

# THE MONEYLETTER®

STRATEGIES FOR SUCCESSFUL INVESTING

## MARKET WISDOM

*Too much debt will drag you down, know  
how much you can afford*

# DEBT WILL AFFECT YOU

*Kieth Richards*

HILLIARD MACBETH, DIRECTOR of wealth management at Richardson GMP, sees Canada's residential real estate boom as a classic bubble. Historically, residential real estate (not to be confused with commercial real estate) has been seen as lifestyle purchasing. It's a place where you live or vacation (your home, cottage, snowbird residence etc). The more recent trend (by historical standards) of retail investors has been to invest in residential real estate for capital

gain potential and income investing. MacBeth's argument is that, like other bubbles, when retail investors (aka "dumb money") move enthusiastically into a nontraditional asset class as an investment, the action signifies bubble conditions.

### Look out!

Statistics Canada reported in September that the ratio of household debt to income has reached 167.6 per cent — the highest it's ever been — and the majority of that debt is mortgage debt. Canadians' household debt is bigger than the country's economy! To me, this is a statistic that may pose a problem for Canada's real estate prices in the future. One can only borrow so much...

Housing starts in the big Vancouver and Ontario markets

approached the same 2008 highs last year. Since the introduction of the government tax on foreign property investors, Vancouver has slowed considerably (33 per cent – 59 per cent drop in sales from Feb-September of this year, yr/yr). But Ontario sales have continued to increase. National Bank economic research suggests Vancouver (and surrounding areas) should experience a 10-20 per cent decline in prices over 2017. They expect a smaller average decline in Toronto prices by about -3 per cent. The chart to the right shows us this year's housing prices in Toronto and Vancouver.

### Comparing the risks

While it is arguable that the stock market is as overvalued as real estate, the stock market has a few advantages that I see when facing this dilemma. First, the cost of maintaining a stock portfolio — all things being equal — excludes those costs surrounding real estate investing. We do not pay property taxes, condo fees, maintenance, or upkeep on our stocks. Another advantage of stocks is their immediate liquidity. If one notes a change in the trend in their stock portfolio, liquidation can usually occur in a matter of minutes — as can trimming one's exposure.

There are no immediate markets in which you can liquidate a

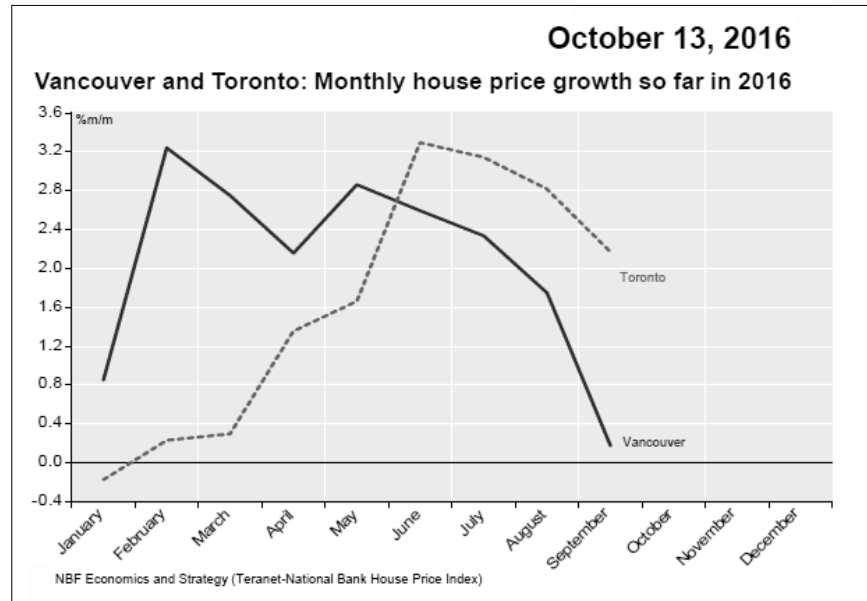


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residential real estate investment (REIT's aside). Your property may sit on the market with a "For Sale" sign on the lawn (or listed with MLS) with no activity on it for months – with a revolving "New Lower Price" sticker to keep pace with the falling market. This is unfavorable in a rapidly falling market, as I might imagine some Vancouver sellers are, or will soon be, noticing.

Hedging one's risk within a residential real estate investment is nearly impossible. Stock risk can be offset by hedging with inverse ETF's or options. Those hedges can be removed on a moment's notice with minimal cost and hassle. Diversification within residential real estate (non REIT) investing is difficult. Conversely, diversifying through many stocks and commodity plays in different sectors and country's economies is pretty easy. Monitoring them for sell signals is simplified through technical analysis – such as those described in my book *Sideways*. Residential real estate is typically a very concentrated investment strategy with less



quantitative sell signals.

For my money, I will always look for assurance that a bad investment can be easily disposed – bubble or not. For that reason, it is my opinion that investing in residential real estate is perhaps less enticing than many retail investors believe.

### A struggle ahead?

Debt isn't limited to the retail consumer in Canada. Prime Minister Justin Trudeau, the guy who claimed that "the budget will balance itself," may have some cold,

hard reality hitting him in the face right now. A new analysis by TD bank says the Trudeau government is on track to run \$150 billion in budget deficits over the next five years. Before the election, even Trudeau's opponents underestimated just how much the left-wing government would spend. Opponents suggested that the deficit would not be \$10 billion as Trudeau claimed, but closer to \$25 – \$30 billion. Trudeau slammed that estimation at the time by stating: "That is completely wrong!"



## It was completely wrong – unfortunately for Canada.

The report estimates that, given Ottawa's current fiscal path, it will take more than a decade to bring the budget back into balance — unless the government raises taxes or cuts spending. Something to look forward to! "I'm still promising to balance the budget, but do it in 2019" said Trudeau. Not according to the TD report. Reality may finally reach Justin when the bearish trend for our loonie, a decline in the long bond, an end to the real estate bubble, and a struggling business environment sink in.

The Canadian long bond is struggling at a key point of overhead resistance right now. The last time it reached similar heights back in 2015 our bond market fell. Remember, foreign investors price our bonds in part according to the credit rating scores, and that rating can be affected by rising debt.

So, too, will the loonie struggle if TD's predictions are correct. In fact, since I first wrote the outline for this article in early October, BOC President Stephen Poloz announced concerns regarding the Canadian economy. Poloz's comments caused a 3 per cent draw-down on our currency vs. the USD in October. I've drawn some potential downside projections based on technical support after

the recent failure of the loonie to hold its prior support level of 0.77. From a technical perspective, we could see the loonie hit 0.70 vs. the USD in the near-term. A worse case scenario would be a return to the low 0.60's, but that would be an extreme case.

Oil plays a role in the loonie's strength. Despite seasonal weakness for oil over the winter, I have a target of \$62 or so on WTI over the coming year. However, any strength in oil should only delay – not forego – the likelihood of a longer-term decline for the loonie due to the above factors. For this reason, I continue to endorse holding significant USD in your portfolio, with a focus on liquidity and quality in your security selection. ▼

## IN THE NEWS

TORONTO, ON - Excellence Canada and PwC Canada are pleased to announce this year's 19 private businesses that have received the Canadian Businesses Excellence Award by clearly demonstrating a strategic approach and measurable outcomes in achieving Delighted Customers, Engaged Employees, and a Culture of Innovation. This annual awards program recognizes outstanding achievements by privately-held Canadian businesses from coast-to-coast.

ValueTrend Wealth Manage-

ment of WorldSource Securities was one of the 19 private Canadian businesses to receive this award!

## Keith on BNN Television

Keith will be on BNN for the 1 hour "MarketCall" show on Monday November 14th at 1:00. Phone in with your questions on technical analysis for Keith during the show. CALL TOLL-FREE 1-855-326-6266. Or email your questions ahead of time (specify they are for Keith) to [marketcall@bnn.ca](mailto:marketcall@bnn.ca)

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