Winter 2019

This new year has come with the usual tidal wave of predictions, from emerging fashion trends to the next big social movement to who'll win the World Series. And, of course, what's in store for investors, and the world economy. The direst of these, unless you're a Baltimore Orioles fan, appears to be the latter.

Prophecies, by their very nature, are up for debate. Even the predictions of Nostradamus, perhaps history's most reputed seer, touted by many as having warned of some of the world's most horrific events, are suspect. To kick off this quarter, we've placed three of the French physician's 942 quatrains (four-line poems that rhyme), written in the 16th Century and predicting future events, next to the prevailing "wisdom" of 2019.

The blood of the just will commit a fault at London,
Burnt through lightning of twenty threes the six:
The ancient lady will fall from her high place,
Several of the same sect will be killed.

Did Nostradamus predict the Great Fire of London? Believers point first to the date and "twenty threes the six" - claiming twenty times three plus six equals sixty-six, and the fire hit London in 1666. Coincidentally, we focused a bit on the Great Fire of London in a previous Folio, and you might recall that the blaze was not the result of a lightning strike. Rather, a spark in the bakery of Thomas Farriner on Pudding Lane was the culprit. The "ancient lady" may represent London herself, and it's true, of course, that the city was devastated. Though death tolls at that time were sketchy at best (generally, only the elites were counted), it's likely many lives were lost.

2019 begins with many economic forecasters seeing their own version of a great fire - the world economy slowing down, China trade wars, higher interest rates, inflation - until the inferno of recession engulfs us late in the year. There are sure to be a few hot spots - growth outside North America will likely slow down. But believing this will lead to a recession is a bit like believing the spark at Farriner's shop was a lightning bolt.

The world's economy is nowhere close to tinder-box status. According to The World Bank, global growth this year is expected to be 2.9%. That's down only 0.1%, catastrophic to no serious pundit. Growth in the emerging economies is expected to be a healthy 4.2%, down just 0.5% from earlier forecasts. (That, by the way, would match growth in 2018.) It is hard to see a recession when economies are growing at these rates. As we've mentioned, a trade deal between China and the US has not been hammered out, but signs point to that happening soon. Europe will struggle with Brexit and, more importantly, social issues arising from years-long Middle East immigration. But none of this amounts to London burning.

Near the gates and within two cities
There will be scourges the like of which was never seen,
Famine within plague, people put out by steel,
Crying to the great immortal God for relief.

Believers say this Nostradamus quatrain foretold the bombing of Hiroshima and Nagasaki ("within two cities"). And, of course, the attack was followed by a massive food shortage in Japan. The survivors of the blast suffering from radiation poisoning were "crying to the great immortal God for relief." A case can always be made that a prediction was on target, so long as it's worded vaguely enough.

Speaking of vague, how about the phrase "too high"? Those are the words being used by many of today's economists when discussing the US Federal Reserve's interest rates. And it's causing, the thinking goes, the economy to be "strained."

Let's again look at history, this time from the 21st Century, to gain a little perspective. Prior to the "Great Recession" (2007-2008), Fed rates (the amount of interest the US Federal Reserve charges banks to borrow in order to meet regulatory reserve requirements) were as high as 5.25%. They currently stand at 2.5%. It's a long held economic belief that the best route to a neutral rate is adding real GDP growth to current inflation, then setting the rate just below that number. If that were the case today, rates would be between 4.25% and 4.75%, since US GDP growth is 3% and inflation is close to 2%. That's too high for current economic conditions, but shows there's plenty of room for the Fed to comfortably raise rates. We expect that to happen this year, without causing any great cries for relief.

The young lion will overcome the older one,
On the field of combat in a single battle;
He will pierce his eyes through a golden cage,
Two wounds made one, then he dies a cruel death.

Many say this quatrain, predicting the death of King Henry II, put Nostradamus, alive at the time of the kings' passing, on the map. In 1559 (remember that date), the king ("the older one") jousted Gabriel, Comte de Montgomery ("the young lion"). Montgomery's lance broke through the king's visor ("pierced his eyes through a golden cage") and splintered. The lance's shards pierced the king's eye and throat ("two wounds made one"). The king, of course suffered agonizing pain before dying. Seems largely on target, yes? Except...experts question the prediction since the quatrain didn't appear in print until 1614, long after both the seer and king had died.

Entering 2019, the price of stocks, especially if the global economy is slowing down, are being questioned. Too expensive seems to be the consensus. As we've noted many times, the best measure of a stock's value is the price paid for each dollar earned by the company. This is known as the price to earnings ratio, or P/E, of any given company or index. (Indices are baskets of companies, such as the S&P 500, put together to represent large US companies as a whole. The S&P TSX does the same for Canada.) Current P/E ratios of indices around the world show the ubiquity of good-value stocks. US large companies are priced just 15 times expected earnings. Canadian and European large companies on aggregate are around 13 times. Emerging economies' stocks are at 11 times. The cynic might point out that earnings expectations are being lowered, but this data reflects that. And, stocks are lower than they were at this time last year.

Let that sink in for a moment. They're priced lower than before earnings increased over 15% last year. And expected to go up another 5-10 percent. To our eye, stocks are currently priced like toys on Boxing Day. Sales abound.

Nostradamus' predictions are all vaguely worded (and often poorly translated), giving those who want to attach them to events that followed plenty of wiggle room. We see a lot of that with today's prognosticators. Everything is too high, too low, too strong, or too weak. Another key to the believability of Nostradamus' warnings was his belief that history repeats itself. His quatrains projected known past events into the future. That, to us, sounds like sound methodology. And why we always take a close look at what the markets have told us, in both the recent and distant past, when making decisions. The best way to predict the future is having a plan, and following it.

We wish you a happy and prosperous 2019.