills – Why gold may continue its ascent

PREPARE FOR FURTHER VOLATILITY

Gerald Hines, Senior Portfolio Manager, First Vice-President, Hines Investments, CIBC Private Wealth Management

It is well known that September and October are vulnerable months for equities. Institutional rebalancing, end of some hedge funds' fiscal year and now COVID in the White House. We expect the unsettled markets to extend into November with the election, mid-month ballot deadlines and a probable contested election landing in the Supreme Court. We remain protective of downside. Remember one does not always have to participate when the picture is uncertain.

Overall, we continue to witness one sector, technology leading the market. Although in corrective behavior currently, a retreat to their longer-term uptrends (a more reasonable rate of ascent) could provide opportunities to add positions. Industrials is another sector that has shown improvement, although stock selection remains paramount. Many Global markets are depicting weakness. We stay attentive to watch the S&P 500 does not also fall prey to weakness.

We find the markets in a state of ambiguity. Weak credentials are visible in the equity markets, yet not fragile enough for a major decline. However, not yet strong enough to support a significant rise at this time.

While we continue to search for quality at a fair price, we remain disciplined to our philosophy:

One does not always need to be active in the market. It's OK to be quiet when there is uncertainty. We'd rather be out of the market wishing we were in, than in the market wishing we were out. If we preserve the capital, there will always be another opportunity.

INFLATION

At Hines Investments, we continue to be wary of the inflation numbers offered by governments. We see increasing evidence in our daily lives of inflation. A quick review of your recent electricity/hydro/gas bill over the last few years will show a rate increase of greater than 2% per year. Last week in the USA unemployment rate release, hourly wage increase was released. Year over year it is up 4.7% (Federal Reserve). This is a far cry from the standard 2% increase we were once use to in contract negotiations.

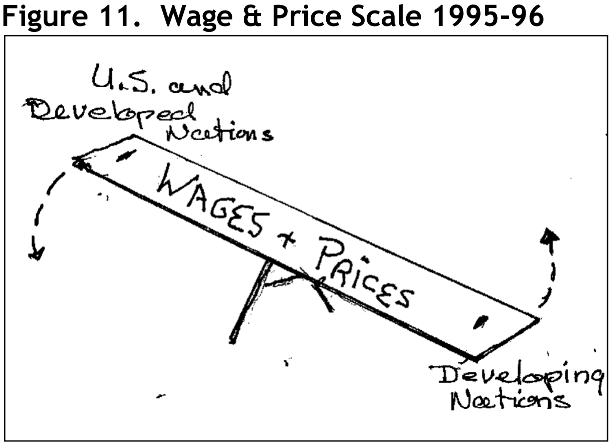
I write the above as a prelude to the next two pages. Our friend and well-known market technician, Louise Yamada based in New York, has written a compelling view on inflation accompanied by her editorial, for us to share with you. We agree with her view that rising rates are coming (not immediately) and at a stronger pace than most market participants will be prepared for.

STILL LOOKING FOR INFLATION IN ALL THE WRONG PLACES

Louise Yamada, Founder & Managing Director, Louise Yamada Technical Research Advisors (LYA)

In the mid-90s we projected that globalization, as well as the internet, were creating a *major global wage and price equalization process* (see Figure 11), and that since the U.S. was at the high end of the global wage and price scale, we had the most to lose. That process progressed as corporations outsourced and set up operations in Mexico and China.

Figure 11. Wage & Price Scale 1995-96



Source: LY Advisors

In the 2 decades-plus that have passed, our domestic U.S. wage and price horizon weakened considerably (deflationary), as wages and jobs declined along with prices of products from the outsourced plants.

Nevertheless, the *inflationary* pressures continue in what we have called consumer essentials: Food, Water, Health Care, Services, (much less so in Energy than we had anticipated); nevertheless, in *non-discretionary outlays*.

Our concern was that the *quality of life in this country would continue to diminish under those circumstances*, as the spread between income and essential outflow would grow, and has grown, wider, as was inevitable, particularly for those at the lower end of the wage / income scale. The global population and consumer growth, now approaching 9 billion people will continue to increase the pricing power of the consumer essentials, especially food today.

We've contended for 2 decades that the powers that be are **looking for inflation in all the wrong places**! One major solution would be to continue to return manufacturing to this country; particularly now that the wage and price equalization process in the U.S. has leveled off (and correspondingly have risen in China), making it more cost effective for corporations to come home, and pull our dependence out of China, simultaneously putting our unemployed workers back to wage earners . *The 1990s diagram above has equalized.*

In this 21st century cycle, each financial crisis has begun with rates at progressively lower levels. Each flood of liquidity created a new bubble. Ultimately rates have gone so low as to be ineffective, creating so much fiat money, that perhaps the next bubble will develop in Gold and Silver as monetary alternatives.

Editorial: Wage and price effect need not have occurred to such an extreme had we demanded free trade WITH a demand for maintaining our safety standards, quality control standards – including not using our banned pesticides. These demands would have made the competitive edge of foreign goods less severe and extended the wage and price adjustment over a longer time frame.

Inflation is being hidden, because of the extensive and growing U.S. debt, the powers that be do *not really want a visible increase in inflation because the interest on our debt would soar and they would have to pay more for Social Security*. The Government inflation measures look to *minimize* the consumer inflationary pressures by measuring-items, *not the amount of content of the items*, and the lesser cost price (rice and beans vs chicken vs beef).

If fewer can afford meat and eat chicken, the chicken is measured; if fewer can afford chicken, the rice and beans cost is measured *to show lower inflation*. Also, if a bag of sugar costs $2 for 5 pounds as it had for decades, the content has been reduced to 4 pounds for the same price, as it stands now… but the lower content is *not registered* even though it represents 20% inflation. Ditto for baking chocolate, crackers, cereal and canned goods (more water less bulk). <u>This is happening with all packaging and we are insane enough to ignore it</u> (the men who measure these items don't go shopping!). Go to **Shadowstats.com** for more accurate inflation numbers.

About the Author:

Louise Yamada is the Managing Director of Louise Yamada Technical Research Advisors (LYA) founded October 2005. Previously Louise was Managing Director and Head of Technical Research for Smith Barney (Citigroup), and while there, was a perennial leader in the Institutional Investor poll and the top-ranked market technician in 2001, 2002, 2003 and 2004.

At Smith Barney for 25 years, in her years as head of Technical Research, Louise authored a weekly flagship report "Market Interpretations". It was there that she identified:

- In 1999-2000 The developing structural bear market equity markets, and the Technology / dot com collapse
- The lift in gold in 2001-02 for a new structural bull market
- The small- and mid-cap outperformance leadership in 2002
- The emerging structural Energy bull in 2004
- and other major 20 plus-year structural reversals then taking place, and not seen since 1980-82

At LYA Louise has made major calls on: The onset of the relative strength structural decline of the Financial sector (beginning March 2007); the continued structural bull market for Gold (from 2002); her 2004 Alternate Hypothesis demonstrating that the 2000-2002-2008 equity market could track the 1929-1932-1938- stock market (it did); Bonds, the last 20+-year trend yet to reverse (2006); and many other key calls on the domestic and foreign stock markets, Energy, Interest Rates and Commodities.

Louise is a Chartered Market Technician (CMT) and a member of the Charted Market Technicians Association, the American Association of Professional Technical Analysts and the Financial Women's Association. Louise appeared as a special guest on *"Louis Rukeyser's Wall Street"* and appears frequently on Bloomberg TV and Radio, CNBC and BNN TV as well as in print and online media including Barron's, the Wall Street Journal, the New York Times, Yahoo Finance and the Financial Times. She has been a frequent guest speaker at conferences and organizations, including the 2009 Fall Conference of the National Organization of Investment Professionals and the 2010 FEI NYSE forum.

There Is Gold In Them There Hills

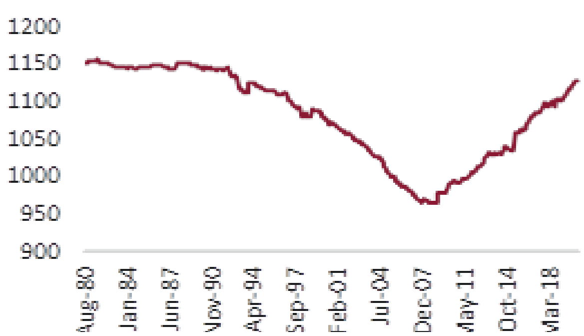
Sheldon Hines, Portfolio Manager, Hines Investments, CIBC Private Wealth Management

The financial implications of the pandemic have focused on the monetary and fiscal stimulus over the past several months. We believe there is also a way to profit from the record amounts of money being printed by seeking opportunities in Gold. Our research has shown opportunities exist, and with a disciplined approach, we can profit from these opportunities while being able to minimize our downside risk.

Over the past month we have seen gold soar to a new record high of ~$2,065/oz, exceeding the previous high of ~$1,900/oz in September 2011 (Bloomberg). However, in real terms (inflation adjusted), the all-time high was achieved in January 1980 at ~$2,800/oz (Credit Suisse).

Fundamentally, the current 10-year inflation adjusted (TIPS) yield is -1%. Our partners at Credit Suisse believe, this could move to ~-2% as the

Chart 1 – Global Gold Reserve Holding (Source: CIBC)

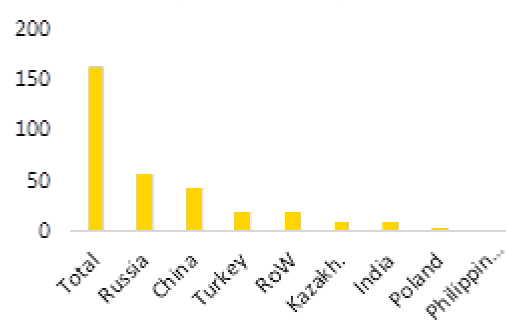


Federal Reserve tolerates higher inflation while keeping interest rates low. This would imply gold moving to a price of ~$2,200/oz. Second, weakness in the US dollar has contributed to the rise in demand for gold. The last factor is inflation. This is partly represented in the TIPS yield, but also expectations that down the road there will be inflation.

Geopolitically, the decoupling of the US and China is also supportive of gold as noted by our colleague Bipin Rai at CIBC Macro Strategy. Chart 1 shows the amount of global gold reserves going back a few decades. It has been rising the past decade and is now back at levels not seen since the 90s. This is around the time the US adopted the "strong dollar" policy.

Chart 2 shows the growth in gold reserves by country. Note, China and Russia have the largest increases in gold reserves. Both of these countries have also reduced their US treasury holdings by

Chart 2 - Changes in Gold Reserve Holdings from 2009-Present (Source: CIBC)



to the same degree over the period. The shift is due to many factors including, perceived risks from the USD expansionary policy, the reduction in external surpluses for those countries, and politics. Politics is especially relevant as regardless of who wins the White House next month, tensions don't appear to be abating anytime soon. On September 4th, the Global Times (Chinese state-backed paper) reported that China was looking to decrease its holdings of US treasuries by 20% to $800B.

As Louise Yamada (LYA Advisors) points out, over the last decade or so, an assumption has been made that gold and interest rates move in the opposite direction. Declining rates correspond with higher gold prices. However, if we look back further in history, in the 70s both gold and interest rates were rising together during an inflationary time. As rates continued to decline, gold perked up in 2002. After a corrective period in 2014, gold continued its ascent in 2015, well before the next drop-in rates. Now gold and interest rates are continuing to move in opposite directions, not because of the rule, but because of the deflationary environment (with fear of higher inflation down the road). A conclusion that gold can do well in both inflationary and deflationary environments, which could accompany both rising and falling interest rates.

Technically, golds 98% rally off its 2015 lows to its recent high has been followed by some well needed consolidation and perhaps a short-term correction. Following the break of support at $1,900 we would expect further pressure towards $1,700-$1,800/oz. While this would represent a 38% correction, it would still maintain the long-term uptrend.

At Hines Investments, our long-term price target for gold is $2,400-$2,600/oz. We understand that gold is a more volatile investment, and risk mitigation is paramount. We employ stop losses to reduce or take the risk off the table when our price targets have broken. We only invest in a select few of the largest gold companies in the world along with an EFT directly invested in gold.

For more information on our portfolios please reach out to us at hinesinvestments@cibc.ca or via phone at 844 887-4995.

Chart 3 – Gold Weekly – Source (Bloomberg)