ISSUE 76 I AUGUST 2017

Taking Stock with Steele

Your Monthly Newsletter

The purpose of this newsletter is to share insights and expertise. Our goal is to ensure that our clients are well informed of changes affecting local business decisions and our investment recommendations. We believe Knowledge Pays and we want our knowledge to help pay for you.

THE QUESTION OF NORTH KOREA IS WAR POSSIBLE AND THE EFFECT ON MARKETS

North Korea has long been a pariah state within the international community. North Korea's impact on global equity markets has been virtually non-existent until recently. In early August, investors exhibited a flight to safety, selling stocks and buying government bonds and gold, following comments from Donald Trump that the US would respond with "fire and fury like the world has never seen" if North Korea did not halt its threats. This rhetoric is much more aggressive than in the past. While the consensus view is that this is simply Donald Trump being Donald Trump, taking a hard line with North Korea could be risky given its seemingly unstable leader.

Is an escalation of war possible?

Possible, but incredibly unlikely. Given all the news coverage about North Korea, it may seem like the danger is clear and present. At the end of the day, North Korea has nothing to gain from taking on nearly the entire world in a war, especially one that involves weapons of mass destruction. While North Korea may be close to attaining nuclear-armed intercontinental ballistic missiles, the use of one such missile would effectively guarantee the end of North Korea and the Kim regime.

What would war look like?

We think that North Korea's development of nuclear missiles is to prevent invasion only and that it does not intend to use them offensively. As previously stated, using nuclear weapons has absolutely no upside for North Korea. As North Korea's number one goal is the reunification of the Korean Peninsula, they may feel that attaining a nuclear missile arsenal allows it to invade South Korea without a counterattack in response. Given that North Korea's military is nearly twice the size of South Korea's military and its military equipment and weaponry is less advanced, it is not a stretch to assume the North would prefer conventional war.

What would this mean for markets?

If North Korea initiated active war with the South, it is difficult to predict how other actors (e.g. China, Russia) would respond. It is possible China would stop supporting the North and that Russia would sit idle but these are grand assumptions. If these assumptions ring true, the effect of conventional war on global markets should be minimal other than temporarily boosting demand for some commodities (e.g. oil, gold, copper). Markets would likely react very negatively following the initial actions of war as the market would price in some possibility of nuclear conflict and some possibility of Chinese or Russian support of North Korea. We think investors should largely ignore North Korea but understanding the situation is important to avoid panic should this unlikely event occur.

Current Rates & Data

Govt of Canada

90 day	0.71%
1 year	1.14%
2 year	1.24%
5 year	1.52%
10 year	1.91%
30 year	2.34%

U.S. Treasury

90 day	1.05%
1 year	1.22%
2 year	1.33%
5 year	1.79%
10 year	2.24%
30 year	2.82%

Canada Prime Rate

2.95%

U.S. Prime Rate

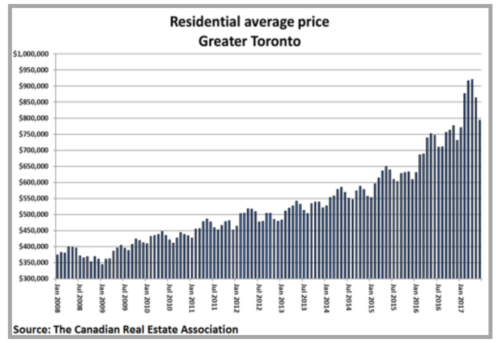
4.25%

Exchange Rates

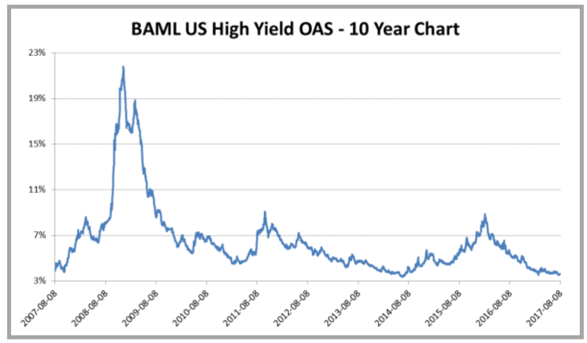
CAD/USD	0.787
USD/EUR	1.175
JPY/USD	109.9

ECONOMIC TIDBITS GTA HOUSING MARKET WEAKENING A BIT & TIGHT HIGH YIELD SPREADS HIGHLIGHT RISK

• GTA house prices have fallen ~19% from the April 2017 peak but are still higher than in January 2017. Months of inventory, active listings and sales activity have reverted to historical averages indicating a more healthy market. Kitchener-Waterloo house prices are ~11% below the April 2017 peak but active listings and months of inventory remain well below average and sales activity well above.



• The excess yield offered by US high yield bonds over risk-free bonds hit 3.55% in July, 0.2% above the ten year low. While this yield hit as low as 2.41% in its history, a yield of 3.55% indicates that owners of high yields bonds will earn historically low returns going forward. Equities are highly correlated with high yield bonds so this low yield may indicate below average equity market returns ahead.



LE JIT A "JUST-IN-TIME" RUNDOWN OF OUR CURRENT INVESTMENT THEME

Amazon's Retail Expansion Creating Opportunities in Retail Without Posing Much Near-Term Threat

- **DAVIDsTEA (DTEA-US)** and **Michaels Companies (MIK-US)** are two ideas related to this theme.
- **DAVIDsTEA** is the second largest loose leaf tea retailer in North America. DAVIDsTEA shares have been under pressure since the July 2015 IPO, trading at US$5.60 versus to an IPO price of US$19. On July 27, Starbucks, which operates Teavana, the largest loose leaf tea retailer in North America, announced it is closing all 379 Teavana stores by spring 2018. DAVIDsTEA should be able to capture a large part of Teavana's CAD$280 million in annual revenues and achieve a level of profitability that loose leaf tea retailers have yet to experience. DAVIDsTEA currently trades at 0.55x trailing revenues ex-cash, at the very low end of the North American retail industry in terms of valuation despite this unique opportunity.
- **Michaels** is the market leader in the North American arts and crafts industry. Michaels trades at 10.5x trailing earnings after over two years of mostly trading at the retailer average of 15-16x trailing earnings. Michaels' shares are down over 35% from the all-time high set in June 2016. This decline was instigated by a slowdown in same store sales growth in response to increasing competition and in turn narrowing margins as well as share sales by private equity funds that have since stopped. Michaels should face limited competition from e-commerce and will likely retain its position as leader in arts and crafts retail.

JEANNINE'S TIP O' THE MONTH How Raymond James Protects Your Investments

We believe the financial integrity and strength of Raymond James offers the most important protection for your accounts. Raymond James has always advocated conservative management, high ethical standards and a commitment to superior client service. Raymond James has been helping investors achieve their financial goals and dreams since 1962 and our predecessor companies in Canada were doing the same for more than 75 years. Clients entrust Steele Wealth Management of Raymond James with their investments for a number of reasons – we have strong corporate backing, we follow security safekeeping measures, we offer industry-wide investor protection and we adhere to strict industry standards.

This newsletter has been brought to you by Steele Wealth Management

Brian Steele, CA, CPA, CFA | Jeannine Campbell | Laura Prust, CIM, CPCA
Kelly Edmonds | Matthew Bell, CFA

Phone: (519) 883-6030   Toll-Free: 1 (877) 642-6408

Email: steelewealthmanagement@raymondjames.ca

Address: Unit #1 595 Parkside Drive | Waterloo, Ontario | N2L 0C7

Website: www.steelewealthmanagement.com

To opt out of receiving this newsletter, please reply to this e-mail with the word "Unsubscribe" in the subject line.

If you know someone who would benefit from receiving this newsletter, please forward it to them and let them know they can subscribe by emailing us at: steelewealthmanagement@raymondjames.ca