Frances Horodelski (audio)

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SPEAKERS
Pat Bolland, Frances Horodelski

Pat Bolland 00:27
Francis, welcome to 2023.

Frances Horodelski 00:30
And let's hope it's a better year than 2022.

Pat Bolland 00:34
Okay, let's, let's get that out of the way. What was your overall impression 2022. Because as I pointed out, it was not a good year, for a lot of investors. We started

Frances Horodelski 00:45
actually 2022 You and I doing the same thing. And I went back and listened in. And, of course, stock markets and economic for casting is always humbling business. And I was probably I wasn't over the top bullish at the beginning of last year. But I, you know, I missed a lot for sure. It was a tough year, I mean, aggravated for sure, by two big things. One, the Russian invasion of Ukraine. I'm sure there were people who saw that coming, they'd seen it coming since 2014. But I don't think anybody thought it was going to happen in February of 2022. And the second thing was the extensive shutdown of China for COVID, which, you know, kind of aggravated the Ukraine situation, you know, supply chains and everything that we were talking about, in 2022. Early on, I expected them to be relieved sooner than they were. But maybe that relief got obfuscated by Ukraine and China shut down. And, and just the way markets swing, because they do get all verklempt about something. And and they take it to the extreme. So last year saw a lot of extremes for sure.

Pat Bolland 02:11
Okay, but we did you did get some things right. And we did talk about them. For instance, we didn't talk about the shift out of technology. What we didn't talk about was the hard sell off. We saw in the tech sector. Why do you think that happened?

Frances Horodelski 02:26

Two reasons, probably probably many reasons. But one was what's I probably got, right? They're just ridiculously overvalued. I mean, metrics that were being used at the beginning of 2022. Following on from 2021. You know, we're, we're price to revenue, even enterprise value to nothing, because there was no EBIT, da. I mean, there was crazy valuation and the momentum from 2021, and taking everybody into 2022, with a lot of enthusiasm. So I think that was the one big item when we just swung too far in valuation. The second item was probably as well that I don't think a lot of people. And certainly I didn't got a sense of all of that overspending in the technology space, whether it'll double ordering and semiconductors, over hiring, in some cases to account for what had happened in 2020 and early 2021. But so we kind of missed sort of the nuts and bolts of the business earnings expectations that already started to come down at the beginning of 2022. But they just did not come down enough.

Pat Bolland 03:47
But everybody was starting to work from home because of the pandemic back in 2020. Everybody's working from home. And all those tech companies were valuable. Did they draw forward their sales? I mean, did they cannibalize their future sales to a degree to

Frances Horodelski 04:00
I think that's absolutely bang on. I mean, it's something like a DocuSign, which I think about in the, in the brokerage industry, in particular, in 2019, you could never sign anything, you know, opening an account or asking for a check to be distributed, or whatever it was, without actually being in the office, March, April of 2020. It just went, like everybody does everything online. But, you know, incrementally how many more people are around to do things online. Now, some would argue with the DocuSign. They'll just keep that example, which went from nothing to everything. You know, now they have this base of clients that are sticky, very sticky. People aren't going back, and there's the opportunity to leverage off of that sticky customer profile. But you know, that's going to take a couple of years before Whether that really flows through to the bottom line,

Pat Bolland 05:02
yeah, no question. And you touched on Ukraine a little bit. But geopolitics in general, it seemed to me that geopolitics took a backseat for last couple of decades, whether it was the growth of China wealth, or the growth of China, people kind of did invest in that. But you know, Trump politics and all the other things that were going on in the market did its own thing. Ukraine definitely upset the applecart didn't it?

Frances Horodelski 05:27
It did, I think, because it wasn't just Ukraine, it was because of what it did to the rest of Europe, in terms of cutting off supply of energy, and we're only lucky to some extent this winter, that in Europe, in particular, the weather has been relatively mild. So it hasn't turned out to be the devastation, you know, shivering in the dark, that it might have been, and NATO banded together and all kinds of things. So it was it was a factor of it wasn't just some, you know, country, invading another country that's happening all the time, sadly. But it was, it was Russia, and they kind of have held a wild card in terms of their energy control of both the production of energy and the delivery of it. So I think that aggravated the situation. And now it's, I mean, who has been almost 11 months, the devastation is just everyone just shakes their head. And it's very hard to see what the outcome will be, because I'm not any, you know, the big joke was him 2020 and 2021. Everybody was happy epidemiologist. And of course, when

Russia invaded Ukraine, they're all you know, defense authorities or do politic politicians. I don't have that extensive knowledge, but sure does look like it's going to be hard to see how it ends.

Pat Bolland 07:08
Well, let's bring it back to finances, though, because one thing you haven't mentioned for 2022 is inflation. And we touched on it at the beginning of the year in terms of creeping wages and energy issues. You've talked about already supply chain you've talked about, but I mean, I don't think very many people saw the huge jumps in inflation, and the knock on effect as far as interest rates are concerned, good day.

Frances Horodelski 07:33
No, even when we were discussing all of this in 2022, I did see that inflation would rise. I did see the Fed raising rates, but I think I said very specifically that I might see 2% Or maybe three, and I'm probably ad libbing there. But I said definitely I didn't see five on Fed funds. And you know, we're within spitting distance of that. And we will be five this this quarter. I think the interesting thing about inflation, is that I like to say this generally about economists is that we are using the same tools that we used for decades, in making our projections going forward. And quite honestly, the last two and a half years are nothing we've really seen before. Now, some say may have been like 1990 and 1819. But we've not seen this kind of crazy, Spike Enos and inflation. But more importantly, we've not seen the Fed act as quickly and as dramatically as they have. And I think they had egg on their face, like a lot of people who use the term transitory. But more importantly, inflation really peaked. Like in the first five months of last year. I mean, if you look at any of the parts of us CPI, and probably to some extent, Canadian CPI, they've all rolled over. I mean, there are a lot of negative signs in the last us CPI report was wages have trended down, food prices have trended down still very high, for sure, energy prices have come down dramatically. So you know, me b, and people I know who are very smart are talking, you know, disinflation, maybe deflation as we go forward, especially because your comps, you've got that base effect. And in 2022, the base effect was negative for inflation, and 2023. The base effect actually could be pretty positive for inflation.

Pat Bolland 09:46
So am I hearing that you're thinking interest rates might come back down?

Frances Horodelski 09:51
A couple of things never to zero. I mean, there's a long time but I don't see zero. And I do see a pause. was probably in maybe March, April, do they come down, I think they're gonna stay higher for longer. Now, just because the Fed doesn't want to do anything, they don't want to be a repeat of the early 1970s, where we saw rates go up, and then they came down and inflation spiked again. So down, I don't think so. But I can let you know, I think we can live with four or 5%, four or 5% Fed funds rate. And at the same time, you know, they are reducing liquidity in the system, they are rolling off their balance sheet, Canada's rolling off its balance sheet, the bank of the Central Bank of Europe, the ECB is rolling off their balance sheet. So there's a lot of liquidity that's going to continue to be pulled out of the system.

Pat Bolland 10:47

Yeah, you and I lived through seven years. And I remember interest rates are 13%. So I, four to 5%, would be low on historical standard zeros ultra low, but four to five would be normal, wouldn't it?

Frances Horodelski 11:01
I think it number one, you know, I look back at inflation levels going back for decades. And you know, we're we're in the middle of the pack to the lower end of it. It's really the rate of change that matters for a lot of these things. And people are feeling the pain of it, no doubt about it, you know, you had a floating rate mortgage, and now all of a sudden you have to refinance or or be subjected to rising rates, I mean, that's very painful. So in the US, it's a little different. Because you probably know this better than I I don't know if you ever owned a house when you were lived in the US, but you get these 25 year mortgages and your rates in there for 25 years, that doesn't happen here. So it will curtail moving around the pain will will not be as great other than people who have to go out to have to move or do want to buy something.

Pat Bolland 11:56
You know, you talk about pain. And I know you just got back from Europe, I spent Christmas in Europe, and I was in Europe and say, the beginning of September. And we traveled around Southern England at that time we had been in Italy during the summertime. And in both places. I was seeing robust economy. I was seeing people flying, I was seeing help wanted ads, the trains and subways were packed. Are things slowing down it? Was it your sense that things have slowed down a little bit?

Frances Horodelski 12:28
No, not not my personal experience now is there at Christmas time. And the markets were Jambres prices were high. But people were spending that was my sense. The UK is a bit of a different beast, because I think they do have a lot of issues. In terms of we all saw the government issues that they faced in terms of the changes at the top and but you know, they I think they have some big issues. But generally speaking, economic activities, pretty decent. I mean, the fourth quarter of 2022. For the US, for example, may come in at three or 4% growth, I don't get a sense that anything's really slowing down, you see it in the soft data, you see it in the the ITSM data where they do surveys, you know, when somebody says, Oh, yeah, my, my business is slowing down? Well, you're not gonna come out and say, it's great. When you see headlines all the time, every time you open the paper, somebody's talking about something being awful a recession on the on the horizon. So it's really hard. People are hard pressed to say, Yeah, I'm bullish in the face of all of that negative press. So the soft data is showing a turn down but real data, not so much it is showing up in in inflation numbers. You know, us car prices are gonna have rolled over a new car prices have rolled over food has rolled over. But you know, there's still a lot of people employed. And there's still a lot of jobs out there for people who might end up losing their job.

Pat Bolland 14:09
Well, that's interesting. You talked about that, because in the most recent earnings quarter, the tech companies in particular, but a lot of companies did the same thing. They had not great earnings, and they turned around and they cut their labor force in some cases by 10s of 1000s. Will we do think see more of that happening? The speed of response by the companies was amazing, but do you see more job cuts happening in response to earnings?

Frances Horodelski 14:37
Yep, well, you know, I thought Bank of America put it the best they're doing it on the they're not cutting that we've seen Goldman we see Morgan Stanley, a Bank of America, I think said it best, they're going to let attrition you know, reduce their headcount so they they've frozen hiring they've frozen, you know, aspects of of their head. count, but they're not cutting across the board. I had some number, you know, Amazon's the poster child for some of this. And I was just looking at their headcount. I mean, they have a million and a half employees, Amazon does. During the during 22. They added 427,300 new jobs. Wow. That's like 50% kind of round numbers. They've only cut? I don't know, you know, 10,000 15,000. Now, that's from corporate stuff, they still have corporate staff of 300,000 people. I mean, there's gonna be a lot more from Amazon. And I think the street would welcome it. I think it's, I think it's fat and bloated. And I think the street would welcome that. And they probably welcome it from other companies in the tech space, generally, because I think, you know, there was a hiring craziness in 2020. So pulling back that craziness fattening up some margins a little bit, getting through 2023, I think it'll be well with Steve by the street, as long as there are other things going on as well. It's not just a one trick pony, when you're analyzing these companies,

Pat Bolland 16:15
I'm getting the sense that you're a little bit more constructive on the stock market.

Frances Horodelski 16:21
I have been constructive. We're acting pretty well, so far this year, still way early. I mean, there's a lot of history that suggests that this year could be very good. You know, the third year of the presidential cycle, and people can talk about all about that stuff. Expectations are coming down. earnings expectations have been trimmed, the product continued to be trimmed. But as I always like to say your trim low enough, you can just step right over them, it's pretty easy to do that. There's a lot of I mean, you know, the technical setup is pretty attractive. If you look, you know, the Chartists if you look at a ton of things, they're all bottoming I mean, it's all quite nice. Of course, the world could end tomorrow. And, you know, I look like an ad say that it might. That may be true. And there's lots of things that could go wrong, for sure. But you know, the first half earnings expectations aren't that great. But you start to see better earnings expectations in the second half. And quite honestly, market should be looking ahead. So, you know, yeah, I'm more constructive. I'm not, you know, mortgaged your house to buy stocks or anything, but I think there's a lot of opportunity. Yes.

Pat Bolland 17:42
Except that I read your blog, just this morning. And it was one of your older blogs, couple of days, maybe. And you talk about copper, which I you know, copper is got the PhD in economics. It's the one you should watch. And you were looking at the supply and demand equations in copper. Not such pretty signs.

Frances Horodelski 18:03
Well, on the supply side, I mean, there are some good signs, because invisible, sorry, visible copper inventories, that's what's tracked on the LME and various, you know, obvious site inventories are low at record, not record lows, at the lowest seed and for at least a decade. It

Pat Bolland 18:30
is yeah, tracking is pretty

Frances Horodelski 18:31
impressive. So, you know, if China doesn't shut down again, I mean, the need for copper remains pretty great. And the supply isn't terrific. At $4 Copper, companies make a lot of money. So in the end, that's what you have to look at who's going to who's going to be able to mine that copper, and his is going to make money at $4 their costs are going up, of course, because you know, in many places they're in in jurisdictions where the government's want money. And also their own costs are going up, whether it's wages or energy prices, so you know, it's not it's not all sweet, sweet profits to the bottom line, but no, I like copper.

Pat Bolland 19:21
Okay, that's good to know any other areas that you liked as we finish up especially in the Toronto Stock Exchange in our concentration, we talked about it last year, concentration in energy stocks and in banks and that kind of stuff.

Frances Horodelski 19:33
Well, well, energy was great last year, up 30%. The TSX was great the year before. And you know, there is a lot of money these companies are churning out a lot of money. Look at Imperial oil, for example, which will probably be debt free in about years time. And all of that excess capital free cash flow and these companies are yielding free cash. free cash flow yields are in the mid and teens. I guess my only concern about energy is that GE, everybody's kind of bullish on it. So I worry about that a little bit. Natural gas, nobody thought it was going to be, you know, closer to $3 in January, which it is now versus people thought it was going to seven and eight and 12. So you got to play your spot. So I do like oil service, because I think ultimately, companies are going to have to drill again. So I'm sort of more intrigued by that aspect. I like or I have been liking gold, but it's kind of it's had a just a huge move here. And the stocks have had a huge move, they all look pretty spiky so I'll pick my spots.

Pat Bolland 20:47
Last year, when we were talking a year ago, you like gold in two, so it

Frances Horodelski 20:51
went up and then I went down. It's like all of these. So some of those things you do have to unfortunately aren't buy and hold you have to be on your toes and trade them a little bit. Canadian banks, I think diversified financial. So come back, they had a horrible year, last year last year. Banks didn't have a great year they were down 9%. But the the Diversified financials and mutual funds, you know, those kinds of companies were horrible last year. So I think there might be an opportunity and those and even the life calls I probably prefer the life coach to the banks. Because they've sort of hung around a little bit more than than the banks have. They've, they've they've held in but I think they have some upside potential. Okay. Oh, sorry. And industrials, I think you got to own at least one industrial in this country. Because they are cheap, cheap, cheap.

Pat Bolland 21:46
Okay. So I know you're right about this stuff. And I promote that you have a blog, but it can anybody get your blog?

Frances Horodelski 21:52
Absolutely. You go to Francis Horton ascii.com. And scroll down to the bottom of any blog and you can put your email address in, they will, you will get a follow up email saying confirm. And then the next day, you will receive it and it's totally free. It'll always be totally free.

Pat Bolland 22:14
And it's always good reading. Thank you, Francis.

Frances Horodelski 22:19
Thank you very much Pat

Pat Bolland 22:20
See you soon

Frances Horodelski 22:21
You too